Referencer for Quick Revision

Final Course Group-II

A compendium of subject-wise capsules published in the monthly journal "The Chartered Accountant Student"

Board of Studies
(Academic)
ICAI

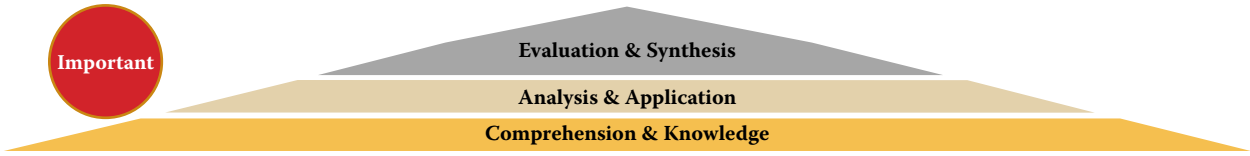
INDEX

			2023	
6A	Risk Management	85-88	March 2020	Introduction to Risk
		88-91	March 2020	Source and Evaluation of Risks
		92	March 2020	Risk Management
6B	Financial Services and Capital Markets	93-94	May 2022	Global Financial Market
		94-96	May 2022	Capital Market – Primary
		96-99	May 2022	Capital Market – Secondary
		100-102	May 2022	Money Market
6C	International Taxation	103-105	June 2020	Transfer Pricing
		106-112	December 2020	Non Resident Taxation
		113	December 2020	Double Taxation Relief
		114-115	December 2020	Taxation of e-Commerce Transactions
		116	June 2020	Tax Treaties: Overview, Features, Application and Interpretation
6D	Economic Laws	117-119	April 2020	Case Study 1
		120-122	April 2020	Case Study 2
		122-125	April 2020	Case Study 3
		126-128	May 2021	Case Study 1
		128-131	May 2021	Case Study 2
		131-134	May 2021	Case Study 3
		134-137	May 2021	Case Study 4
		138-141	December 2021	Case Study 1
		142-145	December 2021	Case Study 2
		146-	December	Case Study 3

Strategic Cost Management and Performance Evaluation

SKILL ASSESSMENT

The questions/ cases are based on ***Skill Assessment***. An illustrative list of the verbs that appear in the requirements for each question/ case is given below. It is important that students answer according to the definition of the verb:



Level	Learning Objective	Illustrative Verbs	Definition/ Explanations[1]
III	**EVALUATION** How are you expected to use your learning to evaluate, make decisions or recommendations?	**Recommend**	♦ To recommend you must: ♦ Identify and explain any reasonable options → evaluate each → conclude → recommend.
		Evaluate	♦ 'Evaluate' means balanced assessment including both the *positive* and *negative* aspects of an issue. ♦ It might mean computations, but it might not. ♦ It is important to emphasise something is in *qualitative terms*, as well as *monetary*.
		Advise	♦ 'Advise' requires to build up a good, comprehensive, *argument* that leads to one or more choices for the owners or managers to consider.
II	**ANALYSIS** How are you expected to analyse the detail of what you have learned?	**Produce**	♦ Begin with very little or nothing to make something or bring something into existence.
		Prioritise	♦ To decide which of a group of things are the most important so that you can deal with them first. Here, you'll also have to *elucidate/ clarify*, for each item, why you put it, where you did in the list of 'priorities'.
		Interpret	♦ Generally, 'Interpret' is translation of one form of words to another, where the latter is more clear in its exact sense than the former. ♦ This is often the *second stage* of 'analyse'.
		Discuss	♦ There needs to be an 'argument'. ♦ You need two or more differing or conflicting viewpoints. Also, any discussion should, if possible, end in an outcome. ♦ For example; advantages vs. disadvantages → outcome; Or reasons why vs. why not → outcome; Or maybe this vs. maybe that → outcome.
		Construct	♦ As 'prepare', but maybe with an *elucidation* as to why you put things.
		Compare and contrast	♦ An elucidation of the similarities and differences between two or more things.
		Categorise	♦ To put things into groups with the same features with an *explanation* after each item saying why you put it in that particular group and not one of the others.
		Analyse	♦ Taking apart information or data to discover *relationships*, *causes*, *patterns* and *connections*. ♦ This is about a series of *detailed explanations*.
	APPLICATION How you are expected to apply your knowledge?	**Tabulate**	♦ An arrangement of facts and numbers in rows or blocks.
		Solve	♦ Generally, 'Calculation' is how to do something. ♦ 'Solve' leave you to select the *most suitable* technique or process.
		Reconcile	♦ To find a way in which two situations (often the results of calculations) that are opposed to each other can agree and exist together.
		Prepare	♦ 'Prepare' is used where there is a fair amount of numerical data given in the question. ♦ You have to consider the relevant data, process it by calculations or rearranging it, then provide it in a specific form.
		Demonstrate	♦ 'Demonstrate' is consistent with situations where there is *only one correct answer*. ♦ You need to show something to be correct, apart from any doubt, by giving proof.
		Calculate	♦ Ascertain or reckon mathematically.
		Apply	♦ Applying the facts, rules, concepts, and ideas. ♦ This is not just talk about it in theory, do it for real i.e. new situations.
I	**COMPREHENSION** What you are expected to understand?	**Illustrate**	♦ Give an example.
		Identify	♦ Recognise, establish or select after consideration.
		Explain	♦ To make something clear or easy to understand by describing or giving information about it. ♦ Write a sentence that makes point → Then write another to clarify why the sentence is so → If point still isn't clear, write another sentence that makes it clearer.
		Distinguish	♦ To recognize the difference between two things. ♦ List the features of each of the things that make them unlike from each other.
		Describe	♦ What it is? ♦ This is *next step* from list, state, define. ♦ You might need to give a *short paragraph* covering the issues.
	KNOWLEDGE What you are expected to know?	**Define**	♦ Just give a textbook or dictionary *definition*, you may use your *own words* instead. ♦ This is simply a *test of memory*.
		State	♦ What is...? ♦ Convey what need to say *in brief*. ♦ No need to explain, unless it isn't clear.
		List	♦ How many...? ♦ Just give a list. ♦ Each of the points on 'list' should be stated in terms of a *full sentence*, for clarity, but there's no requirement to go any further than that.

It may be presumed that the skills specified in Level I are inherent in Level II i.e., only when the student possesses Level I skills, he/ she would be able to achieve Level II skills. Likewise, the skills specified in Levels I and II are inherent in Level III i.e., only when a student possesses Level I and II skills, he/ she would be able to achieve Level III skills.

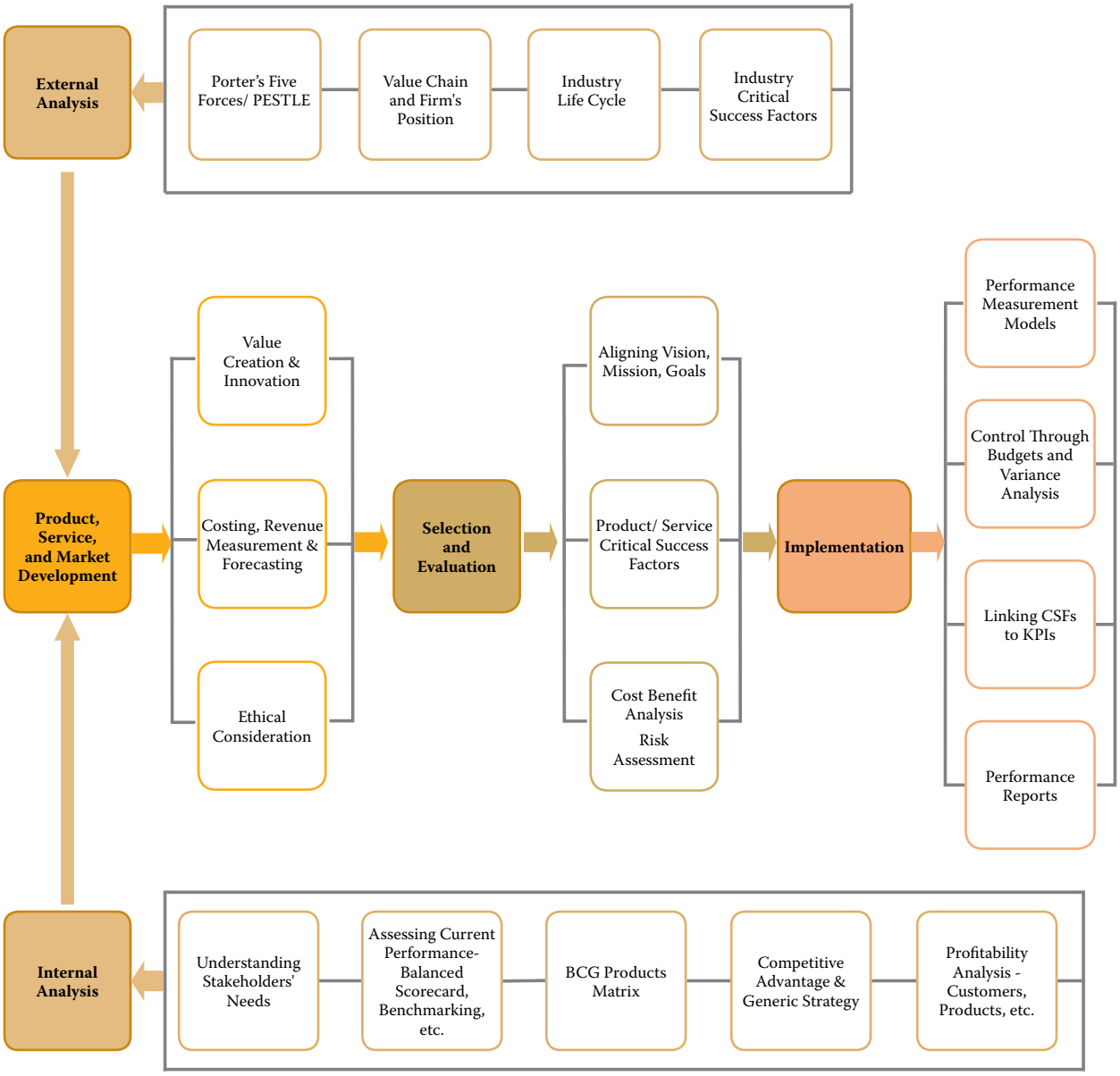
Strategic Cost Management and Performance Evaluation

"Strategy is about making choices and trade-offs; it's about deliberately choosing to be different"

– Michael Porter

With the increasing complexity, volatility, uncertainty, and pace of change in today's global marketplace; Chartered Accountants' position has moved to the **Center** in recent years, becoming more active and dynamic in defining and facilitating both strategy *development and implementation*. They play a more significant role in *driving* **"Value"** and determine *the future strategy of an organization*. The function of the CAs in the implementation of the strategy involves funding the organization's strategic options, as well as creating key performance indicators (KPIs) to measure the organization's progress against its strategy. The syllabus introduces students to the strategic role of "management accounting".

Strategic Role of Management Accounting- An Overview

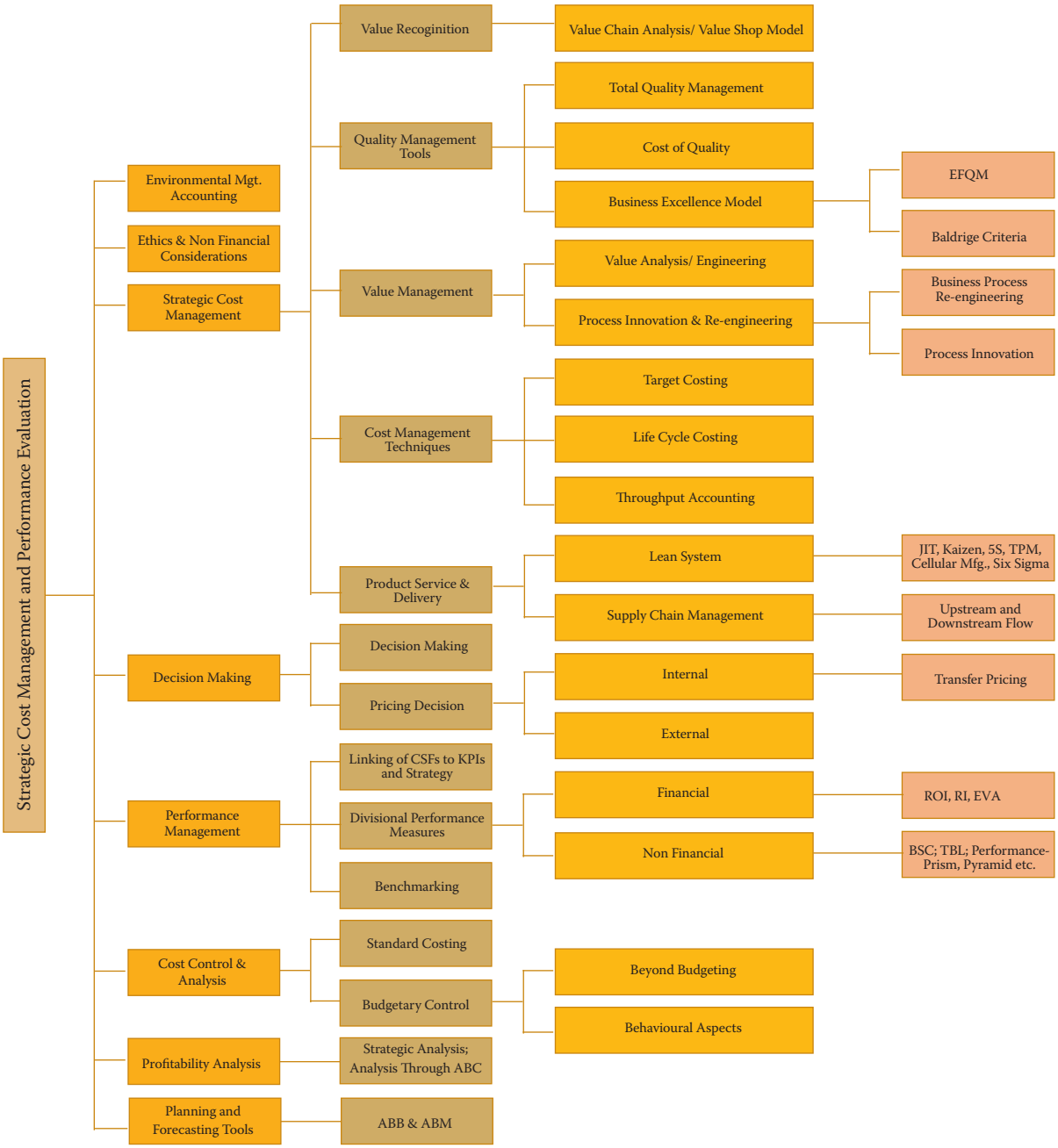


Strategic Cost Management and Performance Evaluation

"Strategy is about setting yourself apart from the competition. It's not a matter of being better at what you do - it's a matter of being different at what you do."

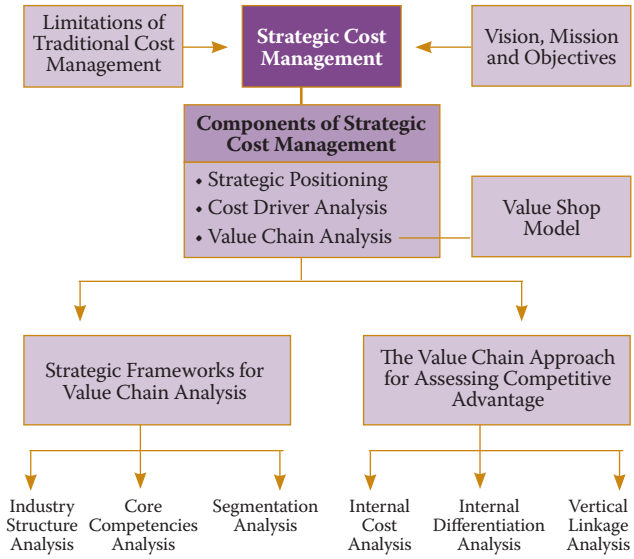
– Michael Porter

Strategic Cost Management and Performance Evaluation (SCMPE) is a vital module of the overall skills base of today's Chartered Accountant. SCMPE examines the Chartered Accountant's role in dynamic organisations operating in the global business environment where organisations are considered as integrated part of the global market supply chain. The *long- term sustainability* of these organisations requires not only a sound internal operating environment but also an outward-looking *strategy* to compete with external environment. In this role, the Chartered Accountant contributes to *strategy development* and *implementation* with the goal of creating *customer* and *shareholder value*. SCMPE combines the strategic cost management techniques which have become increasingly important in contemporary operational environments, with the performance based management framework in one integrated system.



INTRODUCTION TO STRATEGIC COST MANAGEMENT

Chapter Overview



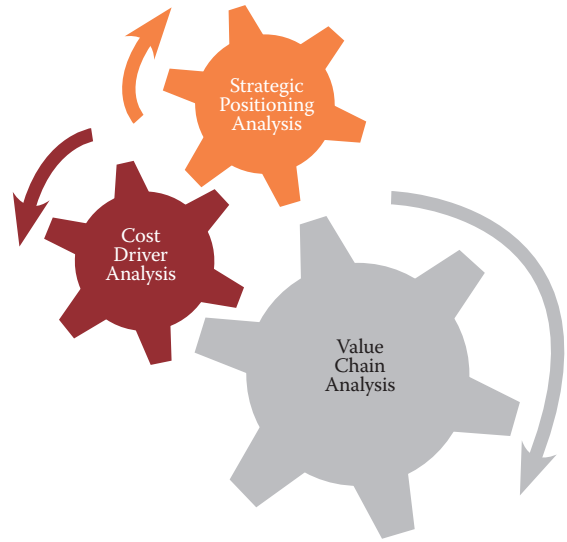
Traditional Cost Management

Traditional cost management system involves *allocation of costs* and *overheads* to the production and focusses largely on cost control and cost reduction.

Strategic Cost Management

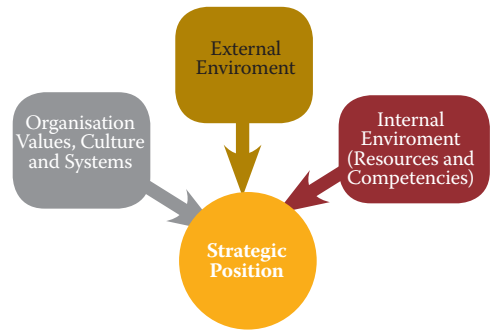
Components of Strategic Cost Management

Strategic Cost Management primary revolves around three business themes - Value Chain analysis, Cost driver analysis and Strategic positioning analysis.



Strategic Positioning Analysis

Strategic Positioning Analysis is a company's *relative position within its industry* matters for performance. Strategic positioning reflects choices a company makes about the kind of value it will create and how that value will be created differently than rivals. The following factors affect the strategic position of a company –



External environment can be analysed using models like **PESTEL** (Political, Economic, Social, Technological, Environmental and Legal factors) and **Porter's 5 forces.**

Cost Driver Analysis

Cost is caused or driven by various factors which are interrelated. Cost is not a simple function of volume or output as considered by traditional cost accounting systems. Cost driver concept is explained in two broad ways in strategic cost management parlance - Structural cost drivers and Executional cost drivers.

Structural cost drivers are the organisational factors which affect the costs of a firm's product. These factors drive costs of an organisation in varied ways. The scale and scope of operation of a company will impact the costs.

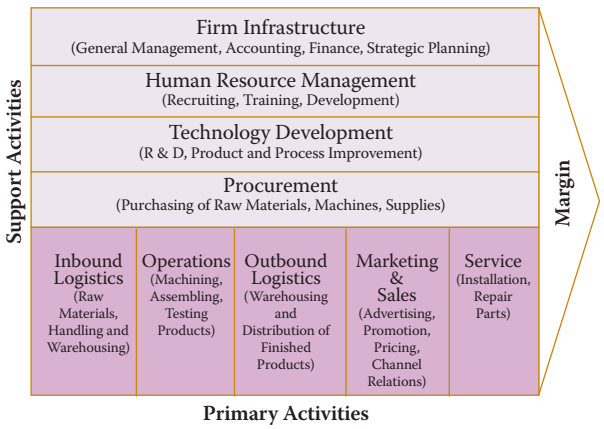
Executional cost drivers are based on firm's *operational decision* on how the various resources are employed to achieve the goals and objectives. These cost drivers are determined by management style and policy. The participation of workforce towards continuous improvement, importance of total quality management, efficiency of plant layout etc. are examples of executional cost drivers.

A company must focus on those cost drivers which is of strategic importance.

Value Chain Analysis

"Value-chain analysis is a process by which a firm identifies & analyses various activities that add value to the final product"

- The idea is to identify those activities which do not add value to the final product/service and *eliminate such non-value adding activities.*
- The analysis of value chain helps a firm obtain *cost leadership* or improve *product differentiation.*
- Resources must be deployed in those *activities* that are capable of producing products *valued by customers.*



Primary activities are those which are directly involved in transforming of inputs (Raw Material) into outputs (Finished Products) or in provision of service. *Secondary activities* (also known as support activities) support the primary activities.

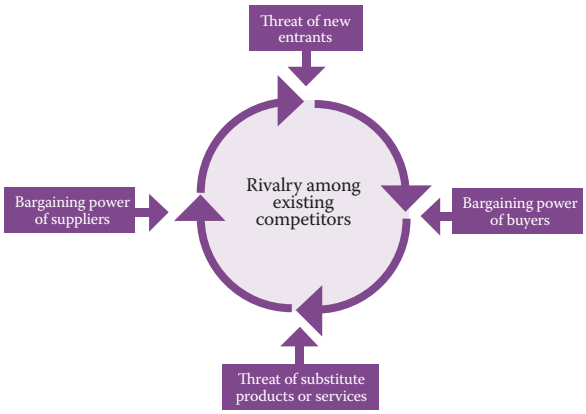
Strategic Frameworks For Value Chain Analysis

The Value Chain analysis requires strategic framework for organizing varied information. The following three are generally accepted strategic framework for Value Chain analysis.

Industry Structure Analysis

An industry might not yield high profits just because the industry is large or growing. The five forces suggested by Porter's play an important role in *determining profit potential of the firms in an industry.*

Factors which influence profitability are:

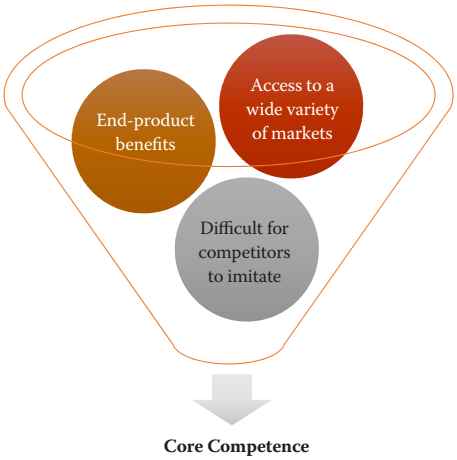


The five forces analysis helps a firm to better understand the *industry value chain* and its *competitive environment.*

Core Competencies Analysis

Core Competency is a distinctive or unique skill or technological knowhow that creates distinctive customer value. A core competency is the primary source of an organisation's competitive advantage. The competitive advantage could result from ***cost leadership*** or ***product differentiation***.

There are three tests useful for identifying a core competence.



In order to attain superior performance and attain competitive advantage, a firm must have distinctive competencies. Distinctive competencies can take any of the following two forms:

- An offering or ***differentiation advantage***. If customers perceive a product or service as superior, they become more willing to pay a premium price relative to the price they will have to pay for competing offerings.
- Relative ***low-cost advantage***, under which customers gain when a company's total costs undercut those of its average competitor.

Segmentation Analysis

A single industry might be a collection of different market segments. This analysis will reveal the competitive advantages or disadvantages of different segments. A firm may use this information to decide to exit the segment, to enter a segment, reconfigure one or more segments, or embark on cost reduction/ differentiation programs.

The Value Chain Approach For Assessing Competitive Advantage

The value chain model can be used by business to assess the competitive advantage. Companies must not only focus on the end product/ service but also on the *process/ activities* involved in creation of these products/ services. The value chain approach can be used to better understand the competitive advantage in the following areas:

Internal Cost Analysis

Organisations can use the value chain analysis to understand the cost of processes and activities and identify the source of profitability.

Internal Differentiation Analysis

Companies can also use value chain analysis to create and offer superior differentiation to the customers. The focus is on improving the value perceived by customers on the companies' products and service offering. The firms must identify and analyse the value creating process and carry out a differentiation analysis.

Vertical Linkage Analysis

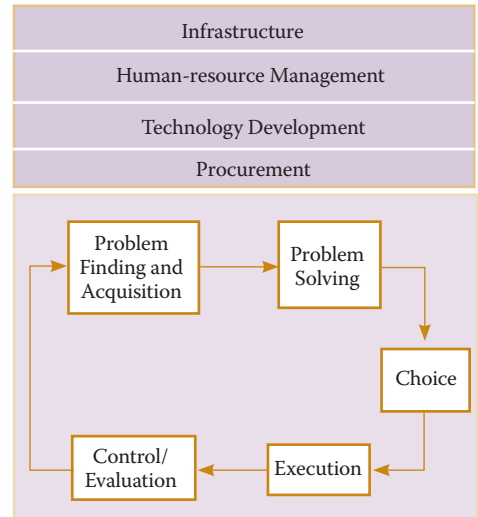
A company generates competitive advantage not only through linkages of internal processes within a firm but also through linkages between a firm's value chain and that of suppliers or users. A vertical linkage analysis includes all upstream and downstream activities throughout the industry.

In the SCM frame work, effective cost management involves a broad focus which Porter calls the value chain. It is a strategic tool used to analyse internal firm activities. Its goal is to recognize, which activities are the most valuable (i.e. are the source of cost or differentiation advantage) to the firm and which ones could be improved to provide competitive advantage. *Cost leadership* can be achieved through techniques like target costing. *Product differentiation* is directly proportional to market movements and changing business requirements.

Value Shop Model or Service Value Chain

This concept aims to serve companies from *service sector*. In value shop principle, no value addition takes place. It only deals with the problem, figure-out the main area requires its service and finally comes with the solution. This approach is designed to *solve customer problems rather than creating value by producing output from an input of raw materials.* **The model has the same support activities as Porter's Value Chain but the primary activities are described differently.** In the value shop they are:

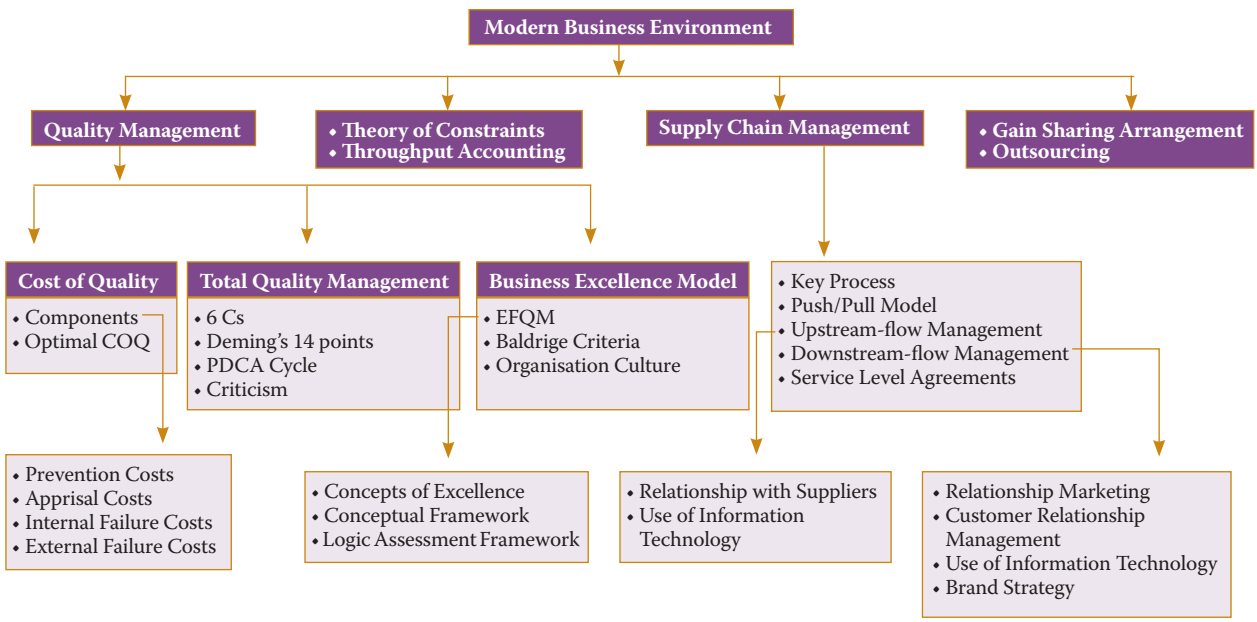
- Problem finding and acquisition.
- Problem solving.
- Choosing among solutions.
- Execution and control/evaluation.



The management in a value shop focuses on areas like problem and opportunity assessment, resource mobilization, project management, solutions delivery, outcome measurement, and learning.

MODERN BUSINESS ENVIRONMENT

Chapter Overview

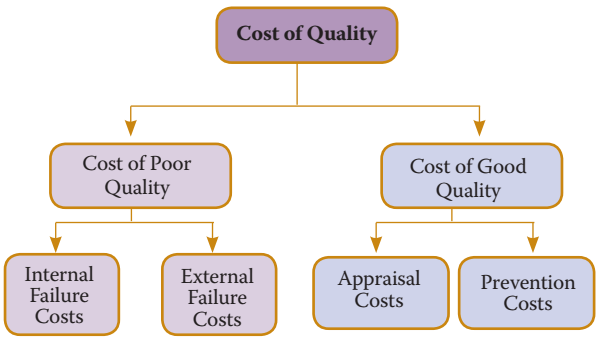


Modern Business Environment

Today's business environment is that of a *buyer's market*. This trend is the result of international transitions and macroeconomic, technological, political, and social changes. The challenge for businesses today is to satisfy their customers through the exceptional performance of their processes.

Cost Of Quality (COQ)

Mr. Philip B. Crosby in his book 'Quality is Free' referred to the COQ costs in two broad categories namely 'Price of Conformance' and 'Price of Non-conformance'. These two can be bifurcated further in to prevention & appraisal costs and internal & external failure costs. Hence, COQ is often referred as PAF (Prevention, appraisal & failure) model. *In other words*, 'Price of Conformance' is known as 'Cost of Good quality' and 'Price of Non-conformance' is often termed as 'Cost of Poor Quality'.



Prevention Costs

- The costs incurred for *preventing* the poor quality of products and services may be termed as Prevention Cost.
- They are planned and *incurred before actual operation* and are associated with the design, implementation, and maintenance of the quality management system.

Appraisal Costs

- The need of control in product and services to ensure high quality level in all stages, conformance to *quality standards* and *performance requirements* is Appraisal Costs.
- Appraisal Cost incurred to determine the degree of conformance to quality requirements (measuring, evaluating or auditing).

Internal Failure Costs

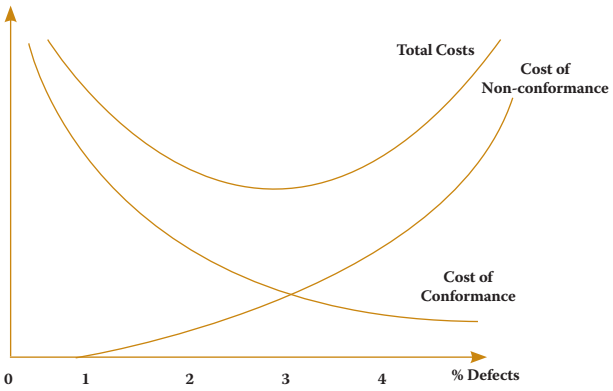
- These are costs that are caused by products or services not conforming to requirements or customer/user needs and are found *before delivery of products and services* to external customers.
- Deficiencies are caused both by errors in products and inefficiencies in processes.

External Failure Costs

- These costs occur when products or services that fail to reach design quality standards are not *detected until transfer to the customer.*

Optimal COQ

It is generally accepted that an increased expenditure in prevention and appraisal is likely to result in a substantial reduction in failure costs. Because of the trade off, there may be an *optimum operating level* in which the **combined costs are at a minimum.**



Total Quality Management (TQM)

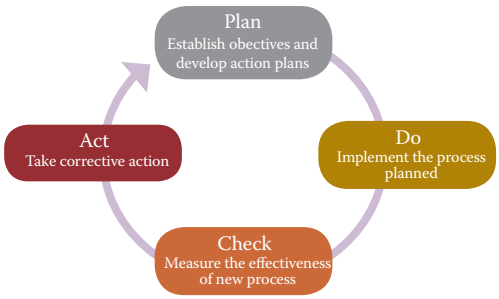
Total Quality Management (TQM) is a management strategy aimed at embedding awareness of quality in all organizational processes. TQM requires that the company maintain this quality standard in all aspects of its business. This requires ensuring that *things are done right the first time and that defects and waste are eliminated from operations.* TQM is a comprehensive management system which:

- Focuses on meeting owner's/ customer's needs, by providing quality services at a reasonable cost.
- Focuses on continuous improvement.
- Recognizes role of everyone in the organization.
- Views organization as an internal system with a common aim.
- Focuses on the way tasks are accomplished.
- Emphasizes teamwork.

Six C's of TQM

The Plan–Do–Check–Act (PDCA) Cycle

Deming developed the Plan – Do – Check – Act cycle. PDCA Cycle describes the activities a company needs to perform in order to incorporate *continuous improvement* in its operation.



Deming outlined his philosophy on quality in his famous "14 Points." These points are principles that help guide companies in achieving quality improvement.

Criticisms of Total Quality Management

- the focus on documentation of process and ill-measurable outcomes;
- the emphasis on quality assurance rather than improvement;
- an internal focus which is at odds with the alleged customer orientation; and
- may not be appropriate for service based industries

The Business Excellence Model

Business Excellence (BE) is a philosophy for developing and strengthening the management systems and processes of an organization to *improve performance* and *create value for stakeholders.*

The essence of this approach is to *develop quality management principles* that increase the overall efficiency of the operation, minimize waste in the production of goods and services, and help to increase employee loyalty as a means of maintaining high standards throughout the business by *achieving excellence in everything* that an organization does (including leadership, strategy, customer focus, information management, people and processes).

Several business excellence models exist world-wide. While variations exist, these models are all *remarkably similar.* The most common include;

- EFQM Excellence Model
- Baldrige Criteria for Performance Excellence
- Singapore BE Framework
- Japan Quality Award Model
- Australian Business Excellence Framework

Business Excellence Model and Organizational Culture

- Business Excellence approach focuses on strengthening the internal function and communication, looks towards the cultivation of strong ties with consumers and can be incorporated into the culture.
- Excellence cannot be attained if the staffs are forced to conform to certain norms. They have to be critically managed and motivated.

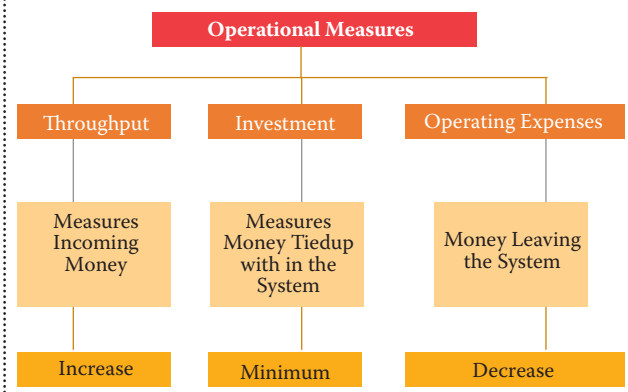
Theory of Constraints

Operational Measures of Theory of Constraints

The theory of constraints focuses on revenue and cost management when faced with bottlenecks. It advocates the use of three key measures. These are:

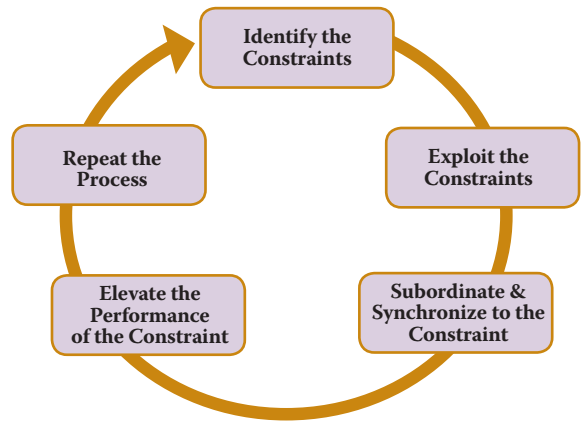
Core Measures	**Definition**
Throughput (T)	♦ Throughput as a TOC measure is the rate of generating money in an organization through Sales. ♦ Throughput = (Sales Revenue – Unit Level Variable Expenses)/ Time ♦ Direct Labour Cost is viewed as a fixed unit level expenses and is not usually included.
Investment (I)	♦ This is money associated with turning materials into Throughput and do not have to be immediately expensed. ♦ Includes assets such as facilities, equipment, fixtures and computers.
Operating Expense (OE)	♦ Money spent in turning Investment into Throughput and therefore, represent all other money that an organisation spends. ♦ Includes direct labour and all operating and maintenance expenses.

Based on these three measures, the objectives of management can be expressed as increasing throughput, minimizing investment and decreasing operating expenses.



Goldratt's Five-Step Method for Improving Performance

The key steps in managing **bottleneck resources** are as follows:



Throughput Accounting

Several ratios were defined by Galloway and Waldron based on the definition of throughput.

Throughput Accounting Ratio:

$$\frac{\text{Throughput per Bottleneck Minute}}{\text{Factory Cost per Bottleneck Minute}}$$

If the TA ratio is greater than 1 the product in question is "profitable" because, if all capacities were devoted to that product, the throughput generated would exceed the total factory cost. If there was a bottleneck, products could be ranked by a variant of the TA ratio (although the ranking is the same as that derived by the use of throughput per bottleneck minute).

Other Performance Ratios suggested include:

$$\frac{\text{Throughput}}{\text{Labour Cost}} \quad \text{and} \quad \frac{\text{Throughput}}{\text{Material Cost}}$$

Supply Chain Management

The Global Supply Chain Forum (GSCF) defines Supply chain management as the *"integration of key business processes from end user through original suppliers that provides products, services, and information that add value for customers and other stakeholders".*

Types of Supply Chain- Push and Pull

Push Model

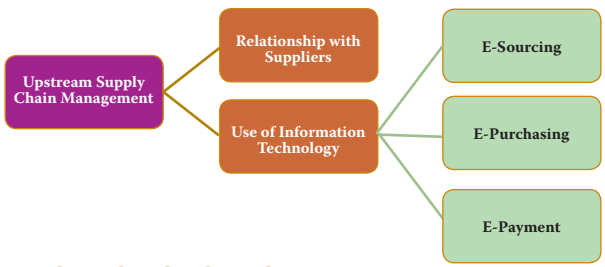
Pull Model

Upstream and Downstream Flow

A supply chain begins right from the supplier and finally ends on end customer or consumer. In the total chain, there are flows of material, information and capital or finance. *When the flow relates to supplier, it is termed as upstream flow. If the flow is with consumers or customers, it is named as downstream flow.*

Management of Upstream Supplier Chain

Management of transactions with suppliers are termed as upstream supply chain management.



Relationship with Suppliers

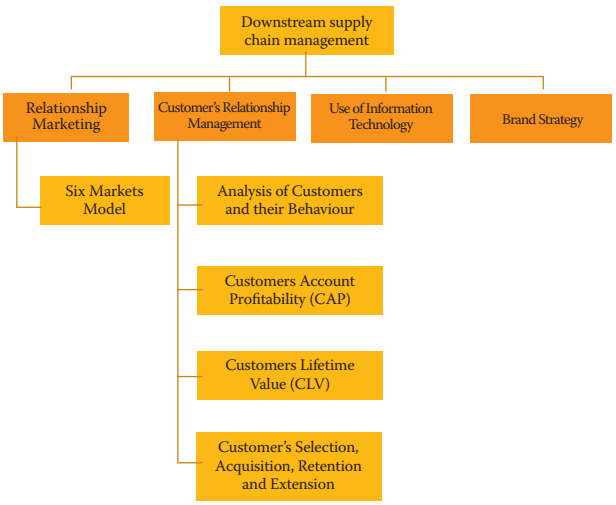
Supplier capabilities of innovation, quality, reliability and costs/ price reductions and agility to reduce risk factors all have witnessed significant changes when aligned with key suppliers. Greater value can be achieved for both businesses, something that would be difficult to achieve if operating independently.

Use of Information Technology

The main activities of upstream supply chain are *procurement* and *logistics*. In modern business environment upstream supply chain management use **E-Procurement** process. E-Procurement is the electronic methods beginning from identification of the organization's requirements and end on payment. E-Procurement includes E-Sourcing, E-Purchasing and E-Payment.

Downstream Supply Chain Management

Management of transactions with consumers or customers are termed as downstream supply chain management.



Relationship Marketing

Marketing plays a vital role to successfully handle the downstream supply chain management. *The Relationship marketing helps the organization to keep existing customer and to attract new customers* through helpful staff, quality service / product, appropriate prices and proper customer care etc.

Six Markets Model identifies the six key "market domains" where organizations may consider directing their marketing activities.

The six markets model suggests that a firm must regulate its actions towards developing appropriate relationships with each of the market areas as the management of relationships in each of the six markets is critical for the attainment of customer retention objective.

The growing interest in relationship marketing suggests a shift in the nature of marketplace transactions from discrete to relational

exchanges, from exchanges between parties with no past history and no future to interactions between parties with a *history and plans for future interaction.*

Customers Relationship Management

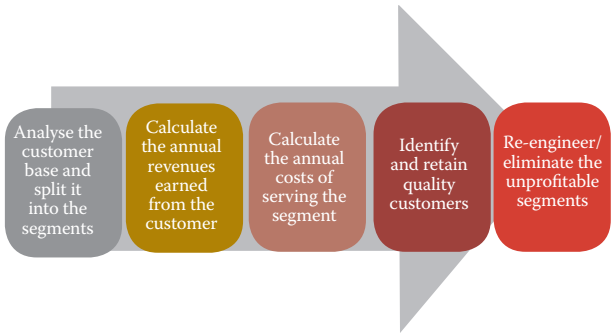
To manage and analyse customer's interaction and data throughout the life cycle with the main motive of improving business relations the strategies and technologies used is Customer Relationship Management (CRM). Relation includes relations with customers, assisting in customer retention and driving sales growth. CRM is knowing the needs of the customers and providing them with best possible solution.

Analysis of Customers and their Behaviour

Analysis of customers is necessary based on geographical location or purchasing characteristics. For industrial customer expectation of benefits - quality, discount, serviceability, size of the should be taken into consideration. During such analysing process, management should keep in mind the physiological need, safety need, social need, status/ego need and self-fulfillment need of existing and future customers.

Customers Account Profitability (CAP)

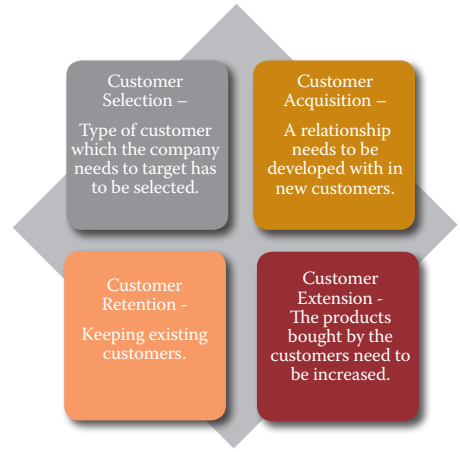
Undertaking a customer account profitability improvement initiative is a **five-step process**:



Customers Lifetime Value (CLV)

Customer Life time value is the present value of net profit that we derive from a customer over the entire lifetime of relationship with that particular customer. It is the *net present value of the projected future cash flows from a lifetime of customer relationship.* It is an essential tool used in marketing to focus on more profitable customers and **stop servicing non-profitable customers.**

Customer's Selection, Acquisition, Retention and Extension



The use of Information Technology in Downstream Supply Chain Management

In managing downstream supply chain, organizations link *their sales system* to the *purchasing system of its customer* through Electronic Data Change. Using E-Business, they sell products. Intelligence gathering is used to monitor the online customer transactions. E-mail is the way through which organization keeps in touch with customers. Use of IT results in quick action, reduction in associated cost and saving in time.

Brand Strategy

Specially branding of product makes a huge difference in its *appeal to customers.* Branding can be usage of logo or specific colour or any other means which makes the product or service distinctively visible among others.

Gain Sharing Arrangements

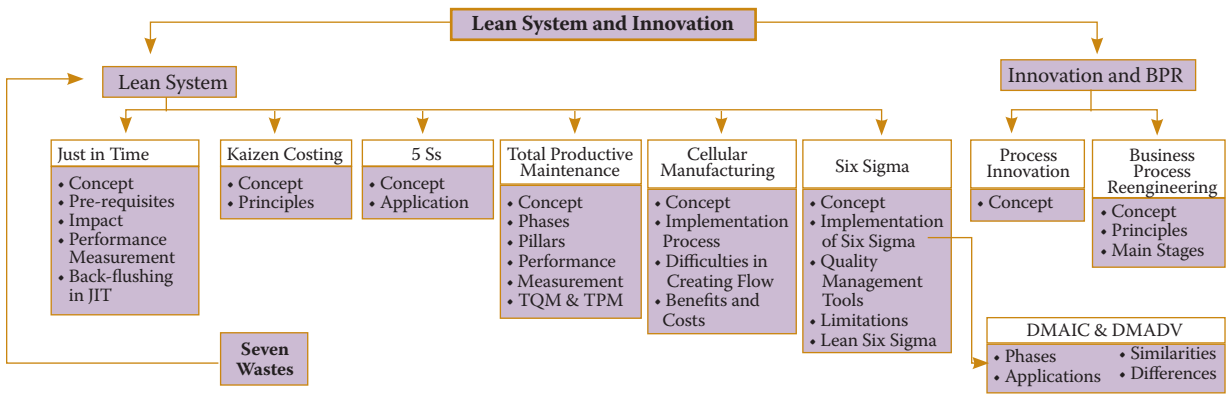
Gain sharing is an approach to the review and adjustment of an existing contract, or series of contracts, where the adjustment provides benefits to both parties.

Outsourcing

Outsourcing is a business practice used by companies to reduce costs or improve efficiency by shifting tasks, operations, jobs or processes to another party for a span of time.

LEAN SYSTEM AND INNOVATION

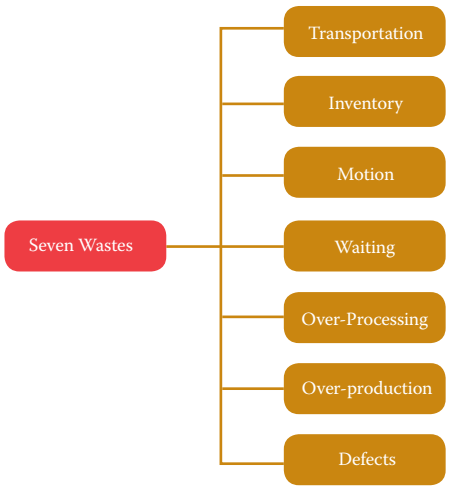
Chapter Overview



Lean System

"Lean System is an organized method for waste minimization without sacrificing productivity within a manufacturing system. Lean implementation emphasizes the importance of optimizing work flow through strategic operational procedures while minimizing waste and being adaptable."

There are generally 7 type of wastes:



Most of lean system techniques are based on following *principles:*

- Perfect first-time quality
- Waste minimization
- Continuous improvement
- Flexibility

The ***characteristics*** of lean manufacturing:

- Zero waiting time
- Zero inventory
- Pull processing
- Continuous flow of production
- Continuous finding ways of reducing process time.

Just-In-Time (JIT)

CIMA defines:

*"System whose objective is to produce or to procure products or components as they are required by a customer or for use, rather than for stock. Just-in-time system **Pull system,** which responds to demand, in contrast to a push system, in which stocks act as buffers between the different elements of the system such as purchasing, production and sales".*

A complete JIT system begins with production, includes deliveries to a company's production facilities, continues through the manufacturing plant, and even includes the types of transactions processed by the accounting system.

Features

- Spare Parts/ Materials from suppliers on the exact date and at the exact time when they are needed
- Straight delivery to the production floor for immediate use in manufactured products
- Visit of engineering staff at supplier sites to examine supplier's processes
- Installation of EDI system that tells suppliers exactly how much of which parts are to be sent
- Dropping off products at the specific machines
- Shorten the setup times
- Eliminating the need for long production runs/ Streamlined flow of parts from machine to machine
- Training to employees how to operate a multitude of different machines, perform limited maintenance
- Several alterations in the supporting accounting systems

Essential Pre-requisites of a JIT system

- Low variety of goods
- Vendor reliability
- Good communication
- Demand stability
- TQM
- Defect-free materials
- Preventive maintenance

Impact of JIT System on

- **Waste Costs:** When fully installed, a JIT system vastly reduce all these types of waste. When this happens, there is a sharp drop in several aspects of a product's costs.
- **Overhead Costs:** The costs of material handling, facilities, and quality inspection decline when a JIT system is installed.
- **Product Prices:** When a company achieves a higher level of product quality, along with ability to deliver products on the dates required, customers may be willing to pay a premium.

Performance Measurements in a JIT System

Many of the performance measurement measures used under a *traditional accounting system are not useful in a JIT environment,* while new measures can be implemented that take advantage of the unique characteristics of this system.

- Machine utilization measurements can be discarded under JIT environment.
- Another inappropriate measurement is any type of piece rate tracking for each employee.
- Any type of direct labour efficiency tracking is highly inappropriate in a JIT system.
- Installing a JIT system does not mean that there should be a complete elimination of operational measures.

Back-flushing in a JIT System

Back-flushing requires no data entry of any kind until a finished product is completed.

Kaizen Costing

This philosophy implies that small, incremental changes routinely applied and sustained over a long period result in significant improvements.

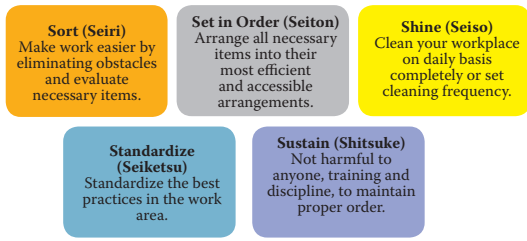
Kaizen Costing Principles

- The system seeks gradual improvements in the existing situation, at an acceptable cost.
- It encourages collective decision making and application of knowledge.
- There are no limits to the level of improvements that can be implemented.
- Kaizen involves setting standards and then continually improving these standards to achieve long-term sustainable improvements.
- The focus is on eliminating waste, improving systems, and improving productivity.
- Involves all employees and all areas of the business.

5S

5S is the name of a workplace organization method that uses a list of five Japanese words: **seiri, seiton, seiso, seiketsu,** and **shitsuke.** It explains *how a work space should be organized for efficiency and*

effectiveness by identifying and storing the items used, maintaining the area and items, and sustaining the new order.

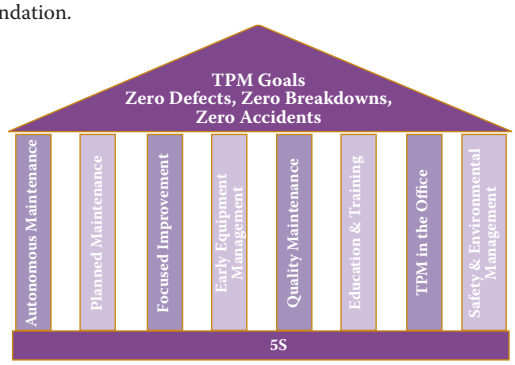


5S methodology is being applied to a wide variety of industries including Manufacturing, Health care, Education & Government.

Total Productive Maintenance (TPM)

Total Productive Maintenance (TPM) is a system of maintaining and improving the integrity of production and quality systems. This is done through the machines, equipment, processes, and employees that add to the value in Business Organisation. TPM helps in *keeping all equipment in top working condition* so as to avoid breakdowns and delays in manufacturing processes.

TPM Strategy focuses on ***eight pillars*** of success with 5S strategy as foundation.



Performance Measurement in TPM

The most important approach to the measurement of TPM performance is known as Overall Equipment Effectiveness (OEE) measure.

Performance × Availability × Quality = OEE %

OEE may be applied to any individual assets or to a process. It is unlikely that any manufacturing process can run at 100% OEE. According to Dal *et al* (2000), Nakajima (1998) suggested that ideal values for the OEE component measures are:

Availability	> 90%
Performance	> 95%
Quality	> 99%

Accordingly, OEE at World Class Performance would be approximately 85%. Kotze (1993) contradicted, that an OEE figure greater than 50% is more realistic and therefore more useful as an acceptable target.

Cellular Manufacturing/ One Piece Flow Production System

A Sub Section of JIT and Lean System is Cellular Manufacturing. It encompasses a group technology. The goals of cellular manufacturing are:

- To move as quickly as possible,
- Make a wide variety of similar products,
- Making as little waste as possible.

Six Sigma

It is quality improvement technique whose objective is to *eliminate defects* in any aspect that affects customer satisfaction. The premise of Six Sigma is that by measuring defects in a process, a company can develop ways to eliminate them and practically achieve "zero defects". Six sigma can be used with balanced scorecard by providing more rigorous measurement system based on statistics.

Numerical Concept of Six Sigma

'Sigma' is a statistical term that measures how far a process deviates from perfection. The higher the sigma number, the closer the process is to perfection.

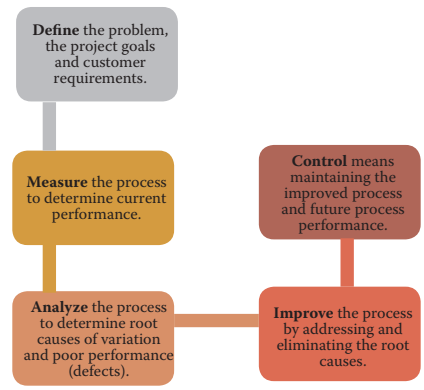
The values of Defect Percentage

Six Sigma is 3.4 defects per million opportunities or getting things right 99.99966% of the time. It is possible to develop ways of reducing defects by measuring the level of defects in a process and discovering the causes.

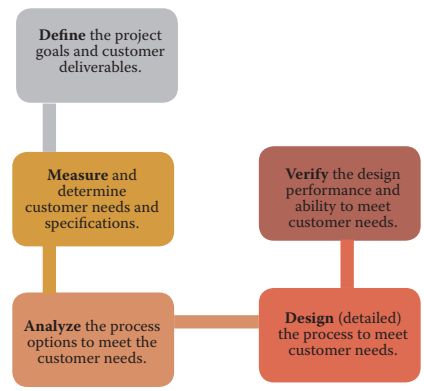
Implementation of Six Sigma

There are two methodologies for the implementation of Six Sigma-

DMAIC: This method is very robust. It is used to improve *existing business process.* To produce dramatic improvement in business process, many entities have used it successfully. It has *five phases*:



DMADV: The application of these methods is aimed at creating a high-quality product keeping in mind customer requirements at every stage of the product. It is an improvement system which is used to develop *new processes or products* at Six Sigma quality levels. Phases are described in diagram:



Both DMADV and DMAIC are fundamental six sigma methodologies for improving quality of product/process. Broadly, DMAIC deals with improving some existing process to make it align with customer's needs while DMADV deals with new design or redesign.

Lean Six Sigma

Lean Six Sigma is the combination of *Lean* and *Six Sigma* which help to achieve greater results that had not been achieved if Lean or Six Sigma would have been used individually. It increases the speed and effectiveness of any process within any organization. By using lean Six Sigma, organisations will be able to Maximize Profits, Build Better Teams, Minimize Costs, and Satisfy Customers.

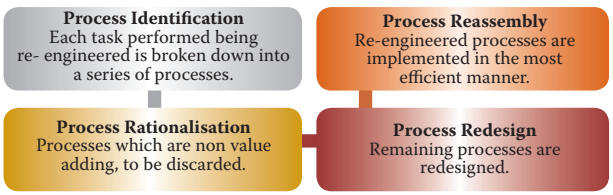
Process Innovation

Process Innovation means the implementation of a new or significantly improved production or delivery method (including significant changes in techniques, equipment and/ or software).

Business Process Reengineering

Hammer defines Business Process Reengineering (BPR) (or simply reengineering) as *"the **fundamental rethinking** and **radical redesign** of business processes to achieve **dramatic improvements** in critical contemporary measures of performance, such as cost, quality, service, and speed."*

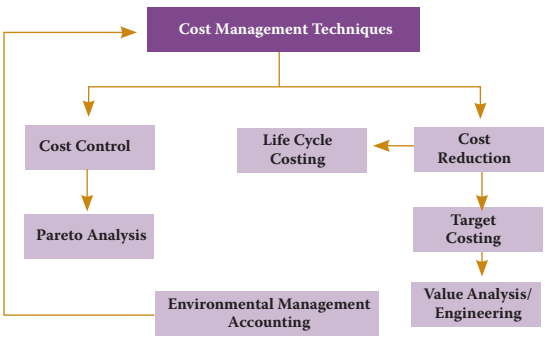
Main Stage of BPR



Porter's Value Chain is commonly used in Business Process Re-engineering as a technique to *identify* and *analyse* processes that are of strategic significance to the organisation.

COST MANAGEMENT TECHNIQUES

Chapter Overview



Target Costing

It can be defined as *"a structured approach to **determining the cost** at which a proposed product with specified functionality and quality must be produced, to generate a desired level of profitability at its anticipated selling price".*

In Target costing, we first determine what price we think the consumer will pay for our product. We then determine how much of a profit margin we expect and subtract that from the final price. The remaining amount left is what is available as a budget to be used to create the product.

Components of Target Costing System

Typically, the total target is broken down into its various components, each component is studied and opportunities for cost reductions are identified. These activities are often referred to as Value Analysis (VA) and Value Engineering (VE).

***Value Analysis** is a planned, scientific approach to cost reduction which reviews the material composition of a product and production design so that modifications and improvements can be made which do not reduce the value of the product to the customer or to the user.*

***Value Engineering** is the application of value analysis to new products. Value engineering relates closely to target costing as it is cost avoidance or cost reduction before production.*

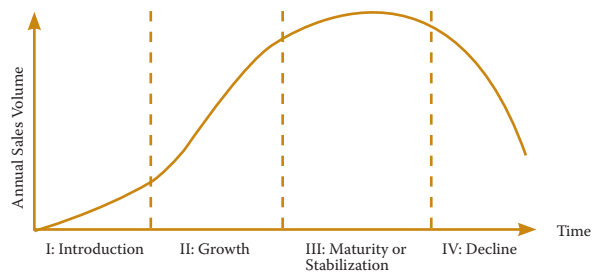
The initial value engineering may not uncover all possible cost savings. Thus, ***Kaizen Costing*** is designed to repeat many of the value engineering steps for as long as a product is produced, constantly refining the process and thereby stripping out extra costs.

Further, Target Costing System is based on involving representatives of all the ***Value Chain*** such as suppliers, agents, distributors and existing after-sales service in the target costing system.

Life Cycle Costing

Life Cycle Costing involves identifying the costs and revenue over a product's life i.e. from inception to decline. Life cycle costing aims to maximize the profit generated from a product over its total life cycle.

The life cycle of a product consists of four phases/ stages viz., Introduction; Growth; Maturity; Saturation and Decline.



Life Cycle Characteristics

	Introduction	Growth	Maturity	Decline
Objectives	Create product awareness & trial	Maximise market share	Maximise profits while defending market share	Reduce expenditures & milk the brand
Sales	Low sales	Rapidly rising	Peak sales	Declining sales
Costs per Customer	High cost per customer	Average cost per customer	Low cost per customer	Low cost per customer
Profits	Negative	Rising profits	High profits	Declining profits
Customers	Innovators	Early adopters	Middle majority	Laggards
Competitors	Few	Growing number	Steady number beginning to decline	Declining number

Strategies

	Introduction	Growth	Maturity	Decline
Product	Offer basic product	Offer product extensions, service & warranty	Diversify brands and models	Phase out weak items
Price	Cost plus profit	Price to penetrate market	Price to match or beat competitors	Price cutting
Advertising	Build product awareness amongst early adopters & dealers	Build awareness & interest in mass market	Stress on brand differences and benefits	Reduce level to keep hard core loyalty
Distribution	Build selective distribution	Build Intensive distribution	Build more intensive distribution	Go selective: Phase out unprofitable outlets
Sales Promotion	Use heavy sales promotion to entice trial	Reduce to take advantage of heavy consumer demand	Increase to encourage brand switching	Reduce to minimal level

Pareto Analysis

Pareto Analysis is a rule that recommends focus on the most important aspects of the decision making in order to simplify the process of decision making. It is based on the 80:20 rule that was a phenomenon first observed by Vilfredo Pareto, a nineteenth century Italian economist. He noticed that 80% of the wealth of Milan was owned by 20% of its citizens. This phenomenon, or some kind of approximation of it say, (70: 30 etc.) can be observed in many different business situations. The management can use it in a number of different circumstances to direct management attention to the *key control mechanism* or *planning aspects.* It helps to clearly establish top priorities and to identify both profitable and unprofitable targets.

Environmental Management Accounting [EMA]

- EMA identifies and estimates the costs of *environment-related activities* and seeks to control these costs.
- The focus of EMA is not on financial costs but it also considers the environmental cost or benefit of any decisions made.
- EMA is an attempt to integrate best management accounting thinking with best environmental management practice.

Environmental Costs

Environmental Prevention Costs–
Those costs associated with ***preventing*** adverse environmental impacts.

Environmental Appraisal Costs–
The cost of activities executed to determine whether products, process and activities are in ***compliance*** with environmental standards, policies and laws.

Environmental Internal Failure Costs –
Costs incurred from activities that have been produced but ***not discharged*** into the environment.

Environmental External Failure Costs –
Costs incurred on activities performed ***after discharging*** waste into the environment. These costs have adverse impact on the organisation's *reputation* and *natural resources.*

Identification of Environmental Costs

To prepare environmental management accounts an intense review of general ledger containing costs of materials, utilities and waste disposal etc. is required. Since the *environmental costs are generally 'hidden' in 'general overheads' of the company,* it becomes difficult for management to identify opportunities to cut environmental costs but nonetheless it is crucial for them to do so to preserve natural resources getting scarcer.

In 2003, the UNDSD identified four management accounting techniques for the Identification and Allocation of Environmental Costs:

Input-Output Analysis

This technique records material inflows and balances this with outflows on the basis that, what comes in, must go out.

Flow Cost Accounting

This technique uses not only material flows but also the organizational structure. Classic material flows are recorded as well as material losses incurred at various stages of production. Flow cost accounting makes material flows transparent by using various data, which are quantities (physical data), costs (monetary data) and values (quantities x costs). The material flows are divided into three categories, material, system, and delivery and disposal.

Life Cycle Costing

Lifecycle costing considers the costs and revenues of a product over its whole life rather than one accounting period. Therefore, the full environmental cost of producing a product will be taken into account. In order to reduce lifecycle costs, an organization may adopt a TQM approach.

Activity Based Costing (ABC)

ABC allocates internal costs to cost centres and cost drivers on the basis of the activities that give rise to the costs. In an environmental accounting context, it distinguishes between ***environment-related***

costs, which can be attributed to joint cost centres, and ***environment-driven costs***, which tend to be hidden on general overheads.

The *environment-driven costs* are removed from general overheads and traced to products or services. The cost drivers are determined based on environment impact that activities have and costs are charged accordingly. This should give a good attribution of environmental costs to individual products and should result in better control of costs.

Controlling Environmental Costs

After Identification and Allocation of Environmental Costs, task of controlling starts. An organization may try to control these costs as mentioned below-

Waste

'Mass balance' approach can be used to determine how much material is wasted in production, whereby the weight of *materials bought is compared to the product yield.*

Water

Businesses pay for water twice – first, to buy it and second, to dispose of it. If savings are to be made in terms of reduced water bills, it is important for organizations to identify where water is used and how consumption can be decreased.

Energy

Often, energy costs can be reduced significantly at very little cost. Environmental management accounts may help to identify inefficiencies and wasteful practices and, therefore, opportunities for cost savings.

Transport and Travel

Again, EMA techniques may be used to identify savings in terms of travel and transport of goods and materials. At a simple level, a business can invest in more fuel-efficient vehicles.

Consumables and Raw Materials

These are directly attributable costs and discussions with management can reduce such costs. For example, toner cartridges for printers could be refilled rather than replaced.

Reasons for Controlling Environmental Cost

There are three main reasons why the management of environmental costs is becoming increasingly important in organizations.

First, a 'carbon footprint' (as defined by the Carbon Trust) measures the total greenhouse gas emissions caused directly and indirectly by a person, organization, event or product.

Second, environmental costs are becoming huge for some companies, particularly those operating in highly industrialized sectors such as oil production. Such significant cossts need to be managed.

Third, regulation is increasing worldwide at a rapid pace, with penalties for non-compliance also increasing accordingly.

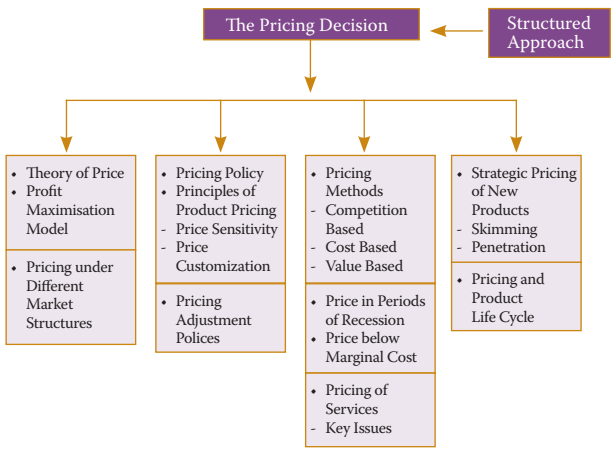
Role of EMA in Product/ Process Related Decision Making

The correct costing of products is a pre-condition for making sound business decisions. The accurate product pricing is needed for strategic decisions regarding the volume and choices of products to be produced. *EMA converts many environmental overhead costs into direct costs and allocate them to the products that are responsible for their incurrence.* The results of improved costing by EMA may include:

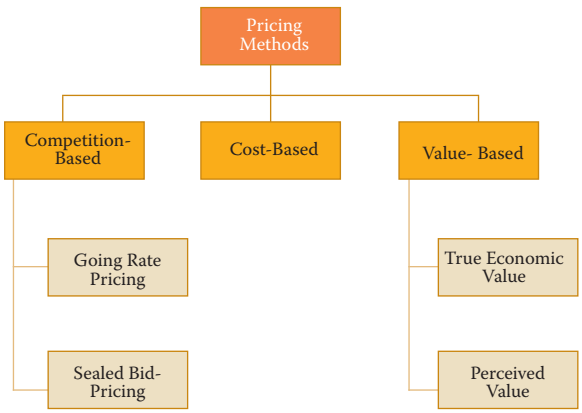
- Different pricing of products as a result of re-calculated costs;
- Re-evaluation of the profit margins of products;
- Phasing-out certain products when the change is dramatic;
- Re-designing processes or products in order to reduce environmental costs and
- Improving housekeeping and monitoring of environmental performance.

PRICING DECISION

Chapter Overview



Pricing Methods



Cost-Based Pricing Method

In many businesses, the common method of price determining is to estimate the *cost of product* & *fix a margin of profit*. The term 'cost' here means **Full Cost** at current output and wages level since these are regarded as most relevant in price determination.

Pricing based on total costs is subjected to two limitations. They are:

- The allocation of inter-departmental overheads is based on an *arbitrary basis*; and
- The allocation overheads will require estimation of normal output which often cannot be done precisely.

In order to avoid these complications, **Variable Costs** which are considered as relevant costs are used for pricing, by *adding a mark-up* (to include fixed costs allocation also).

Sometimes, instead of arbitrarily adding a percentage on cost for profit, the firm determines an *average mark-up* on cost necessary to produce a *desired* **Rate of Return on Investment**. The rate of return to be earned by the firm or industry must depend on the *risk involved*.

Competition-Based Pricing Method

When a company sets its price mainly on the consideration of *what its competitors are charging*, its pricing policy under such a situation is called competitive pricing or competition-oriented pricing. It is not necessary under competitive pricing to charge the same price as charged by the concern's competitors. But under such a pricing, the concern may keep its prices lower or higher than its competitors by a certain percentage.

Going Rate Pricing — It is a competitive pricing method under which a firm tries to *keep its price at the average level charged by the industry*. The use of such a practice of pricing is especially *useful where it is difficult to measure costs*.

Sealed Bid-Pricing — The objective of the firm in the bidding situation is *to get the contract*, and this means that it hopes to set its price lower than that set by any of the other bidding firms. But however, the firm does not ordinarily set its price below a certain level. Even when it is anxious to get a contract in order to keep the plant busy, it cannot quote price below marginal cost. On the other hand, if it raises its price above marginal cost, it increases its potential profit but reduces its chance of getting the contract.

Value- Based Pricing Method

There is an increasing trend to price the product on the basis of *customer's perception of its value*. This method helps the firm in reducing the threat of price wars. Marketing research is important for this method. It is based on:

Objective Value or True Economic Value (TEV)

This is a measure of benefits that a product is *intended to deliver to the consumers relative to the other products* without giving any regard whether the consumer can recognize these benefits or not.

True economic value for a consumer is calculated taking two differentials into consideration:

TEV = Cost of the Next Best Alternative + Value of Performance Differential

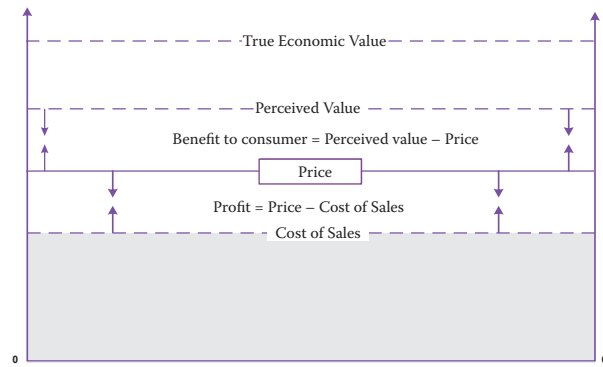
Cost of the next best alternative is the cost of a comparable product offered by some other company. Value of performance differential is the value of additional features provided by the seller of a product.

A firm's product may be superior to the next best alternative in some dimensions but inferior in others.

Perceived Value

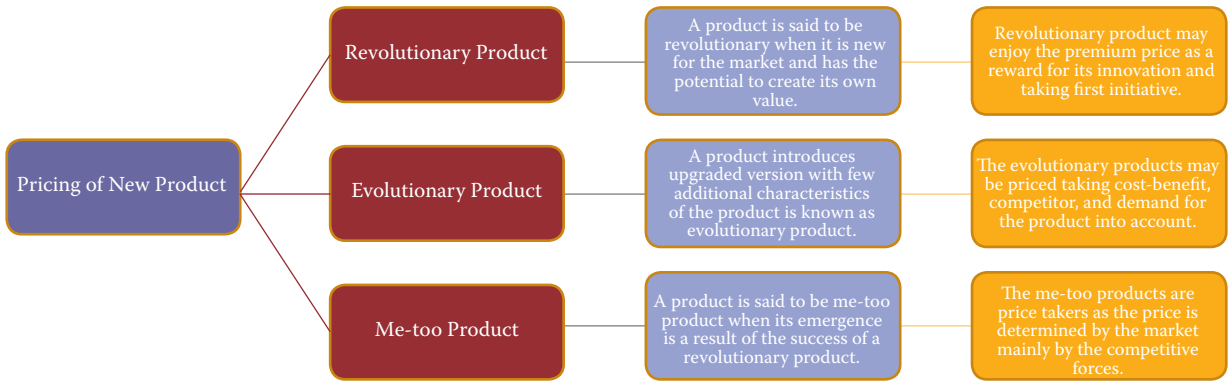
This is the *value that consumer understands the product deliver to it.* It is the price of a product that a consumer is willing to spend to have that product.

At the time of fixing price, it is to be kept in the mind that any price which set below the perceived value but above the cost of goods sold give incentives to both buyers and the seller. This can be understood with the help the diagram given below.

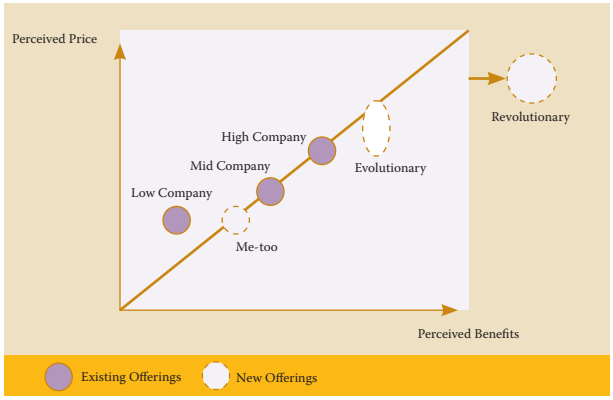


Strategic Pricing of New Products

The pricing of new product poses a bigger problem because of the uncertainty involved in the estimation of their demand. In order to overcome this difficulty, experimental sales are conducted in different markets using different prices to see which price is suitable. A new product is analysed into three categories for the purpose of pricing:



Three New Product Pricing Situations



While preparing to enter the market with a new product, management must decide whether to adopt a skimming or penetration pricing strategy.

Skimming Pricing

It is a policy of high prices during the early period of a product's existence. This can be synchronised with high promotional expenditure and in the later years the prices can be gradually reduced. The reasons for following such a policy are:

- The demand is likely to be *inelastic* in the earlier stages till the product is established in the market.
- The change of high price in the initial periods serves to *skim the cream of the market* that is relatively insensitive to price.
- The *demand for the product is not known* the price covers the initial cost of production.
- *High initial capital outlays, needed* for manufacture, results in high cost of production.

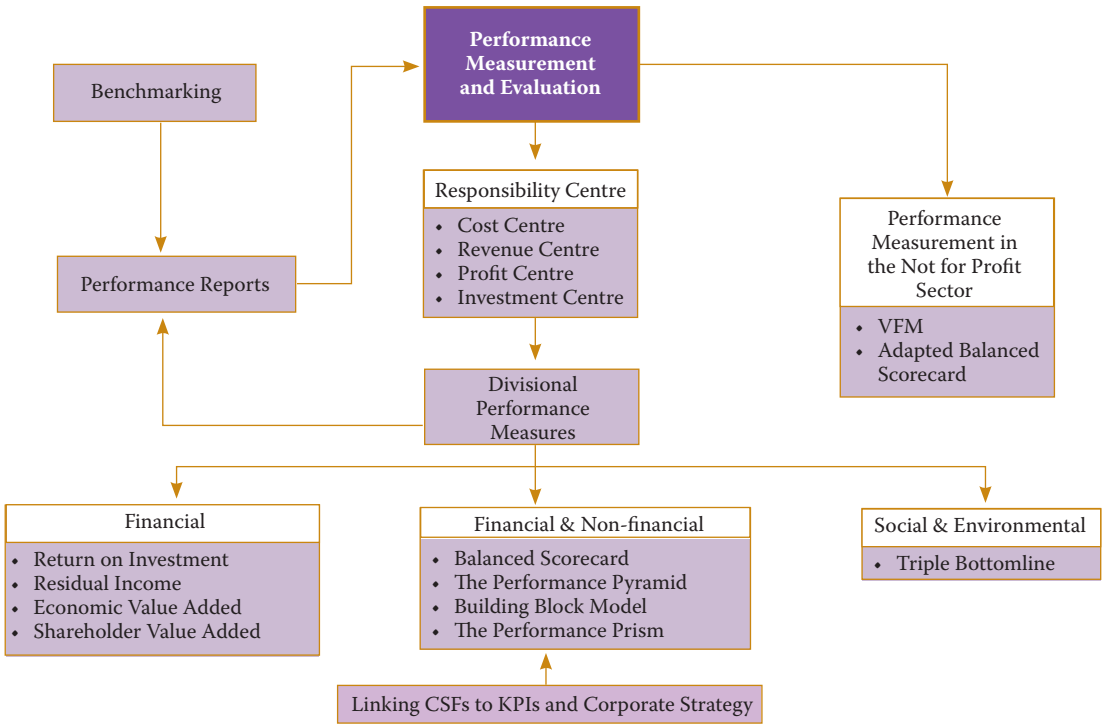
Penetration Pricing

This policy is in favour of using a low price as the principal instrument for penetrating mass markets early. It is opposite to skimming price. The low price policy is introduced for the sake of long-term survival and profitability and hence it has to receive careful consideration before implementation. The three circumstances in which penetrating pricing policy can be adopted are:

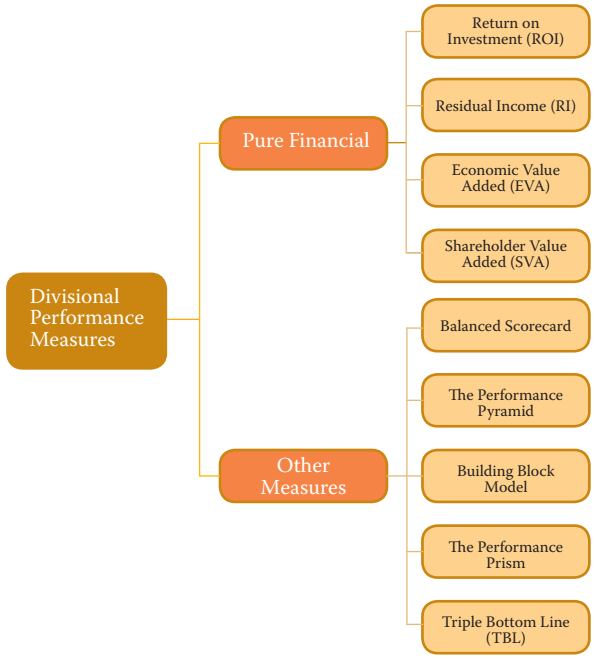
- When demand of the product is elastic to price.
- When there are substantial savings on large scale production.
- When there is threat of competition.

PERFORMANCE MEASUREMENT AND EVALUATION

Chapter Overview



Divisional Performance Measures



Return on Investment (ROI)

- ROI expresses divisional *profit as a percentage of the assets employed* in the division.
- ROI is a common measure and thus is ideal for comparison across corporate divisions for companies of similar size and in similar sectors. ROI can therefore lead to a *lack of goal congruence.*

Residual Income (RI)

- To overcome some of the dysfunctional consequences of ROI, the residual income approach can be used.
- For evaluating the *economic performance* of the division, residual income can be defined as *divisional contribution less a cost of capital charge* on the total investment in assets employed by the division.
- Residual income suffers from the disadvantages of being an *absolute measure*, which means that it is difficult to compare the performance of a division with that of other divisions or companies of a different size.

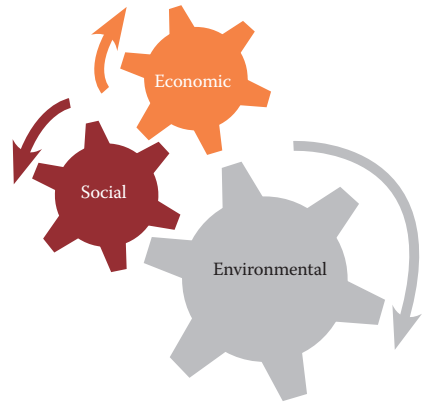
Economic Value Added (EVA)

- Economic Value Added is a measure of economic profit. Economic Value Added is calculated as the difference between the Net Operating Profit After Tax (NOPAT) and the Opportunity Cost of Invested Capital. This opportunity cost is determined by multiplying the Weighted Average Cost of Debt and Equity Capital (WACC) and the amount of Capital Employed.

$$EVA = NOPAT - WACC \times Capital$$

Triple Bottom Line (TBL)

TBL incorporates the three dimensions-



- *Environmental-* measures the impact on resources, such as air, water, ground and waste emissions (Baumgartner & Ebner, 2010, p.79).
- *Social-* relates to corporate governance, motivation, incentives, health and safety, human capital development, human rights and ethical behaviour.
- *Economic-* refers to measures maintaining or improving the company's success.

Linking CSFs to KPIs and Corporate Strategy

In order to truly achieve effective measurement of business performance, the KPIs must be selected and designed in a way that ensures that the CSF is delivered if the KPI meets the threshold, and the CSFs in turn must be designed and constructed in a way that ensures that the company's strategic vision is delivered if the CSFs are met.

Balanced Scorecard

The balanced scorecard is a method which displays organisation's performance into four dimensions namely financial, customer, internal and innovation. The four dimensions acknowledge the interest of shareholders, customers and employees taking into account of both long-term and short-term goals. Kaplan and Norton classified performance measures into four business 'perspectives'

Financial Perspective
Financial performance measures indicate whether the company's strategy implementation and execution are contributing to its revenue and earnings.

Customer Perspective
In this stage, companies identify customers and market segments in which they compete and also the means by which they provide *value* to these customers and markets.

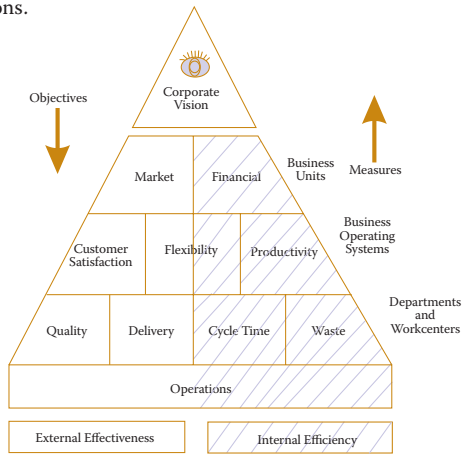
Internal Business Perspective
In this stage companies identify processes and activities which are necessary to achieve the objectives as identified at financial perspectives and customer perspective stage. These objectives may be achieved by reassessing the value chain and making necessary changes to the existing *operating activities*.

Learning and Growth Perspective
In the learning and growth perspective, Companies determine the activities and infrastructure that the company must build to create *long term growth*, which are necessary to achieve the objectives set in the previous three perspectives.

Performance Pyramid

The Performance Pyramid is also known as Strategic Measurement and Reporting Technique by Cross and Lynch 1991. They viewed businesses as performance pyramids. The attractiveness of this

framework is that it links the business strategy with day-to-day operations.

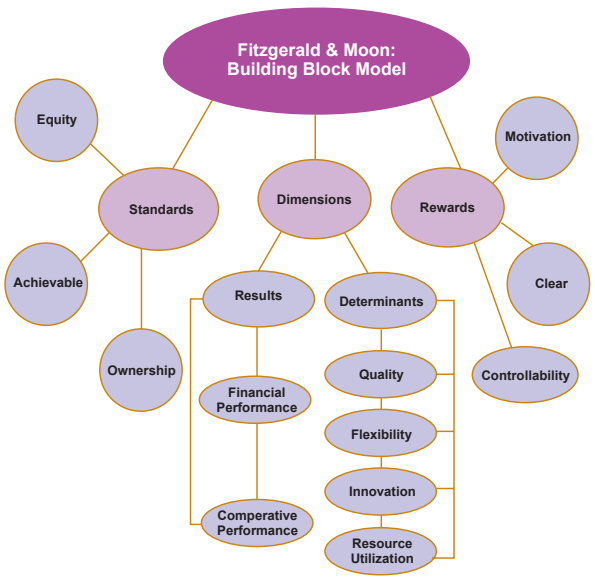


In the above pictorial presentation:

- 'Objectives' are shown from top to bottom.
- 'Measures' are from bottom to the top.
- At the top is the organization's *corporate vision* through which long term success and competitive advantages are described.
- The 'business level' focuses on achievements of organization's CSF in terms of *market* and *financial* measures.
- The marketing and financial success of a proposal is the initial focus for the achievement of corporate vision.
- The above business are linked to achieving *customers' satisfaction*, increase in *flexibility* and high *productivity*.
- The above driving forces can be monitored using the operating forces of the organization.
- The left-hand side of the pyramid contains *external* forces which are 'non-financial'.
- On the other hand, the right-hand side of the pyramid contains *internal efficiency* which are predominantly 'financial' in nature.

The Building Block Model

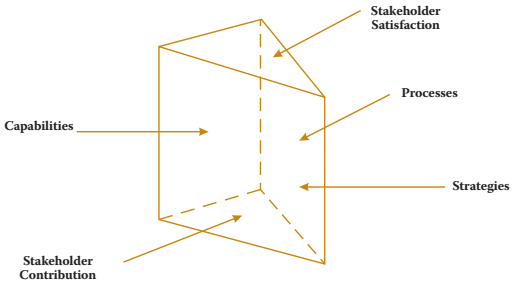
Fitzgerald and Moon proposed a Building Block Model which suggests the solution of performance measurement problems in *service industries*. But it can be applied to other manufacturing and retail businesses to evaluate business performance.



Performance Prism

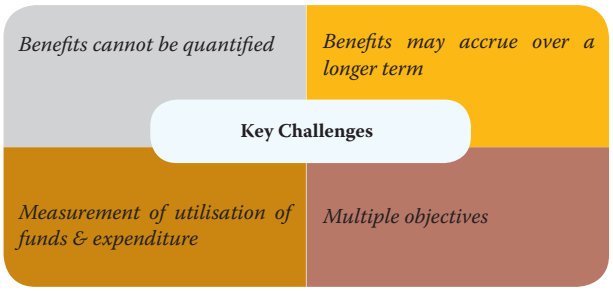
The Performance Prism is an approach to performance management which aims to effectively meet the needs and requirements of **all stakeholders.** This is in contrast with the performance pyramid which tends to concentrate on *customers* and *shareholders* and is also in contrast with value based management, which prioritizes the needs of shareholders. There are five 'facets' to the Performance Prism which lead to key questions for strategy formulation and measurement design:

Comprehensiveness of Performance Prism



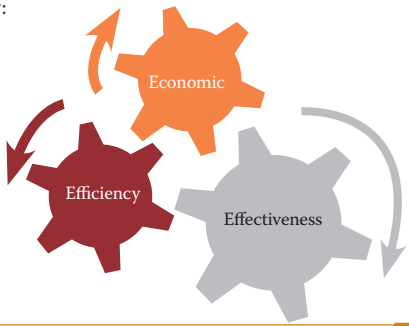
Performance Measurement in the Not for Profit Sector

The following are key challenges for measuring performance in not-for-profit organisations –



Value for Money (VFM) Framework

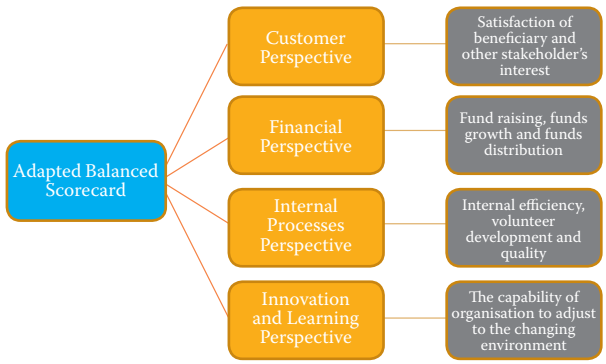
A framework which can be used for measurement of performance in not-for-profit sector is the Value for Money framework. Not-for-profit organisations are expected to provide value for money which is demonstrated by:



- **Effectiveness:** Whether the organisation has a*chieved its desired mission and objectives?*
- **Efficiency:** Whether the *resources and funds* available to the organisation has been *utilised efficiently* i.e, maximum output has been obtained with minimum input?
- **Economy:** Whether the desired *output has been obtained using the lowest cost?* It must be noted that use of lowest cost approach should not compromise quality.

Adapted Balanced Scorecard

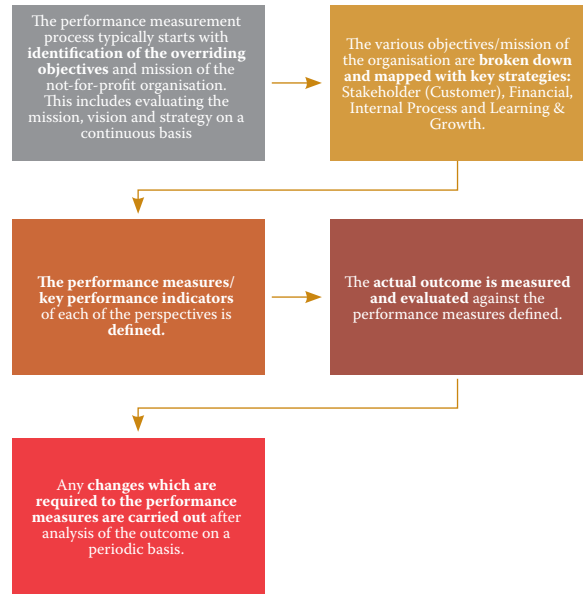
Kaplan developed the 'Adapted Balanced Scorecard' for measuring performance at NGOs. The main assumption of this adapted scorecard is that mission statement and not profits is the main point to be met.



Other Performance Measures

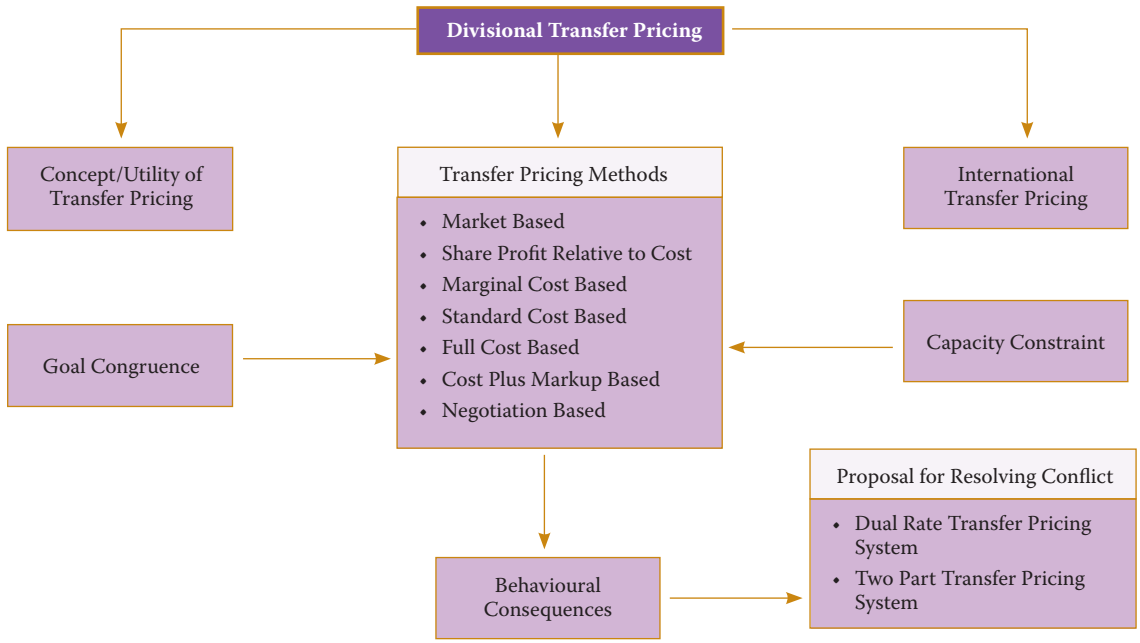
- The ability to raise funds to meet the objectives efficiently.
- Submitting periodic reports to the stakeholders in a transparent manner.
- The best use of financial as well as non-financial resources to achieve desired objectives and mission.
- The long-term impact (benefits) of the activities of the not-for-profit organisations.
- The quality of services provided by the organisations.

Performance Measurement Process

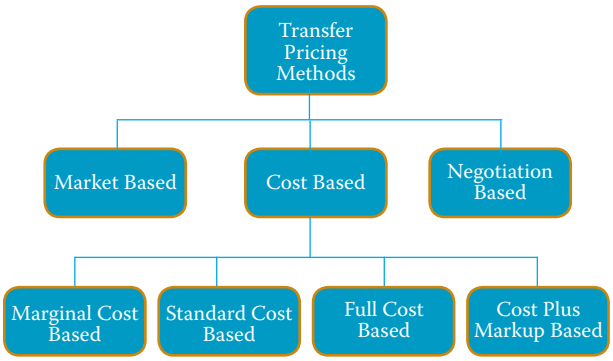


DIVISIONAL TRANSFER PRICING

Chapter Overview



Transfer Pricing Methods



Market Based Transfer Price

Transfer price is based on *market price* of goods or services similar to the ones transferred internally within divisions. The transfer can be recorded at the external market price, ***adjusted for*** *any costs that can be saved by internal transfer* e.g. selling and distribution expenses, packaging cost.

Advantages	*Disadvantages*
♦ Since demand and supply determine market price, it is likely to be unbiased. ♦ Market prices are less ambiguous compared to cost-based pricing. ♦ Since the pricing is competitive, divisional performance can be linked more objectively to its contribution to the company's overall profits.	♦ Market price may not be completely unbiased, if a competitive environment does not exist. ♦ May not be suitable when market prices can fluctuate widely or quickly. ♦ Goods that are transferred may be at an intermediate stage in the production process. At times market price may not be available for such intermediate goods.

Shared Profit Relative to Cost Based Transfer Price

Shared profit relative to cost method is an alternative to market price method. Cost incurred by each division indicates the value it has added to the product cost, that is finally used to arrive at the selling price of the final product. The primary advantage of this method is that *it allocates profit based on the proportion of value addition to the product in terms of cost.*

Cost Based Transfer Price

Cost based pricing models are based on the *internal cost* records of the company. They may be used when the management wants to benchmark performance with the cost targets set within the company or may be an alternative *when market prices for the goods cannot be determined due to lack of comparable market.* Cost based transfer price may consider variable cost, standard cost, full cost and full cost plus mark-up. Therefore, the basis for cost price may be subjective and has to be adapted based on its suitability to the entity.

Advantages	*Disadvantages*
♦ Performance can be benchmarked to internal cost targets (budgets). ♦ Information is more easily available as compared to market price.	♦ The cost basis on which transfer pricing is used can be subjective since there can be multiple ways of interpreting costs. ♦ Since cost is passed on to another division, there may be instances when managers of the supplying division may find little incentive to lower the cost of production by adopting cost efficient methods.

Marginal Cost Based Transfer Price

Transfer price is recorded *marginal cost* required to produce one additional unit:

Advantages	*Disadvantages*
♦ Useful when the supplying division has excess capacity.	♦ No fixed cost or mark-up is allowed to be charged to the purchasing division. Each unit of internal sale will hence result in a loss at approximately fixed cost per unit.

Behavioral Consequences

In such a setup, profit evaluation is centralized at the entity level. Therefore, the supplying division may have little incentive to find measures for making cost efficient. Non-recovery of fixed costs would ***demotivate the supplying division***. It may oppose certain decisions like capacity expansion or further infusion of investment, that lead to higher fixed costs.

Standard Cost Based Transfer Price

Transfer price is recorded at a *predetermined cost*, which is based on budgets and certain assumptions regarding factors of productions like capacity utilization, labor hours etc.

Advantages	*Disadvantages*
♦ Performance evaluation can be done against budgeted cost targets.	♦ Profit performance measurement is centralized and cannot be measured for individual divisions.

Behavioral Consequences

Budgeted costs are generally based on historic records. Therefore, ***little incentive*** exists to make costs more efficient to improve profitability.

Full Cost Based Transfer Price

Transfer price is based on full product cost. It includes *cost of production plus a share of other costs of the value chain* like selling and distribution, general administrative expense, research and development etc.

Advantages	*Disadvantages*
♦ Full cost of goods transferred is recovered, hence the supplying division will not show a loss.	♦ Since mark-up cannot be charged on internal transfers, the supplying division does not record any profit on these sales. This is a disincentive for the supplying division.

Cost plus **a Mark-up Based Transfer Price**

Transfer price is based on *full product cost plus a mark-up*. Mark-up could be a percentage of cost or of capital employed.

Advantages	*Disadvantages*
♦ Since the supplying division makes a profit, this method addresses the disincentive problem discussed above in the full cost method.	♦ Since the transfer price under this method could closely approximate its market price, the purchasing division may bear a share of the selling expenses although none was incurred for such internal sales.

Behavioral Consequences

Special orders from purchasing division may typically be placed to meet short term demands. If transfer price is quoted at below full cost, it may be rejected because they could result in a loss for the supplying division. This could lead to ***sub-optimization of resources***. Fixed costs remain constant in the short run, while the contribution margin from such special orders may have benefited the company as a whole. In such cases, management intervention has to happen for goal congruence.

Negotiation Based Transfer Price

This is a go-between between market and cost methods. Managers of the purchasing and supplying divisions independently negotiate and arrive at a mutually agreeable transfer price.

Advantages	*Disadvantages*
♦ Managers are given autonomy to decide whether to purchase (or sell) from its sister unit or source then from (or to) external market.	♦ This method requires sufficient external information to be available regarding the external market price, terms of trade etc. Internal cost information must also be shared in order to negotiate a reasonable price.

Behavioral Consequences

While autonomy is given to the managers, top management intervention may be required if decisions lead to ***sub-optimal utilization of resources***.

Negotiated prices depend on the ability of the manager to bargain on behalf of the division. This could affect the division's performance. The process may be time consuming that could even lead to conflict among the units.

Transfer Pricing and Goal Congruence

Since internal transfer pricing develops a competitive setting for managers of each division, it is possible that they may operate in the best interest of their individual performance. This can lead to *sub-optimal utilization of resources.* In such cases, transfer pricing policy may be established to promote goal congruence.

Range of transfer price that promotes goal congruence:

(i)	*(ii)*
♦ Minimum Transfer Price (determined by the supplying division) = Additional Outlay Cost per unit + Opportunity Cost per unit. ♦ Additional Outlay Cost = Marginal Cost+ Any Additional Incidental Costs *incurred by the supplying division e.g. storage, transportation etc.* ♦ Opportunity Cost is the benefit that is foregone from selling internally rather than externally.	♦ Maximum Transfer Price (determined by the purchasing division) = Lower of Net Marginal Revenue and the External Buy-in Price ♦ Net Marginal Revenue = Marginal Revenue (i.e. Selling Price p.u.) – Marginal Cost to Purchasing Division

Transfer Pricing Decision, Different Circumstances

Different Capacity Levels

When the supplying division has ***excess capacity***, the range for transfer pricing would be

(i)	*(ii)*
♦ Minimum Transfer Price = Marginal Cost p.u. ♦ This ensures that the supplying department is able to recoup at least its additional outlay incurred on account of the transfer. Fixed cost is a sunk cost hence ignored. ♦ Since capacity can be utilized further, it would be optimum for the supplying division to charge only the marginal cost for internal transfer. ♦ The purchasing division gets the advantage, getting the goods at a lower cost than market.	♦ Maximum Transfer Price = Lower of Net Marginal Revenue and the External Buy-in Price

When the *supplying division operates at* ***full capacity***, the range for transfer pricing would be

(i)	*(ii)*
♦ Minimum Transfer Price = Marginal Cost p.u. + Opportunity Cost p.u. ♦ Since the supplying division is operating at full capacity, it has no incentive to sell the goods to the purchasing division at a price lower than the market price. ♦ If the internal order is accepted, capacity is diverted towards this sale. Hence the supplying division would additionally charge the lost contribution from external sales that had to be curtailed.	♦ Maximum Transfer Price = Lower of Net Marginal Revenue and the External Buy-in Price

Different Demand Levels

Therefore, while catering to different levels of demand, any *change in cost should also be accounted* for to calculate transfer pricing. The general rule for minimum and maximum range of transfer price applies here too.

Proposals For Resolving Transfer Pricing Conflict

Conflict of interest between interests of individual divisions and the company can also be addressed by following the following systems for transfer pricing:

Dual Rate Transfer Pricing System	*Two Part Transfer Pricing System*
♦ The *supplying division* records transfer price by including a normal profit margin thereby showing reasonable revenue. ♦ The *purchasing division* records transfer price at marginal cost thereby recording purchases at minimum cost. ♦ This allows for better evaluation of each division's performance. ♦ It also improves co-operation between divisions, promoting goal congruence and reduction of sub-optimization of resources. ♦ Drawbacks of Dual Pricing include: It can complicate the records, thereby may result in errors in the company's overall records. (ii) Profits shown by the divisions are artificial and need to be used only for internal evaluations.	♦ This pricing system is again aimed at resolving problems related to distortions caused by the full cost based transfer price. ♦ Transfer price = marginal cost of production + a lump-sum charge (two part to pricing). ♦ While marginal cost ensures recovery of additional cost of production related to the goods transferred, lump-sum charge enables the recovery of some portion of the fixed cost of the supplying division. ♦ Therefore, while the *supplying division can* show better profitability, the *purchasing division* can purchase the goods a lower rate compared to the market price.

BUDGETARY CONTROL

Chapter Overview

Budgetary Control

- Control Schemes
  - Feedback Control
  - Feedforward Control
- Behavioural Aspects of Budgetary Control
  - Effect of the Budget Difficulty on Performance
  - Participation in Budget Setting Process
  - Use of Accounting Information in Performance Evaluation
- Limitations of Traditional Budgets
- Beyond Budgeting
  - Characteristics
  - Suitability
  - Benefits
  - Principles for Adaptive Performance Management
  - Implementation of Beyond Budgeting
  - Traditional vs. Beyond Budgeting

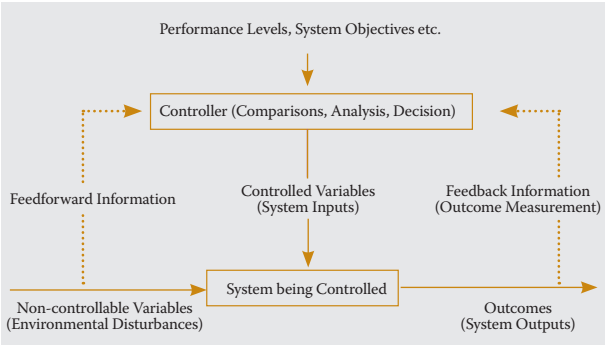
Budgetary Control

Budget is an estimation of revenues and expenses over a specified future period of time which needs to be compiled and *re-evaluated on a periodic basis* based on the needs of the organisation.

Budgetary Control is the process by which budgets are prepared for the future period and are compared with the actual performance for finding out variances, if any. In other words, Budgetary Control is a process with the help of which, managers set financial and performance goals, compare the actual results with the budgets, and adjust performance, as it is needed.

Feedback and Feed-Forward Control

Feedback and Feed-forward are two types of control schemes for systems that react automatically to changing environmental dynamics.



Feedback Control

Feedback as the name suggests is a reaction after an action has taken place. So, *there has to be an error* if we want to take corrective actions.

According to the CIMA's Official Terminology, *It is defined as: 'Measurement of differences between planned outputs and actual outputs achieved, and the modification of subsequent action and/or plans to achieve future required results. Feedback control is an integral part of budgetary control and standard costing systems.'*

A feedback system would simply compare the actual historical results with the budgeted results.

Limitations

Feedback control system does have some operational limitations. First, it *depends heavily on success of the error detection system.* Second, there may be *a time lag between the error detection, error confirmation, and error revision* during which actual results may change again.

Feed-forward Control

In certain cases, we may be able to measure the amount of error before it has actually taken place. We may thus be able to place a control mechanism *before the error takes place.* Feed-forward Control is one such Controlling system.

According to the CIMA's Official Terminology, *It is defined as the 'forecasting of differences between actual and planned outcomes and the implementation of actions before the event, to avoid such differences.'*

A feed-forward control system operates by comparing budgeted results against a forecast. Control action is triggered by differences between budgeted and forecasted results.

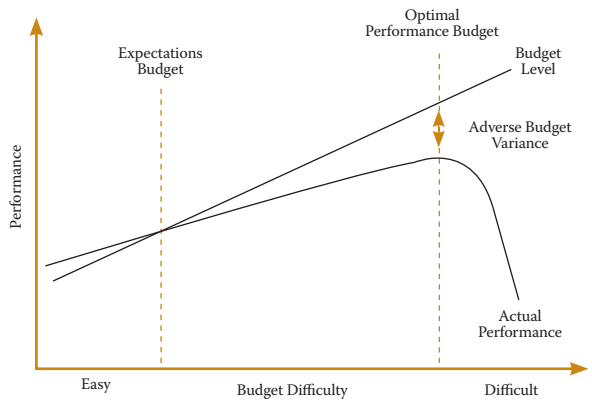
Any manager who ignores feed-forward control will contribute to the downfall of a company.

Limitations

The feed-forward process is an evaluation process and is concerned with the estimates of uncertain future. This problem of uncertainty is likely to limit application of the concept.

Study of future is not well developed; neither are the tools that have potential for overcoming the problem of uncertainty.

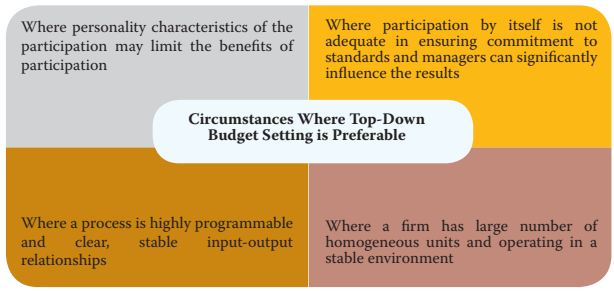
The Effect of Budget Difficulty on Performance



"Budget level that motivates the best level of performance may not be achievable. In contrast, the budget that is expected to be achieved motivates a lower level of performance as managers no longer aspire to

meet the budget target." The balanced scorecard approach of Kaplan and Norton, and the building block approach of Fitzgerald and Norton can be a great help in ensuring that objectives (or targets), or budgets are set for a very wide range of factors, both financial and non-financial.

Circumstances Where Top-Down Budget Setting is Preferable



Use of Accounting Information in Performance Evaluation

Some dysfunctional consequences that arise with accounting measures of performance may not be due to the insufficiency of the performance measures, but rather may be outcome from the way in which the accounting measures are used. The accounting information provided by an *accounting system must be interpreted and used with care.*

Hofstede (1968) found that stress on the actual results in performance evaluation led to more extensive use of budgetary information, and this made the budget more relevant. However, this stress was associated with a feeling that the performance appraisal was unjust. To overcome this problem, the *correct balance must be established* when the *budgeted performance is evaluated.*

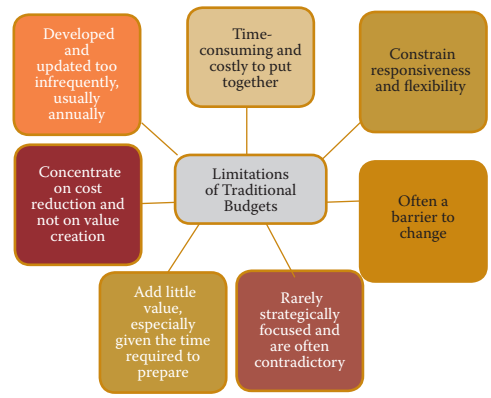
Hopwood (1976) observed three distinct styles of using budget and actual cost information in performance evaluation in manufacturing division of a large US company:

- *Budget Constrained Style: The evaluation is based upon the* Cost Centre head's ability continually to meet the budget on short term basis.
- *Profit Conscious Style:* Performance of the Cost Centre's head is linked to ability in increase the general effectiveness of his unit's operations in relation to the long- term goals of the organisation.
- *Non-Accounting Style:* Accounting data plays a relatively unimportant part in the supervisor's evaluation of the Cost Centre head's performance.

A Summary of the Effects of Three Styles of Management

	Style of Evaluation		
	Budget-Constrained	Profit - Conscious	Non-Accounting
Involvement with Costs	High	High	Low
Job-related Tension	High	Medium	Medium
Manipulation of Accounting Information	Extensive	Little	Little
Relations with Superiors	Poor	Good	Good
Relations with Colleagues	Poor	Good	Good

Beyond Budgeting (BB)



To overcome these limitations a tool came into force known as Beyond Budgeting. **Beyond Budgeting** is a leadership philosophy that relates to an alternative approach to budgeting which should be used instead of traditional annual budgeting.

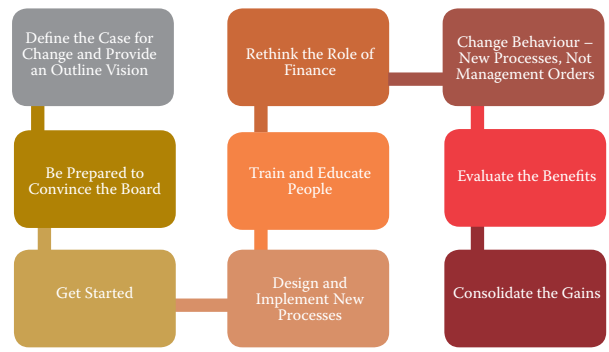
According to CIMA's Official Terminology- *'An idea that companies need to move beyond budgeting because of the inherent flaws in budgeting especially when used to set contracts. It is argued that a range of techniques, such as rolling forecasts and market related targets, can take the place of traditional budgeting.'*

BB identifies its two main advantages.

- It is a more *adaptive process* than traditional budgeting.
- It is a *decentralised process,* unlike traditional budgeting where leaders plan and control organisations centrally.

Implementation of Beyond Budgeting

There are nine steps that Hope and Fraser consider to be essential to implementing the Beyond Budgeting approach.



Conclusion on Budgeting

CASE STUDY

Essentials for Case Study

- Case Study is not about the quantity, but the quality.
- Prepare a plan for each issue.
- Decide what models to use and prioritize the issues.
- Identify the impact and alternative actions that could be taken, as well as the relevant concepts and calculations required.
- Answer should have a logical flow.
- Offer a detailed analysis of the issues and conclude with sound, well justified recommendations.
- Not to spend too much time on calculations.
- Do not place too much attention and time on the presentation.
- Quality of discussion on each issue which is most important, not the ranking order.
- Discuss each of the issues in depth, explaining their impact.
- Do not leave any of the issues undecided.
- Recommendations should include 'what to do', 'why to do it' and 'how to do it'.
- Identify ethical issues and then briefly justify.
- Recommendation should appear at the end of the report.
- Practice makes perfect.

Note:

Not all topics of SCMPE have been covered in this capsule. However, our selection doesn't attach more importance to some topics and less to others.

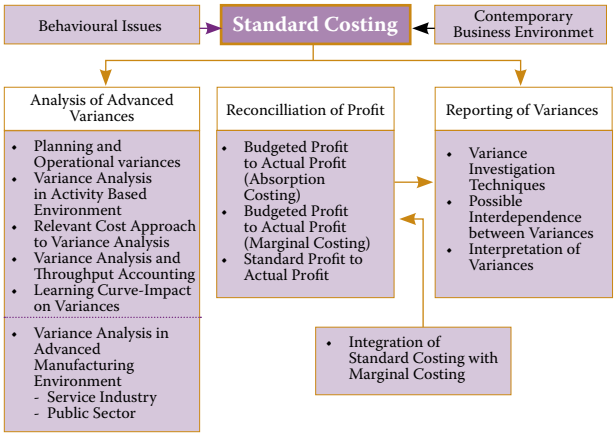
"Competition on dimensions other than price—on product features, support services, delivery time, or brand image, for instance—is less likely to erode profitability because it improves customer value and can support higher prices."

– Michael Porter

Strategic issues are increasingly becoming important, cost management has transformed from a traditional role of product costing and operational control to a broader, strategic focus. Strategic Cost Management (SCM) requires that professional accountants hold new skills that extend *beyond their traditional practices*. They must collaborate with corporate strategists in creating, managing, and protecting value. SCM emphases on developing, implementing and monitoring strategies in order to *enhance value for the organization*. Such a focus *would not be possible without* understanding the key role that *Performance Management* plays in strategy and value creation. Syllabus links strategy, management control systems and performance management. The various models of performance management, the strategy mapping process, as well as flowing performance measures in performance management, are part of the curriculum.

STANDARD COSTING

CHAPTER OVERVIEW



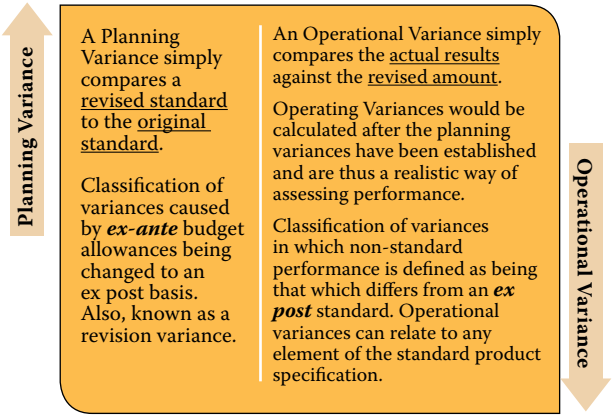
ANALYSIS OF ADVANCED VARIANCES

Variance analysis is examinable both at Intermediate Level (Cost and Management Accounting) and at Final Level (Strategic Cost Management and Performance Evaluation). One main difference in syllabus between the two papers is that the Final Level syllabus **includes analysis of advanced variances**, as follows:

Planning & Operational Variances

When the current environmental conditions are different from the anticipated environmental conditions (prevailing at the time of setting standard or plans) the use of routine analysis of variance for measuring managerial performance is not desirable / suitable. The variance analysis can be useful for measuring managerial performance if the variances computed are determined on the basis of revised targets / standards based on current actual environmental conditions.

In order to deal with the above situation i.e. to measure managerial performance with reference to ***material, labour*** and ***sales variances***, it is necessary to compute the Planning and Operational Variances.

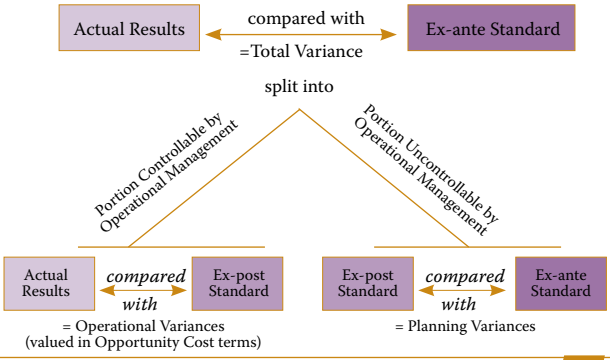


Standard ex ante

Before the event. An ex ante budget or standard is set before a period of activity commences.

Standard, ex post

After the event. An ex post budget, or standard, is set after the end of a period of activity, when it can represent the optimum achievable level of performance in the conditions which were experienced. Thus, the budget can be flexed, and standards can reflect factors such as unanticipated changes in technology and in price levels. This approach may be used in conjunction with sophisticated cost and revenue modelling to determine how far both the plan and the achieved results differed from the performance that would have been expected in the circumstances which were experienced.



Direct Material Usage Variance

Traditional Variance
Actual vs. Original Standard
[Standard Quantity – Actual Quantity] × Standard Price

Planning Variance
Revised Standard vs. Original Standard
[Standard Quantity – Revised Standard Quantity] × Standard Price

Operational Variance
Actual vs. Revised Standard
[Revised Standard Quantity – Actual Quantity] × *Revised Standard Price*

Direct Material Price Variance

Traditional Variance
Actual vs. Original Standard
[Standard Price – Actual Price] × Actual Quantity

Planning Variance
Revised Standard vs. Original Standard
[Standard Price – Revised Standard Price] × *Revised Standard Quantity*

Operational Variance
Actual vs. Revised Standard
[Revised Standard Price – Actual Price] × Actual Quantity

Note:
Direct Material Usage Operational Variance using *Standard Price*, and the Direct Material Price Planning Variance based on *Actual Quantity* can also be calculated. This approach reconciles the Direct Material Price Variance and Direct Material Usage Variance calculated in part.

Like Material Variances, here also Labour Efficiency and Wage Rate Variances should also be adjusted to reflect changes in environmental conditions that prevailed during the period.

Direct Labour Efficiency Variance

Traditional Variance
Actual vs. Original Standard
[Standard Time – Actual Time] × Standard Rate

Planning Variance
Revised Standard vs. Original Standard
[Standard Time – Revised Standard Time] × Standard Rate

Operational Variance
Actual vs. Revised Standard
[Revised Standard Time – Actual Time] × *Revised Standard Rate*

Direct Labour Rate Variance

Traditional Variance
Actual vs. Original Standard
[Standard Rate – Actual Rate] × Actual Time

Planning Variance
Revised Standard vs. Original Standard
[Standard Rate – Revised Standard Rate] × *Revised Standard Time*

Operational Variance
Actual vs. Revised Standard
[Revised Standard Rate – Actual Rate] × Actual Time

Note:
Direct Labour Efficiency Operational Variance using *Standard Rate*, and the Direct Labour Rate Planning Variance based on *Actual Hours* can also be calculated. This approach reconciles the Direct Labour Rate Variance and Direct Labour Efficiency Variance calculated in part.

The conventional Sales Volume Variance reports the difference between actual and budgeted sales valued at the standard price per unit. The variance just indicates whether sales volume is greater or less than expected. It does not indicate **how will sales management has performed.** *In order to assess the performance of sales management, market conditions prevailing during the period should be taken into consideration.*

Accordingly, the sales volume variance can be sub-divided into a planning variance (market size variance) and operational variance (market share variance).

A Planning Variance simply compares a revised standard to the original standard. An Operational Variance simply compares the actual results against the revised amount. Controllable Variances are those variances which arises due to inefficiency of a cost centre /department. Uncontrollable Variances are those variances which arises due to factors beyond the control of the management or concerned department of the organization.

Planning variances are generally *not controllable.* Where a revision of standards is required due to environmental/ technological changes that were not anticipated at the time the budget was prepared, the planning variances are truly *uncontrollable.* However, standards that failed to anticipate known market trends when they were set will reflect faulty standard-setting: it could be argued that these variances were controllable at the planning stage.

Variance Analysis in Activity-Based Costing

Variance analysis can be applied to activity costs (such as setup costs, product testing, quality testing etc.) to gain understanding into why actual activity costs vary from activity costs in the static budget or in the flexible budget.

Interpreting cost variances for different activities requires understanding whether the costs are output unit-level, batch level, product sustaining, or facility sustaining costs[2].

We use the similar track to variance analysis for activity-based costing as for traditional costing. The price variance is the difference between standard price and actual price for the actual quantity of input used for each cost driver. The efficiency variance measures the difference between the actual amount of cost driver units used, and the standard allowed to make the output. We multiply the difference in quantities by the standard price per cost driver to get the rupee value of the variance[3].

ABC approach is based on the assumption that the overheads are basically variable (but variable with the delivery numbers and not the units output). The ***efficiency variance*** reports the cost impact of undertaking more or less activities than standard, and the ***expenditure variance*** reports cost impact of paying more or less than standard for the actual activities undertaken[4].

Learning Curve- Impact on Variances

Learning curve is a geometrical progression, which reveals that there is steadily decreasing cost for the accomplishment of a given repetitive operation, as the identical operation is increasingly repeated. The amount of decrease will be less and less with each successive unit produced. As more units are produced, people involved in production become more efficient than before. Each additional unit takes less time to produce. The amount of improvement or experience gained is reflected in a decrease in man-hours or cost. Where learning takes place with a regular pattern it is important to take account of reduction in labour hours and cost per unit.

Automated manufacturing is unlikely to have much variation or to display a regular learning curve. In less-automated processes, however, where learning curves do occur, *it is important to take the resulting decline in labour hours and costs into account in setting standards, determining prices, planning production, or setting up work schedules.*

With the help of the learning curve theory the standard time of any batch or unit can be computed then compare the actual data with the standard and compute the variances.

Relevant Cost Approach to Variance Analysis

Traditional approach to variance analysis is to compute variances based on total actual cost for production inputs and total standard cost applied to the production output. This is ambiguous, when inputs are limited. Failure to use limited inputs properly leads not only to increased acquisition cost but also to a lost contribution. Therefore, it is necessary to consider the *lost contribution* in variance analysis. When this approach is used, price or expenditure variances are not affected.

Variance Analysis and Throughput Accounting

Variance analysis has no emphasis on the constrained resources. Instead, it is based on the *efficiency* and *cost of operatio*n of each part of the manufacturing system, rather than the ability of the entire system to generate a profit. Thus, a firm may find that it attains excellent efficiency and price variances by having long manufacturing rounds and buying in large quantities. A system based on constraint management will likely show very odd results under a variance reporting system.

For example, when a terminal upstream from the constrained resource runs out of work, a manager functioning under throughput accounting system will shut it down in order to avoid the formation of an unnecessary level of work-in-process inventory. However, this will result into a negative labor efficiency variance, since the terminal's staff is not actively producing anything.

Throughput accounting does use variance analysis, but not the ones used by a traditional system. Instead, its main emphasis is on tracking variations in the size of the inventory buffer placed before the constrained resource, to confirm that the constraint is never halted due to an inventory shortage.

Variance Analysis in Advanced Manufacturing Environment/ High-Technology Firms

The variance analysis generally applies to all types of organizations; however, high-technology firms like Audio Technology, Automotive, Computer Engineering, Electrical and Electronic Engineering, Information Technology, Medical devices, Nanotechnology, Semiconductors, Telecommunication apply the model somewhat differently. Now much of electronic industry is highly automated. A large part of manufacturing process is computerized.

In the high-technology environment that is emerging, many costs that once were largely variable have become fixed, most becoming committed fixed cost. Some high technology manufacturing organizations have found that the two largest variable costs involve materials and power to operate machines. In these companies, the emphasis of variance analysis is placed on direct materials and variable manufacturing overhead.

Much of the manufacturing labour consists of highly skilled experts/ operators/ programmers are largely committed cost. Firms don't want to take risk losing such highly trained personnel even during an economic downturn. The result is **less direct labour and more overhead.** For these firms labour variances may no longer be meaningful because direct labour is a committed cost, not a cost expected to vary with output.

Standard Costing in Service Sector

Standard Costing can be equally applicable for various types of industries for example accountants, solicitors, dentists, hairdressers, transport companies and hotels. Service industries comprise a wide range of different businesses that differ in size and types of service provided. Standard costing and variance analysis is more tough to apply to service sector organizations as *major portion of their cost is comprised of overhead expenses rather than production expenses.* While traditional variance analysis of overheads does not deliver very useful information for overheads control purposes, **application of activity based costing can provide an effective basis for variance analysis** of overheads in service sector organizations although this may need significant time and effort in the implementation of a MIS.

McDonaldization[5]

McDonaldization is a process of rationalisation, which takes a task and breaks it down into smaller tasks. This is repeated until all tasks have been broken down to the smallest possible level. The resulting tasks are then rationalised to find the single most efficient method for completing each task. All other methods are then deemed inefficient and discarded.

The impact of McDonaldization is that standards can be more accurately set and assessed. It can be easily ascertained that how much time and cost should go into each activity. The principles can be applied to many other services, such as hairdressing, dentistry, or opticians' services.

Standard Costing in Public Sector[6]

In order to cost control in public sector (e.g. street cleaning refuse disposal and so on), regular variance analysis is required. Actual unit costs should be calculated on a monthly basis and compared with estimated unit cost. To achieve this comparison, information needs to be maintained about the unit of service adopted. For example, statistics would be maintained on the number of visits made and the number of hours worked. In this example, time recording may be beneficial in providing the detailed information necessary for variance analysis. Actual monthly costs should be taken from the organisation's financial management system and each month financial reports should be produced which offer an accurate image of budgeted vs actual expenditure. These reports are must for budgetary control. Actual expenditure reported on financial systems may require *some modification* to take account of:

- Trade Payables (services used but bills unpaid)
- Accruals (services used but bills yet to be received)
- Timing Differences (some costs are not incurred evenly over the year)

STANDARD MARGINAL COSTING

Standards and Variances can be calculated on the basis of marginal costing. A standard marginal costing system incorporates only costs which are variable to the product. Accordingly, the absorption of fixed costs, and the variances derived therefrom, do not feature in a standard marginal costing system. **When Marginal Costing is in use there is no Overhead Volume Variance, because Marginal Costing does not absorb Fixed Overhead**. Fixed Overhead Expenditure Variance is the only variance for Fixed Overhead in a Marginal Costing system. It is calculated as in an Absorption Costing system.

RECONCILIATION OF PROFIT

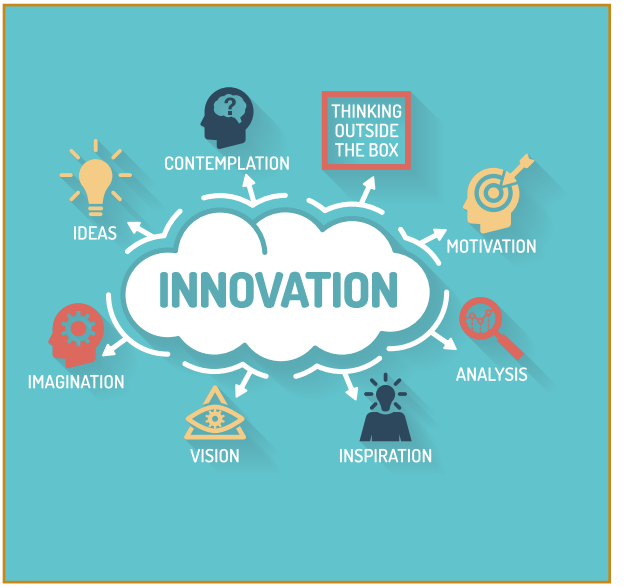
Generally, under variance analysis we compute various variances from the actual and the standard/budgeted data. Sometimes all or a few variances and actual data are made available and from that we are required to prepare standard product cost sheet, original budget and to reconcile the budgeted profit with the actual profit. Some important concepts are given below:

Reconciliation Statement-I
Budgeted Profit to Actual Profit (Absorption Costing)

Budgeted Profit				☐
(Budgeted Quantity × Standard Margin)				
Effect of Variances				
Material Cost Variance				
Material Price Variance		☐		
Material Usage Variance				
Material Mix Variance	☐			
Material Yield Variance	☐	☐	☐	
Labour Cost Variance				
Labour Rate Variance		☐		
Labour Idle Time Variance		☐		
Labour Efficiency Variance				
Labour Mix Variance	☐			
Labour Sub-Efficiency Variance	☐	☐	☐	
Variable Overhead Cost Variances				
Variable Overhead Expenditure Variance		☐		
Variable Overhead Efficiency Variance		☐	☐	
Fixed Overhead Cost Variances				
Fixed Overhead Expenditure Variance		☐		
Fixed Overhead Volume Variance				
Fixed Overhead Capacity Variance	☐			
Fixed Overhead Efficiency Variance	☐	☐	☐	
Sales Margin Variances (in terms of Profit)				
Sales Margin Price Variance		☐		
Sales Margin Volume Variance				
Sales Margin Mix Variance	☐			
Sales Margin Quantity Variance	☐	☐	☐	☐
Actual Profit				☐

Reconciliation Statement-II
Budgeted Profit to Actual Profit (Marginal Costing)

Budgeted Profit				☐
(Budgeted Quantity × Standard Margin)				
Effect of Variances				
Material Cost Variance				
Material Price Variance		☐		
Material Usage Variance				
Material Mix Variance	☐			
Material Yield Variance	☐	☐	☐	
Labour Cost Variance				
Labour Rate Variance		☐		
Labour Idle Time Variance		☐		
Labour Efficiency Variance				
Labour Mix Variance	☐			
Labour Sub-Efficiency Variance	☐	☐	☐	
Variable Overhead Cost Variances				
Variable Overhead Expenditure Variance		☐		
Variable Overhead Efficiency Variance		☐	☐	
Fixed Overhead Cost Variances				
Fixed Overhead Expenditure Variance		☐		
Fixed Overhead Volume Variance				
Fixed Overhead Capacity Variance	NA			
Fixed Overhead Efficiency Variance	NA	NA	☐	
Sales Contribution Variances				
Sales Contribution Price Variance		☐		
Sales Contribution Volume Variance				
Sales Contribution Mix Variance	☐			
Sales Contribution Quantity Variance	☐	☐	☐	☐
Actual Profit				☐



Reconciliation Statement-III
Standard Profit to Actual Profit (Absorption Costing)

Standard Profit				☐
(Actual Quantity × Standard Margin)				
Effect of Variances				
Material Cost Variance				
Material Price Variance		☐		
Material Usage Variance				
Material Mix Variance	☐			
Material Yield Variance	☐	☐	☐	
Labour Cost Variance				
Labour Rate Variance		☐		
Labour Idle Time Variance		☐		
Labour Efficiency Variance				
Labour Mix Variance	☐			
Labour Sub-Efficiency Variance	☐	☐	☐	
Variable Overhead Cost Variances				
Variable Overhead Expenditure Variance		☐		
Variable Overhead Efficiency Variance		☐	☐	
Fixed Overhead Cost Variances				
Fixed Overhead Expenditure Variance		☐		
Fixed Overhead Volume Variance				
Fixed Overhead Capacity Variance	☐			
Fixed Overhead Efficiency Variance	☐	☐	☐	
Sales Margin Variance (in terms of Profit)				
Sales Margin Price Variance		☐		
Sales Margin Volume Variance				
Sales Margin Mix Variance	NA			
Sales Margin Quantity Variance	NA	NA	☐	☐
Actual Profit				☐

INVESTIGATION OF VARIANCES

Variances focus attention on deviations, but all deviations cannot be taken as 'out of Control' situations. However, variance investigation on the other hand may not be fruitful in any given situation considering that it requires resources and thus a ***cost benefit analysis*** should be considered before undertaking investigation.

Investigating variances is a key step in using variance analysis as part of performance management. *"Interpretation may suggest possible cause of variances but investigation must arrive at definite conclusions about the cause of the variance so that action to correct the variance can be effective."* There are behavioural as well as technical consequences to the decision to investigate variances. If no variances are investigated, it may cease to be motivated by the system which produce variances. Investigating favourable and adverse variances may create positive behavioural reinforcements, with implications for motivation, aspiration levels and inter-departmental relationships.

Factors to be Considered When Investigating Variance

Certain set of factors should be considered before undertaking the variance investigation of the actual performance against the estimates set.

Size: A standard is seen as an average of the estimates and therefore small variations seen from the standard should be ignored and not investigated further. In addition, organizations can establish limits and the variances seen beyond those limits should be undertaken for further investigation.

Type of Variance: Adverse variance is given more importance by the organization over favourable variances seen with regards to the estimates.

Cost: The costs associated with the undertaking of the investigation should be lower than the benefits associated with the investigation of variances for the organization to undertaken the said investigation.

Pattern in Variance: The variances need to be monitored over a period of time and if the variance of a particular cost is seen to be worsening over time then in that case the investigation in relation to the variance needs to be undertaken.

Budgetary Process: In case the budgetary process is uncontrollable and unrealistic then in that case the investigation should be re-evaluating the budgetary process rather than undertaking investigation of the variances.

Method Used for Investigating Variance[7]

Simple Rule of Thumb Model

It is based on arbitrary criteria such as investigating if the absolute size of a variance is greater than a certain amount or if the ratio of the variance to the total cost exceeds some predetermined percentage. They are based on *managerial judgement* and do not consider statistical significance.

Statistical Decision Model

For the statistical models, two mutually exclusive states are possible. First assumes that the system is 'In Control' and a variance is simply due to *random fluctuations around the expected outcome*. The second possible state is that the system is in some way 'Out of Control' and corrective action can be taken to remedy the situation.

POSSIBLE INTERDEPENDENCE BETWEEN VARIANCES

It is a term used to express the way in which the cause of one variance may be wholly or partially explained by the cause of another variance. For control purposes, it might therefore be essential to look at several variances together and not in isolation. Some **examples** of interdependence between variances are listed below:

Use of cheaper material which is poorer quality, the material price variance will be favourable, but this can cause more wastage of materials leading to adverse usage variance.

Using more skilled labour to do the work will result in an adverse labour rate variance, but productivity might be higher as a result due to experienced labour.

Changing the composition of a team might result in a cheaper labour mix (favourable mix variance) but lower productivity (adverse yield variance).

Workers trying to improve productivity (favourable efficiency variance) in order to get bonus (adverse rate variance) might use materials wastefully in order to save time (adverse materials usage).

Cutting sales prices (adverse sales price variance) might result in higher sales demand from customers (favourable sales volume variance).

Similarly, favourable sales price variance may result in adverse sales volume variance.

INTERPRETATION OF VARIANCES

There can be a number of ***potential causes leading to variances*** in the operational costs

Material Price Variance

- Might be caused due to the *use of a different supplier.*
- *Order size* can result in variance.
- Any form of unexpected increase in *buying costs* such as higher delivery charges.
- Efficiency or inefficiency associated with the *buying procedure* adopted.
- Lack of appropriate *inventory control* can result in emergency purchase of material resulting in adverse variance.

Material Usage Variance

- Purchase of inferior *quality material.*
- Implementation of better *quality control.*
- Increased *efficiency* in production can help in bringing down wastage rate.
- Changes made in the *material mix.*
- Careless way of *handling material* by production department.
- *Change in method* of production/ design.
- *Pilferage* of material from the production department.
- Poor *inspection.*

Labour Rate Variance

- Unexpected increase in the *pay rate* of labour.
- Level of *experience* of the labour can impact the direct cost of labour.
- Payment of bonuses added to the direct labour costs.

Labour Efficiency Variance

- Improvement in work or productivity *efficiency.*
- *Workforce mix* can have an impact upon labour efficiency levels.
- *Industrial action* in relation to workforce.
- *Poor supervision* of the workforce.

Labour Rate Variance

- Change in the *composition* of the workforce can impact direct labour costs.

Labour Efficiency Variance

- *Learning curve effect* upon the labour efficiency levels.
- *Resource shortages* causing an unexpected delay and lowering of labour efficiency levels.
- Using inferior *quality of material.*
- *Introduction of new machinery* resulting in improvement of labour productivity levels.

Fixed Overhead Variance

- Fixed Overhead Expenditure Variance (adverse) are caused by *spending in excess* of the budget.
- Fixed Overhead Volume Variance is caused by *changes in production volume.*

Variable Overhead Variance

- Variable Overhead Expenditure Variance are often caused by changes in machine running costs.
- Variable Overhead Efficiency Variances- Causes are similar to those for a direct labour efficiency variance.

Sales Price Variance

- Higher *discounts* given to customers in order to encourage bulk purchases.
- The effect of low price offers during a *marketing campaign.*
- Poor *performance by sales personnel.*
- *Market conditions or economic conditions* forcing changes in prices across the industry.

Sales Volume Variance

- Successful or unsuccessful *direct selling efforts.*
- Successful or unsuccessful *marketing efforts* (for example, the effects of an advertising campaign).
- Unexpected changes in *customer preferences* and *buying patterns.*
- Failure to satisfy demand due to *production difficulties.*
- Higher demand due to a *cut in selling prices,* or lower demand due to an *increase in sales prices.*

REPORTING OF VARIANCES

Computation of variances and their reporting is not the final step towards the control of various elements of cost. It in fact demands an analysis of variances from the side of the executives, to ascertain the correct reasons for their occurrence. After knowing the exact reasons, it becomes their responsibility to take necessary steps so as to **stop the re-occurrence of adverse variances in future**. To enhance the utility of such a reporting system it is necessary that such a system of reporting should not only be prompt but should also facilitate the concerned

managerial level to take necessary steps. Variance reports should be prepared after keeping in view its ultimate use and its periodicity. Such reports should highlight the essential cost deviations and possibilities for their improvements. In fact the variance reports should give due regard to the following points:-

- The concerned ***executives should be informed*** about what the cost performance should have been.
- ***How close*** the actual cost performance is with reference to standard cost performance.
- The analysis and ***causes of variances.***
- Reporting should be based on the principle of ***management by exception.***
- The ***magnitude of variances*** should also be stated.

BEHAVIOURAL ISSUES[8]

Variance analysis may encourage ***short-termism*** due to their inherent tendency towards short-term, quantified objectives and results.

A negative perception of an organization's variance analysis process can also encourage other ***sub-optimal behaviour*** among employees such as attempts to include budget slacks.

The behavioural issues connected with variance analysis could be managed by participating employees during budget setting so that they do not assess the procedure as biased. It is also vital for an organization's performance measurement system to be based on an extensive range of ***quantitative*** and ***qualitative*** measures so as to encourage management to adopt a long-term view that is aligned with an organization's strategic direction.

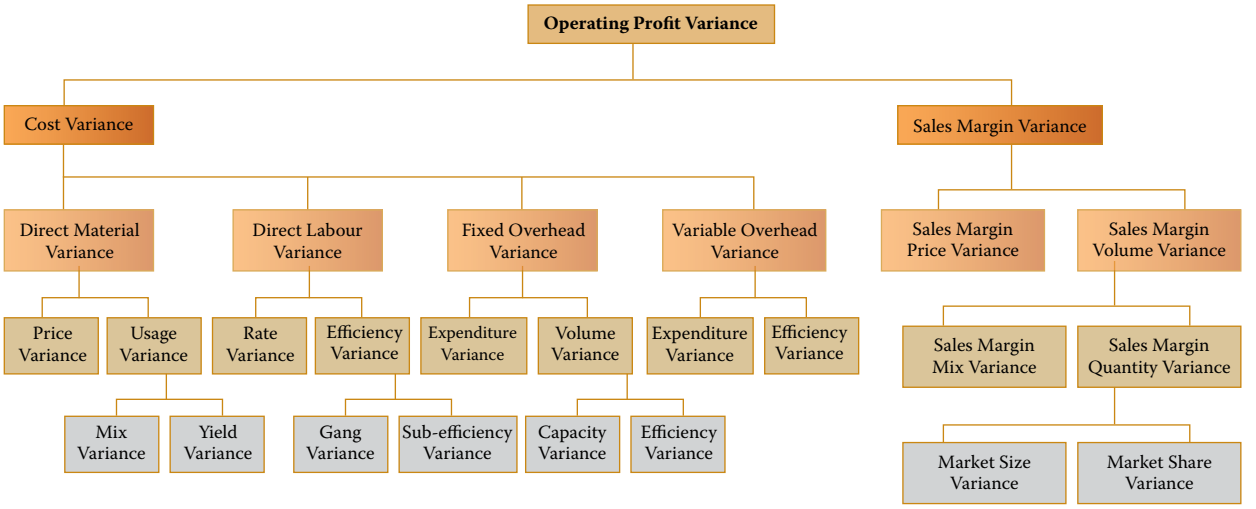
Ethics[9]

Variance analysis for evaluating performance can have strong ethical consequences. For example, standard costing methods have been proposed for medicine as a means for improving performance. Interpretation of a favourable variance may be difficult because it either reflects insufficient treatment or compliance to guidelines. Most hospitals in various countries are reimbursed as specified by the diagnostic related groups (DRG). Each DRG has specified standard "length of stay". If a patient leaves the hospital early, the hospital is financial impacted favourably but a patient staying longer than the specified time costs the hospital money.

STANDARD COSTING IN CONTEMPORARY BUSINESS ENVIRONMENT[10]

- Products ***not to be standardised***
- Standard costs become ***outdated quickly***
- Production is ***highly automated***
- Often use ***ideal standards***
- The emphasis is on ***continuous improvement***
- Analysis may ***not give enough detail***
- Reports may ***arrive too late*** to solve problems

FORMULAE



Sales Variances (Absorption Costing)

Sales Margin Variance*
(Actual Margin) *Less* (Budgeted Margin)
[(AQ × AM) – (BQ × SM)]

Sales Margin Price Variance
(Actual Margin) *Less* (Standard Margin)
[(AM × AQ) – (SM × AQ)]
Or [AQ × (AM – SM)]

Sales Margin Volume Variance
(Standard Margin) *Less* (Budgeted Margin)
[(SM × AQ) – (SM × BQ)]
Or [SM × (AQ – BQ)]

Sales Margin Mix Variance
(Standard Margin) *Less* (Revised Standard Margin)
(AQ × SM) – (RAQ × SM)
Or SM × (AQ – RAQ)
Alternative Formula
[Total Actual Qty. (units) × {*Average* Standard Margin *per unit* of Actual Mix Less *Average* Budgeted Margin *per unit* of Budgeted Mix}]

Sales Margin Quantity Variance
(Revised Standard Margin) *Less* (Budgeted Margin)
(RAQ × SM) – (BQ × SM)
Or SM × (RAQ – BQ)
Alternative Formula
[*Average* Budgeted Margin *per unit* of Budgeted Mix × {Total Actual Qty. (units) Less Total Budgeted Qty. (units)}]

Market Size Variance
[Budgeted Market Share % × (Actual Industry Sales Quantity *in units* – Budgeted Industry Sales Quantity *in units*) × (*Average* Budgeted Margin *per unit*)]

Market Share Variance
[(Actual Market Share % – Budgeted Market Share %) × (Actual Industry Sales Quantity *in units*) × (*Average* Budgeted Margin *per unit*)]

* *in terms of profit*

Note:

BQ	=	Budgeted Sales Quantity
AQ	=	Actual Sales Quantity
RAQ	=	Revised Actual Sales Quantity
	=	Actual Quantity Sold Rewritten in Budgeted Proportion
SM	=	Standard Margin
	=	Standard Price per Unit – Standard Cost per Unit
AM	=	Actual Margin
	=	Actual Sales Price per Unit – Standard Cost per Unit

Market Size Variance

Budgeted Market Share % × (Actual Industry Sales Quantity *in units* – Budgeted Industry Sales Quantity *in units*) × (*Average* Budgeted Margin *per unit*) ***Or***
(Budgeted Market Share % × Actual Industry Sales Quantity *in units* – Budgeted Market Share % × Budgeted Industry Sales Quantity *in units*) × (*Average* Budgeted Margin *per unit*) ***Or***
(Required Sales Quantity *in units* –Total Budgeted Quantity *in units*) × (*Average* Budgeted Margin *per unit*)

Market Share Variance

(Actual Market Share % – Budgeted Market Share %) × (Actual Industry Sales Quantity *in units*) × (*Average* Budgeted Margin *per unit*) ***Or***
(Actual Market Share % × Actual Industry Sales Quantity *in units* – Budgeted Market Share % × Actual Industry Sales Quantity *in units*) × (*Average* Budgeted Margin *per unit*) ***Or***
(Total Actual Quantity *in units*– Required Sales Quantity *in units*) × (*Average* Budgeted Margin *per unit*)

Market Size Variance + Market Share Variance

(Required Sales Quantity *in units* – Total Budgeted Quantity *in units*) × (*Average* Budgeted Margin *per unit*) ***Add***
(Total Actual Quantity *in units*– Required Sales Quantity *in units*) × (*Average* Budgeted Margin *per unit*) ***Equals to***
(Total Actual Quantity *in units* – Total Budgeted Quantity *in units*) × (*Average* Budgeted Margin *per unit*)

Sales Margin Quantity Variance

Sales Variances (Marginal Costing)

Sales Contribution Variance
(Actual Contribution) *Less* (Budgeted Contribution) [(AQ × AC) – (BQ × SC)]

Sales Contribution Price Variance
(Actual Contribution) *Less* (Standard Contribution)
[(AC × AQ) – (SC × AQ)]
Or [AQ × (AC – SC)]

Sales Contribution Volume Variance
(Standard Contribution) *Less* (Budgeted Contribution)
[(SC × AQ) – (SC × BQ)]
Or [SC × (AQ – BQ)]

Sales Contribution Mix Variance
(Standard Contribution) *Less* (Revised Standard Contribution)
(AQ × SC) – (RAQ × SC)
Or SC × (AQ – RAQ)
Alternative Formula
[Total Actual Qty. (units) × {*Average* Standard Contribution *per unit* of Actual Mix Less *Average* Budgeted Contribution *per unit* of Budgeted Mix}]

Sales Contribution Quantity Variance
(Revised Standard Contribution) *Less* (Budgeted Contribution)
(RAQ × SC) – (BQ × SC)
Or SC × (RAQ – BQ)
Alternative Formula
[*Average* Budgeted Contribution *per unit* of Budgeted Mix × {Total Actual Qty. (units) Less Total Budgeted Qty. (units)}]

Market Size Variance
[Budgeted Market Share % × (Actual Industry Sales Quantity *in units* – Budgeted Industry Sales Quantity *in units*) × (*Average* Budgeted Contribution *per unit*)]

Market Share Variance
[(Actual Market Share % – Budgeted Market Share %) × (Actual Industry Sales Quantity *in units*) × (*Average* Budgeted Contribution *per unit*)]

Note:

BQ	=	Budgeted Sales Quantity
AQ	=	Actual Sales Quantity
RAQ	=	Revised Actual Sales Quantity
	=	Actual Quantity Sold Rewritten in Budgeted Proportion
SC	=	Standard Contribution
	=	Standard Price per Unit – Standard Cost (variable) per Unit
AC	=	Actual Contribution
	=	Actual Sales Price per Unit – Standard Cost (variable) per Unit

Market Size Variance

Budgeted Market Share % × (Actual Industry Sales Quantity *in units* – Budgeted Industry Sales Quantity *in units*) × (*Average* Budgeted Contribution *per unit*) ***Or***
(Budgeted Market Share % × Actual Industry Sales Quantity *in units* – Budgeted Market Share % × Budgeted Industry Sales Quantity *in units*) × (*Average* Budgeted Contribution *per unit*) ***Or***
(Required Sales Quantity *in units* – Total Budgeted Quantity *in units*) × (*Average* Budgeted Contribution *per unit*)

Market Share Variance

(Actual Market Share % – Budgeted Market Share %) × (Actual Industry Sales Quantity *in units*) × (*Average* Budgeted Contribution *per unit*) ***Or***
(Actual Market Share % × Actual Industry Sales Quantity *in units* – Budgeted Market Share % × Actual Industry Sales Quantity *in units*) × (*Average* Budgeted Contribution *per unit*) ***Or***
(Total Actual Quantity *in units*– Required Sales Quantity *in units*) × (*Average* Budgeted Contribution *per unit*)

Market Size Variance + Market Share Variance

(Required Sales Quantity *in units* – Total Budgeted Quantity *in units*) × (*Average* Budgeted Contribution *per unit*) ***Add***
(Total Actual Quantity *in units*– Required Sales Quantity *in units*) × (*Average* Budgeted Contribution *per unit*) ***Equals to***
(Total Actual Quantity *in units* – Total Budgeted Quantity *in units*) × (*Average* Budgeted Contribution *per unit*)

Sales Contribution Quantity Variance

- **Sales Price Variance** is equal to **Sales Margin/ Contribution Price Variance**. This is because, for the actual quantity sold, standard cost remaining constant, change in selling price will have equal impact or turnover and profit/ contribution.
- **Sales Margin Volume Variance** is **equal** to **Sales Volume Variance × Budgeted Net Profit Ratio**
- **Sales Contribution Volume Variance** is **equal** to **Sales Volume Variance × Budgeted PV Ratio**

A Relation
Sales Margin Volume Variance in terms of Profit & Contribution

Sales Margin Volume Variance	Standard Margin Per Unit × (Actual Quantity – Budgeted Quantity) ***Or***
Sales Margin Volume Variance	[Standard *Contribution* Per Unit – Standard Fixed Overheads Per Unit] × (Actual Quantity – Budgeted Quantity) ***Or***
Sales Margin Volume Variance	[Standard *Contribution* Per Unit × (Actual Quantity – Budgeted Quantity)] – [Standard Fixed Overheads Per Unit × (Actual Quantity – Budgeted Quantity)] ***Or***
Sales Margin Volume Variance	Sales Contribution Volume Variance – Fixed Overhead Volume Variance ***Or***
Sales Contribution Volume Variance	Sales Margin Volume Variance + Fixed Overhead Volume Variance
Note: Production units equals to Sales units for both actual & budget.	

Sales Variances (Turnover or Value)

Sales Variance
(Actual Sales) *Less* (Budgeted Sales)
[(AQ × AP) – (BQ × SP)]

Sales Price Variance
(Actual Sales) *Less* (Standard Sales)
[(AP × AQ) – (SP × AQ)]
Or [AQ × (AP – SP)]

Sales Volume Variance
(Standard Sales) *Less* (Budgeted Sales)
[(SP × AQ) – (SP × BQ)]
Or [SP × (AQ – BQ)]

Sales Mix Variance
(Standard Sales) *Less* (Revised Standard Sales)
(AQ × SP) – (RAQ × SP)
Or SP × (AQ – RAQ)
Alternative Formula
[Total Actual Qty. (units) × {*Average* Standard Price *per unit* of Actual Mix Less *Average* Budgeted Price *per unit* of Budgeted Mix}]

Sales Quantity Variance
(Revised Standard Sales) *Less* (Budgeted Sales)
(RAQ × SP) – (BQ × SP)
Or SP × (RAQ – BQ)
Alternative Formula
[*Average* Budgeted Price *per unit* of Budgeted Mix × {Total Actual Qty. (units) Less Total Budgeted Qty. (units)}]

Market Size Variance
[Budgeted Market Share % × (Actual Industry Sales Quantity *in units* – Budgeted Industry Sales Quantity *in units*) × (*Average* Budgeted Price *per unit*)]

Market Share Variance
[(Actual Market Share % – Budgeted Market Share %) × (Actual Industry Sales Quantity *in units*) × (*Average* Budgeted Price *per unit*)]

Note:

BQ	=	Budgeted Sales Quantity
AQ	=	Actual Sales Quantity
RAQ	=	Revised Actual Sales Quantity
	=	Actual Quantity Sold Rewritten in Budgeted Proportion
SP	=	Standard Selling Price per Unit
AP	=	Actual Selling Price per Unit

Market Size Variance

Budgeted Market Share % × (Actual Industry Sales Quantity *in units* – Budgeted Industry Sales Quantity *in units*) × (*Average* Budgeted Price *per unit*) ***Or***

(Budgeted Market Share % × Actual Industry Sales Quantity *in units* – Budgeted Market Share % × Budgeted Industry Sales Quantity *in units*) × (*Average* Budgeted Price *per unit*) ***Or***
(Required Sales Quantity *in units* –Total Budgeted Quantity *in units*) × (*Average* Budgeted Price *per unit*)

Market Share Variance

(Actual Market Share % – Budgeted Market Share %) × (Actual Industry Sales Quantity *in units*) × (*Average* Budgeted Price *per unit*) ***Or***
(Actual Market Share % × Actual Industry Sales Quantity *in units* – Budgeted Market Share % × Actual Industry Sales Quantity *in units*) × (*Average* Budgeted Price *per unit*) ***Or***
(Total Actual Quantity *in units*– Required Sales Quantity *in units*) × (*Average* Budgeted Price *per unit*)

Market Size Variance + Market Share Variance

(Required Sales Quantity *in units* – Total Budgeted Quantity *in units*) × (*Average* Budgeted Price *per unit*) ***Add***
(Total Actual Quantity *in units*– Required Sales Quantity *in units*) × (*Average* Budgeted Price *per unit*) ***Equals to***
(Total Actual Quantity *in units* – Total Budgeted Quantity *in units*) × (*Average* Budgeted Price *per unit*)

Sales Quantity Variance

Direct Material Variances

Direct Material Total Variance#
[Standard Cost* *Less* Actual Cost]
(The difference between the Standard Direct Material Cost *of the actual production volume* and the Actual Cost of Direct Material)
[(SQ × SP) – (AQ × AP)]

Direct Material Price Variance
[Standard Cost of Actual Quantity *Less* Actual Cost]
(The difference between the Standard Price and Actual Price for the Actual Quantity)
[(SP – AP) × AQ]
Or
[(SP × AQ) – (AP × AQ)]

Direct Material Usage Variance
[Standard Cost of Standard Quantity for Actual Production *Less* Standard Cost of Actual Quantity]
(The difference between the Standard Quantity *specified for actual production* and the Actual Quantity *used*, at Standard Purchase Price)
[(SQ – AQ) × SP]
Or
[(SQ × SP) – (AQ × SP)]

Direct Material Yield Variance
[Standard Cost of Standard Quantity for Actual Production *Less* Standard Cost of Actual Quantity in Standard Proportion]
(The difference between the Standard Quantity *specified for actual production* and Actual Quantity in *standard proportion*, at Standard Purchase Price)
[(SQ – RAQ) × SP]
Or
[(SQ × SP) – (RAQ × SP)]
Alternative Formula
[*Average* Standard Price *per unit* of Standard Mix × {Total Standard Quantity (units) Less Total Actual Quantity (units)}]

Direct Material Mix Variance
[Standard Cost of Actual Quantity in Standard Proportion *Less* Standard Cost of Actual Quantity]
(The difference between the Actual Quantity *in standard proportion* and Actual Quantity *in actual proportion*, at Standard Purchase Price)
[(RAQ – AQ) × SP]
Or
[(RAQ × SP) – (AQ × SP)]
Alternative Formula
[Total Actual Quantity (units) × {*Average* Standard Price *per unit* of Standard Mix Less *Average* Standard Price *per unit* of Actual Mix}]

Note:

SQ	=	Standard Quantity = Expected Consumption for Actual Output
AQ	=	Actual Quantity of *Material Consumed*
RAQ	=	Revised Actual Quantity = Actual Quantity Rewritten in Standard Proportion
SP	=	Standard Price per Unit
AP	=	Actual Price per Unit
(*)	=	Standard Cost refers to 'Standard Cost of Standard Quantity for Actual Output'
(#)	=	Direct Material Total Variance (also known as material cost variance)

Material Purchase Price Variance
[Standard Cost of Actual Quantity – Actual Cost]
(The difference between the Standard Price and Actual Price *for the actual quantity of material purchased)*
[(SP – AP) × PQ]
Or
[(SP × PQ) – (AP × PQ)]

Note:

PQ	=	Purchase Quantity
SP	=	Standard Price
AP	=	Actual Price

Direct Labour Variances

Direct Labour Total Variance[a]
[Standard Cost[b] – Actual Cost]
(The difference between the Standard Direct Labour Cost and the Actual Direct Labour Cost *incurred for the production achieved)*
[(SH × SR) – (AH* × AR)]

Direct Labour Idle Time Variance

Direct Labour Rate Variance
[Standard Cost of Actual Time – Actual Cost]
(The difference between the Standard Rate *per hour* and Actual Rate *per hour* for the Actual Hours *paid*)

[(SR – AR) × AH*] ***Or***
[(SR × AH*) – (AR × AH*)]

Direct Labour Efficiency Variance
[Standard Cost of Standard Time for Actual Production – Standard Cost of Actual Time]
(The difference between the Standard Hours *specified for actual production* and Actual Hours *worked* at Standard Rate)
[(SH – AH#) × SR] ***Or***
[(SH × SR) – (AH# × SR)]

Direct Labour Mix Variance *Or* Gang Variance
[Standard Cost of Actual Time *Worked* in Standard Proportion – Standard Cost of Actual Time *Worked*]
(The difference between the Actual Hours *worked in standard proportion* and Actual Hours *worked in actual proportion*, at Standard Rate)
[(RAH – AH#) × SR] ***Or***
[(RAH × SR) – (AH# × SR)]
Alternative Formula
[Total Actual Time *Worked* (hours) × {*Average* Standard Rate *per hour* of Standard Gang Less *Average* Standard Rate *per hour* of Actual Gang@}]
@ on the basis of hours worked

Direct Labour Yield Variance *Or* Sub-Efficiency Variance
[Standard Cost of Standard Time for Actual Production – Standard Cost of Actual Time *Worked* in Standard Proportion]
(The difference between the Standard Hours *specified for actual production* and Actual Hours *worked in standard proportion*, at Standard Rate)
(SH – RAH) × SR ***Or***
(SH × SR) – (RAH × SR)
Alternative Formula
[*Average* Standard Rate *per hour* of Standard Gang × {Total Standard Time (hours) Less Total Actual Time *Worked* (hours)}]

Direct Labour Idle Time Variance

[Standard Rate per Hour × Actual Idle Hours]

(The difference between the Actual Hours *paid* and Actual Hours *worked* at Standard Rate)

[(AH* – AH#) × SR]
Or
[(AH* × SR) – (AH# × SR)]

Note:

SH	=	Standard Hours = Expected time (Time allowed) for Actual Output
AH*	=	Actual Hours *paid for*
AH#	=	Actual Hours *worked*
RAH	=	Revised Actual Hours = Actual Hours (worked) rewritten in Standard Proportion
SR	=	Standard Rate per Labour Hour
AR	=	Actual Rate per Labour Hour Paid
(b)	=	Standard Cost refers to 'Standard Cost of Standard Time for Actual Output'
(a)	=	Direct Labour Total Variance (also known as labour cost variance)

In the absence of idle time
Actual Hours Worked = Actual Hours Paid

Idle Time is a period for which a workstation is available for production but is not used due to e.g. shortage of tooling, material, or operators. During Idle Time, Direct Labour Wages are being paid but no output is being produced. The cost of this can be identified separately in an Idle Time Variance, so that it is not 'hidden' in an adverse Labour Efficiency Variance.

Some organizations face Idle Time on regular basis. In this situation, the Standard Labour Rate may include an allowance for the cost of the expected idle time. Only the impact of any unexpected or abnormal Idle Time would be included in the Idle Time Variance.

Fixed Production Overhead Variances

Fixed Overhead Total Variance@
(Absorbed Fixed Overheads) *Less*
(Actual Fixed Overheads)

Fixed Overhead Expenditure Variance
(Budgeted Fixed Overheads)
Less
(Actual Fixed Overheads)

Fixed Overhead Volume Variance
(Absorbed Fixed Overheads)
Less
(Budgeted Fixed Overheads)

Fixed Overhead Efficiency Variance
(Absorbed Fixed Overheads)
Less
(Budgeted Fixed Overheads for Actual Hours#)

Fixed Overhead Capacity Variance
(Budgeted Fixed Overheads for Actual Hours#)
Less
(Budgeted Fixed Overheads)

Or

Fixed Overhead Total Variance@
(Absorbed Fixed Overheads) *Less*
(Actual Fixed Overheads)

Fixed Overhead Expenditure Variance
(Budgeted Fixed Overheads)
Less
(Actual Fixed Overheads)

Fixed Overhead Volume Variance
(Absorbed Fixed Overheads)
Less
(Budgeted Fixed Overheads)

Fixed Overhead Calendar Variance
(Possible Fixed Overheads)
Less
(Budgeted Fixed Overheads)

Fixed Overhead Capacity Variance
(Budgeted Fixed Overheads for Actual Hours#)
Less
(Possible Fixed Overheads)

Fixed Overhead Efficiency Variance
(Absorbed Fixed Overhead)
Less
(Budgeted Fixed Overheads for Actual Hours#)

 # Actual Hours (Worked)

Note:

Standard Fixed Overheads for Production (Absorbed)
= Standard Fixed Overhead Rate per Unit × Actual Production in Units
= Standard Fixed Overhead Rate per Hour × Standard Hours for Actual Production

Budgeted Fixed Overheads
= It represents the amount of fixed overhead which should be spent according to the budget or standard during the period
= Standard Fixed Overhead Rate per Unit × Budgeted Production in Units
= Standard Fixed Overhead Rate per Hour × Budgeted Hours

Actual Fixed Overheads Incurred

Budgeted Fixed Overheads for Actual Hours
= Standard Fixed Overhead Rate per Hour × Actual Hours

Possible Fixed Overheads
= Expected Fixed Overhead for Actual Days Worked
$= \frac{\text{Budgeted Fixed Overhead}}{\text{Budgeted Days}} \times \text{Actual Days}$

(@)
= Fixed Overhead Total Variance also known as 'Fixed Overhead Cost Variance'

Fixed Overhead Efficiency Variance

(Absorbed Fixed Overheads) – (Budgeted Fixed Overheads for Actual Hours)
Or
(Standard Fixed Overhead Rate per Hour × Standard Hours for Actual Output) – (Standard Fixed Overhead Rate per Hour × Actual Hours)
Or
Standard Fixed Overhead Rate per Hour × (Standard Hours for Actual Output – Actual Hours)

Fixed Overhead Capacity Variance

(Budgeted Fixed Overheads for Actual Hours) – (Budgeted Fixed Overheads) ***Or***
(Standard Fixed Overhead Rate per Hour × Actual Hours) – (Standard Fixed Overhead Rate per Hour × Budgeted Hours) ***Or***
Standard Fixed Overhead Rate per Hour × (Actual Hours – Budgeted Hours)

Fixed Overhead Volume Variance-I

(Absorbed Fixed Overheads) – (Budgeted Fixed Overheads) ***Or***
(Standard Fixed Overhead Rate per Unit × Actual Output) – (Standard Fixed Overhead Rate per Unit × Budgeted Output) ***Or***
Standard Fixed Overhead Rate per Unit × (Actual Output – Budgeted Output)

Fixed Overhead Volume Variance-II

(Absorbed Fixed Overheads) – (Budgeted Fixed Overheads)
Or
(Standard Fixed Overhead Rate per Hour × Standard Hours for Actual Output) – (Standard Fixed Overhead Rate per Hour × Budgeted Hours)
Or
Standard Fixed Overhead Rate per Hour × (Standard Hours for Actual Output – Budgeted Hours)
Or
Standard Fixed Overhead Rate *per Hour* × (Standard Hours per Unit × Actual Output – Standard Hours per Unit × Budgeted Output)
Or
(Standard Fixed Overhead Rate per Hour × Standard Hours per Unit) × (Actual Output – Budgeted Output)
Or
Standard Fixed Overhead Rate per Unit × (Actual Output – Budgeted Output)

Overhead Variances can also be affected by idle time. It is usually assumed that Overheads are incurred when labour is working, not when it is idle. Accordingly, hours worked has been considered for the calculation of Variable and Fixed Overheads Variances.

Variable Production Overhead Variances

Variable Overhead Total Variance@
(Standard Variable Overheads for Production – Actual Variable Overheads)

Variable Overhead Expenditure (Spending) Variance
(Budgeted Variable Overheads for Actual Hours#)
Less
(Actual Variable Overheads)

Variable Overhead Efficiency Variance
(Standard Variable Overheads for Production)
Less
(Budgeted Variable Overheads for Actual Hours#)

 # Actual Hours (Worked)

Note:

Standard Variable Overheads for Production/Charged to Production
= Standard/Budgeted Variable Overhead Rate per Unit × Actual Production (Units)
= Standard Variable Overhead Rate per Hour × Standard Hours for Actual Production

Actual Overheads Incurred

Budgeted Variable Overheads for Actual Hours
= Standard Variable Overhead Rate per Hour × Actual Hours

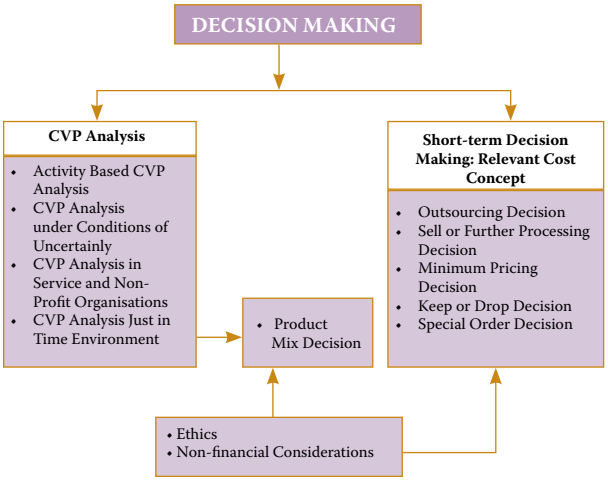
(@)
= Variable Overhead Total Variance also known as 'Variable Overhead Cost Variance'

Variable Overhead Efficiency Variance
(Standard Variable Overheads for Production) – (Budgeted Overheads for Actual Hours) ***Or*** (Standard Variable Overhead Rate *per Hour* × Standard Hours for Actual Output) – (Standard Variable Overhead Rate *per Hour* × Actual Hours) ***Or*** Standard Variable Overhead Rate *per Hour* × (Standard Hours for Actual Output – Actual hours)

Variable Overhead Expenditure Variance
(Budgeted Variable Overheads for Actual Hours) – (Actual Variable Overheads) ***Or*** (Standard Rate *per Hour* × Actual Hours) – (Actual Rate *per Hour* × Actual Hours) ***Or*** Actual Hours × (Standard Rate *per Hour* – Actual Rate *per Hour*)

DECISION MAKING

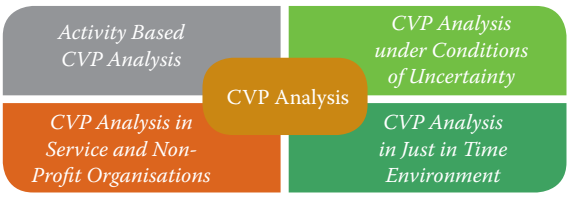
CHAPTER OVERVIEW



CVP ANALYSIS[11]

CVP analysis involves analysing the interrelationships among revenues, costs, levels of activity, and profits. CVP analysis is useful for numerous decisions related to production, pricing, marketing, cost structure, and many more. Although CVP analysis is most useful for planning, it can also be used to assist with ***controlling decisions*** and ***evaluating decisions***.

Consider a decision about choosing *additional features of an existing product* i.e. product modification. Different choices can affect selling prices, variable cost per unit, fixed costs, units sold, and operating income. CVP analysis helps managers make product decisions by estimating the *expected profitability* of these choices.



Activity Based CVP Analysis

Conventional CVP analysis assumes *volume based* measures. An alternative approach is activity based costing. In an activity-based costing system, costs are segregated into unit and *non-unit-based* categories. Activity-based costing acknowledges that some costs vary with units produced and some costs do not. However, while activity-based costing admits that non-unit- based costs are fixed with respect to production volume changes, it also argues that many non-unit-based costs vary with respect to other cost drivers. In contrast, the volume based approach combines the cost of these activities and treat them as fixed costs since they do not vary with output volume. Activity based costing provides a more accurate determination of costs because it separately identifies and traces non- unit based costs to products rather than combining them in a pool of fixed costs as volume based approach does.

The Break-even can then be expressed as follows:

Break-even units = [Fixed costs + (Setup cost × Number of Setups) + (Engineering Cost × Number of Engineering Hours)]/ (Price - Unit Variable Cost)

A comparison of the ABC break-even point with the conventional break-even point reveals two important differences.

First, the fixed costs differ. Some costs previously identified as being fixed may actually vary with non-unit cost drivers, in this case setups and engineering hours.

Second, the numerator of the ABC break-even equation has two non-unit-variable cost terms: one for batch-related activities and one for product- sustaining activities.

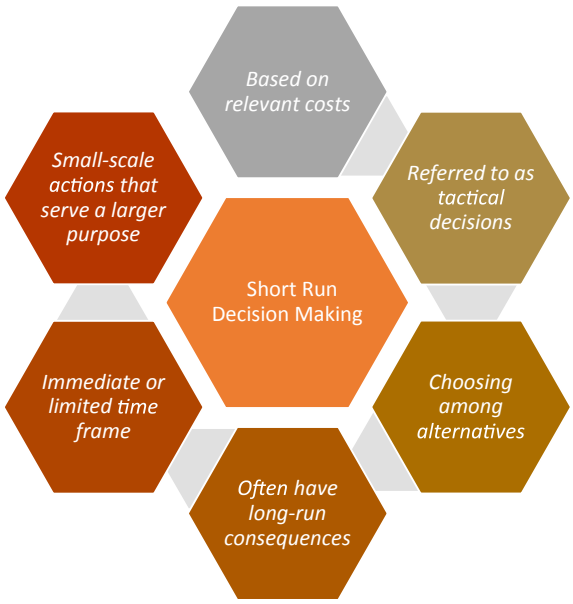
"The use of activity-based costing does not mean that CVP analysis is less valuable. In fact, it becomes more valuable, since it delivers more precise understandings concerning cost behaviour. These understandings produce better decisions. CVP analysis within an activity-based framework, however, must be improved".

Therefore, the cost equation for Just in Time can be expresses as follows:

Total Cost = Fixed Cost + (Unit variable Cost × Number of Units) + (Engineering Cost × Number of Engineering hours)

"Managers often use CVP analysis to guide other decisions, many of them are of strategic nature due to tremendous potential of increase in the profitability and organisational effectiveness"

SHORT RUN DECISION MAKING



Short-run decision making involves the act of choosing one course of action among various feasible alternatives available. Short-term decisions sometimes are referred to as tactical, or relevant, decisions because they involve choosing between alternatives with an immediate or limited time frame.

Strategic decisions, on the other hand, usually are long term in nature because they involve choosing between different strategies that attempt to provide a *competitive advantage* over a long time frame.

Short run decisions involve evaluation of the costs and benefits of short term actions, such as *whether to make a product or outsource, whether to accept a special order, whether to keep or drop an unprofitable segment, and whether to sell a product as is or process it further.* If resources are limited, managers may also have to decide on the *most appropriate product mix*. While such decisions tend to be *short run* in nature, it should be emphasized that they often have ***long-run consequences***.

Consider a second example, suppose that a company is thinking about producing a component instead of buying it from suppliers. The immediate objective may be to lower the cost of making the main product. Yet this decision may be a small part of the overall strategy of establishing a cost leadership position for the firm. Therefore, short-run decisions often are *small-scale actions* that *serve a larger purpose*[12].

The tactical decision making approach just described emphasized the importance of identifying and using **relevant costs**. But how do we identify and define the costs that affect the decision?

CVP Analysis in Service and Non-Profit Organisations

CVP analysis can also be applied to decisions by service and non-profit organisations. To apply CVP analysis in service and non-profit organisations, we need to *focus on measuring their output*, which is different from tangible units sold by manufacturing and merchandising companies.

CVP Analysis in Just in Time Environment

In a firm has implemented *Just in Time,* the variable cost per unit sold is reduced, and fixed costs are increased. Direct labor is considered as fixed instead of variable. On the other hand, direct material vary with production volume (unit- based variable cost) due to emphasis on *total quality* and *long-term purchasing.* Waste, scrap, and quantity discounts are removed. Other unit-based variable costs, such as power and sales commissions, also exist. Further, the batch - level variable is absent as in Just in Time, the batch is equal to one unit.

For a cost to be relevant to a decision it must be

- A future cost, i.e. related to the future.
- A differential Cost, i.e. its level must be different for each of the alternatives under consideration.

Accordingly, only future costs can be relevant to decisions. However, to be relevant, a *cost must not only be a future cost but must also differ from one alternative to another.* If a future cost is the same for more than one alternative, it has no effect on the decision. Such a cost is irrelevant cost. The ability to identify relevant and irrelevant costs is a vital decision making skill.

Non-Financial Considerations

With increase in competition, dynamic market changes and changing needs of customers, non-financial information have gained relevance in the decision-making process. Information to which monetary value can be attached is in the nature of financial information. Information of an organization like number of employees, employee morale, customer satisfaction that cannot be expressed in monetary terms is termed non -financial in nature. *Non- financial information is **long term focused** and ensures profitability and sustainability in long term for an organization thereby evaluating the internal performance of the company.* Non- Financial information which a company should focus that would turn out to be advantageous while making decisions for a company are:

Quality	Employee Satisfaction	Customer Satisfaction
Corporate Social Responsibility	Environmental Factors	Intellectual Property
Intangible Assets	Competitor's Movements	Brand Name

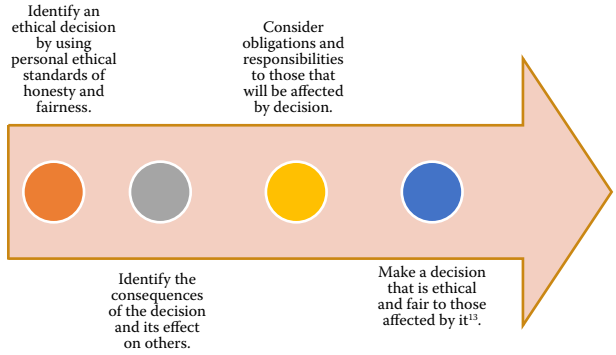
Decisions made in a business rest on the *balance between the perceived effects of financial and non-financial information.* Following are Limitations of Non- Financial Information-

Limitations of Non- Financial Information

- Time and Cost of the company involved.
- Subjective measurement – No proper of common denominator to measure performance.
- Improper measures will lead the companies to draw attention on wrong objectives.
- Lack of Statistical Reliability – Possible chances of error.
- Management Disintegration when excess of measures and indications used by the company.

Ethics

Ethics are moral principles that guide the conduct of individuals. By their behaviour and attitude, managers set the company culture.

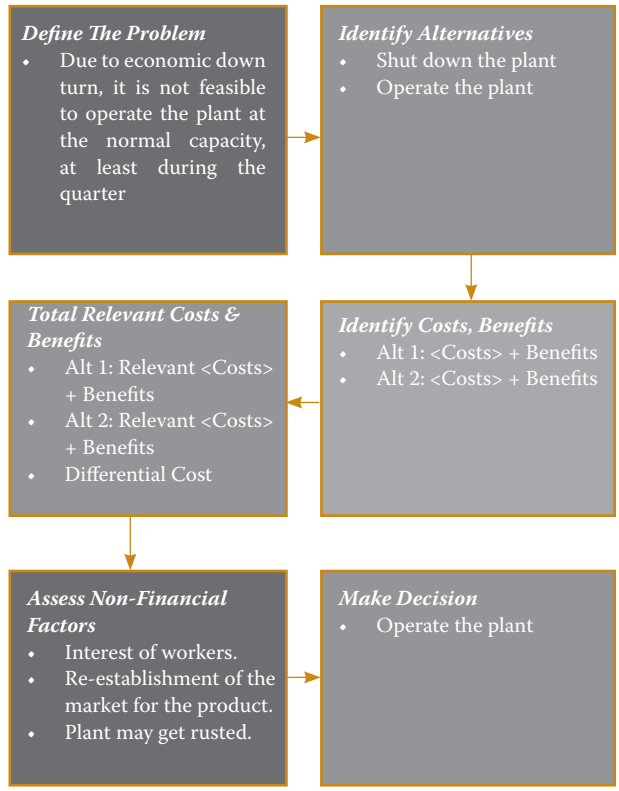


Some ethical problems can be can be avoided simply by using common sense and not focusing solely on the short term at the expense of *long term.*

Firms with a strong code of ethics can create strong customer and employee loyalty. Furthermore, a firm that values people more than profit and is viewed as operating with integrity and honour is more likely to be a commercially successful business[14].

Decision Making Model

An Application



SOME APPLICATIONS OF CVP ANALYSIS AND COST CONCEPTS

Short run decisions are many and varied but some of the more important ones, **we shall look in this chapter include:**

Outsourcing Decision[15]

Outsourcing decision is often called a 'make or buy' decision. It involves a decision of whether to continue 'making' a product versus 'buying' it from an external firm. Outsourcing enables a firm to

- reduce costs *or*
- benefit from supplier efficiencies

Outsourcing decision requires *incremental analysis*. The incremental amounts are based on the difference in the *cost of buying a product or service* compared to the *cost of producing the item or providing the service in house.*

Incremental Costs

- **Incremental Costs** are the additional costs incurred from outsourcing. The main cost is the purchase price of the products or the cost of the services that are being provided by external firms.

Incremental Cost Savings

- **Incremental Cost Savings** are reductions of costs that will no longer be incurred as a result of outsourcing. They are often called avoidable costs because if a company outsources, it can 'avoid' certain costs. Variable product cost savings are always incremental. Because they reduce total costs, they cause profits to increase. In some circumstances, a portion of fixed costs can be saved such as equipment rental costs or supervisor salaries that can be avoided.

Opportunity Costs

- **Opportunity Costs** are the costs forgone as a result of selecting a different alternative. They are always incremental. For example, if a company decides to outsource, it is able to lease its factory space that the product being outsourced no longer will occupy.

Outsourcing Decisions- Accept or Reject?

If incremental cost savings + opportunity costs < incremental costs	*If incremental cost savings + opportunity costs > incremental costs*	*If incremental cost savings + opportunity costs are = incremental costs*
reject the outsourcing, unless qualitative factors fiercely impact the decision.	accept the outsourcing unless qualitative factors fiercely impact the decision.	focus primarily on qualitative factors to evaluate the decision.

Qualitative Factors

While considering the decision to Outsourcing the management should consider qualitative aspects like quality of goods, reliability of suppliers, impact on the customers and suppliers etc.

A firm generally decides to outsource:

- If it costs less rather than to manufacture it internally;
- If the return on the necessary investment to be made to manufacture is not attractive enough;
- If the company does not have the requisite skilled manpower to make;
- If the concern feels that manufacturing internally will mean additional labour problem;
- If adequate managerial manpower is not available to take charge of the extra work of manufacturing;
- If the component shows much seasonal demand resulting in a considerable risk of maintaining inventories;
- If transport and other infrastructure facilities are adequately available;
- If the process of making is confidential or patented;
- If there is risk of technological obsolescence for the component such that it does not encourage capital investment in the component.

Sell or Further Process

Sell or process further refers to a decision-making situation where an executive has to decide either to sell a component/ product/ raw material as it is or alternatively process it further by incurring additional expenses. For instance, sometime, a redundant material lying in stores for a long time may be sold as scrap at a small value or may be thrown away as waste. This material may, however, be converted into a product of higher saleable value by carrying out some further operations or processes. On further processing the component/product/raw material may not only be improved or reconditioned but will mostly fetch a higher sale value as well. Here if the *differential sales value is more than the further processing cost*, then it is beneficial to process the product further otherwise sell it without further processing. Such type of decision making problems usually arise in the case of joint products.

There are two rules to follow when ascertaining whether the further processing is worthwhile:

- Only the incremental costs and revenues of the further process are relevant
- The joint process costs are irrelevant - they are already 'sunk' at the point of separation

Qualitative Factors

Qualitative factors related to processing further decisions include resource availability such as the readiness of employees to work extra hours to further process the products and availability of materials required for the processing. In addition, the influence on customers that prefer the original product should also be considered, as sales to these customers may be lost to competitors.

Minimum Pricing Decisions

The minimum pricing approach is a useful method in situations where there is a lot of intense competition, surplus production capacity, clearance of old inventories, getting special orders and/or improving market share of the product.

The minimum price should be set at the incremental costs of manufacturing, plus opportunity costs (if any).

For this type of pricing, the selling price is the lowest price that a company may sell its product at usually the price will be the *total relevant costs of manufacturing.*

Keep or Drop Decisions[15]

Another type of operating decision that management must make is whether to keep or drop unprofitable segments, such as product lines, services, divisions, departments, stores, or outlets.

The decision is based on whether or not the segment's revenue exceeds the costs directly traceable to the segment, including any direct fixed costs.

Incremental Revenue

- **Incremental Revenue** is the difference in revenue between the original sales revenue and the new revenue that is expected to result due to dropping a segment.
- If dropping a product will cause an increase in demand for another product, the additional revenue for the other product should be taken into consideration.

Incremental Cost Savings

- Variable costs associated with a segment to be dropped are Incremental Cost Savings that cause profit to increase.
- Direct fixed costs related to a segment being dropped are avoidable if that segment is dropped because they can be eliminated if the segment is dropped.

Opportunity Costs

- **Opportunity Costs** are common in keep or drop decisions. They often arise due to rental of production space that will become vacant if the decision is made to drop a product. Opportunity costs are always incremental.

Decision - Keep or Drop?

If incremental cost savings > incremental revenue lost	*If incremental revenue lost = incremental cost savings*	*If incremental cost savings < incremental revenue lost*
the segment should be dropped, unless qualitative characteristics fiercely impact the decision.	qualitative effects must be used to make the decision.	the segment should not be dropped, unless qualitative characteristics fiercely impact the decision.

Qualitative Factors

Qualitative factors related to keep or drop decisions often include considerations of employees that will be terminated if the product is dropped, the effect a lay off might have on employees that are not terminated, effects of suppliers from which the materials needed for the product will no longer be purchased, and the effect of customers who previously purchased the product being dropped.

Special Order Decisions[15]

Special order decisions focus on whether a special priced order should be accepted or rejected. These orders often can be attractive, especially when the firm is *operating below its maximum productive capacity.*

Price discrimination laws require that firms sell identical products at the *same price to competing customers* in the same market. This law does not apply to

- Noncompeting customers from the same market.
- Potential customers in markets not ordinarily served.

Special order decisions are based on incremental analysis. Incremental analysis enables managers to emphasis on the *relevant areas of a decision.*

Incremental Revenue

- **Incremental Revenues** are the additional revenues generated from accepting the special order. The revenue can result from additional sales of products or from providing services.
- If the company is operating at less than capacity, revenue of regular customers will not be affected.
- If the company is operating at capacity, it will have to give up some regular sales in order to provide the special order.

Incremental Costs

- **Incremental Costs** are the additional costs incurred from accepting a special order. Variable operating costs include special packing, commissions, and shipping costs.
- Most often, a firm's recurring fixed costs will remain the same in total if a special order is accepted.
- Occasionally the acceptance of a special order may cause additional fixed costs such as special purpose tool, Inspection Cost. In these cases, these additional fixed costs are relevant and should be considered in an incremental analysis.

Decision - Accept or Reject?

If incremental revenue < incremental cost	*If incremental revenue = incremental cost*	*If incremental revenue > incremental cost*
reject the special order, unless qualitative characteristics fiercely impact the decision.	qualitative effects must be used to make the decision.	accept the order, unless qualitative characteristics fiercely impact the decision.

Dangers of Concentrating Excessively on a Short-Run Time Horizon[16]

- It is vital that the information presented for decision-making relates to the appropriate time horizon.
- If inappropriate time horizons are selected there is a risk that misleading information will be presented.
- Long-term considerations should always be taken into account when special pricing decisions are being evaluated.
- The effect of accepting a series of successive special orders over several periods constitutes a long-term decision.
- If demand from normal business is considered to be permanently insufficient to utilize existing capacity, then a long-term capacity decision is required.
- This decision should be based on a comparison of the relevant revenues and costs arising from using the excess capacity for special orders with the capacity costs that can be eliminated if the capacity is reduced.

Product Mix Decision

Many times, the management has to take a decision whether to produce one product or another instead. Generally, decision is made on the basis of contribution of each product. Other things being the same the product which yields the *highest contribution* is best one to produce. But, if there is shortage or limited supply of certain other resources which may act as a key factor like for example, the machine hours, then the *contribution is linked with such a key factor for taking a decision.*

For example, in an undertaking the availability of machine capacity is limited and the machine hours required for one unit of the two products are different. In such cases the contribution is to be linked with the machine hour and the product which yields the *highest contribution per machine hour* is to be preferred for taking decision.

Sources / References:

1. *CIMA Article (Feb. 2010) by David Harris;*
2. *Cost Accounting: A Managerial Emphasis, 13/e by Charles T. Horngren, p275;*
3. *Managerial Accounting: An Introduction to Concepts, Methods and Uses by Michael W. Maher, Clyde P. Stickney, Roman L. Weil, p 362;*
4. *Performance Operations by Robert Scarlett, p119;*
5. *www.mcdonaldization.com/whatisit.shtml;*
6. *Costing and Pricing Public Sector Services: Essential Skills for the Public Sector (2011) by Jennifer Bean, Lascelles Hussey;*
7. *Management and Cost Accounting by Colin M. Drury;*
8. *Managerial Accounting: A Focus on Ethical Decision Making by Steve Jackson, Roby Sawyers, Greg Jenkins;*
9. *Cornerstones of Financial and Managerial Accounting (2011) by Jay Rich, Jeff Jones, Dan L. Heitger, Maryanne Mowen, Don Hansen, Standard Costing: A Managerial Control Tool, p 1020;*
10. *Accounting: An Introduction, 6/E by Peter Atrill, Eddie McLaney, David Harvey;*
11. *Accounting: Concepts and Applications by W. Albrecht, James Stice, Earl Stice, Monte Swain; Cost Management: A Strategic Emphasis by Blocher; Managerial Accounting, Hansen Mowen; Cost Accounting: A Managerial Emphasis, 13/e by Charles T. Horngren; Cost Management: Accounting and Control by Don Hansen, Maryanne Mowen, Liming Guan; Essentials of Modern Business Statistics with Microsoft Excel by David R. Anderson, Dennis J. Sweeney, Thomas A. Williams;*
12. *Managerial Accounting: The Cornerstone of Business Decision-Making by Maryanne M. Mowen, Don R. Hansen, Dan L. Heitger;*
13. *Financial & Managerial Accounting by Carl S. Warren, James M. Reeve, Jonathan Duchac;*
14. *Cost Management: Accounting and Control by Don Hansen, Maryanne Mowen, Liming Guan;*
15. *Managerial Accounting: The Cornerstone of Business Decision-Making by Maryanne M. Mowen, Don R. Hansen, Dan L. Heitger; http://www.unf.edu/;*
16. *Management Accounting for Business By Colin Drury*

- **For previous capsule, final students may refer November 2017 Journal.**
- **Intermediate students may also refer pages 17 to 20 of this capsule for quick reference of 'Cost Variance' formulae.**

Frameworks for Reporting to External Stakeholders about Sustainability and Value Creation: Global Trends

Framework for external reporting on sustainability and value creation

- Triple Bottom Line (sustainability)
- GRI (sustainability)
- Integrated Reporting Framework (sustainability through value creation)

Performance Reports

Background

Corporate Reporting is the platform used by organisations to provide information to its users about its business. Corporate Reporting is a useful tool to connect with *stakeholders,* external to the organisation because:

- Presentation of their business performance, in particular their financial performance, enables them to get access to equity, debt or other types of financing.
- By showcasing their performance, capabilities and strategy, these reports can assist organisations to negotiate with customers and suppliers.
- Showcasing their strong performance would assist them to recruit talented employees and retain them. Talented employees in turn are an asset that every company should nurture for future growth.

Therefore, corporate reporting is an important exercise that *goes beyond reporting past performance.* Instead, it is a very important tool to *present* the organisation's business and its *future* prospects. A widely read corporate report would be the annual report released each year by organisations. It has a plethora of vital information that is useful to assess an organisation's performance. Information contained here is largely focussed on financial performance, current year and of past years. At the same time, it also focusses on *management narratives* and *non-financial issues.*

Good quality corporate reporting helps an organisation demonstrate to its *stakeholders* its operational capabilities, take advantage of opportunities and its ability to manage risks due to changes in the business environment. To enable this understanding, the report should contain information that is concise, relevant and transparent. Importantly, the user must be able to connect information spread over many pages/ reports to get a complete understanding of the *business model.*

Many frameworks govern corporate reporting. Examples are Indian Accounting Standards (Ind AS), International Financial Reporting Standards (IFRS), disclosures under Companies Act 2013, SEBI Guidelines and Disclosures etc. All of them aim at full, accurate and timely disclosures of financial and relevant non-financial information.

In the recent past users of the corporate reports, felt that information, while available in sufficient detail, was scattered within different reports or sections of the annual report. It has been difficult to piece together relevant information to get complete information about the business.

In the recent past, human race has taken quantum leaps due to globalisation and changes in technology impacting daily life. There is also a highlighted concern about climate change and its impact. This has led to the following realisations:

- **Environmental impact:** Businesses utilise natural resources as inputs, convert them into outputs to make profits out this activity. So, businesses deplete natural resources to earn profits. Natural resources are limited in supply since nature cannot replenish the deleted resource at the same rate. **For example**, the resource that gets deplete faster than its replenishment rate is fossil fuel. Likewise, there are many other resources that get utilised without the sources being allowed renew itself. It might lead to scenarios where these resources may not be available to future generations. It could also affect the ability of the businesses to sustain in the long run. When these resources run out, organisations may have to close down unless they take corrective action now. So, there is an important realisation that **"Sustainability"** of the *environment* is critical for "sustainability" of *organisation.* An organisation should try to reduce its "ecological footprint" **for example** minimise "carbon footprint" generated by its activities. It should avoid wastage of natural resources in business operations. Develop CSR activities that can nurture the natural resource, like use renewable energy, recycling waste, rehabilitation of mines from which mining activities are done, rehabilitation of wildlife, fisheries etc.
- **Societal impact:** Business operations impact the lives of the employees that work with them as well as the society in large. Organisations have to be socially responsible. Exploitation of workforce through long work hours, low wages, child labour etc. are examples of unethical business practices that should cease. If businesses can impact the community it influences through corporate social responsibility programs, it will improve the quality of life for such communities. CSR programs help in building healthier communities, this nurtures talent.
- **Economic impact:** For profit organisations have their main objective to deliver financial returns to their investors. While profit is important, it is crucial for organisations to ensure that profit objective does not negatively impact the environment or society. The *investing community* has become more sensitive to these issues and wants transparency about how the organisation creates **"value"**.

To address this change in investor mindset, a number of initiatives to develop useful, transparent corporate reporting was undertaken that has culminated in development of few Frameworks that organisations can use to report about their activities in relation to sustainability and value creation. Organisations can choose to present their information using any of the following frameworks:

1. **Triple Bottom Line (TBL report).** As explained earlier, traditional accounting systems had a restricted view limited to the financial performance of the organisation. This concept expands this view to include the impact of business on environment and society as well. The 3Ps draws the organisation's attention to not just "Profit" motive but also to nurturing "Planet" and "People" towards a sustainable future.
2. **Global Reporting Initiative report (GRI report)** as per the GRI Guidelines issued by an independent institute called GRI whose mission is to develop and disseminate globally acceptable *sustainability reporting guidelines.*
3. **Integrated Report <IR>** as per the Integrated Reporting Framework laid out by the International Integrated Reporting Council (IIRC). It provides the providers of 'capital' with a holistic view of the *organisation's value creation process.*

Triple Bottom Line Reporting

British business author John Brett Elkington in year 1994 coined the term TBL. But the origin of concept actually lies in Brundtland report by World Commission on Environment and Development, (now known as Brundtland Commission) published in year 1987, in which **Sustainable Development** is explained as is *"development that meets the needs of the present without compromising the ability of future generations to meet their own needs".* It is also important here to note that United Nations Conference on Environment and Development taken place in year 1992, gave stress on sustainable development.

As mentioned earlier **every business needs to be sustainable rather only profitable**.

But what comes to mind is:

→ When can a business be called sustainable?

→ The obvious answer is when management makes sustainable business decisions.

Hence, the real question is:

→ When does a business decision become sustainable? How does one measure the performance of business decisions in terms of sustainability?

Answer lies in TBL i.e. **Triple Bottom Line.**

Triple bottom line

To measure the performance of business decisions in economic terms we consider only one bottom line i.e. profit, but to consider sustainability of business decisions, there are three bottom lines i.e. **People, Planet** and **Profit** (also known as dimensions of TBL).

TBL truly extends the scope of traditional accountancy, and transforms it into modern day **sustainability reporting** (which is beyond financial reporting because it considers *social* and *environmental performance* too). Some organisations even have separate business sustainability reporting system and they apply the standard of sustainability reporting pronounced by **Global Reporting Initiative**, which is the independent, international organisation that helps businesses and other organisations take responsibility for their impacts, by providing them with the global common framework (standards) to report those impacts.

Dimension (sets) of TBL

- **Planet** – *the environmental bottom line* measures the impact on resources, such as air, water, ground and emissions to determine the *environment impact* and *ecological footprints*.
- **People** – *the social equity bottom line* relates to corporate governance, motivation, incentives, health and safety, human capital development, human rights and ethical behaviour.
- **Profit** – *the economic bottom line* refers to measures maintaining or improving the company's success in term of adding value to shareholders.

A **sustainable decision** is one which is acceptable from the aspect of each bottom line.

TBL believes in a *stakeholder approach* rather than a shareholder approach. TBL implies that businesses must consider the full cost, hence becoming a substitute to **full cost accounting** with even wider perspectives.

TBL can be used to encourage each division and manager within the organisation to act in a responsible manner from holistic perspective.

Global Reporting Initiative (GRI)

Global Reporting Initiative (GRI) is an independent organisation that is working at promoting the use of globally applicable reporting standards. They are promoting the GRI Standards that promote transparency and accountability on sustainable development **by reporting** on *economic, environmental* and *social issues*. They have a range of partners who believe in their vision that include governments and various donor foundations.

Need for "Global Reporting Initiative"

The Framework has been developed to encourage organisations across the world to report on how their business activities are impacting "Economic, Environmental and Social" sustainability. The **need for standardised reporting globally** is that users can compare reports of different organisations to identify the ones that are more sustainable to these three aspects – *economy, environment* and *social*. Sustainability is important to leave behind a conducive environment and healthy society for our future generations.

Global Reporting Standards

A Sustainability Report prepared as per GRI Framework is used by organisations to report their impact on the economy, environment and society. Impact includes both *positive* and *negative* matters. Users can then be better informed about the risks and opportunities that the organisation faces.

The degree to which the GRI Standards have been applied gives an organisation the choice to prepare the report as per:

i) **Core Option :** indicates that the report has *minimum information* needed to understand the organisation, material topics and related impacts and how they are managed.

or

(ii) **Comprehensive Option:** In addition to information that comes under the "core option", it has *additional disclosures* regarding an organisation's strategy, ethics and integrity. The report should have extensive discussion about the material topics and related impacts.

The report has to clearly state that it is "in accordance" with Core Option or Comprehensive Option.

Thus, Core Option has less details than Comprehensive Option.

Organisations can also prepare **"GRI referenced" report** when it wants to report on specific economic, environmental or social impact as per selected standards but is not looking to provide a full report as per the GRI Standards. Include specific reference to which standard or section has been used.

An overview of the GRI Standards are:

Universal Standards

3 Universal Standards are applicable to all organisations.

(1) **GRI 101 – Foundation**, starting point for using GRI Standards. It contains the Reporting Principles that define the *report content* and *quality*.

Reporting Principles for 'Report Content' include: Stakeholder Inclusiveness, Sustainability Context, Materiality and Completeness.

Reporting Principles for 'Report Quality' include: Accuracy, Balance (positive and negative impacts), Clarity, Comparability, Reliability and Timeliness.

GRI 101 is used to identify *material matters* related to the economy, environment and society. The organisation will then use the topic specific standards to report on them.

(2) **GRI 102 – General Disclosures,** to report contextual information about an organisation. Information related to"
   (a) organisation's profile,
   (b) strategy,
   (c) ethics and integrity,
   (d) governance,
   (e) reporting process, and
   (f) stakeholder engagement process are reported here.

(3) **GRI 103 – Management Approach,** to report management's approach to material matters. It discusses *why a matter is material*, where is the impact and how is the organisation managing the impact. Management Approach will include the policies, goals, responsibilities, resources, grievance methods, specific actions related to the material topic.

Topic Specific Standards

Circumstances unique to each organisation's business operations will determine what to report under the Topic Specific Standards.

Below is a summary of the discussions that happen under each category covered under the Topic Specific Standards.

Under each of the sub-topics under the economic, environmental and social categories, the report should include discussion about management's approach disclosures, topic specific disclosures or both.

This list is only for the student's reference to help them understand the content of the report better.

The below standards will apply to all reports published on or after **July 1, 2018** except GRI 207, GRI 303 and GRI 403 w.e.f. Jan 2021 and GRI 306 w.e.f. Jan 2022.

(A) GRI 200 – Economic	
201: Economic Performance	• Direct economic value generated and distributed • Financial implications and other risks and opportunities due to climate change • Defined benefit plan obligations and other retirement plans • Financial assistance received from the government.
202: Market Presence	• Ratios of standard entry level wage by gender compared to local minimum wage • Proportion of senior management hired from the local community
203: Indirect Economic Impacts	• Infrastructure investments and services supported • Significant indirect economic impacts
204: Procurement Practices	• Proportion of spending on local suppliers
205: Anti-corruption	• Operations assessed for risks related to corruption • Communication and training about anti-corruption policies and procedures • Confirmed incidents of corruption and actions taken
206: Anti-competitive behaviour	• Legal actions for anti-competitive behaviour, anti-trust, and monopoly practices
207: Tax	• Approach to tax • Tax governance, control, and risk management • Stakeholder engagement and management of concerns related to tax • Country-by-country reporting
(B) GRI 300 – Environmental	
301: Material	• Materials used by weight or volume • Recycled input materials used • Reclaimed products and their packaging materials
302: Energy	• Energy consumption within the organisation • Energy consumption outside of the organisation • Energy intensity • Reduction of energy consumption • Reductions in energy requirements of products and services
303: Water and Effluents	• Interactions with water as a shared resource • Management of water discharge related impacts • Water withdrawal • Water discharge • Water consumption
304: Biodiversity	• Operational sites owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas • Significant impacts of activities, products, and services on biodiversity • Habitats protected or restored • IUCN Red List species and national conservation list species with habitats in areas affected by operations
305: Emissions	• Direct (Scope 1) GHG emissions • Energy indirect (Scope 2) GHG emissions • Other indirect (Scope 3) GHG emissions • GHG emissions intensity • Reduction of GHG emissions • Emissions of ozone-depleting substances (ODS) • Nitrogen oxides (NOX), sulfur oxides (SOX), and other significant air emissions
306: Waste	• Waste generation and significant waste related impacts • Management of significant waste related impacts • Waste generated • Waste diverted from disposal • Waste directed to disposal
307: Environment Compliance	• Non-compliance with environmental laws and regulations
308: Supplier Environmental Assessment	• New suppliers that were screened using environmental criteria • Negative environmental impacts in the supply chain and actions taken
(C) GRI 400 – Social	
401: Employment	• New employee hires and employee turnover • Benefits provided to full-time employees that are not provided to temporary or part-time employees • Parental leave
402: Labor / Management Relations	• Minimum notice periods regarding operational changes
403: Occupational Health and Safety	• Occupational health and safety management system • Hazard identification, risk assessment, and incident investigation • Occupational health services • Worker participation, consultation, and communication on occupational health and safety • Worker training on occupational health and safety • Promotion of worker health • Prevention and mitigation of occupational health and safety impacts directly linked by business relationships • Workers covered by an occupational health and safety management system • Work-related injuries • Work-related ill health
404: Training and Education	• Average hours of training per year per employee • Programs for upgrading employee skills and transition assistance programs • Percentage of employees receiving regular performance and career development reviews
405: Diversity and Equal Opportunity	• Diversity of governance bodies and employees • Ratio of basic salary and remuneration of women to men
406: Non-Discrimination	• Incidents of discrimination and corrective actions taken
407: Freedom of Association and Collective Bargaining	• Operations and suppliers in which the right to freedom of association and collective bargaining may be at risk
408: Child Labour	• Operations and suppliers at significant risk for incidents of child labour
409: Forced and Compulsory Labour	• Operations and suppliers at significant risk for incidents of forced or compulsory labour
410: Security Practices	• Security personnel trained in human rights policies or procedures
411: Rights of Indigenous People	• Incidents of violations involving rights of indigenous peoples
412: Human Rights Assessment	• Operations that have been subject to human rights reviews or impact assessments • Employee training on human rights policies or procedures • Significant investment agreements and contracts that include human rights clauses or that underwent human rights screening
413: Local Communities	• Operations with local community engagement, impact assessments, and development programs • Operations with significant actual and potential negative impacts on local communities
414: Supplier Social Assessment	• New suppliers that were screened using social criteria • Negative social impacts in the supply chain and actions taken
415: Public Policy	• Political contributions
416: Customer Health and Safety	• Assessment of the health and safety impacts of product • Incidents of non-compliance concerning the health and safety impacts of products and services
417: Marketing and Labelling	• Requirements for product and service information and labelling • Incidents of non-compliance concerning product and service information and labelling • Incidents of non-compliance concerning marketing communications
418: Customer Privacy	• Substantiated complaints concerning breaches of customer privacy and losses of customer data
419: Socio Economic Compliance	• Non-compliance with laws and regulations in the social and economic area

Source: https://www.globalreporting.org/standards/gri-standards-download-center/?g=9c1bfe70-c407-4c4b-9139-04d64d5ba335

Integrated Reporting

This article is based on the International <IR> Framework (Dec'2013). The International Integrated Reporting Council (IIRC) has published on 19 Jan'2021 revisions to the International <IR> Framework, originally released in 2013, to enable more decision-useful reporting. This latest version applies to reporting periods commencing 1 January 2022.

Integrated Reporting Framework and the Integrated Report

The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession, academia, NGOs. IIRC's long-term vision is to promote "integrated thinking" that will result in efficient allocation of capital, that enable financial stability and sustainability. Integrated thinking takes into account the *inter-relationships* between its various functional and operating units and **"the capital"** that the organisation uses. As explained later, the term "capital" is not restricted to financial capital alone but is defined to include a wider variety of resources / enablers that support the *value creation* process of a business. This "integrated thinking" is facilitated by presenting the "Integrated Report" (<IR>).

Need for "Integrated Thinking"

Impact of *"intangibles"* to the business model: Traditionally assets of an organisation have been tangible assets, that have been reported within the financial statements. Intangibles have also been recognised, pegged a monetary value and reflected in the financial statements. The tangible assets have traditionally formed major part of the assets side of the balance sheet. This worked well as long as value created by business was more internally driven. "Internally driven" implies that business being less impacted by the changes in the external environment in which it operates. Examples of which could include: its ability to get raw materials directly from the source rather than depending on suppliers, business reach being more regional rather than having national or globalised reach, labour force creating products being majorly semi-skilled therefore easily replaceable etc. However, due to globalisation many businesses have become national /international players rather than being limited to being regional in scope. Due to outsourcing of business processes, the supply chain of organisations has changed. An organisation is now dependent on other organisations for its materials, labour, IT systems etc. Use of technology within the business many times becomes a game changer driving value for the business. (e. g.) Online sales versus brick and mortar outlets). The service sector has seen tremendous boom in development (e.g. IT industry, banking). Consequently, human capital has become more skilled, so talented employees have become a critical value driver of business.

To summarise, *during the last two decades, every organisation has become inter-dependent on other organisations and the external environment to conduct its business. Businesses have become dependent on relationships with suppliers /customers /government agencies, natural resources, human capital, infrastructure and technology. These relationships and interactions are intangibles, that cannot be strictly quantified and reflected in the balance sheet. These can be looked upon as "capitals" beyond the regular financial capital of the balance sheet. This aspect cannot be immediately perceived by the users of corporate reports unless they are informed about it. However, this interdependency is very critical for an organization to function.* **For example,** if it runs out of a particular natural resource with which it makes products, then this could impact business. (World is facing shortage of 'Silica' which is used in innumerable industries like electronics, construction. The other natural resources in short supply are energy giving fossil fuels and water.) Likewise, only talented employees can deliver on attaining strategic objectives, therefore talent has to be groomed. In the modern world innovation is the key to success, something that can be driven only by motivated, talented employees.

Therefore, the need to have a narrative in the form of an Integrated Report <IR> that spells out how an organisation can manage, preserve and grow /deplete these "capitals". Information about managing these capitals has become paramount to assess business performance, stability and sustainability.

Definition of Integrated Report <IR>

An Integrated Report <IR> can be defined as: *"An integrated report is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term".*

Source: https://integratedreporting.org/resource/international-ir-framework/

Objectives of Integrated Report

Information presented in an integrated or connected manner can enable the user to understand the following:

- The *various types of capitals* (defined later), in addition to financial capital that the organisation uses to create value. Understand their *interdependencies*, including *trade-offs* between them.
- Capacity of the organisation to respond to various *stakeholder's legitimate needs* and *interests*. Stakeholders here include not just the providers of financial capital, but includes customers, suppliers, local communities, government authorities, employees and any other interested party.
- Ability of the organisation to *respond to changes in the external environment* towards both risks and opportunities.
- Promotes understanding of the organisation's *business model*, its *activities, performance* (financial and non-financial metrics) outcome over a period of time – past, present and future. Traditional corporate reporting has primarily presented historic (past) information.
  <IR> is a *more future oriented report* that focusses on how an organisation's strategy can be aligned to the external environment.
- Enables accountability and stewardship for the different types of capital (financial, manufactured, human, intellectual, natural, social and relationship). An organisation can create value only when it is able to develop the interest of its key stakeholders, broadly contained within the various "capitals".
- *Disclosure about* how the organisation is working towards *maintaining its capital* in the report can serve as a tool for better corporate governance.
- Supports integrated thinking that can enable better decision making to *create value* over short, medium and long term time horizons.

In India SEBI has mandated the reporting of "Business Responsibility Report" (BRR) for the top 500 listed companies. For the year 2017-18 they may voluntarily adopt "Integrated Reporting" and include it in the annual report. Alternatively, they may present this separately on their website and give reference to it in the annual report.

Integrated Framework as prescribed by IIRC

The <IR> should be prepared in accordance with the Integrated Framework laid out by IIRC. The Framework provides Guiding Principles and Content Elements that can be referred to while preparing the <IR>. The Framework ***does not prescribe*** any specific KPI metrics or measurement methods or about the disclosure of individual matters. It is left to the judgement of the preparers of the report to decide on the content based on the case-specific scenario of each organisation. Points to consider while preparing an Integrated Report:

- Preparers must use judgement about *materiality* of a matter under consideration to determine its inclusion in the report.
- Preparers must use judgement about *manner of disclosure* of matters including the basis for measurement, disclosure methods as found appropriate.
- If information presented in the <IR> is similar to information presented elsewhere, then the content in the <IR> should be prepared on the basis or should be *reconciled with the information presented elsewhere.*
- It may be prepared in compliance with *governing regulations.*
- <IR> aims at explaining how an organisation creates value over time. The report can contain *quantitative* and *qualitative information* to explain this. It is more than just a summary of other communication that an organisation publishes. It makes explicit connectivity of how value is created by an organisation.
- It may either be a standalone report or be included as a distinguishable part of another report (example an annual report). It has to be *clearly identified* as an <IR>.
- Those charged with governance should *acknowledge* the (i) integrity of the information in the report (ii) that the report was prepared by seeking their opinion and (iii) an opinion as to whether the report is in accordance with the Framework.

Users of <IR> would primarily be those who provide financial capital to the organisation. However, there may be interested parties like suppliers, customers, employees, business partners, local communities, regulators, legislators and policy makers who may also want to understand <IR>.

Fundamental Concepts related to the Integrated Report

Value creation for the organisation and for others

The integrated report provides *qualitative* and *quantitative disclosures* about how the organisation creates, diminishes or preserves value.

Value created for the organisation itself enables financial returns to the providers of financial capital.

Value created for others is also of interest to the providers of financial capital. Notably it must be understood that:

- Value is influenced by *external environment*.
- Value is created through *relationships with stakeholders*, internal and external. Internal factors like management and operations, employees, licenses, patents, financial stability of the organisation. External factors that impact value creation are suppliers, customers, prevailing economic conditions, government policies etc. Together they can enhance /deter /preserve the value created by the organisation.
- Value creation is *subjective* and changes based on the perspective of each stakeholder. **Example** could be: A good employer may not be very profitable. Therefore, while the employee may be satisfied with the value an organisation provides them, but if the target financial metrics are not met, the investors may not be satisfied with the value an organisation provides them.

Value creation is *not an independent activity* within the organisation's sole control. **Value is created using capital**. In integrated reporting, capital is not limited to just financial capital. There are six different categories: *financial, manufactured, human, natural, intellectual, social and relationship* capitals (details are covered later). A combined effect of these capital is what results in *value creation* for the company.

The ability of an organisation to create value is linked to the value it creates for others. This happens through a wide range of activities, interactions and relationships. **Example:**

Sales to customers will change financial capital. This is reflected in the financial statements. At the same times, after sales support interactions handled by after-sales personnel (human capital) can impact customer satisfaction (social capital). Customer satisfaction will determine their willingness to give more business to the organisation in future (developing a relationship). Any material issues with customer satisfaction like harmful content detected while consuming product that has resulted in causalities, faulty technology leading to product recalls will have to be disclosed and discussed in the Integrated Report. Positive instances like superior technology (intellectual capital) enhancing customer satisfaction can also be discussed.

Another instance would be willingness of key suppliers to trade with the organisation and the terms and conditions of these agreements. Suppose there is a case of vendor lock-in, where the organisation has to be dependent on one particular supplier and is unable to switch to other suppliers without substantial switching costs. This may be disclosed and discussed to make the users aware of potential risks to business. Likewise highlighting positive instances where long term procurement agreements will improve business operations and product quality can also be disclosed in the report.

Therefore, the play of activities, interactions and relationship are building blocks for the value chain. *An organisation's strategy, leadership and culture are internal factors that need to be aligned with the external environment in which the business operates*. The business model should promote development of all stakeholders in order to sustain in the long run. Therefore, by *disclosing issues that are relevant to stakeholders*, an organisation can align itself better to promote *mutual development*. It will also give the user insight about the building blocks in the value creation process. <IR> thus serves as a tool to make the organisation align towards its own *financial stability* and *sustainability* and *better corporate governance*. Capital allocation can then be streamlined to support activities that would enable sustainability and stability of the organisation.

The Framework also includes scenarios where there may have been **no change in the value or that the value of the company is preserved**. Scenarios when value preservation may need to be discussed would be:

(i) **Businesses being merged and acquired.** Generally the "value creation" of an acquired /merged business *does not happen immediately*. In reality, integration of two businesses is challenging due to *operational* and *organisational cultural differences*. So in reality, although the deal may be closed, the "value creation" from the acquired business is deferred. Here, the management may wish to point out the steps it wishes to take to steer the business integration so that it creates value in the long run. This could include measures to stabilise the acquired business. Discussion could centre around how the experience of the top management (strategic initiative) will enable the management at the operational level (tactical initiatives) to have seamless integration. These are steps taken by an organisation to **"preserve value".**

This discussion may be needed in order to reassure the providers of finance that the management has a clear road map on how to manage the "business /value acquired" so that it generated sustainable value in the long run. Others such as employees of the company may also be interested in the management's outlook.

(ii) **Debt Restructuring:** Challenges faced by an organisation may lead to situations where there is a cash flow crunch in operations. This may hinder it from meeting its debt obligations. If fresh capital investments cannot be infused, the organisation may go for debt restructuring. It negotiates with the bank to draw up a better scheme of arrangement that can enable it to meet its obligations. Such instances put concerns about the organisation's liquidity on various stakeholders like investors, bankers, suppliers, employee union, government who would be anxious if the organisation would be able to meet its obligations.

A discussion by the management on the road map that the organisation plans to follow to improve its solvency would highlight the risks that the organisation faces. Accordingly, the stakeholders can make informed judgements about the organisation's value.

The report should also take into consideration the effects of business operations that have been **"externalised". For example,** smoke emission from the factory does not impact the organisation directly. However, the impact is felt in the form of air pollution in the city. Similarly, waste dumped in landfill does not impact the organisation but does impact the city living conditions. These are impacts that are externalised. Where judged ***material*** they need to be discussed in the report. Providers of financial capital may need to be aware of material information of these externalities to assess their effects.

Example, *externality could negatively impact business:* Chennai city faced severe drinking water supply the summer of 2019. The crisis impacted normal life for many months. Many IT firms had to request their employees to work from home since they could not provide water facilities at office. If unprepared, this crisis could have disrupted business for some of these firms.

Do You Know?

The Business Roundtable (BRT) is an association of CEO's of America's top companies. These CEO members lead companies with more than 15 million employees and more than $7 trillion in annual revenues. The BRT released an updated statement on the **'Purpose of a Corporation'** in Aug' 2019. The statement stated a fundamental commitment to ***all stakeholders***- customers, employees, suppliers, communities and shareholders; representing a move away from the long-standing view that shareholder profit is the only purpose of corporations. The statement received support from 181 CEOs, including the leaders of Abbott, Accenture, Amazon, Apple, American Airlines, American Express, Bank of America, Boston Consulting Group, Citigroup, The Coca-Cola Company, Cognizant, Dell, Procter & Gamble and Walmart.

The Capitals – Financial, Manufactured, Human, Intellectual, Natural, Social and Relationship

Capitals are the stocks of value change through activities and outputs of an organisation. **For example,** financial capital increases when profit is made, human resource capital improves when employees are better trained. Overall Value of stock of capital keeps changing. One type of capital can be transformed into another, so there is constant flow between the capital. **For example,** (i) New equipment purchased increases manufactured capital while decreasing financial capital or (ii) talented employees (human resource capital) have developed a patent for a component (intellectual capital) that increases the product's sales, thus profits (financial capital) or (iii) a school is built for local community children to study in (societal and relationship with the outflow of financial capital).

Categories and descriptions of capitals

(1) **Financial Capital:** Refers to the conventional "monetary" capital. It is generated through financing (either in the form of equity or debt), investments and surplus generated from business operations. *Businesses use this pool of funds to create value by transforming it into other forms of capital like manufactured, intellectual, people, environmental, social and relationship capitals.*

(2) **Manufactured Capital:** The "physical infrastructure" needed to manufacture a product or provide service. These are manufactured physical objects (as against natural physical objects like lakes and mountains). **Examples**, machinery, building, infrastructure such as roads, bridges or even inventory held for sale / captive consumption.

(3) **Intellectual Capital:** These are resources that are critical to value creation. **Examples,** of intellectual property are patents, copyrights, software, licenses, brand value.

(4) **Human Capital:** The combined know-how, skill, effort and experience of the workforce of an organisation forms its human capital. A motivated workforce can enable the organisation to achieve its objectives. To derive this mutual benefit, their work should be aligned with the organisation's governance framework, risk management approach, ethical values. They also need to understand the organisation's strategy and develop and implement it. To retain the work force loyalty, an organisation has to groom talent and the leadership team.

(5) **Social and Relationship Capital:** An organisation has multiple stakeholders, direct and indirect, internal and external to the organisation. They include customers, vendors, suppliers, associates, alliances, dealers, sales network, government, regulatory authorities, communities and society.

Social and Relationship capital refers to:

a. The *shared norms, common value* and *behaviour stakeholders* may have with the organisation. **For example**, both the organisation and supplier may value not to employ child labour, value safe working environment for employees etc. An organisation may take due diligence while doing business with a supplier to ensure that these norms are met.

b. Key stakeholder *relationships* and the *trust* and *willingness* an organisation has built with external stakeholders. Trust must be earned but can be easily lost. Therefore, an organisation must strive to build trust be it with customers, suppliers or regulatory authorities. **For example,** timely settlement of suppliers' dues will build strong relationships. This will contribute positively because they will be more willing to engage with the organisation while doing business.

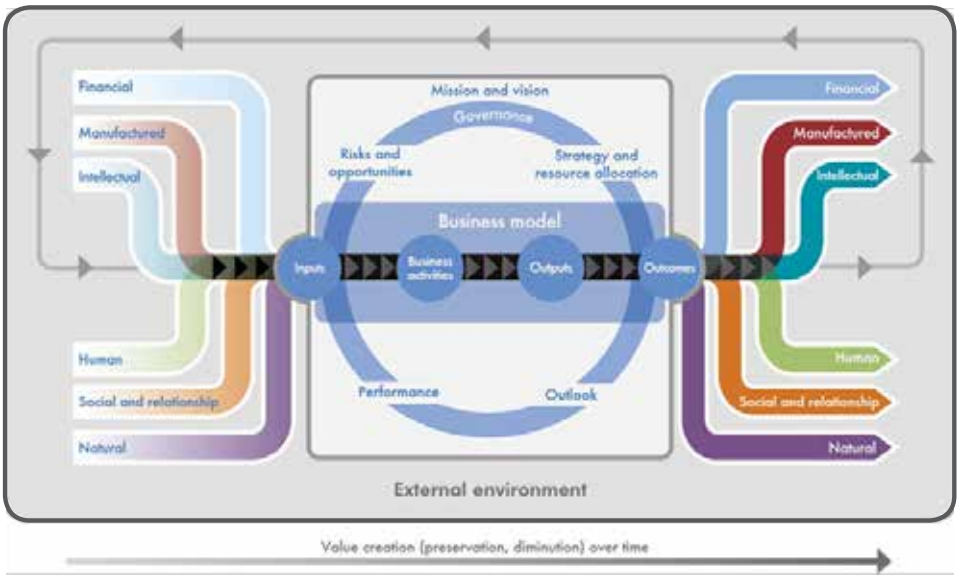
c. Relationship is built on the *brand* and *reputation* that the organisation has developed. **For example,** the trust that the customer places on the organisation while consuming products manufactured by it, with the belief that it is not detrimental to the users' health. This trust and willingness of the customer forms the very basis of brand loyalty, value that the organisation has to maintain.

d. An organisation's *social license* to operate: Social license is the acceptance of an organisation's business practices by its employees, stakeholders and larger public. An organisation has to work to build trust within itself and with the external environment it operates in. Closely linked to the **Triple Bottom Line** concept, it should take care of its employees, the environment and corporate social responsibility. Any issue that arises that can erode this social license should be quickly resolved.

The management may discuss any material matters relating to its social and relationship capital like the *corporate social responsibility* initiatives that it has undertaken. Any issue that can threaten social license to operate may also be addressed here.

(6) **Natural Capital:** Renewable and non-renewable natural resources that an organisation uses for its business operations. These would be land, water, air, fossil fuel etc. Certain industries for example those in the agriculture and mining industries are highly dependent on natural resources for their business. Proper utilisation and maintenance of these resources can determine the future sustainability of the organisation.

Not all capitals are equally relevant or applicable in all organisations. However, the Framework provides this guideline so that no aspect of the "value chain" is overlooked.



Source : https://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf

Value Creation Process

The business model of an organisation uses capitals as inputs and through various business activities converts them as outputs (products or service). The organisation's activities and its outputs lead to outcomes in terms of their effects on the capital. *Nurturing capital* in terms of its availability, quality and affordability in order to sustain business in the long run. **For example,** if a company's food product (activity leading to output) causes health issues like diabetes or obesity to the consumers (affects the society and relationship capital), in the long run the public will avoid its products. This can impact *business sustainability*. Therefore, the company has to change its strategy to additionally provide healthy offerings so that consumers have a choice about the food they want to consume. This change can nurture both customer satisfaction and public health to promote business stability and sustainability. Therefore, business models need to be *flexible* to adapt to changes internal and external.

Preparation and Presentation of the Integrated Report

An <IR> is prepared with the help of Guiding Principles and Content Elements, preparers of the report can refer to Guiding Principles to understand the concepts that underpin the preparation and presentation of the report. They can refer to Content Elements to understand to understand what the report should include. These are not water-tight guidelines. Preparers must *exercise judgement to* decide on these matters while preparing the report.

Guiding Principles of the Integrated Report

1. **Strategic focus and future orientation:** The report has to provide *insight into the organisation's strategy* and *enumerate how it can create value* in the short, medium and long term time horizons. It might want to **highlight** significant risks, opportunities and dependencies flowing from the organisation's market position and business model. The management has to clearly articulate about the continued availability, quality and affordability of *significant capitals* relevant to the organisation's business since only when capital is nurtured, it will help sustain business in future. They may provide their opinion about learnings from past experiences that have influenced future directions, relationship between past and future performance and factors that can change them.
2. **Connectivity of information :** The usefulness of the <IR> is enhanced when it is *logically structured, presented in an understandable yet concise way*. Information has to be clearly delineated but linked together to present a holistic picture of business model and value creation process. The Content Elements (subject matter of the report) should have a *clear narrative* that helps conjure a total picture of dynamic and systemic interactions of the organization's activities. Connectivity of information could talk about the flexibility and ability of the organisation's strategy to help the business model adapt to changes within and to the external environment. *Qualitative, Quantitative* and *KPI metrics* information can be used in the narrative to connect information.
3. **Stakeholder relationships :** An effective <IR> report would be transparent in providing *accountability to key stakeholders by their disclosing legitimate needs and interests.* Accountability places the organisation in the role of stewardship to take care of the value creating capitals. Engagement with stakeholders like suppliers, consumers and employees would happen in the regular course of business. In some cases, engagement with local communities or regulatory authorities, NGOs may happen in special circumstances. An organisation has to understand their information needs and concerns. Needs and concerns that are *material* may be discussed in the <IR> along with the actions and decisions the organisations have taken to address them. Thus <IR> could serve as a *tool to build trust and resilience between the organisation and its stakeholders*.
4. **Materiality :** *A matter related to value creation is material when its known or potential impact on the organisation's value creation ability is significant and important.* While exercising judgement about the magnitude of the effect it should be noted that it can be both quantitative or qualitative, financial or non-financial, internal or external to the organisation and relate to different time frames (short, medium or long). Disclosure of material matters requires *judgement*, an ability to think from different perspectives. This can be developed with regular engagement with the providers of capital and other stakeholders.
5. **Conciseness :** The information should be presented in a *logical structure, avoiding repetition* and *clearly cross-linked* within the report to establish connectivity of information. The narrative should be written in *lucid language* that is easy to understand.
6. **Reliability and completeness :** Information presented should include both *positive* and *negative matters* to make the report complete. Information should be without material error to enhance its reliability.
7. **Consistency and comparability:** Information presented should be *consistently* prepared over time. Any change in compilation or measurement of information should be disclosed. **Tools** such as *industry benchmarks*, presenting information in the form of ratios or comparing standard quantitative indicators enables users to compare the report with that of other organisations.

Content Elements of the Integrated Report

The content of an organisation's Integrated Report would vary depending on the *individual circumstances of each organisation*. Therefore, Content Elements are stated in the form of questions rather than of checklists of specific disclosures. **Judgements need to be made** to decide on what to report on using the Integrated Reporting Framework as a reference. Questions can be posed for each of the categories of Content Elements below:

1. **Organisational overview and external environment**
   - What is the Vision and Mission of the organisation?
   - What is the ownership structure, its culture, ethics, values?
   - What are the principal activities and markets?
   - What is the competitive landscape, the organisation's position in the value chain?
   - Significant legal, social, environmental, political, commercial aspects from the external environment in which the organisation operates may also be discussed.
   - Key quantitative information may be presented here.
2. **Governance**
   - How does an organisation's governance structure influence value?
   - What are the skills and experience of those charged with governance? Actions they take to influence and monitor the strategic direction of the company.
   - Processes in place to make strategic decisions and its implementation.
   - How are remuneration and compensation linked to value creation?
   - These are some of the discussions that can be laid out in this section.
3. **Business model**
   - A business model with the help of business activities transforms inputs into outcomes or outputs that fulfill the organisation's strategic objectives.
   - The report has to enumerate what constitutes inputs, business activities, outputs and outcomes.
   - There can be a pictorial representation of the model along with an explanatory narrative.
   - Connection with other Content Elements like strategy, risk and opportunities, performance (financials and KPIs).
4. **Risks and opportunities**
   - Specific risks and opportunities that affect the organisation's ability to create value.
   - How is the organisation dealing with them?
   - Address the continued availability, quality and affordability of capital.
   - Disclosure about the likelihood of occurrence of the perceived risk and opportunity.
   - Discuss specific steps to mitigate risk or to create value from opportunities.

- Where a particular risk can threaten the fundamental ability of the organisation to create value, it needs to be reported even if the likelihood of occurrence is small.

5. **Strategy and resource allocation**
   - Identification of short, medium and long term strategic objectives.
   - Resource allocation the organisation has planned to achieve the objectives.
   - Link the strategic objectives with resource allocation plans, ability to adapt to change in the external environment.
   - Discussion about what gives the organisation its competitive advantage: innovation, development and use of intellectual capital, environmental and social considerations that give it the competitive edge.
6. **Performance**
   - The report may contain qualitative and quantitative information about the performance of the organisation.
   - Include quantitative indicators comparing actual performance with targets explaining their significance and importance.
   - Include a narrative of the organisation's effects (both positive and negative), connecting financial performance with regard to other capital.
7. **Outlook**
   - Report can discuss the changes the organisation can expect in the external environment.
   - How is the organisation equipped to respond to critical risks and uncertainties that can arise?
8. **Basis of preparation and presentation**
   - The report should disclose how the report was prepared.
   - The basis for determining materiality, reporting boundary, summary of significant framework and methods.

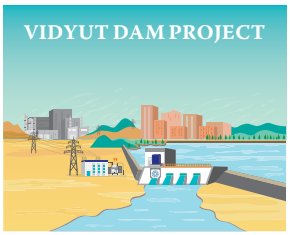
Conclusion

Investors well informed about the organisation's business operations can take *mature decisions* that will improve the financial environment and the economy as a whole. Organisations that are profitable, by taking along their stakeholders in their success stories, will always be rewarded. Also, organisations that talk about the risks the business faces improve transparency of corporate report. ***With multiple scandals rocking the investment world, there is a need to improve the integrity of corporate reporting. The Integrated Report aims to fulfill that needs.***

Case Study

The basic objective of the case study is to allow the students to apply ideas and insights from theory to the *real life issues* and *problems*.

Case Study - Triple Bottom Line



A preliminary investigation for the **Vidyut Dam Project** was completed in 1962 in a South-Asian country (here-in-after referred as country) and its design was completed in 1973 with a 600 MW capacity power plant. Construction began in 1979, but was delayed due to economic, environmental and social impacts. In year 1987, technical and financial assistance was provided by the neighbouring country to said country after signing of MoU, but this was interrupted just a year later with political instability. Hence, said country was forced to take control of the project and at the first, it was placed under the direction of the irrigation department of concerned home state of said country. However, in July 1989 the Vidyut Hydro Development Corporation Limited (VHDCL) was formed to manage 1,900 MW Vidyut Hydro Power Complex; wherein 75% stake held by union government and remaining 25% stake by concerned home state government. The 1,900 MW **Vidyut Hydro Power Complex comprises of Vidyut Dam and 1,000 MW Vidyut Hydro Power Plant (250MW×4)**, Beejuree HEP (400 MW), and Vidyut PSP (500 MW).

The **Vidyut Dam** is a 260.61 m (855 ft) multi-purpose high rock and earth-fill embankment dam on the Karaka River near Chapala town. Its length is 574.85 m (1,886 ft), crest width 20.11 m (66 ft), and base width 1,128.06 m (3,701 ft). The dam creates a reservoir of 4.0 cubic kilometres (~32,00,000 acre ft).

The **1,000 MW Vidyut Hydro Power Plant** (Vidyut HPP) was ***commissioned*** in 2007-08 as a multipurpose project, with variable speed features which can optimise the round trip efficiency under varying water levels in its reservoirs. Power is distributed to 10 northern states (including concerned home state) of said country. The complex will afford irrigation to an area of 2,71,139 hectares (=6,70,000 acres), irrigation stabilisation to an area of 6,07,028 hectares (=15,00,000 acres), and a supply of 270 million imperial gallons (1.23×10^6 m^3) of drinking water per day. 162 million gallons of drinking water for around 4 million people of the neighbouring state, apart from 108 million gallons of drinking water for around 3 million people of the concerned home state. Due to regulated releases from the Vidyut storage reservoir, the existing downstream hydro projects are also benefitted by way of augmentation in generation at no additional cost to them. Concerned home state also gets 15% of generated power as free. The total expenditure for this project was USD 1 billion. Since 2007-08, which was the first year of operation, VHDCL has been a profit making company.

The Vidyut Dam has been the object of protests by environmental organisations and local people of the region. The protest was against the displacement of town inhabitants and environmental consequences of the weak ecosystem. ***"We don't want the dam. The dam is the mountain's end"*** was the prominent slogan.

The relocation of nearly 1.5 lakh people or may be even more, from the area has led to protracted legal battles over resettlement rights and, ultimately, resulted in the project's delayed completion despite the fact that land acquisition was started in 1980. There is no master plan for rehabilitation nor even a clear estimate of the number of people affected. According to the 2003 status report of the public work department of Chapala town, the Dam replaced 15,550 families. This estimate excludes a large number of people who lost their lands but have not been officially recognised as project-affected. Among those officially recognised, allotted with land of poor quality or with multiple ownership claims.

Near to year 2006, while filling of the reservoir has led to the reduced flow of Karaka River's water from the normal 1,000 cu ft/s (28 m^3/s) to a mere 220 cu ft/s (6.3 m^3/s). This reduction has been central to local protest against the dam, since the Karaka River is considered sacred river whose waters are crucial to religious beliefs.

Old Chapala town shifted and named as New Chapala Town (NCT) which is semi-ultra-modern hill station at height of 1,555-1,855 m above MSL, with better road network and district head quarter (shifted to NCT, earlier about 65 kms away from Chapala). NCT equipped with better health (got 80 bed modern hospital against 25 bed hospital in old Chapala, and also got 5 primary health centres with additional 75 bed facility in total) and education facilities (hostel facility of 900 students, degree college with university campus which can accommodate 440 residential students and faculties, and against 1 inter college in old Chapala, 5 inter-college established (one in NCT and 4 in nearby villages). This all done at project cost.

In addition to the human rights concerns, the project has spurred concerns about the environmental consequences of locating such a large dam in the fragile ecosystem of the foothills of great mountain range. There are further concerns regarding the dam's geological stability. The Vidyut dam is in a major geologic fault zone. This region was the site of a 6.7 magnitude earthquake in September 1992, with an epicentre 55 km (34 mi) from the dam. Dam proponents claim that the complex is designed to withstand an earthquake of 8.4 magnitude, but some seismologists say that earthquakes with a magnitude of 8.5 or more could occur in this region. Were such

a catastrophe to occur, the potentially resulting dam-break would submerge numerous towns downstream, whose populations total near half a million.

In spite of concerns and protestation, operation of the Vidyut Dam continues and is completed. But VHDCL was aware of these and tried to respond in a constructive way. The spirit of CSR initiative is depicted by its CSR initiative title 'VHDC Sahridaya' (Corporate with a Human heart), wherein the focus areas are:

- *Shiksha* - Education Development
- *Svasth* - Nutritional Health and Sanitation and Drinking Water Projects
- *Nipun* - Livelihood Generation and Skill Development Initiatives
- *Unnaati* - Rural and Infrastructure Development
- *Yogy* - Empowerment Initiatives
- *Srrishti* - Environment Protection Initiatives

Out of these 'VHDC Srrishti' has some special mentions, 'Environment Focussed Initiatives' is working with three objectives Soil and Water Conservation, Green Energy Generation and Technology Promotions and Environment Protection and Promotion.

To conserve soil and water VHDCL is working on water harvesting and water harvesting tanks (capacity 3,000 litres each) were installed in the project affected villages for rainwater harvesting. Through this activity, beneficiaries were able to store almost 9 lakh litres of rainwater during monsoon. In addition, VHDCL under this program installed more than 730 LED based Solar Street Lights and more than 180 LED based Solar High Mast Lights in near-by towns and villages in year 2019-20. Moreover, to promote plantation of different fruit, fodder, and medicinal plants, VHDCL planted 2,70,202 plants/ sampling till now.

VHDCL has won many awards in the last decade in different categories including CSR domain, but most recent and relevant (for case study) among them are→

- HR Platinum Award for Training Excellence in 2019-20
- National CSR Leadership Award 2020
- CSR Innovation and Leadership Award 2020

It has not only gained recognition in term of awards, VHDCL has obtained following Certifications:

- ISO 9001:2015 Certification (Quality Management System).
- ISO 14001:2015 Certification (Environment Management System).
- OHSAS 18001:2007 Certification (Occupational Health and Safety Management System).

Required

As part of the policy initiative, if VHDCL is willing to implement the Triple Bottom Line (TBL) reporting initiative; then **ADVISE** the management regarding dimensions of TBL, and what are perspectives composed by different dimensions of TBL. Also, enumerate the challenges, expected benefits, and initiatives under each dimension in context of Vidyut Dam and Vidyut Hydroelectric Power Plant (1,000 MW).

Solution

British business author **John Brett Elkington** in year **1994** coined the term **TBL**. Every business needs to be **sustainable, rather than** only **profitable**. A business is said to be sustainable, when management makes sustainable business decisions. To consider sustainability of business decision there are three bottom lines i.e. **People, Planet and Profit** (also known as dimensions of TBL), instead of single bottom line (i.e. Profit).

Here-in VHDCL, shows *strong commitment for CSR* through the certification (regarding quality, environment and safety) they obtained and also through the awards they won (in the domain of CSR and Training).

Dimensions (sets) of TBL

(i) **People,** the **social equity** bottom line relates to corporate governance, motivation, incentives, health and safety, human capital development, human rights and ethical behaviour.

The project has major concerns about the **displacement of town inhabitants**, followed by reduction in flow of Karaka River from the normal 1,000 cu ft/s (28 m^3/s) to a mere 220 cu ft/s (6.3 m^3/s). Former concern is more significant than the later concern, because later was of short duration; it is obvious when the reservoir is filled to its maximum capacity, the flow of the river will again become normal. Regarding the displacement, it is mentioned in the case itself that according to the 2003 status report of the public work department, the Dam replaced 15,550 families. Further, this estimate excludes a large number of people who lost their lands but have not been officially recognised as project-affected. Even those officially recognised, allotted with land of poor quality or with multiple ownership claims. This concern substantiates in absence of a full-proof master plan.

It is not the case that local resident were/ are in complete distress, they were/are compensated with **alternative and better facilities** and **remedies** as well that too at **project cost**, which includes the:

- Development of hill station to attraction for tourism – The New Chapala Town (NCT) is developed with semi-ultra-modern facility at height of 1,555-1,855 m above MSL as pre-planned hill station which will attract the tourist. By creation of lake due to the impoundment of the reservoir of Vidyut Dam, scope of water sports is there. Hotels, Guides and Tour and Travels will cause *employment opportunities* for locals.
- Better road network leads to *ease of living* and *improved communication channels* which also help in establishing suitable industries according to environmental aspects.
- Shifting of district head quarter to NCT results in reduction of distance of travel by town residents to reach to district head quarter for any task by about 65 kms, hence *life of locals will be further eased*.
- *Improved health facilities* - NCT equipped with better health facilities. It got 80 bed modern hospital against a 25 bed hospital situated in old Chapala town. Apart from this also got 5 primary health centres with additional 75 beds in total.
- *Improved Education facilities* in terms of hostel facility of 900 students and increase in number of inter-colleges.

Not only the local resident (directly affected), ***other too got benefit from project***, such as 250 cusecs (~162 million gallons per day) of water supply to neighbouring state, which will meet drinking water need of around 4 million people, apart from 167 cusecs (~108 million gallons per day) of water supply to concerned home state, which will meet the drinking water need of around 3 million people. Power is also distributed to 10 northern states (including concerned home state) of said country.

VHDCL showed social commitment through Shiksha, Svasth, Nipun, Unnaati, and Yogy as part of their CSR initiative.

(ii) **Planet**, the **environmental** bottom line measures the impact on resources, such as air, water, ground and emissions to determine the **environmental impact** and **ecological footprints**.

The project has spurred concerns about the **environmental consequences** of locating such a large dam in the fragile ecosystem of the foothills of great mountain range, which will result in **weak ecosystem** and concerns over a **catastrophe to occur** (due to earthquake - the potential dam-break). Regarding the later concern, it is also mentioned in the case that the Vidyut dam is in a major geologic fault zone. This region was the site of a 6.7 magnitude earthquake in September 1992, with an epicentre 55 km from the dam. In response to which the Dam proponents claim that the complex is designed to withstand an earthquake of 8.4 magnitude, but some seismologists say that earthquakes with a magnitude of 8.5 or more could occur in this region. Were such a catastrophe to occur, the potentially resulting dam-break would submerge numerous towns downstream, whose populations total near half a million.

The major environmental **benefit** is generation of 1,000 MW (3,532 MU of Annual Energy) of **environment friendly** peaking power.

In order to leave improved environment footprint and to trade-off the environmental loss caused during construction, VHDCL through **initiative** 'VHDC Srrishti' working on:

- *Rainwater Harvesting* – It has installed the necessary infrastructure in the affected areas to harvest almost 9 lakh litres of rainwater during monsoon.
- *Green Energy Generation and Technology Promotions* through installing LED based Solar Street Lights and LED based Solar High Mast Lights.
- *Environment Protection and Promotion* through plantation of 2,70,202 samplings so far, of different fruit, fodder, and medicinal plants.

(iii) Profit, the **economic** bottom line refers to measures maintaining or improving the company's success in terms of adding value to shareholders.

It is an inherent feature (rather project specific concern) of hydro power projects that the duration of construction is quite lengthy and huge capital outlay is involved. In case of Vidyut Dam too, Construction began in 1979, but was delayed due to economic impact apart from social and environmental pressure. In 1987, technical and financial assistance was provided by the neighbouring country, but this was interrupted years later with political instability. Project then placed under the direction of the irrigation department of concerned home state of said country. However, in July 1989 the Vidyut Hydro Development Corporation Limited (VHDCL) was formed to manage such 1,900 MW Vidyut Hydro Power Complex; wherein 75% stake held by union government and remaining 25% stake by concerned home state government. The total expenditure for this project was USD 1 billion. Since 2007-08, which was the first year of operation, VHDCL is a profit making company.

The initiative includes the feature of variable speed, the 1,000 MW Vidyut HPP has variable speed features which can optimise the round trip efficiency under varying water levels in its reservoirs to keep the *cost of operation low*.

The quantifiable economic benefits include:

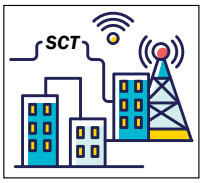
- The generation of 1,000 MW (3,532 MU of Annual Energy) of environment friendly peaking power. This will no doubt lead to industrial and agricultural growth in the northern region.
- 15% of generated power will be given free to the concerned home state, apart from power as per their share, where the distress is caused due setting up of the project. Hence, the state has economic benefit from the project too.
- Irrigation of 2.71 lakhs hectares of area, beside irrigation stabilisation of 6.07 lakhs hectares. Hence, supporting other economic activities as well indirectly.

To conclude, the project largely seems **sustainable** as running in *profit* since it was operational, leaving minimal and positive *environmental* footprint, and also payback society (especially directly affected local population) with alternate better facilities and compensation (may be with few minor exceptions or irregularity on case to case basis).

Case Scenario

Case Scenarios, as opposed to Case Studies, are *short cases*. Written in a more compact style with an appealing narrative, the Case Scenario's focus is on covering more depth in a *specific area*.

Case Scenario – Six Sigma



Smooth Connect Telecom (SCT) is the private sector telecom company. SCT is second largest player in telecom sector of country, with subscriber base of more than 10 million. SCT achieved this magnificent growth by acquiring competitor in recent years. SCT deals in fixed line telephone services, corporate services and mobile (cellular) services. SCT is meeting all the requirements from regulator in efficient and timely manner.

SCT is known for continuous innovation in its services, with changing pace of technology and business need like wise use of Optical Fiber Wire and VoLTE (Voice over Long-Term Evolution) etc. This helps the SCT in acquisition of many corporate clients.

The largest player in telecom industry is Voice Telecom, which is resulting company out of corporate restructuring of state-owned telecom corporation. Voice Telecom still own largest market share due infrastructural advantage over other players in the market. SCT is also facing tough competition from Voice Telecom on pricing and customer volume.

Majority of telecom operators, including SCT and Voice Telecom, usually criticised by customers for poor customer services, misallocation of call duration and call drop; but majority of complaints are on account of;

a. Calculating wrong tariff, and
b. Dull and delayed response from customer care executives.

Hence, by focussing on customer services, if SCT improves its billing process and handles the customer complaints wisely; then SCT can gain competitive advantage over other players including Voice Telecom. In order to improve the quality of customer services, SCT decide to practice Six Sigma initiative.

Required

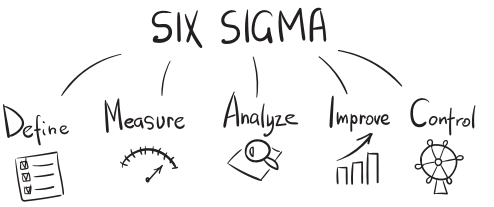
Enumerate the modus operandi that 'how SCT can **APPLY** DMAIC method to implement Six Sigma'.

Solution

Six Sigma was first used by Mr Bill Smith of Motorola Corporation in 1986 for *improvement of manufacturing process and elimination of defects*. Six-Sigma seeks to improve the quality of process by identifying and removing the cause of defects (defect can be anything, which lead to customer dissatisfaction). Six Sigma uses quality management and statistical methods with special infrastructure of people. Six-Sigma can be implemented through two methodologies;

1) **DMAIC** (Define, Measure, Analyse, Improve and Control) - Improve existing business process (remove defect).
2) **DMADV** (Define, Measure, Analyse, Design and Verify) - Create new business process (defect free).

DMAIC methodology of Six Sigma implementation at SCT



Define – Define the improvement area

Define includes definition of customer requirement or problem faced by customer.

First and foremost, requirement of is to ensure customer must be billed correctly, because wrong billing may lead to either of;

a. Delayed revenue – due to litigation for wrong billing
b. Loss of revenue – due to porting to alternate telecom operator by customer

Customer care *executives need to be trained*, so that they can guide the customer in most appropriate way and ensure lowest possible wait time to solve customer complaint.

Measure – Existing process for comparison

Existing performance needs to be measured

Since performance need to be measured specially in two domains 'billing processes' and 'customer complaint handling', hence SCT needs to have a system through which it can collect reliable information (likewise number of complaints as percentage of total customers, similarly wrongly billed customers against total customers; is there any process of reissue the correct bill? – if yes –than in how many cases it is issued? and average time to solve complaints) in order to measure existing performance.

Performance is required to be measured against each of *critical success factors* (which will create value for customer).

Analyse – Cause effect relationship between factors of process
Existing process needs to be mapped in order to determine the root cause of problem

SCT should further analyse the information collected in second point (measure) above for determining the performance, in order to reach to root cause of customer complaints and wrong billing; So that necessary *preventive* and *corrective* steps then can be taken.

Improve – Plan improvement on basis of analysis
Existing process need to be improved in order to mitigate the root cause threats

Once the SCT done with the analysis, it has to identify the possible solution to root causes, in order to improve the performance.

Any improvement, which is so ever is suggested; needs to be both **feasible** from SCT prospective and **valuable** from customers' perspective.

Improvement can be done by reissue of bill where it was wrongly issued earlier, if already process of revision of bill is in existence than wait time for reissue need to be curtailed.

Control – Continuous control to identify and correct the process variance
Improved processes need to be controlled continually in order to assure enhanced performance shall be maintained

Post improvement in process (issue of bill and handling of customer complaints), the manager who is responsible for such process at SCT need to assure continuous control over the process, so that customer services should create same value for customer and keep them satisfied.

For monitoring, KPI against CSFs can be established and reported on daily basis, likewise number of complaints (especially which remain unresolved at day end) and wrong billing cases. These KPI will also act as early signal to Line Manager or Senior Management.

In order to implement Six Sigma as per DMAIC method, SCT need to form a team of line managers from different processes which are need to be improved (or critical from prospective of customer services). Team and implementation project should lead by some senior management person (may be CEO him-self).

Case Scenario – Performance Measurement

Shakti Automobiles Limited (SAL) is a leading battery based e-rickshaw manufacturing firm, under brand 'Shah Swaari' in three models – Super, Star, and Speed. SAL started this business around 5 years back when it was only manufacturer of such e-rickshaw. SAL manufactures all assembly components themselves, irrespective of fact that these components can be acquired from market at a cheaper rate. Major component of total costs in manufacturing of such e-rickshaw is variable in nature. Company was performing well, earning reasonable and enjoyed large market share up-till two year ago majorly due to first mover advantage. But due to increasing competition as new entrant coming into market and rough macro economic conditions, market share starts shrinking; resultantly profit starts declining. If no major steps taken, then company may run into red in year to come.

Mr Pillai, CEO attended some workshop last week, where he learned about the lean management and techniques of cost management. He asked Mr Reddy, Chief Management Accountant to report on underlying reasons behind current performance with available set of possible solution. Mr Reddy immediately convened a meeting of top ranked officers, which is chaired by CEO, at meeting;

Mr Swami, VP Marketing mentioned that it is difficult to maintain same level of sales in upcoming years because price of Shah Swaari is much higher than price offered by all the competitors in market. Quality and features of other are also similar.

Mr Dutta, Customer Relation Officer also supported Mr Swami and said that the popularity of their product is declining, he quoted that he receives lot of complaints from buyers in e-mails and tele-calls due to manufacturing defects; which arise in product within a month period of purchase and frequency of such calls and emails have increased in recent years. He also mentioned that in some cases, customer reported that assembled part did not belong to model they purchased, and some customers say, assembly is not as per specification provided.

Mr Sodhi, Head Workshop and Repairs agrees that the repair issues in case of recently sold vehicle have been increased.

Mr Murthy, VP Production and Operations who recently joined the SAL replied, firstly large percentage of worker are unskilled; secondly due to large amount and categories of raw materials, dumped by store at production floor; that's too well prior to need. These two reasons cause worker fails to differentiate among parts which appear similar. He also mentioned entire business process, especially production process is quite old and contains certain activities which are purely unnecessary, he also highlight importance of industry 4.0 and give stress on business re-engineering through artificial intelligence, machine learning, etc.

Mr Naidu, VP Purchases immediately responded about economics of discount involved behind purchase of large quantity and also mentioned buying too less may lead to stock-out situation.

Required

You were also presented at meeting as deputy to Mr Reddy. Post meeting you came back to your desk and start working. Mr Reddy called to you to his cabin, on reach to his cabin; he asked you to prepare draft of report (**ADVISE**) seek by CEO; and meet him with copy of draft after half an hour from now.

Solution

Report

Addressed to;
Office of CEO,
Shakti Automobiles Limited (SAL).
Dated – 19th Jan 2021

Report on underlying reasons behind current performance and Lean Management, Cost Management tools

(i) First reason behind weak financial performance is highlighted by Mr. Swami i.e. **Price** of SAL's Product Shah Swaari is much higher than price offered by all the competitors in market. Quality and features of other products are also similar.

Target Costing as cost management technique can be applied. Since market condition are stiff and *bargaining power of customers* is high due to multiple competitors, and these competitors are selling the product at price lesser then price offered by SAL. Hence, price offered by such vendors should be considered as 'Target Price' and after reducing 'Target Profit' from same 'Target Cost' can be identified. Production, operations facilities along with product need to be reengineered to achieve such 'Target Cost'.

(ii) Second reason is that SAL manufactures all assembly components themselves, irrespective of fact that these components can be acquired from market at a cheaper rate.

Relevant cost of both, **'Make or Buy'** needs to be compared. As mentioned that major component of total costs in manufacturing of such e-rickshaw is variable in nature, hence, such major component of costs can be controlled if SAL buy the all the components instead of Making them.

Only those products need to be made in house whose variable cost of manufacturing is less then market price and vice versa.

(iii) Third and major reason is popularity of their product is declining, this is evident from declining in market share and lot of complaints from buyers in e-mails and tele-calls for manufacturing defects.

Since these defects arise in product within month period of purchase. Hence, product needs to be looked at. Further, some of cases customer reported that assembled part is not belonging to model they purchased and some customers say assembly is not as per specification provided. Hence, quality is needed to be ensured in the product delivered.

One of way to look at **'Quality'** is conformance to need of customer, to ensure same Total Productivity Management/ Total Quality Management supported by Six Sigma need to be applied as part of Lean System Management.

Total Quality Management is management of entire process, including planning process, to meet customer's requirements. **PRAISE** analysis can be used in order to achieve improve quality.

Using **DMAIC** (Define, Measure, Analyse, Improve and Control) methodology of **Six Sigma**, existing business process can be improved to ensure customer satisfaction, reducing cycle time and reduction in waste also.

(iv) Fourth reason being, large percentage of worker are unskilled. Each worker should be provided with ***requisite training***. Though ***Kaizen***, workers should be involved into improvement of existing process so that they become able to address small problems or improve a process.

(v) Fifth and second major reason is large amount and categories of raw materials, dumped by store at production floor; that's too well prior to need. This reason may be root cause of one of complaint by customer that assembled part is not belong to model they purchased.

JIT can be implemented as part of lean system. JIT is **pull system of production**, with **single piece flow** after considering **takt time**. In JIT, production facility is need to be integrated with vendor system for signal (Kanban) based automatic supply which depends upon demand based consumption. Under JIT system of inventory storage cost is at lowest level due to direct issue of material to production department as and when required and resultantly less/no material lying over in store or production floor.

Note - Takt time is the maximum time to meet the demands of the customer, this will help to decide the speed of/at manufacturing facility. Heijunka can be applied in order to reduce variation between takt times over the production.

Cost benefit analysis of 'reduction in storage cost along with opportunity cost saved' and 'increase in ordering cost, purchase cost along with stock-out cost' need to be made.

(vi) Sixth reason for low performance is **old established businesses processes,** especially production processes and contains **certain activities which are purely unnecessary**.

Value Analysis is need to be applied in order to ensure maximum value to customer by eliminating activities which are not value generating, this will control cost also, that's too strategically.

Process Innovation and **Business Process Re-engineering** can also be applied. Re-engineering is rethinking and radical design of business process in order to achieve improvement. It will help the SAL to keep them at par with changing technology by synchronisation along with redesign, retool the business process.

Further details can be tabled on requisition basis.

Closure of Report

Mr Reddy,
Chief Management Accountant
(For Management Accounting Division)
Shakti Automobiles Limited

Skill Assessment Based Questions

The questions at this level are based on **skill assessment**. An illustrative list of the verbs that appear in a question requirement for each question is given in November 2019 issue. It is important that students answer the question according to the definition of the verb.

Question 1

About Problem	Target Verb/(s)
Life Cycle Costing	Advise

Royal Bakers is famous for cakes and cookies. Mr Das the owner at Royal Bakers is interested in offering affordable products to their customers, hence keen to capture the small scope of cost-effectiveness. Royal Bakers located in the centre of the city where space has a huge cost and royal baker is running out of space during peak hour causing loss of sale. Most of the customers are regular to Royal Bakers. Royal Bakers is known for fast service, Mr Das wish to be true to the tagline *'Close your eyes to wish and open them to find it cooked for you'.* The hurdle rate is 12%.

Non-availability of skilled workers and high attrition rate of workers including chefs is the cause of worry for Mr Das. In order to retain workers, Royal Bakers is paying a higher salary than industry standards. The raw material is easily available as and when required. Royal Bakers is considering two different models of baking oven machine to replace its old oven. The baking capacity of both machines are the same and both will occupy a similar amount of space.

The first model is the automatic oven which will cost about ₹10,00,000. Another model is the semi-automatic oven which will cost at ₹5,60,000. The annual operating cost (including depreciation) is 40% of the acquisition cost and ₹4,20,000 in case of automatic and semi-automatic oven *respectively*. After 3 years of use, the automatic oven can be salvage at ₹70,000, whereas semi-automatic oven will fetch ₹20,000 only. The automatic oven is more advanced and equipped with latest technologies to speed up the baking, because only ingredient need to be inserted in right proportion and mix. Whereas in semi-automatic machine some part of the process needs to be performed manually by the workers.

Required

ADVISE which oven shall royal baker acquire.

Note- You can ignore taxes but need to consider the time value of money; decimal accuracy up-to two digits is expected.

Answer

Statement of the Comparable Life Cycle Cost

Particulars	Automatic (₹)	Semi-Automatic (₹)
Acquisition Cost	10,00,000	5,60,000
PV of Entire Life Cash Operating Cost (W.N.2)	2,16,000	5,76,000
PV of Salvage Value (W.N.3)	(49,700)	(14,200)
Total Cost of the Oven *over the life cycle*	11,66,300	11,21,800

***Note** – Hurdle rate of 12% (marginal cost of capital rate) is considered, for purpose of application of time value of money.*

Working Note 1 – Depreciation (₹)

Particulars	Automatic	Semi-Automatic
Acquisition Cost	10,00,000	5,60,000
Salvage Value	70,000	20,000
Depreciable Value	9,30,000	5,40,000
Useful life in a number of years	3	3
Depreciation on SLM basis	3,10,000	1,80,000

Working Note 2 – Present Value of Entire Life Cash Operating Cost

Particulars	Automatic	Semi-Automatic
Annual Operating Cost	4,00,000	4,20,000
Depreciation (see W.N. 1)	3,10,000	1,80,000
Annual Cash Operating Cost	90,000	2,40,000
Cumulative PV factor @ 12% for 3 years	2.40	2.40
PV of Entire Life Cash Operating Cost (₹)	2,16,000	5,76,000

**Annual operating cost is 4,00,000 i.e., 40% of 10 Lakhs, in case of automatic machine.*

Working Note 3 – Present Value of salvage value

Particulars	Automatic	Semi-Automatic
Salvage Value	70,000	20,000
PV Factor @ 12% for 3rd year	0.71	0.71
PV of Salvage Value (₹)	49,700	14,200

Advise

Based upon life cycle cost, Royal Bakers are advised to acquire semi-automatic oven, because it causes a **saving of ₹44,500**. The cost has ***qualitative implications*** too, apart from quantitative or monetary implications. Similarly, a management decision is also impacted by qualitative and non-monetary quantitative factors. Hence, decision taken in part a above may differ if Royal Bakers consider-

Finishing of bake products – the look and taste

It is obvious the presence, which one important feature for bakery product in order look delicious and tempting; will be way different if cooked in the automatic and semi-automatic machine. The taste may also be different, which is more critical from prospective of customer retention because a large number of the customers are regular to the royal baker, hence maintaining the principal customer is maybe a key consideration. This factor may go in favour of any of version oven. If look goes in favour of automatic oven, then taste may be in semi-automatic due to corrections by the worker during baking and relatively authentic preparation.

Manpower

Availability of skilled workers and retention of workers is the cause of worry presently. In order to operate an automatic oven obviously fewer workers are required; hence money can be saved by cutting down recruitment cost and excess salary paid to the worker in order to retain them. On the other hand, skilled workers are already in scarcity, automatic machine obviously requires a more technically competent operator. But largely this factor moves in favour of automatic machine despite is costlier.

Space

Royal Bakers located in the centre of the city where space has a huge cost and Royal Bakers is running out of space during peak hour causing loss of sale. Although the size of both the ovens are same, the number of worker and space required for them surely be less in case of the automatic oven. Hence, this factor again moves in favour of automatic oven.

Power consumption and availability

Although the power consumption cost is presumed to already include in annual operating cost hence considered as a monetary factor but need and availability of power is a very important factor; in order to ensure uninterrupted baking. In the absence of stand-by power back-up, power cut may lead to downtime. It will complete downtime for the automatic oven and to a certain extent in the case of semi-automatic (because the manual process will keep going on). Stand-by power back-up will also have an additional cost.

Customisation

In case of cookies, it may be ok to produce the standard product; but the cake needs to base upon the order of the customer, who may seek customisation. Scope of customisation needs to evaluate. In the case of the semi-automatic oven, the scope of customisation and ethnicity will be relatively high.

Speed

Royal Bakers is known for fast service, and Mr Das wish to be true to tagline 'Close your eyes to wish and open them to find it cooked for you'. The automatic oven is more advanced and equipped with latest technologies to speed up the production. Hence, this factor moves in favour of automatic oven.

Detection of the defect

If speed thrills, then it kills too. In case of the bakery, rework and reprocessing is hardly possible, even if possible then at a huge cost; hence, it is essential to keep vigil control over quality and detection of defect at the earliest stage. In the semi-automatic oven, there is the scope of reviewing the material after stage/s and improvisation can be done.

Overall, Royal Bakers should take the decision only after due and careful consideration of above factors.

Question 2

About Problem	Target Verb/(s)
Theory of Constraints	Calculate, Interpret, Apply

Ajanta Digital Solutions (ADS) is a renowned name for manufacturing a wide variety of digital stationery products for office and academic use. The 'Abacus division' of ADS is engaged in the production of basic calculators, capable of academic and commercial use. Presently Abacus is manufacturing only three models, named C-100, C-125, and C-500. These calculators are sold to customers through wide-spread retailers and distributors' network across the country.

During manufacturing process, each calculator needs to pass through various steps, before it gets ready. PC-IA is the essential step and performed manually, where processing chip is being installed, activated, and tested. The production capacity of Abacus is constraint by PC-IA. The basic information pertaining to top-line and the prime cost is as follows (Amount in ₹)-

Particulars	C-100	C-125	C-500
Sale price per unit	140	200	450
Material cost per unit	72	104	200
Labour cost per unit	30	52.5	75

All the process and division at ADS are operating for a single shift of 8 hours in a day. Conversion cost per hour (including labour cost) is ₹5,600. The standard output for PC-IA during a day is the processing of either 800 units of C-100 or 560 units of C-125, or 320 units of C-500. ADS is capable of sale more than, what they are presently capable to produce in all range of models. The CEO of ADS recently attended a science fair, Robo-tech 4.0; where he saw a Robot developed by Synergy Robotics Limited, capable to assembly including installation of processing chip to any sort of device.

Required

Management hired you as cost consultant, advice on the following aspects→

(i) On a random day if 480 units, 140 units and 120 units of C-100, C-125, and C-500 respectively are produced and sold, CALCULATE at what efficiency level current constraint (bottleneck) is operational. INTERPRET the same. COMPUTE profit earned during such day.

(ii) FIND production of which model is more beneficial, considering the ranking (based upon throughput performance ratio).

(iii) APPLY Goldratt's five steps to remove the bottleneck at Abacus.

Answer

(i) Efficiency level can be measured with help of Efficiency Ratio, which is one among the control ratios.

Efficiency ratio indicates the degree of efficiency attained in production. It is expressed in term of standard hours for actual production as a percentage of the actual hours spent in producing that work.

$$\frac{\text{Standard hours for actual production} \times 100}{\text{Actual hours worked}}$$

= (9.8/8) × 100

= 122.5%

Working Note – Standard hour required for actual production

Product	Actual output (Units) (a)	Standard Daily Output (Units) (b)	Standard Hourly Output (Units) (c) (b)/8	Standard Hour Required (a)/(c)
C-100	480	800	100	4.8
C-125	140	560	70	2
C-500	120	320	40	3
Standard Time Required (in hours)				9.8

Interpretation – 122.5% signifies that efficiency (usage) of exploiting bottle-neck activity is 22.5% better than the standard use. PC-IA is producing out-put which require 9.8 hours, in 8 hours.

Profit earned during the day

Particulars	Amount in (₹)
Revenue [(480×140) + (140×200) + (120×450)]	1,49,200
Less: Material Cost [(480×72) + (140×104) + (120×200)]	73,120
Less: Conversion Cost (including labour cost) [5,600 × 8hrs.]	44,800
Profit	31,280

(ii) Statement of ranking, based upon throughput performance ratio (using throughput contribution)

Particulars	C-100	C-125	C-500
Sale price per units ...(a)	₹140	₹200	₹450
Material cost per unit ...(b)	₹72	₹104	₹200
Throughput contribution per unit ...(c) = (a) – (b)	₹68	₹96	₹250
Maximum possible production ...(d)	800	560	320
Maximum possible throughput contribution ...(e)= (c)×(d)	₹54,400	₹53,760	₹80,000
Conversion cost (including labour cost) (5,600×8hrs) ...(f)	₹44,800	₹44,800	₹44,800
Throughput performance ratio ...(e)/(f)	1.21	1.20	1.78
Ranking	II	III	I

Considering the throughput performance ratio (or TA ratio) and ranking above most beneficial model to produce is C-500 followed by C-100 and C-125.

$$\text{TA Ratio} = \frac{\text{Throughput contribution}}{\text{Conversion cost}}$$

- Throughput accounting developed by Galloway and Waldron which use the term factory cost and completely relay upon the Goldratt's theory of constraints which use the term operating expenses, but the meaning of factory cost and operating expenses used at both places are *identical.*
- Theory of constraints consider *short-run time horizons* and assume other current operating cost to be fixed costs.
- Higher the throughput performance ratio (or TA ratio) is better and beneficial.
- All the products/ models which have throughput performance ratio (or TA ratio) **more than one** may be produced/ continued to produce, depending upon constraint function.

(iii) Application of Goldratt's five steps to remove the bottleneck at Abacus

Goldratt's theory of constraints describes the following mentioned five steps process of identifying and taking steps to remove the bottlenecks that restrict output.

1. **Identifying the System Bottlenecks** – At Abacus division of ADS, PC-IA is bottleneck.
2. **Exploit the Bottlenecks** – Bottleneck activities' capacity must be fully utilised. Although the efficiency of bottleneck activity is already 122.5% but further attention on the possibility to enhance the flow of products from bottleneck activity is needful.
3. **Non-bottleneck activities are subordinate** – Bottleneck activity should setup the pace for non-bottleneck activities. Abacus shall plan its production keeping PC-IA at the centre point, because even if the efficiency of other activities which are non-bottleneck enhanced beyond current level; the output can be maximum possible by PC-IA.
4. **Elevate the bottleneck** – Eliminate the bottleneck by enhancing the capacity and efficiency. Major change (business reengineering) or continuous minor change (Kaizen) may do. In the case of Abacus, the introduction of the robot may be a way to elevate the bottleneck.

   Note – There will always be one bottleneck in the system, if such bottleneck is eliminated then a new constraint emerges as a bottleneck. Hence, this process continues. Ultimately improvement is a never-ending continues process.
5. **Repeat the process** – Apply step 1 to new bottleneck activity which emerges at Abacus and repeat the process.

Question 3

About Problem	Target Verb/(s)
Target Costing	Explain, Calculate, Evaluate

Venice Light Works (VLW) manufactures multicolour glow bulb (MCG-10) used for lighting and decoration. MCG-10 considered as reliable product in market due to zero-defect. VLW sells MCG-10 through retail-chains and individual shopkeeper apart from factory outlet. MCG-10 has demand throughout the year but there is high demand during festival seasons especially ahead of Diwali. Company follows the lot purchase system and manufacture the product ahead of peak season of festivals. Presently the VLW is working at 80% of capacity and manufacture 4,00,000 bulbs annually, at following per unit cost:

Particulars	Behaviour	Amount (₹)
Direct Material	Variable	22
Direct Labour	Variable	6
Factory Overhead		
1. Engineering Cost	Fixed	10
2. Machining Cost	Fixed	5
3. Inspection Cost	Variable	5
Administration Overheads	Fixed	12
Selling and Distribution Overheads	Fixed	12
	Total Cost	72

Recently the competition in decorative lights and electronic markets has escalated, due to goods imported from Chinese manufactures at cheap rates. Such imported light bulbs are also sold through same shops at which MCG-10 is available for sale. Due cheaper in rate customer prefer imported light bulb rather MCG-10.

To be competitive in market, the marketing department of VLW conducted applied research and suggested that price should be 12.5% lower than the current prices. VLW during last three financial years and during current year records the pre-tax profit @ 10% rate of sale, management of VLW wish to earn the same rate of profit (margin) in upcoming years too.

Production and operation manager is of opinion that cost reduction, in order to be competitive in market may result in reduction in quality, whereas Manager - Quality control suggests, if number of inspection staff increased, then inspection can be performed at each stage and defect can be curtailed at the earliest stage to eliminate rework cost.

Management accountant is of the opinion that since MCG-10 is mature product, hence majority of cost associated in production of MCG-10 are committed in nature, price cutting seems difficult; it may hit the top line and bottom line adversely. In response to him, Chief engineer suggest product (MCG-10) can be redesigned; but marketing manager shown his resistance on the suggestion of redesigning of product because according to him 'existing product appearance and features are key reasons for popularity of product in market and leads to sale'.

Required

(i) CALCULATE the price suggested by marketing department.

(ii) COMPUTE the target cost and new margin, appraise percentage decline in margin.

(iii) If proportionate cost reduction plan is applied, then

(a) CALCULATE planned cost reduction for each cost category.

(b) EXPLAIN proportionate cost reduction plan.

(iv) Based upon discussion taken place among the functional manger, EVALUATE the possibility of cost reduction in order to analyse the possibility of application of target costing. Also suggest course of action to adopt.

Answer

(i) Price suggested by marketing department (Target Price)

Current cost per unit – ₹72 per unit

Profit (Margin) @10% of sale price

Sale Price = ₹72 + 10% of Sale Price

So, let presume sale price is 'X'

X = ₹72 + 10% of X

X = ₹72 + 0.1X

X - 0.1X = ₹72

0.9X = ₹72

X = ₹72/ 0.9

X = ₹80

New price will be 12.5% less than current price

₹80 – 12.5% of 80

₹80 – ₹10 = ₹70

(ii) Target cost and new margin

Target Price – Margin (i.e. 10% of sale price) = Target Cost

Target Cost = ₹70 – 10% of 70

₹70 – ₹7 = ₹63

New Margin (under target costing) is ₹7

Percentage decline in margin

$$\frac{\text{Existing Margin} - \text{New Margin (under target costing)}}{\text{Existing Margin}} \times 100$$

$$= \frac{8-7}{8} \times 100$$

= 12.5%

Note

There is decline in margin in absolute term, whereas in relative term the margin remains same i.e. 10% of sale price.

(iii) Planned cost reduction for each cost category under proportionate reduction plan

Amount in ₹

Particulars	Existing Cost	Target Cost
Direct Material	22	19.25
Direct Labour	6	5.25
Factory Overhead		
1. Engineering Cost	10	8.75
2. Machining Cost	5	4.375
3. Inspection Cost	5	4.375
Administration Overheads	12	10.5
Selling and Distribution Overheads	12	10.5
Total Cost	72	63

Under proportionate reduction plan cost for each category is proportionately reduced in proportion of existing weight. Here, a presumption is needed to be taken that all the cost are avoidable in nature, where as in case of every business; there are some of cost categories which are true sense unavoidable and committed in such a way that, these continue to occur even in shut down situation (e.g. salary to guard, minimum rental for electricity and water meter etc.); same is pointed by Management Accountant, that product is matured in nature (means not in designing or research phase) hence committed cost may be unavoidable in nature.

Note

Students must note that fixed costs are not as same as unavoidable cost. Fixed cost may be avoidable in nature.

(iv) Possibility of cost reduction and Suggested course of action for VLW

Target costing comprises four stages. First being determining the product target price, quality, and functionality; second determine the target cost; thirdly designing the product and production process to achieve the target costing, and fourth use pilot project to evaluated feasibility. Based upon discussion taken place among the functional managers, it is evidential that VLW is presently moving towards third stage.

As stated by management accountant that product MCG-10 is mature nature hence majority of cost are of committed nature, hence may be unavoidable in nature. Product MCG-10 is *material-oriented product* and raw material cost is around 30% of total cost. So, if *gain sharing arrangement* can be entered with vendor then surely VLW can save some portion of material cost.

As said by production and operation manager, cost reduction may lead to compromise with quality. He may be right, but he needs to look for scientific way to reduce the cost of operations like change in batch size (if required can shift to JIT) or outsource some part of operations; scientific management can also be applied in order to curtail motion time and reduction in labour cost.

Quality Manager is of opinion with extra inspection staff, quality can be assured, but appointment of additional inspector and supervisor will also lead to increase in cost; hence effective way to ensure quality while reducing cost of application of practice of *TQM* and *Kaizen*. Kaizen costing will be great help to management of VLW to cut the cost, with support and participation from worker.

Chief engineer suggestion is appreciable, because target costing is most beneficial in those case where the product is in designing and planning phase. As per research around 70-80% of cost is committed at stage of designing of product. It is important to note that the word 'committed' is used as 'not incurred'; therefore, cost being committed (i.e., not incurred cost) will be incurred when it became due in course of production. But redesigning is not feasible from the prospects of marketing of product as per the statement made by marketing manager.

Marketing manager can conduct applied research in order to develop understanding the temperament of customer of MCG-10, whether they are price sensitive or conformance to need is their priority. If customer found price sensitive (existing recommendation of marketing team shows high possibility of this, because marketing team feels customers can be retained is price is reduced by 12.5%) then product redesign may opted. But if conformance to need is their (customers) priority, then *value chain analysis* can be used to identify the activities which creates value to customer and other than these activities (which are not creating the value) can be eliminated in order to reduce the cost.

So, there are possibility to reduce the cost, even if not in all the cost category then surely in some of categories; so that target cost can be achieved.

"Every effort has been made to include all possible elucidations for a given case/ question aided by outline and well-chosen photographs for quick industry/ concept reference".

CASE STUDY

The basic objective of the case study is to allow the students to apply ideas and insights from theory to the *real life issues* and *problems*.

Pricing Strategy

ITB is a multi-brand diversified conglomerate corporation that deals in a wide range of industries, from hotels to FMCG; from paper to tobacco; from IT solutions to agro/agri (AGRO) business through its different divisions and departments, which are working independently. Managers of some of these divisions are accountable for their cost and revenue, while in others they are additionally accountable for the capital employed too. ITB is still diversifying its business.

FMCG Division

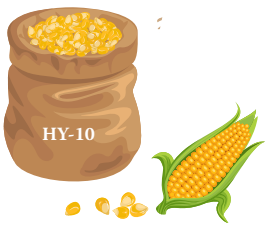
In the recent quarter, the FMCG Division of ITB launched ***moonfeast*** dream cream biscuits, which are flavoured twin cream biscuits. These biscuits are available in two different sizes of packing - price ₹5 for 35 grams and ₹10 for 80 grams. Division decided the price considering the cost it incurred and a preferred margin. The margin stipulated by manager for two years period.

The market segment relevant to such cream biscuits is highly competitive and hostile, customers are price sensitive too, but the segment has a turnover value of nearly ₹4.5 crores during such recent quarter. Response to ***moonfeast*** dream cream biscuits is merely reasonable. The Division is looking forward to launching a range of flavours. A report containing investment requirements regarding the new flavours sent to corporate head office for approval. As per market research report of a trade association, during the same quarter total of around 375 MT biscuit was sold in the relevant segment.

AGRO Division

A high-yield variety of hybrid maize seed **HY-10** was developed after incurring the huge R&D cost, nearly ₹2.35 crores by AGRO Division. Maize is largely a Rabi crop and seed rate depends upon the factors like purpose, seed size, season, plant type, sowing method (For winter and spring maize seed rate of 8-10 kg/acre is desired, whereas for sweet corn, baby corn, and pop-corn seed rate of 8, 16, and 7 kg/acre is respectively desired). **HY-10** committed and provide high yield and big-deep grains; also reduces the seed rate requirements to 80%-90% of aforementioned. **CP-555** was a prominent seller prior to the lunch of **HY-10** and its 4 kg packing was sold for in the range of ₹1,450-1,500 generally. Other players are also working on developing HYV maize seeds.

AGRO Division has lined up many such more development projects which are duly approved by the divisional head, and some are in pipeline. **HY-10** approved by the regulator and government authorities three seasons ago and available for commercial sale thereafter in the market. **HY-10** sold in a pack of 2, 10, and 25 kgs only. Figures pertaining to these three seasons are tabled below–



Season	Revenue (thousand ₹)	Volume of sale (quintal)
First	7,460	149.2
Second	13,185	293.0
Third	12,460	311.5

ITB Hotels

ITB hotels are known for state of art amenities and great hospitality. The occupancy rate ranges from 70% to 80% on average, but for few metropolitan locations, the occupancy touches to 90% to 100%. ITB hotels follow tariff policy, wherein tariff is based upon the cost of living of individual city (wherein hotel is located) and occupancy rate (of the individual hotel) when customer check-in. Dr. Angel Gupta who is a regular guest at ITB in Mumbai (due to her medical conferences) surprised to see the variation between the tariffs. She was charged ₹5,400 per night when her stay during the trip falls on weekdays and ₹8,000 when it falls on weekends.

Required

(i) COMMENT on the ITB's organisational structure and its appropriateness.
(ii) DEFINE responsibility accounting and responsibility centre.
(iii) EXPLAIN profit centre and investment centre.
(iv) IDENTIFY the nature of FMCG and AGRO Divisions from the preview of responsibility accounting.
(v) EVALUATE the pricing strategies adopted (along with appropriateness, and set of advice where it seems inappropriate) by–
  a) FMCG Division
  b) AGRO Division
  c) ITB Hotels

[Support your answer with facts and figures (calculation thereof) given in the case]

Solution

(i) **Organisational Structure** outlines the roles of individuals in the organisation and decides the way in which authority and responsibility are allocated among them and how they are coordinating with each other to attain organisational objectives. ITB is following the **divisional structure** wherein various divisions operating autonomously. Since divisions are operating independently hence may be termed as **strategic business units (SBUs)**. Due to high autonomy, the ***decision-making process is usually decentralized***.

This type of organisation structure is fit for growing companies that are diversifying because it's easy to bolt on another division. Since ITB is a multi-brand diversified conglomerate corporation that deals in a wide range of industries and still diversifying its business hence the **divisional form of organisational structure best fits ITB**.

Mind it, in divisional structure too, some functional departments are working horizontally throughout the organisation and known as corporate function or shared/support services, such as Accounts and HR & Payroll, etc.

(ii) **Responsibility accounting** is that type of management accounting that collects and reports planned actual accounting information in terms of responsibility centers. A **responsibility centre** is a specific unit of an organisation assigned to a manager who is held responsible for its operation and resources. The division can be designate as either of **cost, profit, revenue, or investment centre** depending upon the responsibility (accountability) assigned to its manager (s)/ divisional manager.

(iii) **Profit Centre and Investment Centre.**
Wherein the manager of division is accountable for the cost and revenue of division, it shall be categorised as **profit centre**. Thus, the performance of such division shall be measured in terms of the **difference between the revenues and costs** (the absolute amount of profit).
But wherein manager is additionally (apart from cost and revenue) accountable for the capital employed too –categories

as **investment centre**. The performance of an investment centre can be measured by appraising profit/return in relation to the investment base of centre, **ROI, RI, and EVA** are some prominent financial performance measures.

(iv) FMCG Division is a **profit centre** because it decides its own prices as well as a cost but for investment, it has to take the *approval of the head office*, as it is mentioned in the case that a report containing investment requirement regarding the new flavours sent to corporate head office for approval. Moreover, the desired margin, which is used to determine the price also stipulated by the manager only.

AGRO Division is an **investment centre** because it takes investment decisions on its own, without the intervention of head office, as it is mentioned in the case that AGRO Division has lined up many such more development projects which are duly approved by the divisional head, and some are in pipeline.

(v) FMCG Division

FMCG Division determines the prices based upon the cost it incurred and desired margin stipulated by manager. Hence, pricing strategy (hence the decision) adopted is the **cost-plus margin** approach.

Concept Insight

It is important to note the **limitations of cost-plus margin** approach:

- It ignores the price charged by the competitors,
- It also ignores the price which customer ready to pay, and
- Enterprise not looking towards cost control and management.

FMCG Division determines the two different **prices of moonfeast dream cream biscuits;** ₹5 for 35 grams and ₹10 for 80 grams; hence the price ranges from **₹125 to ₹142.86 per kg** in **comparison** to **an average price of ₹120 per kg only** (see the working note below) charged by other players in the relevant segment.

It is mentioned in the case that the market segment relevant to such cream biscuits is highly competitive and hostile, customers are price sensitive too; hence selling them product at a **premium price** (which more than the average price) is not a good strategy to penetrate into the market and acquire market share. This is the reason that response to moonfeast dream cream biscuits is merely reasonable.

Hence it is **advisable** for divisional managers of the FMCG Division to pick the **penetration strategy,** which means **keep the prices low initially** (in comparison to average market price or near rival) to gain the market share (and product acceptance), once market share reach a reasonable level then prices can be reinstated to normal level (the average market price).

Note – FMCG Division can practice techniques like Target costing, Kaizen to bring the cost down to reduce the price and sell the product at or lower than market-led prices.

Working note– Determination of price charge by other players in the relevant segment during the said quarter.

Turnover – ₹4.5 crores

Quantity sold – 375 MT (Metric Ton) - since 1 MT is equal to 1,000 kg hence 3,75,000 kg biscuits were sold during the said quarter.

Average price per kg – ₹4.5 crores / 3,75,000 kg = ₹120 per kg.

AGRO Division

The price charged by the AGRO Division for HY-10 during three previous sessions are tabled below, which depicts AGRO Division use the strategy of **price skimming** in the case of HY-10 because the prices were initially high (₹500 per kg) and continually decline thereafter (₹450 then ₹400 per kg). The price initially charged for HY-10 was much more than the price range of ₹362.5-375 per kg that CP-555 charged which was a prominent seller prior to lunch of HY-10.

Season	Revenue (in thousand ₹)	Volume of sale (in quintal)	Volume of sale (in kg)	Price per kg (in ₹)
First	7,460	149.2	14,920	500
Second	13,185	293.0	29,300	450
Third	12,460	311.5	31,150	400

Price skimming seems an **appropriate strategy** for the AGRO Division because HY-10 was developed after incurring the **huge R&D cost** (nearly ₹2.35 crores), that need to be recovered in few early years because some **other players are also working** on developing HYV maize seeds; if once they developed HYV maize seeds then ITB may not be in a position to charge the high price to recover its R&D cost from the product.

Customer (formers) might not mind paying a high price for HY-10 because it committed and actually provide high yield and big-deep grains and also reduce the seed rate requirements to 80%-90% of normal requirement.

Hotels

The tariff charged by ITB hotels is based upon the cost of living of an individual city (wherein the hotel is located) and occupancy rate (of the individual hotel) when customers check-in. It means ITB is relying upon the strategy of **differential pricing**.

One of the factors that determine the price in the case of ITB hotels is occupancy rate. It means ITB considers the importance of capacity constraints. The practice of charging a higher price for the same product or service when the demand for it approaches the physical limit of the capacity to produce that product or service is known as **peak-load pricing**.

The pricing strategy **seems appropriate largely,** but for regular guests like Dr. Gupta, it may be annoying.

Peak–load pricing, on one hand, generates high profit for ITB at the same time it brings equilibrium in demand and supply. But guests like Dr. Gupta, who is a regular guest of ITB may not be happy with differential pricing (tariff ₹5,400 per night on weekdays and ₹8,000 per night on weekends) on account of the peak load factor. The impact of peak-load pricing will be more likely to be seen in those metropolitan locations when the occupancy rate touches 90% to 100%

CASE SCENARIO

Case Scenarios, as opposed to Case Studies, are *short cases*. Written in a more compact style with an appealing narrative, the Case Scenario's focus is on covering more depth in a specific area.

Profitability Analysis

"A" is a mid-size bank with a loan asset portfolio that primarily comprises of housing loans and commercial loans. Efforts are underway to identify business opportunities that can contribute positively to the bank's bottom line. As a management analyst, you are analyzing the interest income from loan portfolios, the main income portfolio for any bank. You notice interest income from two types of loan portfolios – student education loans and consumer durable loans. These loan portfolios have not been focused upon until date since the loans form a minor portion of the entire loan portfolio, each less than 1% of the total loan portfolio. Consequently, the interest income generated is also minor in terms of the entire interest income of the bank. The primary focus has always been on housing loans and commercial loans, which form a major portion of the loan segment.

Following is some information you have about the interest on the student education loan segment and the interest on consumer durable loan segment:

Interest income earned on student education loan segment and consumer durable loan segment.

(₹ in Lakhs)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Interest earned on Student Education Loans	15	18	21	28	35
Interest earned on Consumer Durable Loans	30	28	22	16	12

Other information available to you:

Student Education Loans:

The bank recognizes around 150 educational institutions for the purpose of providing educational loans to students who need financing. These are premier institutes that are well recognized for their academic rigor. Due to the quality of their courses, 100% of the students get job placements immediately after graduation. Due to this the loan default on these loans has been very negligible, if any. Also, the bank has identified around 25 courses, predominantly post graduate courses, for which it has been extending education loans to students.

On the other hand, information from peer group banks shows that on an average each bank recognizes around 450 educational institutions. The number of courses recognized are both graduate and post graduate degrees, almost 100 courses. Not all institute are premier. The recognition of these degrees in the market varies. Therefore, only around 80% of the graduates to whom peer bank group offers financing, find job placements immediately after graduation.

Consumer Durable Loans:

The bank provides unsecured consumer durable loans for limited product purchase such as TVs, Refrigerators, mobile phones etc. It has a list of 15 products for which it provides loans to customers who need financing. The loan disbursement procedure is routed through sales personnel who are present in select branches of stores with whom the bank has tie up for such loans. Loan processing takes few days with due diligence done based on the loan application documents that the customer submits. Again, due to this due diligence, default rates have been negligible.

On the other hand, information from peer banks suggests that that on an average each bank recognizes about 45 products for which they provide customers financing when they want to purchase the consumer durable item. Also, loan processing is done online, with the help of the respective bank's inbuilt loan application system. Loan disbursement is immediate. The consumer durable can be purchased from any store, not just from recognized stores that have a tie up with the respective bank. This enables hassle free shopping experience to many.

Required

Put forward your inputs (**recommend**) based on the information provided above, to find business opportunities that can help Bank "A" grow its lending portfolio and interest income.

Solution

Student Education loans and Consumer Durable loans have been a very minor part of "A"'s business operations, each being less than 1% of entire loan portfolio. At the same time, these maybe segments that **can potentially grow** our lending portfolio and increase our interest income earning capacity.

Student Education Loans:

It can be seen that interest income from student education loans have increased steadily from ₹15 Lakh in Year 1 to about ₹35 Lakh in Year 5. This shows that the volume in this loan segment has been *steadily growing* in the recent years. It could be a *potential area to explore to expand our loan offering*. Currently, "A" recognizes 150 educational institutions for the purpose of providing education loan to students in need of financing *but* each bank in peer bank group on an average recognizes 450 such institutes for the same purpose. The number of courses "A" recognizes for which a loan is extended is 25 courses, mostly courses that are undertaken to earn a higher qualification like post-graduation degree. However, peers on the other hand each recognizes, a broader variety of 100 courses, both graduate and post-graduate degree for which they are willing to finance students. Therefore, it seems that "A" *can expand the range of courses* for which it provides student education loans. "A" can also recognize *more educational institutions to expand* its potential market volume. However, this comes at the ***risk of default***. Currently "A"'s approach to this segment has been *conservative*, limiting loans only to institutes and courses that enable the student with a very high possibility of finding a job immediately after qualifying. These may be courses that are sought out by potential job recruiters. Hence, students to whom loans were provided by "A", have not defaulted on any of the loan repayments. Its *loan default rate in almost negligible*. "A"'s peer banks have a *much broader market reach*, but at the same time, immediately after graduation only 80% of the students to whom loan financing was provided, have been able to find jobs. The job recruiters may not immediately require the some of the courses that some of the institutions offer. This increases the risk of loan default.

It is recommended to study the student education loan market segment more carefully. "A"'s strategy can be then laid out based on our internal benchmark requirements and risk profile.

Consumer Durable Loans:

The consumer durable loan segment has seen a steady decline in interest income from ₹30 Lakh in Year 1 to ₹12 Lakh in Year 5. "A" provides financing to customers to purchase from a list of 15 consumer durable products that it has identified including TVs, refrigerators, mobile phones. These are disbursed through its sales personnel present in the select stores with whom it has tie up for this purpose. Due to due diligence procedures, the loan default rate has been very low.

On the other hand, peer bank group have a much broader range of products, on an average of 45 products for which financing can be provided. There is no restriction on where the product is being purchased from. This widens the market range. Also, their customers can apply for these loans online. Disbursement of loan in immediate. This provides for hassle free shopping experience.

It is recommended to study "A"'s loan disbursement procedures further in order to increase the loan volume for consumer durables. Currently, it is restricted to purchases for specific products from select stores. Loan is being disbursed only after due diligence procedures, which have a time lag of few days. Increasing the range of products for which financing is offered and a dedicated bank system where the customer can apply for these loans may ramp up its volumes. ***At the same time, the downside risk to be addressed is the risk of fraud*** due to immediate loan disbursement or extending loans to customers whose credit worthiness might be lower. This would increase the risk of default.

Conclusion- By expanding customer base "A" has the advantage of tapping these customers for future ***cross selling*** of its home loan and commercial loan products. "A"'s current customer base especially from the home loan portfolio can also be researched to identify potential customers who may need either student education loans or consumer durable loans. Hence, the two customer segments may be considered for future expansion purpose. "A" needs to tailor its strategy based on internal benchmarks and risk profile capacity.

SKILL ASSESSMENT BASED QUESTIONS

The basis objective of the case study is to allow the students to apply ideas and insights from theory to the *real life issues* and *problems.*

Question 1

About Problem	Target Verb/ (s)
Pricing Strategy	Calculate, Elucidate

"Zinc" a brand of **Zink Pen and Plastic Limited (ZPPL)**, is a household name for stationery products. The R&D Division of "Zinc" developed a new pen **'Zentonic'** with assorted ink colours with the tagline ***'give your writing a Zen energy'.***

"Zinc" has used market research/ studies to determine that if price of ₹40 is charged for pen, demand will be NIL. It has also been established that demand will rise or fall by 2,000 units for every ₹1 fall/ rise in the selling price. The further information is also available in Annexure as a result of these studies.

The Board members in presence of functional heads at ZPPL are discussing the different pricing strategies that can be adopted in context to 'Zentonic'.

Dissension is clearly visible between the marketing head and the finance head. The marketing head is striving to keep the price as low as possible to capture the commercial space and maximise the revenue, whereas the finance head argued in favour of keeping the price high to maximise the profit because the design and R&D of 'Zentonic' will not be matched by the competitors currently. The distinct parameters (revenue and profit) of performance linked pay seem to be the major reason for contradiction between two functional heads. Board members consider both the thoughts and instruct you (management accountant) to drive the price(s).

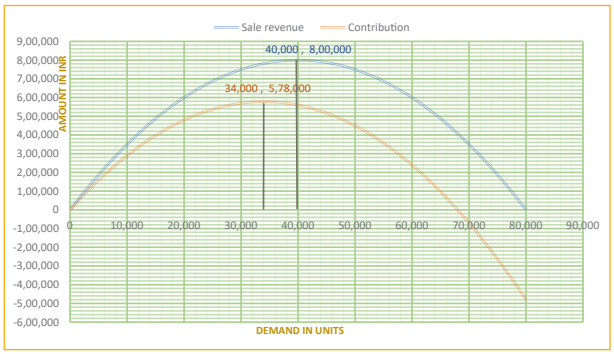
ZPPL ***diversifies*** itself into the online learning space and starts a web-based platform **'ZenZick',** which offers quality videos for competitive and professional exams such as JEE, NEET, UPSC, KVPY and etc. In order to attract the viewer, 'ZenZick' offers few lectures on fundamental concepts of curriculum after registration at the website without any cost, but for complete access, candidates need to have paid account.

Required

(i) CALCULATE the unit selling price of **'Zentonic'** that will maximise revenue and maximise profit.

(ii) ELUCIDATE the pricing strategy advocated by marketing head and finance head for **'Zentonic'** and pricing strategy adopted for **'ZenZick'**

Annexure



For Your Conceptual Understanding

Sale price per unit in ₹	Demand in units	Sale revenue in ₹	Variable cost in ₹ (@ ₹6 per unit)	Contribution in ₹
40	-	-	-	-
39	2,000	78,000	12,000	66,000
38	4,000	1,52,000	24,000	1,28,000
37	6,000	2,22,000	36,000	1,86,000
36	8,000	2,88,000	48,000	2,40,000
35	10,000	3,50,000	60,000	2,90,000
34	12,000	4,08,000	72,000	3,36,000
33	14,000	4,62,000	84,000	3,78,000
32	16,000	5,12,000	96,000	4,16,000
31	18,000	5,58,000	1,08,000	4,50,000
30	20,000	6,00,000	1,20,000	4,80,000
29	22,000	6,38,000	1,32,000	5,06,000
28	24,000	6,72,000	1,44,000	5,28,000
27	26,000	7,02,000	1,56,000	5,46,000
26	28,000	7,28,000	1,68,000	5,60,000
25	30,000	7,50,000	1,80,000	5,70,000
24	32,000	7,68,000	1,92,000	5,76,000
23	**34,000**	**7,82,000**	2,04,000	**5,78,000**
22	36,000	7,92,000	2,16,000	5,76,000
21	38,000	7,98,000	2,28,000	5,70,000
20	**40,000**	**8,00,000**	2,40,000	5,60,000
19	42,000	7,98,000	2,52,000	5,46,000
18	44,000	7,92,000	2,64,000	5,28,000
17	46,000	7,82,000	2,76,000	5,06,000
16	48,000	7,68,000	2,88,000	4,80,000
15	50,000	7,50,000	3,00,000	4,50,000
14	52,000	7,28,000	3,12,000	4,16,000
13	54,000	7,02,000	3,24,000	3,78,000
12	56,000	6,72,000	3,36,000	3,36,000
11	58,000	6,38,000	3,48,000	2,90,000
10	60,000	6,00,000	3,60,000	2,40,000
9	62,000	5,58,000	3,72,000	1,86,000
8	64,000	5,12,000	3,84,000	1,28,000
7	66,000	4,62,000	3,96,000	66,000
6	68,000	4,08,000	4,08,000	-
5	70,000	3,50,000	4,20,000	-70,000
4	72,000	2,88,000	4,32,000	-1,44,000
3	74,000	2,22,000	4,44,000	-2,22,000
2	76,000	1,52,000	4,56,000	-3,04,000
1	78,000	78,000	4,68,000	-3,90,000
0	80,000	-	4,80,000	-4,80,000

Answer

(i) The unit selling price of **'Zentonic'** that will maximise revenue and maximise p rofit can be easily derived through *demand function*. The graph shows sales revenue is maximised at 40,000 units and contribution **(so profit)** is maximised at 34,000 units.

Note – Fixed cost will be fixed irrespective of the level of activity (presuming fixed cost does not hold feature of step cost).

To calculate the selling price for these two levels of output, we can insert the number of units into the equation for the demand function.

Demand function **q = 80,000 – 2,000p** or **p = 40 – 0.0005q**

Whereas p represents selling price and q represents level of output.

Revenue will be maximum when the selling price will be **₹20**.

When q is 40,000 units of Zentonic pens,

⇨ 40,000 = 80,000 – 2,000p

⇨ 2,000p = 40,000

⇨ Then p will be **₹20**

Profit will be maximum when the selling price will be **₹23**

When q is 34,000 units of Zentonic pens,

⇨ 34000 = 80,000 – 2,000p

⇨ 2,000p = 46000,

⇨ Then p will be **₹23**

Accordingly, sales revenue at profit maximisation level would be ₹7,82,000 (₹23 × 34,000 units) and the expected profit at this level is already given i.e., 5,78,000 (refer graph). Therefore, variable cost will be ₹2,04,000 or ₹6 per unit. [not required in question]

(ii) The marketing head is striving to keep the price low as possible to make capture the commercial space and maximise the revenue. The pricing strategy advocated by him is **penetration pricing**. It includes setting the price low with the goals of attracting customers and gaining market share. The price will be raised later once this market share is gained.

The finance head argued in favour of keeping the price high to maximise the profit because the design and R&D of Zentonic will not be matched by the competitors currently. The pricing strategy advocated by him is **price skimming**. Under price skimming, high prices are set when a new product is launched so that fewer sales are needed to break even and to reimburse the cost of investment of the original research into the product. Since it involves selling a product at a high price, sacrificing high sales to gain a high profit is therefore called "skimming" the market. Price dropped to increase demand once the customers who are willing to pay more have been 'skimmed off'.

The pricing strategy adopted for **'ZenZick'** is **freemium**, freemium is a revenue model that works by offering a product or service free of charge (typically digital offerings such as software) while charging a premium for advanced features, functionality, or related products and services. The word "freemium" is a portmanteau combining the two aspects of the business model i.e., "free" and "premium".

Question 2

About Problem	Target Verb/ (s)
Service Level Agreement	Compute, Explain

Red Star Limited (RSL) is the largest manufacturer of Air-Conditioners. RSL is not good at attending the customer calls due to lack of capabilities, but it is an important activity from the aspect of the value chain. Hence, in order to improve customer experience (downstream supply chain), RSL decided to hire Krishna Infotech & BPO Services (KIBS) for attending the calls of their existing and prospective customer.

Service level agreement (SLA) was duly entered and **service level (SL) of 90/20 has been prescribed to keep a check on service quality.** Invoice will be generated monthly, and SL will also be observed on monthly basis. For the first month along with the invoice, KIBS provide the following details to RSL–

- Total calls offered 5,120
- Calls answered within threshold time 4,850
- Short or Abandon calls within threshold time 115

CFO while authorising the payment queues generated by the account executive in ERP, come across the KIBS payment; he immediately seeks a copy of SLA from legal but not able to understand the technical aspects hence he decided to calls you (management accountant) to EXPLAIN few terms (including SL) and certain COMPUTATIONS.

Required

(i) What is the SLA threshold and what is the threshold time in this case?

(ii) Explain the significance of 90/20 SL.

(iii) Compute the SL level for the first month.

(iv) Whether KIBS attained the SL level to full the terms of SLA?

(v) For how many calls KIBS can bill to RSL?

Answer

(i) A service-level agreement (SLA) threshold is the *activity response* time specified in a service level agreement. In the current case, the SLA threshold is the *number of seconds within which a call shall be responded* to by a tele-caller at KIBS. The threshold time, in this case, is 20 seconds it is represented by a service level (SL) of 90/20.

(ii) A **service-level agreement (SLA)** defines the *level of service you expect from a vendor, laying out the metrics by which service is measured.* **Service level** basically *measures the performance.* Service level (SL) of 90/20 signifies that 90% of the calls shall be answered within 20 seconds.

Concept Insight

SLA is the document that outlines the wider service agreements between a service provider and its customer, whereas SL is the acceptable level of service performance regarding which agreement has been entered.

Mind it, both the SLA and SL are **not the same.**

(iii) Service Level (SL) measure the performance and can be computed for voice calling BPO services using the following formula–

$$SL = \frac{\text{Total calls answered within threshold time}}{\text{(Total calls offered-Short or abondon calls within threshold time)}}$$

SL = 4,850/ (5,120 - 115)

SL = 4,850/ 5,005

SL = 96.90%

(iv) Against the expected service level of 90%, KIBS attain the service level of 96.90% which means out of each 100 calls nearly 97 class are answered within 20 seconds (threshold time), whereas the requirement was minimum requirement is 90%; hence KIBS attain the SL level to full the terms of SLA.

(v) No, doubt SL used for measuring the performance which relies upon the calls answered within the threshold time, but the calls answered beyond threshold time also cause costs and resources at end of the BPO vendor (KIBS in this case) hence **billing shall be for total calls responded/answered** (rather only those which are answered in threshold time). Hence, in a given case, the KIBS can raise an invoice for 5,005 calls i.e., 5,120 (total calls offered) – 115 (short or abandon calls within threshold time).

Question 3

About Problem	Target Verb/ (s)
Cost of Quality	Analyse

NZ Ltd. implemented a quality improvement programme and had the following results:

Particulars	2020	2021
	(Figures in ₹ '000)	
Sales	6,000	6,000
Scrap	600	300
Rework	500	400
Production Inspection	200	240
Product Warranty	300	150
Quality Training	75	150
Materials Inspection	80	60

Required

ANALYSE the quality costs

Answer

Analysis

The total cost of quality in the year 2020 was ₹17,55,000. The total cost of quality in the year 2021 was ₹13,00,000. Therefore, over all the cost of quality decreased by ₹4,55,000 from 2020 to 2021. Given the same scale of operations in both years (annual turnover being 60,00,000), the profits therefore would have increased by ₹4,55,000. The break-up is summarized in the table (refer workings).

In the year 2021, more emphasis was given to **Quality Training**, the spend increased by 75,000 p.a. Quality training is a *preventive cost* that is aimed at improving the quality of output / performance of the employees. The benefit of this spend can be seen in the reduction of internal failure costs (scrap and rework costs).

The total *internal failure costs* of **Scrap and Rework** was ₹11,00,000 in the year 2020 that reduced to just ₹7,00,000 in the year 2021, this reduction of ₹4,00,000 per year is directly on account of the quality training given to employees. *Better quality output* resulted in reduced scrap and need for rework.

Material Inspection Costs decreased by ₹20,000 from 2020 and 2021. Appraisal costs check for conformance with accepted standards for production. The reduction in material inspection costs could be due to *better understanding with the vendors about material requirements needed for production, better quality of materials procured* etc. When the input material is of good quality and conforms with the production requirements, material inspection costs can be reduced substantially.

Better quality input material may also be a reason for the drastic reduction in rework and scrap costs highlighted above.

Product Inspection Costs increased by ₹40,000 from 2020 to 2021. This *appraisal cost* checks for conformity of the product with accepted standards of production. Quality checks on the production line is important to detect defects at the earliest. Product inspections during the manufacturing process (in-line product inspection) help in detecting defects while the product is being made. Defects can be corrected / rectified, or the unit produced can be scrapped.

Pre-shipment product inspection ensures that the product conforms with the specifications agreed with the customer. This control prevents defective units / non-conforming units from reaching customers, an external quality failure. External quality failure has costs in the form of product returns, warranty expenses etc. **Product Warranty** expenses reduced significantly by ₹1,50,000 from the year 2020 to 2021. This improvement can be attributed to *better quality production and increased product inspection.*

External quality failure has *hidden costs* in the form of shrinkage of market share, negative impact on brand image etc. Quality reassurance ensures that the goodwill of the company is maintained and there is no negative impact on the company's future business prospects.

Workings

Figures in ₹'000

Sr. No	Particulars	2020	2021	Savings / (extra spend)
1.	**Prevention Costs**			
(a)	Quality Training	75	150	(75)
2.	**Internal Failure Costs**			
(a)	Scrap	600	300	300
(b)	Rework	500	400	100
	Total	1,100	700	400
3.	**Appraisal Costs**			
(a)	Product Inspection	200	240	(40)
(b)	Materials Inspection	80	60	20
	Total	280	300	(20)
4.	**External Failure Costs**			
(a)	Product Warranty	300	150	150
	Total (1+2+3+4)	**1,755**	**1,300**	**455**

Question 4

About Problem	Target Verb/ (s)
Make or Buy	Comment, Assess

Mr. Venkatesh, who recently joined the Tirupati Casting and Forge Limited (TCFL) as assistant manager in the management accounting division is collecting, estimating, and arranging the information required for make vs. buy decision and pricing decision; using which chief management accountant can consider the best way to go while taking uncertainties into account and advise the management accordingly.

X-104

Balaji Enterprises (BE) ready to deliver product X-104 (in a semi-furnished state) for ₹40 under a continuous supply agreement. TCFL insists on inserting a stable price clause in the supply agreement, to which BE responds that variation will be pass on to TCFL. Finally, it was decided if the agreement entered then the price (which is currently ₹40/-) shall be subject to periodical (after each quarter) review.

Y-29

TCFL is producing the product Y-29 (at full capacity) and able to sell the entire production through a network of distributors (and through retailers, in those areas where there is no distributor appointed). TCFL contacted by an e-retail platform, with a proposal; wherein the platform shows interest in offering the product Y-29 to its customers (members/ subscribers). The E-retail platform has two types of customers, "the plus" category and others. The E-retail platform will charge ₹1,300/- from "plus" category and ₹1,350/- from others, E-retail platform has the policy to keep margin (to meet its cost and earn a profit) of 8.3$\bar{3}$% and 12.50% on the procurement cost for the sale made to "plus" category and other customers respectively. In the proposal, the E-retail platform also states the price which it can pay to TCFL; according to the requirements stated above.

Mr. Venkatesh compiled the following tables, for product X-104 and Y-29 respectively on a per unit basis–

X-104

Particulars	In-house production	Purchased from BE, there-after furnishing and re-labelling at TCFL
Selling price of product	115	112
Variable costs	73	25
Fixed costs	18	18
External purchase cost	NA	40

Y-29

Particulars	Amount in ₹
List Price	1,400
Price charge from distributors	1,225
Variable cost incurred by TCFL	870

Required

(i) COMMENT how TCFL should respond to the proposal of the e-retail platform regarding product Y-29 and ASSESS the sensitivity of such decision.

(ii) COMMENT on the make vs. buy decision regarding product X-104 and ASSESS the sensitivity of such decision to the external purchase price.

Answer

(i) Pricing (Decision on the proposal by E-retail platform) & Sensitivity

Decision on the proposal by E-retail platform – Since the TCFL is producing the product Y-29 at **full capacity** and able to sell **entire production** through a network of distributors at **₹1,225** (results in a contribution of ₹355), hence **shall not accept the proposal** of the E-retail platform at the stated price of **₹1,200** (results in a contribution of ₹330) (see the statements below for the calculations).

Price stated by E-retail platform

Particulars	Plus Customer	Others
Sale price	1,300	1,350
Less- margin kept on the procurement cost	100 (i.e.8.3$\bar{3}$%)	150 (12.5%)
Procurement cost (price stated by E-retail platform)	1,200	

Comparable Contribution

Particulars	If sold through distributors	If sold through E-retail platform
Selling price for TCFL	1,225	1,200
Less- Variable costs	870	870
Contribution	355	330

Sensitivity of the decision on the proposal by E-retail platform

If the contribution from each unit of Y-29 sold to the E-retail platform increased to 355 and beyond then TCFL will be indifferent, among the distributors and E-retail platform. Thus, the price stated by the E-retail platform needs to increase by ₹25 per unit (from ₹1,200 to ₹1,225) i.e., 25/1,200 which come out to be **0.0208$\bar{3}$ or 2.08$\bar{3}$%** (25/1,200×100)

Hence, **if the price stated by the E-retail platform in the proposal increase by more than 2.08$\bar{3}$% then the original decision would be reversed** (because beyond that point selling through the E-retail platform will become more profitable for TCFL).

(ii) Make vs. Buy Decision & Sensitivity Analysis

Make vs. Buy Decision – Since the contribution is ₹47 when the product X-104 is purchased from BE and then furnishing and re-labelling done at TCFL, in comparison to ₹42 when it is produced in-house (see the calculation below); hence it is beneficial to buy the product X-104.

Comparable Contribution

Particulars	In-house production	Purchased from BE, there-after furnishing and re-labelling at TCFL
Selling price of product	115	112
Less- Variable costs	73	25
Less- External purchase cost	-	40
Contribution	42	47

Sensitivity to the external purchase price

To be indifferent, among the in-house production and buying from BE, the contribution from the product X-104 when it is purchased from BE needs to fall to ₹42 per unit. Thus, the external purchase cost needs to increase by ₹5 per unit (from ₹40 to ₹45) i.e., 5/40 which come out to be **0.125 or 12.5%** (5/40×100). Hence, **if the external purchase price increased by more than 12.5% the original decision would be reversed** (because beyond that point buying from BE will not remain beneficial).

Concept Insight

Sensitivity analysis is capable to incorporate **uncertainty** into **decision making** (by taking each uncertain factor in turn), and also calculates the change (**percentage change** – relative measure hence comparison of importance among factors become easy) that is **minimally required** in factor(s) before the **original decision is reversed**.

Since sensitivity analysis considers uncertainly related to each factor in turn, hence where **multiple factors changing simultaneously; it has no utility**. Apart from this, sensitivity analysis only calculates the change that is **minimally required** in factor before the decision is reversed; but it **does not consider or calculates the probability** of such a change.

Question 5

About Problem	Target Verb/ (s)
Transfer Pricing	Comment, Recommend

AB Cycles Ltd. has 2 divisions, A and B which manufacture bicycle. Division A produces bicycle frame and Division B assembles rest of the bicycle on the frame. There is a market for sub-assembly and the final product. Each division has been treated as a profit centre. The transfer price has been set at the long-run average market price. The following data are available to each division:

	₹
Estimated selling price of final product	3,000 p.u.
Long run average market price of sub-assembly	2,000 p.u.
Incremental cost of completing sub-assembly in division B	1,500 p.u.
Incremental cost in Division A	1,200 p.u.

Required

(i) If Division A's maximum capacity is 1,000 p.m. and sales to the intermediate are now 800 units, should 200 units be transferred to B on long-term average price basis? COMMENT.

(ii) What would be the transfer price, if manager of Division B should be kept motivated? Substantiate your RECOMMENDATIONS with suitable reasons.

(iii) If outside market increases to 1,000 units, should Division A continue to transfer 200 units to Division B or sell entire production to outside market? COMMENT.

Answer

(i) In this case there are two options available –

Option A	₹
Sell at the sub assembly stage (after completion of Division A)	2,000
Less: Incremental cost in Division A	1,200
Contribution	800

Option B	₹
Sell at the final product stage	3,000
Less: Cost at Division A and Division B (₹1,200 + ₹1,500)	2,700
Contribution	300

Therefore it is profitable to sell at the subassembly stage because of higher contribution, provided there is a market.

Hence, if there is market at intermediate stage, first priority is to sell intermediary (sub assembly).Therefore, 800 units should be sold as sale of intermediary.

The balance capacity available of (1,000 – 800) = 200 units should be transferred to B and B should complete the assembly and sell as final product, since the company can earn ₹300 per unit for each unit of such sale.

(ii) Recommendation

If B Div. receives the subassembly at market price of ₹2,000, plus its own incremental cost of ₹1,500 will give total cost of ₹3,500, thereby yielding a loss of ₹3,500 – ₹3,000 = ₹500 per unit, whereas the company makes a profit of ₹300 per unit.

The loss of ₹500 per unit would demotivate the manager of Division B. This would impact the company as inhouse production of the bicycle does yield a positive result, a profit of ₹300 per unit. In order to keep the manager of Div. B motivated, the company can adopt a **dual rate transfer pricing** policy. Division A can record the transfer price at the long run average market price of ₹2,000 per unit for each bicycle transferred to Division B. This lets Division A show reasonable revenue based on current market conditions, not constraining the "departmental profit center approach" towards operations.

Division B on the other hand can record the transfer price at the marginal cost of production for Division A. The marginal cost for Division A is ₹1,200 per unit. If Division B is allowed to record the transfer price at ₹1,200 unit per sub-assembly unit purchased from Division A, it would show a profit of ₹300 per unit of bicycle sold.

	₹
Sell at the final product stage	3,000
Less: Transfer Price for each sub assembly purchased from Division A	1,200
Less: Incremental cost for Division B to process further	1,500
Contribution	300

The problem with Dual transfer pricing system is that it can complicate the records since Division A records the transfer price at ₹2,000 per sub-assembly unit transferred to Division B. Division B records its transfer price at ₹1,200 per sub assembly unit it purchases from Division A. This can lead to errors in the company's overall records.

(iii) Both Divison A and the Company make higher contribution by selling to intermediate market. If the market demand increases to 1,000 units, the full quantity should be sold outside as intermediary and nothing should be transferred to Divison B.

Question 6

About Problem	Target Verb/ (s)
Transfer Pricing	Discuss

A manufacturer of Cell Phones has many operating units within its organization structure. The 'assembly plant' that assembles parts to make the final product. The others are mainly units that manufacture 'component parts' for the cell phone. The management promotes decentralized system of working, where the manager of each unit has the power to take decisions independently. The management only oversees that the impact of major operating decisions such that they promote "goal-congruence" that will benefit or not adversely impact the company.

'Max' is the head of the 'battery manufacturing' division. The division

sells *most of its output* to its final 'assembling plant' division headed by 'Ruby'. Battery is an important component of a cell phone. The company has an ***overall mission to sell only products that are of good quality,*** for which long lasting life of the battery component is critical. In March this year, the engineers of both the previously mentioned divisions created an innovative design to improve battery life. These newly designed batteries will be used in ***a new range of cell phones*** that the company plans to produce. The 'battery' division had spent ₹50 lakhs developing a suitable prototype that was acceptable to the engineers from the 'assembly plant' division. The managers are discussing a suitable transfer price for these newly developed batteries.

As mentioned before, part of the sales from the 'battery' division is also to external customers. However, at the current levels the 'battery' division is operating only at 60% capacity producing 60,000 units annually. Its annual capacity is 1,00,000 units. The annual demand for the newly developed batteries would be an additional 40,000 units. By accepting this internal order, the entire annual capacity of the 'battery' division can be utilized.

It is now close to the year end for the company. ***A very important metric*** to determine the payout is the *division's financial performance*. Therefore, there is intense pressure to sell more and cut costs. Each division maintains separate accounting records.

'Max' wants to charge a transfer price of ₹300 per unit of battery. Total manufacturing cost is ₹250 per unit of battery while the variable cost is ₹230 per unit.

'Ruby', the manager of the 'assembly plant' has been trying to convince 'Max' to reduce the transfer price to ₹275 per unit. 'Ruby' argues that the additional production for the new range of cell phones would help utilize unused capacity. In line with the current arrangement, she wishes to get all her batteries from the in-house department due to their higher quality level. However, she finds the cost of ₹300 per unit very high. She shares quotes from other vendors for similar quality batteries where the average market price is ₹275 per unit. She wishes 'Max' to provide her the batteries at this rate, which she feels is a more competitive price.

As per the company's policy, if a cell phone is found defective within 1 year from date of sale, it will be completely replaced by a new phone. Cost of replacement of a cell phone is ₹3,000 per cell phone. The annual demand for the newly developed cell phone range is expected to be 40,000 units per year. Batteries procured from outside vendors could result in 0.1% of sales becoming defective. These will require replacement of the entire cell phone by the company. 'Ruby' argues that this is a miniscule portion of the annual sales. All the same, to keep this at a minimum threshold, quality inspection procedures are in place that costs the company ₹5,00,000 per year. Batteries manufactured in-house have always met the required quality standards. It would not result in any defective products.

'Max', the manager of the 'battery' division justifies the internal transfer price rate of ₹300 per unit on these counts:

1. The *quality of in-house batteries is superior* compared to the external market providers. They will not result in any sale returns due to defective batteries.
2. *Sales policy* of the 'battery' division for both external and internal sales is –

   Selling price / transfer price = Total Cost + 20% mark up. Therefore, based on a total cost of ₹250 per unit, the transfer price is arrived as ₹300 per unit.
3. The division has spent ₹50 lakhs to *develop prototype* as per the assembly line requirements. Being a profit center 'Max' insists that this cost be recouped by charging a higher rate.

Both 'Max' and 'Ruby' decide to approach senior management whom they report to in order to resolve their dispute by **examine in detail.** Assume that currently the opportunity cost of excess capacity is zero. There are no pending sales orders that help utilize the excess capacity. Also given, that the demand for cell phones has been increasing, so the industry is in the cusp of a *growth phase*.

Required

(i) Impact on the company's financials if (i) Batteries are procured at ₹275 each from external market and (ii) Batteries are procured in-house at ₹300 each.

(ii) As a member of the senior management committee, with the idea of goal congruence of the divisions and the company as a whole:

(a) How would you convince 'Ruby' to buy the batteries from the in-house division?

(b) How would you convince 'Max' to reduce his transfer price from ₹300 for each battery?

Hint: For examine in detail use verb 'DISCUSS'.

Answer

(i) Impact on the company's financials:

Amount in ₹

Department	Case a: Batteries procured from outside at ₹275 per unit	Case b: Batteries procured in house at ₹300 per unit
'Battery' Division	---	28,00,000
'Assembly Plant' Division	(1,16,20,000)	(1,20,00,000)
Overall Company	(1,16,20,000)	(92,00,000)

Case a: Batteries procured from outside at ₹275 per unit

Cost outflow to the company, incurred by the 'assembly plant' division would be ₹1.162 crores. This comprises of the following:

1. Procurement cost: 40,000 units procured at ₹275 per unit = ₹1.1 crores.
2. Additional quality inspection cost: ₹5 lakhs or ₹0.05 crores.
3. Cost of replacement of defective units at a defect rate of 0.1% of annual sales
   = 40,000 units × 0.1% × ₹3,000 per unit = ₹1.2 lakh or ₹0.012 crores

Total outflow = ₹1.1 crore + ₹0.05 crore + ₹0.012 crore = ₹1.162 crores.

When batteries are procured from outside, 'battery' division will not incur any cost outflow. However, the unit has unused / excess capacity. Since currently the opportunity cost of unused capacity is zero, this is a *non-quantifiable waste*. The company may have to consider scaling down capacity / activities in this division by shutting down some of its machines. However, since it is given that the **cell phone industry is in the cusp of a growth phase**, it is possible to bring in orders from the external market, to utilize the balance 40% unused annual capacity.

The company should however be cautious since the 'battery' division would be catering to its rival cell phone manufacturers. While the 'assembly plant' would be procuring batteries externally from the battery unit's rivals. It could lead to a situation where the company is working against itself for the sake of maintaining profitability of its individual units. This goes **against the concept of goal congruence** that could affect the company's ability to sustain business in the long run. This would be a separate study that would need inputs from other senior management executives.

Case b: Batteries procured in house at ₹300 per unit

Net cost outflow to the company will be ₹92 lakhs.

The 'battery' division would earn a revenue of ₹300 per unit while incurring a variable cost of ₹230 per unit. Total cost of production is ₹250 per unit, that includes a fixed cost of ₹20 per unit. However, this has been ignored since it is a sunk cost. Therefore, each internal sale to the assembly plant division would net revenue of ₹70 per unit. The total additional revenue earned from this internal transfer would be 40,000 units × ₹70 per unit = ₹28 lakhs. This comes with the additional benefit, that the unit is operating at full capacity, producing high quality component for another unit within the company. Thereby, **aiding goal congruence**.

The 'assembly plant' division would incur a cost outflow of ₹1.2 crores because of the internal transfer. (40,000 units × ₹300 per unit). Although this is costlier than the option of procuring from the external vendors, it comes with high quality assurance. Sale of defective cell phones can be avoided, thereby **improving the company's brand image and customer loyalty**.

Net outflow to the company = cost to the 'assembly plant' division – additional revenue for 'battery' division = ₹1.2 crores - ₹0.28 crores = ₹0.92 crores or ₹92 lakhs.

At the overall company level, this can also be simply calculated as the marginal cost of producing additional 40,000 batteries = 40,000 units × ₹230 per unit = ₹92 lakhs. Fixed cost of manufacture, a sunk cost, is ignored.

Conclusion: It is better to manufacture the batteries in-house due to the following reasons–

1. ***External procurement cost*** is ₹275 per unit while the marginal cost of manufacturing a battery is only ***₹230 internally***.
2. ***Quality of in-house production is higher***, requiring no additional quality control checks.
3. ***Promotes goal congruence,*** where each division will work towards sustaining the company's business growth.

(ii) Negotiating with managers of individual units:

Negotiating with 'Ruby', the manager of 'assembly plant' division:

Ruby argues in favor of procuring similar batteries from the external market at a price of ₹275 per unit that is much lower than the internal transfer price quote of ₹300 per unit. Overall it costs ₹1.162 crore per year to procure the components as against her division bearing an internal transfer cost of ₹1.2 crore. However, by using external batteries, replacement of defective units would be 0.1% out an annual sale of 40,000 units that is 40 units need to be replaced. 'Ruby' may argue that this is a miniscule portion of the annual sales. However, the company's **image of providing quality products may take a hit**. For the company, procurement cost, along with the cost of replacement and additional quality inspection cost makes it costlier than producing the batteries in-house.

Cost of external procurement = ₹1.162 crore / 40,000 units = ₹290.50 per unit.

Cost of manufacturing in-house = marginal cost of production = ₹230 per unit.

The fact internal transfer is the better option has to be reasoned out with 'Ruby'. She in turn should be given the assurance, ***the company would give importance to other non-financial metrics while evaluating her unit's performance for bonus payouts***. One of these could be the number of successful innovative designs collaborated along with other departments such as the 'battery' division. This would have a more positive impact on the employee morale. Excessive emphasis on financial metrics could lead to decisions that may benefit the unit but may be detrimental to the company.

Negotiating with 'Max', the manager of the 'battery' division:

The 'battery' division is currently operating at 60% capacity. With the additional order to produce 40,000 units, the capacity can be utilized completely. This avoids wastage of resources. Quality of components is another positive feature that the company should give credit to 'Max's' division. Therefore, he is justified in charging a premium for quality. At the same time, the following points need to be reasoned out with him:

→ Development cost of new design of ₹50 lakh is a sunk cost for the company. It need not be passed onto the 'assembly plant' division. Instead during performance appraisal, 'Max' ***can highlight this as an investment*** that has paid off in the form a successful design for the new range of products that the company is planning to manufacture. ***Such project initiative outflows need to viewed investments and not as costs against the unit.*** During performance appraisal for bonus payout, the management can consider the payoffs from such project initiatives, how successful they have been and how many did not yield any result. This is Research and Development that is important for the long-term sustainability of the company.

→ It is given that the opportunity cost for excess capacity is nil. Therefore, the unit's excess capacity is waste. Therefore, for determining the transfer price, 'Max' should consider only the marginal cost of producing a battery unit rather than following a cost-plus mark-up pricing policy. As explained above, fixed cost is again a sunk cost to the company.

Therefore, as a senior management committee member, 'Max' has to reasoned out in reducing the transfer price from ₹300 per unit. **Ideally**, the transfer price should ***include only the marginal cost of production*** of ₹230 per unit. Given the decentralized working of the organization, ***leverage can be given for 'Max' to charge a premium for the quality of his products***. Overall, it would not affect the company's financials. However, there has to be a check on how reasonable this premium is since it could lead to decisions that are detrimental to the company. Also, ***performance evaluation should also include non-financial metrics*** like quality of products produced, innovative designs and production techniques that are factors that will sustain business in the long run.

Question 7

About Problem	Target Verb/ (s)
Relevant Cost Concepts	Analysis

An apparel manufacturing company has raw material inventory of polyester fabric bales that was initially procured to be used in manufacture of shirts. Later, keeping in mind the current fashion trend, the design department suggested manufacture of cotton shirts instead. Therefore, the bales of polyester fabric are now not required. It was procured at ₹1,00,000 few months back, the scrap value if sold in the external market would be ₹45,000 **(alternative 1)**. The fabric has alternative uses:

Alternative 2:

The material can be used to make polyester jackets. This would require the following **additional work and materials:**

Material A	500 bales of material
Material B	1,000 units
Direct Labor	3,000 hours unskilled
	2,000 hours semi-skilled
	1,000 hours highly skilled
Extra selling and delivery expenses	₹50,000
Extra advertising	₹25,000

This conversion can produce 1,000 units of polyester jackets that can be sold at ₹400 each. Material A is already in stock and widely used within the company. Although present stock will be sufficient to meet normal production requirements, extra material used to facilitate alternative will need to be replaced immediately. This will avoid any loss due to stock out of Material A for the products under regular production. Material B is an imported dye item, which cannot be very easily procured due to import restrictions. At present Material B is used in the production of high-end fashion clothing that on an average gives a gross contribution of ₹750 per unit of such clothing (without the cost of Material B). Each unit high-end fashion clothing requires 5 units of Material B.

	Material A	Material B
Acquisition cost at the time of purchase	₹87 per bale	₹75 per unit
Net realizable value	₹85 per bale	₹45 per unit
Replacement cost	₹90 per bale	---

Alternative 3:
The company also manufactures curtains for which it uses polyester fabric of a different variety and texture. The bale of polyester fabric currently lying as obsolete inventory can also be used as a substitute to the regular polyester material that is used to make curtains. For this, certain modifications to the texture are required to be done along with certain other procedures that will make the material suitable for utilization in curtain production.

The substitute will contribute towards production of about ~10% of the monthly curtain production. The following would be the **additional work and material** required:

Material C	1,000 units
Direct Labor	1,500 hours unskilled
	500 hours semi-skilled
	500 hours highly skilled

In a month, 15,000 bales of regular polyester fabric used for curtain production is procured at a rate of ₹80 per bale. This month, due to the substitution, only 13,000 bales of regular polyester fabric would be required. With reduced procurement for the current month, the supplier will reduce the bulk discount given on regular purchases. Accordingly, the procurement rate of regular polyester fabric will be at a rate of ₹85 per bale for the current month.

Material C has to be made in-house since it cannot be procured as such from the external market. The **standard cost per unit of Material C** would be as follows:

Direct labor, 2 hours unskilled labor	₹10
Raw materials	₹09
Variable overhead: 1 hours at ₹1 per hour	₹01
Fixed overhead: 1 hours at ₹3 per hour	₹03
Total standard cost of production	₹23

The wage rate and overhead recover rates for the company are as follows:

Variable overhead	₹1 per direct labor hour
Fixed overhead	₹2 per direct labor hour
Unskilled labor	₹5 per direct labor hour
Semi-skilled labor	₹10 per direct labor hour
Skilled labor	₹15 per direct labor hour

The unskilled labor can be procured on contract basis to meet the exact production requirements. The contract expires once the work is done. Semi-skilled labor is part of the permanent labor force, but the company has excess supply of this type of labor at the present time. Highly skilled labor is in short supply and cannot be increased significantly in the short term. This labor force is presently engaged in the manufacture of upholstery. Each unit of upholstery requires 4 hours of highly skilled labor. The contribution from sale of each unit of upholstery is ₹36. To cater Alternative 2 or 3, they need to discontinue production of upholstery until the work is completed.

Required

Present cost information by giving detailed ANALYSIS whether the obsolete bale of polyester fabric should be sold (Alternative1), used production of jackets (Alternative2) or used as a substitute for curtain cloth production (Alternative 3).

Answer

The textile company has to take a decision whether to–
(i) sell the bale of obsolete polyester fabric;
(ii) produce jackets by using this obsolete polyester fabric; or
(iii) use obsolete polyester fabric as substitute for curtain cloth production.

To make a decision, the company has to consider the relevant cost for each option, along with any additional expenses that need to be incurred. The alternative that yields the highest cash contribution/ benefit should be chosen.

Alternative 1: If obsolete bale of polyester fabric is sold as scrap in the external market it would yield cash return of ₹45,000. The original procurement cost is a sunk cost that needs to be ignored.

Alternative 2: Utilize the obsolete polyester fabric to make jackets. In addition to the polyester material, Material A and B would be added to the production process. It would also require the work of additional labor.

Calculation of net cash contribution from Alternative 2:

Particulars	Amount (₹)
Sales Proceeds (1,000 jackets × ₹400 each)	4,00,000
Material A (note 2.1)	45,000
Material B (note 2.2)	1,50,000
Direct Labor - unskilled (note 2.3)	15,000
Direct Labor - semi skilled (note 2.4)	-
Direct Labor - highly skilled (note 2.5)	24,000
Variable Overhead (note 2.6)	6,000
Extra selling and delivery	50,000
Extra advertising	25,000
Net contribution	**85,000**

Note 2.1: Material A is already in stock and widely used within the company. However, if this is used to make jackets as per alternative 2, it has to be replaced immediately so that other normal production activities are not impacted. Therefore, the relevant cost for Material A would be its current replacement cost at ₹90 per bale. Alternative 2 uses 500 bales of Material A. Therefore, relevant cost = 500 bales × ₹90 per bale = ₹45,000.

Note 2.2: Material B is a scarce material due to import restrictions. It can alternatively be used to make high-end fashion apparel. Gross contribution from high-end apparel clothing is ₹750 per unit sold. Each unit requires 5 units of Material B. Therefore, the gross contribution per unit of Material B would be ₹750 / 5 = ₹150.

Alternative 2 uses 1,000 units of Material B. Therefore, relevant cost = 1,000 units × ₹150 per unit of Material B = ₹1,50,000.

Note 2.3: Unskilled labor is hired on contract basis to meet exact production requirements. The contract expires once the work is done. Relevant cost = payment made to labor hired specially for this purpose = 3,000 hours × ₹5 per hour = ₹15,000.

Note 2.4: Semi-skilled labor is part of the permanent labor force, but the company has excess supply of this type of labor at the present time. This means that there is spare capacity within this workforce, their idle time can be used towards making jackets as per Alternative 2. Therefore, there is no additional cost incurred for the 2,000 hours of work needed for Alternative 2. Therefore, relevant cost = nil.

Note 2.5: Skilled labor is a scarce resource, additional labor cannot be hired easily in the short term. Therefore, relevant cost will include the payment made for the current work plus opportunity cost incurred due to diverting this scarce resource. Each unit of upholstery requires 4 hours of highly skilled labor. The contribution from sale of each unit of upholstery is ₹36. Therefore, the contribution per hour of highly skilled labor is ₹36 / 4 = ₹9 per hour of skilled labor. Alternative 2 requires 1,000 hours of skilled labor. Therefore, opportunity cost = 1,000 hours × ₹9 per hour = ₹9,000. In addition, the skilled labor is paid ₹15 per hour, the pay for making jackets as per alternative 2 = 1,000 hours × ₹15 per hour = ₹15,000. Relevant cost = opportunity cost + pay = ₹9,000 + ₹15,000 = ₹24,000.

Note 2.6: Variable overhead cost will be ₹1 per direct labor hour. Direct labor hours will equal the hours spent by unskilled, semi-skilled and highly skilled labor = 3,000 + 2,000 + 1,000 hours = 6,000 hours. Therefore, variable overhead cost = 6,000 hours × ₹1 per hour = ₹6,000.

Alternative 3: Use the obsolete bales of polyester fabric as a substitute to make curtain cloth material.

In addition to the obsolete bales of polyester fabric, this would require in-house manufacture of Material C, in addition to extra labor. The change in procurement rate of input regular polyester material should also be considered.

Calculation of net cash contribution from Alternative 3:

Particulars	Amount (₹)
Net savings in procurement cost for the current month (note 3.1)	95,000
Material C (note 3.2)	20,000
Direct Labor - unskilled (note 3.3)	7,500
Direct Labor - semi skilled (note 3.4)	-
Direct Labor - highly skilled (note 3.5)	12,000
Variable Overhead (note 3.6)	2,500
Net contribution	**53,000**

Note 3.1: In a month, 15,000 bales of regular polyester fabric used for curtain production are procured at a rate of ₹80 per bale. This month, due to the substitution, only 13,000 bales of regular polyester fabric would be procured at a higher procurement rate of ₹85 per bale for the current month.

The original cost of procurement = 15,000 bales × ₹80 per bale = ₹12,00,000

Cost of procurement for current month = 13,000 × ₹85 per bale = ₹1,05,000

Therefore, savings in procurement cost due to substitution = ₹95,000

Note 3.2: Cost of in-house production of Material C. Material C costs ₹23 per unit to be produced internally. Fixed overhead cost of ₹3 per unit has to be ignored since it is a sunk cost for this decision. Therefore, for analysis, the in-house cost of production of Material C would be ₹20 per unit. Alternative 3 requires 1,000 units of Material C. Therefore, the cost of Material C = 1,000 units × ₹20 per unit = ₹20,000.

Note 3.3: Unskilled labor is hired on contract basis to meet exact production requirements. The contract expires once the work is done. Relevant cost = payment made to labor hired specially for this purpose = 1,500 hours × ₹5 per hour = ₹7,500.

Note 3.4: As explained in note 2.4 above, there is no additional cost in the utilization of semi-skilled labor force. Their idle time is used towards this extra production as per Alternative 2 or Alternative 3. Therefore, there is no additional cost incurred for the 500 hours of work needed for Alternative 3. Therefore, relevant cost = nil.

Note 3.5: As explained in note 2.5 above, skilled labor is paid at ₹15 per hour for this work. The opportunity cost of diverting this scarce resource from regular production of upholstery material is ₹9 per hour. Therefore, relevant cost for alternative 3 = 500 hours × (₹15 + ₹9) per hour = 500 × ₹24 per hour = ₹12,000.

Note 3.6: Variable overhead cost will be ₹1 per direct labor hour. Direct labor hours will equal the hours spent by unskilled, semi-skilled and highly skilled labor = 1,500 + 500 + 500 hours = 2,500 hours. Therefore, variable overhead cost = 2,500 hours × ₹1 per hour = ₹2,500.

To summarize the net cash contribution from various alternatives:

Alternative 1: sell as scrap→ ₹45,000.

Alternative 2: Make of 1,000 jackets→ ₹85,000

Alternative 3: Substitute in curtain cloth production→ ₹53,000.

Conclusion: Alternative 2 yields the highest net cash contribution. Therefore, the obsolete inventory should be used to make polyester jackets.

"Every effort has been made to include all possible elucidations for a given case/ question aided by outline and well chosen photographs for quick industry reference / concept reference."

STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

"If all you're trying to do is essentially the same thing as your rivals, then it's unlikely that you'll be very successful."

– Michael Porter

Many of the tasks CAs perform are vital to evaluate the organisation's performance. It includes analysis of net profit, cash flow, accounts receivable, return on investment, breakeven point etc. This information is then used to help in making sound business decisions. The modern role, however, extends beyond this to include aligning the organisation's structure with its business strategy. This involves allocating resources to fund the organisation's strategic choices, as well as developing KPIs to measure the organisation's performance against its strategy. Subject develops students' ability to recognise business problems and opportunities, and use their knowledge, values, and judgment to develop business solutions for stakeholders. Subject needs students to critically analyse business problems and demonstrate strong analytical skills through interpreting and evaluating case studies, case scenarios and skill assessment based questions. This Capsule is having focus on operational excellence and lean initiatives like 5S, Kaizen, etc. These practices of lean have spread rapidly over the years among many manufacturers in numerous industries.

CASE STUDY

The basis objective of the case study is to allow the students to apply ideas and insights from theory to the *real life issues* and *problems*.

Case Study- KAIZEN (with integration to 5S and PDCA)

At **Sanjivini Hospital,** stores recently complete the exercise of numbering the patient files to keep the record in to shorten retrieve, because the reception desk finds it cumbersome to locate the file in case of revisiting patients. The different departments (OPD, IPD, and OT) of Sanjivini Hospital uses some of the surgical items, out of common inventory pool; hence visual control is used to prevent stock-out situation or improve inventory control.

*"If someone asked me to suggest a basic procedure for solving problems scientifically, rationally, efficiently, and effectively by removing the barriers and reducing the wastes – **KAIZEN** may be the best possible answer".* This is the opening remark of the CMD of Sanjivini Hospitals at the recent board meeting, after which a clear split in the viewpoint of directors over the utility of Kaizen is visible; some of the directors favour the organisation-wide innovations wherein top management's active involvement is essential; whereas some others believe performing those improvement initiatives which can be applied through an operational level workforce with the little amount of resources are essential.

The executive director responsible for planning and operation read an executive summary followed by a presentation wherein the facts and figures related to operations were highlighted. In response to a question raised by the independent director regarding the proper disposal of surgical wastes, he mentioned that during the year (just completed) colour coding was used throughout where it was possible, after considering a suggestion letter from a nurse, and this significantly prevent mix-up of medical wastes, which make disposal easy and cheap. The head of housekeeping division added, on the feedback from ward boy, all switches were labelled to save energy and cost on the environment day.

CEO, gave stress upon the clarifying ideal situation because he feels it is useful to identify problems in your working place, because the gap between 'desired ideal status' and 'actual current situation' is 'problem/(s)'. He further added, – *"if the problems are complex and composite then the Kaizen process with help of the PDCA cycle needs to be practiced; if the problem is simple and relates to operations then Kaizen initiatives can be clubbed with 5S".* He mentioned both the ways have their own importance at Sanjivini Hospital in order to respond to MUDA (waste).

In favour of the Kaizen initiatives that can be clubbed with 5S, the CMD argues *"these are quick and easy and helps to eliminate or reduce waste"*. The HR (executive director) head supports the CMD by stating that *"it promotes personal growth of employees and the organization and also act a barometer of leadership"*. The finance head (who is also an executive director) supported the CMD by stating that *"these ideas (small changes) can be implemented by the worker him/herself with very little investment of time"*.

The finance head also quoted a reference of the report that was published in The New Indian Express recently, stating that private hospitals spend 50 percent of operational costs on salaries of medical staff, including doctors. The analysis says that hospitals spend 28-32 percent on drugs and consumables and maintaining a bed in a super-specialty hospital takes about ₹15,000-25,000 every day.

Then he (finance head) presented the following facts and figures in front of the board–

During the previous period (t_{-1}), at Sanjivini Hospital the average bed capacity was 350 and the average overall actual operation cost for a week of seven working days was ₹4,59,37,500 against the standard cost of ₹18,500 per bed per day.

During the period just ended (t_0) with the Kaizen initiatives the goal of cost reduction was 8%. The average bed capacity increased by 10% and the average overall actual operation cost for a week of seven working days was ₹4,63,54,000 against the standard cost of ₹17,020 per bed per day.

Required

(i) Assist the management of Sanjivini Hospital to CALCULATE the following, using Kaizen Costing –
   a. Cost base for the period just ended (t_0)
   b. Kaizen Cost reduction target during the period just ended (t_0) in amount
   c. Cost base for the period just started (t_1)

(ii) ASSESS the performance of Sanjivini Hospital for the period just ended (t_0) from the perspective of Kaizen Costing.

(iii) After briefly explaining Kaizen and the 5S and IDENTIFY at-least three practices adopted by Sanjivini Hospital wherein Kaizen overlaps with 5S activities.

(iv) ADVISE the management at Sanjivini Hospital, how it can track the Kaizen suggestions.

(v) After stating the Kaizen process, do synthesis of the relationship between the Kaizen process and PDCA Cycle.

(vi) LIST at-least three practices that can help Sanjivini Hospitals to foster the Kaizen culture.

Solution

(i) Kaizen Costing

- Cost base for the period just ended (t_0) = ₹4,59,37,500 / (7 days × 350 beds) = ₹18,750 per bed per day.

  Note – Cost base for Kaizen Costing purpose shall always be calculated in per-unit basis to equalise the change in capacity level.

- The Kaizen Cost reduction target during the period just ended (t_0) in amount will be 8% of the cost base for the period just ended (t_0) i.e., actual cost = 8% of cost base i.e., 8% of ₹18,750 per bed per day. This comes out to be ₹1,500.

  Note – Here 8% is the Kaizen Cost reduction rate and ₹1,500 is the Kaizen Cost reduction target.

- Cost base for the period just started (t_1) = ₹4,63,54,000 / (7 days × 385 beds) = ₹17,200 per bed per day.

  Working Note – Average bed capacity i.e., 350 + 10% of 350 = 385 beds.

Concept Insight

It is important to understand the difference between the Standard Cost and Kaizen Costing, so refer the table of differentiation below–

Standard Costing	Kaizen Costing
It is a cost control technique.	It is a cost reduction technique.
It assumes current work condition will remain same.	It assumes continuous improving conditions.
Meet cost performance standard.	Achieve cost reduction target.
For larger period usually six or twelve months.	For relatively short span – e.g., monthly or quarterly.
For variance analysis comparison is among the actual & standard cost.	Gap between actual cost and kaizen target cost identified.
Variances need to be reported and addressed.	Reasons for missing kaizen target cost need to be addressed.

(ii) Performance of period just ended (t_0) from the perspective of Kaizen Costing is appreciable because during the years the Kaizen Cost reduction target was ₹1,500, means through Kaizen initiatives it has to reduce the cost from ₹18,750 per bed per day to ₹17,250 per bed per day; whereas Sanjivini Hospital attains the actual average operating cost of ₹17,200 per bed per day, means a reduction of ₹1,550 (i.e., more than Kaizen Cost reduction target was ₹1,500).

In other words, one can say rather than reducing the cost by 8% Kaizen initiatives helps to reduce case by 8.27%; hence performance is acceptable and appreciable.

For better understanding on questions i and ii, refer the table below–

Period	Actual Cost	Standard Cost*	Kaizen Cost Base	Kaizen Cost Reduction Target	Kaizen Cost Target
t_{-1}	18,750	18,500			
t_0	17,200	17,020	18,750	1,500 (i.e., 8%)	17,250
t_1			17,200		
Cost Reduction during t_0	1,550 (attained)			1,500 (desired i.e., 8%)	

** Irreverent for KAIZEN costing.*

(iii) KAI means **change** and **ZEN** means **improvement,** hence 'KAIZEN' represents a change for the better. 'KAIZEN' is a lean process that continuously strives for problem-solving to achieve Total Quality Management.

5S represents a scientific way of workplace management so that work can be performed effectively, efficiently, and safely. 5S acts as the foundation of eight pillars of TPM and represents;

- Seiri means Sorting
- Seiton means Set in Order
- Seiso means Shine
- Sieketsu means Standardization
- Shitsuke means Sustain

At Sanjivini Hospital, the following Kaizen initiatives can be linked with 5S–

- Colour coding of the waste bin to prevent mix-up of medical wastes.
- To save energy, switches were labelled.
- Visual control to prevent stock-out situation or improve inventory control.
- Proper numbering of the patient files to shorten retrieve time.

Note – the Kaizen initiative taken place at Sanjivini largely covered by second 'S' Seiton i.e., set in order.

(iv) Tracking of Kaizen suggestions can easily be practiced at Sanjivini Hospital by maintaining a Kaizen suggestion board that generally comprises–

Kaizen Suggestions	To Do	Doing	Done

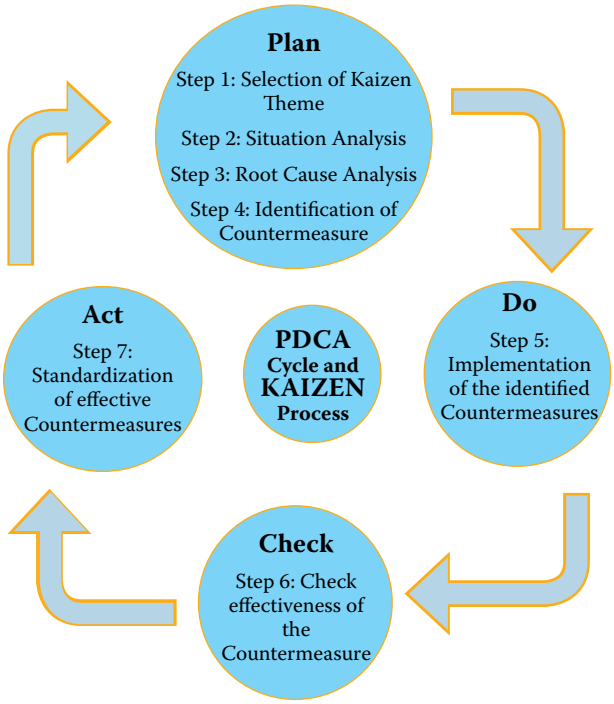
Sanjivini Hospitals can use the KAIZEN suggestion board in the following way (steps)–

- Write the idea on a paper and stick it when you come- up with ideas for improvement.
- Move the paper to "TO DO" when a supervisor or work improvement team are discussing.
- Move the paper to "Doing" when you are practicing the ideas after agreement from the supervisor or work improvement team.
- Move the paper to "Done" when you complete the ideas.

Note – If Sanjivini hospital willing then can collaborate with 5S initiatives as an extension to the Kaizen suggestion board.

(v) The relationship between the Kaizen process and PDCA cycle

Kaizen is solving problems process at working place, to improve situation and condition, whereas PDCA (also known as Deming Cycle) is an iterative four-step management method used in business for the control and continuous improvement of processes and products. PDCA stands for the plan–do–check–act. The PDCA Cycle provides a framework and structure for identifying improvement opportunities. The seven steps of the Kaizen process are:



Note –

The important point that needs to keep in mind is **'the continuous nature of improvements'.** Don't stop after Act, do plan further on.

(vi) The practices that Sanjivini Hospital needs to stress upon in order to foster the culture of Kaizen.

- Promote the culture of sharing of ideas – Best practices can be evolved within the hospital through sharing and discussing the idea (change) that can solve the problem causing a gap in existing and ideal position. Such practices shall be adopted in every vertical of the hospital.
- Do whatever best can be done with existing resources – Reach to the level of optimum utilization and remember there always scope for improvement.
- Foster esprit-de-corps culture – A culture in which no blaming other's opinions, instead of this they support in implementation after the agreement from the supervisor or work improvement team.
- Integrate everyone's image – To have overall perspective while evaluating any individual initiative (suggested change).

Case Study- 5S

Mijaj is the leading household name in the nation for electronics and automobiles. Mijaj inaugurated its two-wheeler plant at Santnagar with a planned capacity of one million motorcycles per annum, more than a decade ago. The plant was originally built on a 65-acre area with another 155 acres allocated for a vendor cluster. The production unit spread out in 40,000 square meters and is operated by 600 line engineers.

In the plant, safety became a critical issue. This is also evident from the report of the review committee, which was submitted to the board of directors recently. Report details all those incidences (that occurred in the last couple of years) when safety norms were breached or safety measures in operation were failed and result in incident or accident.

Total such incidences are 54, out of which major are 11. Results of detailed investigation show that 14 such incidences were taken place due to sheer negligence of workers (it was also identified that 4 of such incidences occurred while the concerned worker was during overtime hours), whereas 37 incidences taken place due to poor workplace management and the remaining 3 are due to power failure.

Out of 37 incidences that took place due to poor workplace management, 19 were due to using either the wrong tool (tool required either misplaced or non-accessible due to any reason) or hazardous/toxic elements were not handled properly including failure to keep the process within the control limits (2 were serious, but no causality); 5 were due to breakdown or failure of machines (4 were serious, and the one incident resulted in a fire resulting in two casualties and injuries to many). It was also identified that all the 5 machines involved were not regularly cleaned and even regarding one of such machines a complaint (that it sparks some time) was also registered by the operator with maintenance staff (same remain unresolved). The remaining 13 were due to cluttered production floor (1 among them were serious, involving one casualty and injuries to some others).

VP Finance after reading the report sent a letter to the board, wherein immediate action is requested. He included the adverse monetary effect of such incidences in the letter.

During the next board meeting, wherein you (management accountant) are also present; an independent director who is an HR professional said 'the consequences of such incidences include defame and low employee morale (apart from litigation and pressure from employee unions), hence resolution shall be prompt and apt.

The CEO responded 'BSC (balanced scorecard) is already in practice at Santnagar plant of Mijaj, which includes Internal Process, and Learning & Growth, the score is also acceptable in both the perspective'. A question was posed related to accidents due to employee negligence are they (employees) learned enough? CEO while responding to question referred report from the HR head, wherein it was mentioned that during such two years 27 training programs were organised and average attendance turned out nearly 80%. Every employee who works on the production/assembly line has to undergo 3 months of training at the time of joining.

The MD expresses his concern over the number of such incidences and surprised to know that BSC is failed to deliver. MD prior to this board meeting, attended a CPE meet wherein he comes to know about 5S, red tag, and marking; but not sure whether these will help or not. MD ordered you to prepare documents showing the application of 5S to the Mijaj's Santnagar plant, apart from preparing the precise checklist and list of benefits owning to different 'S'. It was decided a task force of the director and top executives shall be formed to respond to the issue.

Required

(i) EXPLAIN the 5S briefly followed by a piece of information to the task force on *'is the root causes of incidences that took place due to poor workplace management are connected with the scope of 5Ss?'* Support your answer by correlating the facts given in the case and highlight how 5S can be helpful to Mijaj.

(ii) You prepared the document as desired by MD and gave it to the computer operator to punch in, but she merged the checklist and list of benefits as follows–

a. Working out the procedures defining the course of processes.

b. Are lines, pipes, etc. clean, will they demand repairing?

c. Quick informing about damages (potential sources of damages.

d. Do tools or remainders of materials to production lie on the floor (in the workplace)?

e. Has the floor any irregularity, cracks, or causes other difficulties for the operator's movement?

f. Are the oil's stains, dust, or remains of metal found around the position, machine, on the floor?

g. Better usage of the working area.

h. Are pipe outlets of oils not clogged by some dirt?

i. Shortening of the time of seeking necessary things.

j. Is attention given to keeping the workplace neat and clean?

k. Decreasing of mistakes quantity resulting from the inattention.

l. Is the position (location) of the main passages and places of storing clearly marked?

m. Are all transport palettes stored on the proper heights?

You are also required to CLASSIFY (and re-arrange) in relevant categories of 5S.

(iii) LIST, why do balanced scorecard fails to deliver in all the cases? Critically ASSESS the CEO's response to the question posed.

(iv) EXPLAIN taskforce, for what purpose red-card/tag is meant? How is it used? Are there any other colours tag too?

Solution

(i) **5S** represents a scientific way of workplace management so that work can be performed effectively, efficiently, and safely. 5S first developed by Hiroyuki Hirano and was come into practice as part of the Toyota Production System. 5S is usually considered as an essential component of Lean manufacturing, and the foundation of eight pillars of TPM. 5S are as follows–

- ***Seiri*** means **sorting,** aiming to remove all unwanted, unnecessary, and unrelated materials at the workplace.
- ***Seiton*** means **set-in-order** that consists of putting everything in an assigned place so that it can be accessed or retrieved quickly as well as returned in that same place quickly.
- ***Seiso*** means **shine**. The shining process consists of cleaning up the workplace, keeping it neat, and giving it a 'shine'.
- ***Seiketsu*** means **standardization,** which involves defining the standards by which personnel must measure and maintain cleanliness.
- ***Shitsuke*** means Sustain. **Sustaining** the discipline, which helps in It maintain orderliness and to practice the first 4 S as a way of life

Note – Practice of 5S is a sequential process.

Yes, the root causes of incidences that took place due to poor workplace management at the Santnagar plant of Mijaj are highly connected with the scope of 5Ss.

The incidences that took place were largely due to items at the workplace are either not properly sorted or not in order. Lake of maintenance of the machines in term of cleaning and repair also another major reason for same.

Total of 37 incidences took place due to poor workplace management at the Santnagar plant of Mijaj, which represent more than 2/3 incidence of the last two years.

Description	Reason	Can be overcome
13 incidences (1 were serious, involving one casualty)	Cluttered production floor	**Seiri (sorting)** Use red and yellow tags with store and designated holding area
19 incidences (2 were serious, but no causality)	Using either wrong tool (tool required either misplaced or non-accessible due to any reason) or hazardous/toxic elements were not handled properly including failure to keep the process within the control limits	**Seiton (set in order)** Use of label, signs, colour code, line marking, tool form, or shadowing
5 incidences (4 were serious, involving two casualties)	Breakdown or failure of machines, because they were not regularly cleaned and repaired (even the repair request/ complaints remain unresolved)	**Seiso (Shine)** The operator shall assume the role of cleaner. Cleaning shall involve inspection of all aspects of the machine – front, rear, left-right, top and bottom

If first 3S (sorting, set in order, and shine) become the standard which is adopted by organisation sustainably then the probability of incidences which took place due to unattended-ness of worker shall also be reduced. At the Santnagar plant of Mijaj, there were 14 such incidences in the previous two years. Hence, 5S practice can really help the Mijaj in reducing the probability of more than 90% of incidence to promote safety.

(ii) Classification of checklist items and benefits in relevant categories of 5S

Description of item	Checklist/ Benefit	Category
a. Working out the procedures defining the course of processes.	Benefit	Seiketsu (Standardize)
b. Are lines, pipes, etc. clean, will they demand repairing?	Checklist	Seiso (Shine)
c. Quick informing about damages (potential sources of damages.	Benefit	Seiso (Shine)
d. Do tools or remainders of materials to production lie on the floor (in the workplace)?	Checklist	Seiso (Shine)
e. Has the floor any irregularity, cracks, or causes other difficulties for the operator's movement?	Checklist	Seiri (Sort)
f. Are the oil's stains, dust, or remains of metal found around the position, machine, on the floor?	Checklist	Seiso (Shine)
g. Better usage of the working area.	Benefit	Seiri (Sort)
h. Are pipe outlets of oils not clogged by some dirt?	Checklist	Seiso (Shine)

i. Shortening of the time of seeking necessary things.	Benefit	Seiton (Set-in-order)
j. Is attention given to keeping the workplace neat and clean (SoPs)?	Checklist	Seiketsu (Standardize)
k. Decreasing of mistakes quantity resulting from the inattention.	Benefit	Shitsuke (Sustain)
l. Is the position (location) of the main passages and places of storing clearly marked?	Checklist	Seiton (Set-in-order)
m. Are all transport palettes stored on the proper heights?	Checklist	Seiton (Set-in-order)
Note- Alternate Classification may also be possible.		

(iii) The prominent reasons for the failure of a balanced scorecard to deliver in all the cases are–

- Managers mistakenly think mere use of non–financial measures and Balanced Scorecard is meant for reporting purposes only.
- In case senior executives delegate the responsibility of the implementation to middle-level managers.
- If companies, try to copy measures and strategies used by the best companies rather than developing their own measures suited for the environment under which they function.

Mere draw down the BSC and compute the score is no guarantee that things can't go wrong. An in-depth evaluation is required. The KPIs established may be outdated or irrelevant. Targets may be understated, and performance may be overstated.

CEO's remark includes a reference to report from the HR head, wherein it was mentioned that *during such two years 27 training program was organised and average attendance turned out nearly 80%*. Since learning is something more than training; hence conducting training program will not be enough, if participation and learning of worker are not assured. Physical attendance will not ensure the learning, for this worker need to be engaged and they shall be motivated to practice what they learn during training.

Note - Positive motivation is better than negative motivation to build a constructive culture, hence do link incentive for compliance rather than charging penalty for not following what asked for.

(iv) Red tags help to identify objects that need to be removed from the workplace, in the process of sorting.

How it works - While sorting, place a red tag on the undecided items. This lets everyone know this item needs to be evaluated. Notate on the tag whenever item used afterward that, this will help in deciding the frequency of use and take the decision to leave the item where it was originally placed, relocate the item, or dispose of the item.

Note - Until determining their value, such red-tagged items are placed in the Red Tag Holding Area.

Yes, apart from the red tag, another tag that can be used is the **yellow tag**. A yellow tag contains detailed information (including expected use, dates, etc.) of needful items, which are useful but not required currently, hence usually kept in store.

Case Study – Business Proceess Reengineering

Sim-tech Electronics Limited (SEL) deals in a wide range of electronic products for domestic and commercial use. SEL was established around 40 years back and famous for completely indigenous products. Raw materials including assembly components are procured from registered vendors only. Delayed processing of invoices by SEL is the major concern of vendors. Even a few vendors deny the further supply of material.

The processes at SEL were traditionally designed and hardly modified since its inception. Accounts payable function (process) is also not an exception and requires rationalization. It's not only the obsession of managers but also the fear of workers; that hinders the SEL from revamped even to make minor changes.

The CEO, who joined SEL recently, presided over a meeting where all the functional heads (including finance, marketing, and store, etc.) were present. Highlighting the concern of vendors, the CEO remarked ***'If managers have the vision, re-engineering will provide the way'.*** Many functional heads were unable to understand what the CEO intended to say, especially 'what he meant from the word re-engineering? Is this meant by improvement or innovation?'

Currently, the accounts payable department receives a duplicate hard copy of the purchase order (from the purchasing department), a duplicate of good receipt note (from gate/store), and invoice (from vendor); then match the particulars in all three and only if matched proceed for payment. Managing accounts payables (including processing vendor's invoices) as part of working capital management is KRA of CFO. He mentioned ***'we are thinking to completely automate the process, to speed up the invoice processing'.*** To which the CEO responded ***'Don't automate, do obliterate'. Further CEO said 'why only accounts payable, why not others or all?'***

VP-Production and Operations raised his concern over the identification criteria for processes to be rationalised. VP-HR and Payroll jumped into the discussion with the plausible conflicts and challenges out of the changes, SEL aiming at. CEO stressed the importance of ***'breaking away from the old rules'***.

Required

You were also present in the meeting (as management accountant), hence required to

(i) CEO stressed the 'breaking away from the old rules' and mentioned 'don't automate, do obliterate'. Synthesis of both the statements in the context of BPR. Also ADVISE how account payable function (process) can be re-engineered at SEL.

(ii) Improvement, Redesign, and Re-engineering are not the same. Briefly COMPARE the terms to help the functional heads, who unable to understand the CEO's remark.

(iii) LIST, set of criteria that can be applied to identify the processes suitable for re-engineering.

(iv) LIST the plausible conflicts which SEL may face along with possible the way-out.

(v) CEO said 'why only accounts payable why not others or all'. STATE the steps involved in Business Process Reengineering Life Cycle?

Solution

(i) Business Process Re-engineering (BPR) is a **fundamental rethinking and radical redesign** of business process to achieve **dramatic improvement** in **critical contemporary measures** of performance, such as cost, quality, service, cycle time, etc. **Frederick Winslow Taylor** said to develop a science for each element of a man's work, whereas **Micheal Hammer** thinks differently hence drastically deviate from Taylor in the following manner:

– Hammer looks at ***processes as a whole*** not just as a collection of parts; because only then you can decide on the best way to do the whole process and redesign it radically.

– Hammer wrote an article titled ***'Re-engineering work: Don't automate, obliterate',*** wherein he said don't use IT just to make existing processes faster; be prepared to design a completely new process. Basically, Hammer favours **breaking away from the old rules.**

Hence in both the statement CEO advocates for BPR.

Re-engineering of accounts payable at SEL

Currently, the accounts payable department receives 3 documents in physical hard copy and then matches the same to proceed for payment to the vendor.

Out of these three documents (duplicate hard copy of purchase order, a duplicate of good receipt note, and invoice) accounts payable department can skip invoice and it can proceed for payment based upon auto-matching of good receipt note with purchase order.

Further, a real-time ERP solution (maybe cloud-based or SEL's server-based) can put into place to automate the process of matching the purchase order and goods receipt note (because both the document either created or hosted on the ERP). This also results in saving time, earlier spent in punching the data (at end of account payable department), and physical movement of documents from one department from others.

Maintaining records and generating reports become easy and cheap, Such ERP will also auto-check the invoice details whenever punched into the system.

(ii) Difference between Process Improvement, Process Redesign, and Process Re-engineering

Process Improvement targets to tap incremental improvements, while keeping the process stable (in relative term to process redesign and process re-engineering), whereas **Process Re-engineering** involves radical redesigning of core processes.

Process Redesign is the middle path to both the extremes (Process Improvement and Process Re-engineering).

Refer to the diagram to understand the difference in scope and outcome of Process improvement, Process redesign, and Process re-engineering–

Strategic opportunities or environmental threat (process need to be re-vamped)			**Process Re-engineering**
The process has big problems and needs to change		**Process Redesign**	
Process is stable	**Process Improvement**		
	Smaller sub-process	Mid-sized processes	Core processes (using value chain)

(iii) Criteria to identify the processes

The processes for re-engineering shall be selected with the utmost care by a cross-functional team of managers considering the vision and business goals from a holistic view. SEL shall consider the following points to identify the processes –

- That can be broken into the parts.
- Those which are behaving like constraints (Bottleneck).
- Feasible to make the change.
- Cross-functional and cross-organisational.
- Core processes that have high impact – the business process which capable to add value substantially. One can use a **value chain** to identify high-level processes.
- Front-line customer serving - Business processes that are customer-facing used by front-end employees.

(iv) Challenges in employing BPR

Business Process Re-engineering results in radical changes in the process and may involve automation (or further automation) hence challenges pertaining to change is expected, SEL can expect the following plausible challenges which they need to respond–

- **Decreased employee morale** – Since BPR starts with a mindset that the existing process is not perfect, improvement can be made; means what employees are performing is not of optimal worth. Changes in role and responsibility are expected after BPR, with which employees may not be comfortable and may lose job satisfaction. The staff of the accounts payable department of SEL may be transferred to some other department.
- **Reduced staff (Layout)** – Automation leads to reduction of the workforce, hence job security is a cause of worry. In the accounts payable department of SEL too, many may lose the job.
- **Incomplete impact analysis** – Processes may be complex, hence BPR may result in either indirect effect or effect on an invisible element that can't be predicted with the acute degree.
- **All or nothing methodology** – BPR is all about radical change and looks at ***processes as a whole*** not just as a collection of parts, hence either complete change or nothing to change.

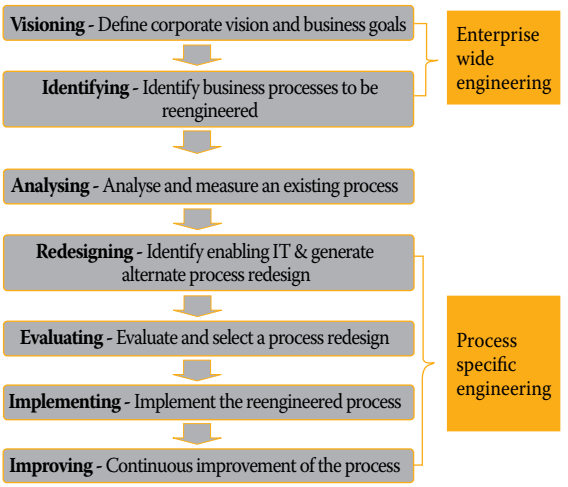
Overcoming BPR challenges

The challenges are due to change and rection of people who will be impacted by change if change management is applied properly then SEL can easily overcome the majority of challenges posed above.

- Focus on all ***change management*** impacts – People, Process, and Systems.
- Communicate early and often.
- Practice continues improvement.

(v) Business Process Re-engineering Life Cycle

Business process re-engineering life cycle involves seven steps out of which first two are enterprise-wide and the remaining five are process specific. Refer to the diagram below–



Skill Assessment Based Questions

The basis objective of the case study is to allow the students to apply ideas and insights from theory to the *real life issues* and *problems.*

Question 1

About Problem	Target Verb/ (s)
Target Costing	Calculate, Assess, Advise, Comment

PX-2 manufactures cartons primarily for the use of manufacturers of electronic products. Cartons are customized for each brand that individual manufacturers produce. Cartons for each brand are unique, having specific scheme of instructions, bar code, information, and pictures. Presently, PX-2 produces at least 35 different types of cartons for each brand and has a market share of 40% in this segment. The market for electronic products is expected to grow exponentially in India. This has attracted not just more electronic products manufacturers but also suppliers of similar cartons to cater to the demand from such manufacturers. Therefore, an electronic product manufacturer can procure customized cartons for its product/(s) from multiple carton manufacturers. PX-2 has been in this business for many decades. It is a family run business.

Production Process

Kraft paper is the primary raw material required to make corrugated cartons. PX-2 buys this from external suppliers. The Kraft paper is loaded into machines called corrugators. Corrugator machines processes this into cardboard sheets. These sheets are then printed upon with unique colour along with information relevant to the electronic product for which it is being made and cut into appropriate size. Batches of finished cartons are packed together and shipped to the warehouse. In the recent years, awareness about corporate social responsibility has led manufacturers of cartons to use recycled paper as raw material to make cartons. Recyclable paper material is procured from scrap paper dealers. Raw material needed for production is stored within the factory premises.

Following is the information available about the production plan and standard costs based on budgets:

- Product Mix: The input mix to produce corrugated cardboard sheets is as below:

Material	Product Mix	Market Price per ton (₹)
Kraft paper	80%	50,000
Recyclable paper	20%	20,000

- Input Output Yield: A ton of raw material processed in the corrugators yields half ton of cardboard sheets (corrugated).
- Operating Costs: A corrugator machine can process 5 tons of cardboard sheets during an hour long production run. Operating cost of the machine for one hour is ₹30,000.
- Printing Costs: Cost of printing customized information and colour/ design costs ₹5,000 per ton of cardboard sheet.
- Other costs required to complete the manufacturing process (Inc. glue, dyes, and wax) is ₹20,000 per ton of cardboard sheet.

These standards represent **"best practices"** for the company that have been followed for the past many years. Standard costs are revisited once every year since it is not possible to do more dynamic costing due to the 35 different types of cartons being produced. This is acceptable both to the production manager and the senior management of the company. Accordingly, the total standard cost computed from the above inputs is acceptable for evaluation of the manufacturing performance.

Storage

PX-2 receives and stores raw material within factory premises. It has a warehouse located 20 kms from its factory where finished corrugated cardboard sheets (cartons) are stored. Shipment of goods from factory to warehouse is made using trucks that the company owns. Later, based on the demand, shipments are made from the warehouse to electronic product/(s) manufacturers all over India. Stacking, dispatching, and shipping of goods is done manually.

Financial Performance

PX-2 sells each ton of carton at ₹1,40,000. In addition to the manufacturing costs detailed above, following costs are incurred:

- Shipping of goods to the warehouse 20 kms away is ₹6,000 per ton.
- Warehouse maintenance expense is ₹30,000 per ton.
- Required profit margin of finished corrugated cardboard sheets (cartons) is ₹5,000 per ton.

A back-of-the-envelope calculation indicates that the cost of operations is actually higher than this sales price. Since the market is highly competitive, PX-2 does not have the flexibility to increase its sale price.

Problem at hand

A close competitor of PX-2 is able to sell similar cartons at ₹1,10,000 per ton. There is not much product differentiation between the goods. A "competitor-study" indicates that the competitor is making reasonable return even at this price. Likewise new entrants are eating into PX-2's market share.

On the production side, the production management team is convinced that they have the best practices in place and that the costs being incurred are reasonable. The loss making financial performance, in their opinion is due to market pricing of the product. On the other hand, the sales manager is of the opinion that given the market competition, the product cannot be sold at any higher price. Hence, the loss cannot be addressed by increasing the sale price.

Required

As a newly employed management accountant you have been requested to suggest possible solutions to improve profitability. Following questions will help you address the problem:

(i) CALCULATE the current cost of operations to produce 1 ton of cartons. Given the current sale price of ₹1,40,000 per ton, what is the profit or loss being incurred?

(ii) Intense market competition and the ability of a competitor to sell a similar product at a much lower price, requires you to use target costing methodology to solve the problem. Taking the competitor's sale price of ₹1,10,000 per ton CALCULATE the target manufacturing cost.

(iii) In the current set-up, CALCULATE ideal manufacturing cost considering most efficient use of resources. Ideal manufacturing cost is when there is no wastage of current resources.

(iv) What conclusions would you draw when you the target manufacturing cost and the ideal manufacturing cost? [Hint: ADVISE].

(v) ASSESS whether the company return improve its profitability when the following actions are taken:

(a) The product input mix is changed as kraft paper 55% and recyclable paper 45%. Market price per ton of kraft paper is now ₹51,000 and of recyclable paper is ₹15,000.

(b) Input output yield improves to 85% from the current level of 50%.

(c) Storage of finished goods at the warehouse is being improved. The company is moving to a smaller warehouse within the same vicinity. Automation of stacking and dispatch operations will be done using forklifts. Storage space is being optimized by stacking the goods on racks that can store more volume within the same floor space. This can reduce warehouse operating costs by ₹5,000 per ton.

(d) Trucks used for shipping are being replaced by more fuel efficient, larger ones. This would save the company ₹2,000 per ton.

(vi) COMMENT on how the above target costing study has made PX-2 environmentally responsible.

Answer

(i) Current cost of producing 1 ton of finished corrugated cardboard sheets (cartons):

Particulars	₹
Raw material cost (refer note 1 below)	88,000
Add: Operating cost (corrugator machine)	6,000
Add: Printing costs	5,000
Add: Other costs	20,000
Current manufacturing cost per ton	1,19,000
Add: Shipping of goods to the warehouse	6,000
Add: Warehouse maintenance expense	30,000
Total cost of operations per ton	1,55,000

At the current sale price of ₹1,40,000 per ton, the company is incurring a loss of ₹15,000 per ton of cartons produced.

Note 1: Material Cost

Material	Product Mix	Market price per ton (₹)	Procurement Price per ton of Input (₹)
Kraft paper	80%	50,000	40,000
Recyclable paper	20%	20,000	4,000
Total procurement price per ton of raw material			44,000

With a yield of 50%, the input raw material needed to produce a ton of corrugated cardboard sheet is 1 ton/50% = 2 tons of raw material. Hence the raw material cost for production of one ton corrugated sheets is 2 tons of raw material × ₹44,000 per ton = ₹88,000.

Note 2: Corrugator Machine

In one hour, the corrugator can produce 5 tons of cardboard sheet. Operating cost for one hour is ₹30,000. Hence operating cost per ton is ₹6,000.

(ii) Target Manufacturing Cost when with sale price of ₹1,10,000 per ton.

Target Manufacturing Cost = Sale price – Required profit margin – Non-manufacturing expense

Particulars	₹
Competitive selling price	1,10,000
Less: Profit margin and non-manufacturing expenses	
Shipping of goods to the warehouse	6,000
Warehouse maintenance expenses	30,000
Required profit margin	5,000
Target manufacturing cost (per ton)	69,000

(iii) Ideal manufacturing cost of production per ton of corrugated cardboard sheet. Ideal manufacturing cost would be the cost incurred when the resources are used in the most efficient manner. In the given problem, the input-output yield of 50% is the only sub-optimized resource. Hence, the ideal cost of production, without wastage of resources would be when the input-output yield is 100%.

When Yield is 100%, only one ton of raw material is needed to produce one ton of corrugated cardboard sheets. As calculated in Note 1 of question 1, the material procurement cost per ton is ₹44,000.

Therefore, the ideal manufacturing cost would be–

Particulars	₹
Raw material cost (yield 100%)	44,000
Add: Operating cost (corrugator machine)	6,000
Add: Printing costs	5,000
Add: Other costs	20,000
Ideal manufacturing cost (per ton)	75,000

(iv) Conclusions drawn from target manufacturing cost and ideal manufacturing cost. Target manufacturing cost is ₹69,000 per ton while ideal manufacturing cost is ₹75,000 per ton of output. Hence, it can be concluded that even with the most efficient use of resources, the target manufacturing cost cannot be achieved. As mentioned in the problem, the "competitor-study" indicates that the competitor selling at ₹1,10,000 per ton is able to earn a reasonable return even at such lower price.

Therefore, it can be concluded that the **presumption that production is based on "best-practices" is wrong.** Unlike the opinion of the production team, the cost being incurred is not reasonable. *Competitors have a more cost efficient production process* that is yielding them profits even at lower sale prices. Therefore, production personnel have to undertake study of more recent advancements in the production process that the new entrants are able to implement. Such a study would include **value analysis** and **value engineering practices.** Study of the input-output yield, which is currently at 50% may result in same savings through streamlining production activities. Similarly, the production can revisit the product mix. If cheaper recyclable paper can be used to in more quantity to produce the same quality of cardboard sheets, significant savings in cost can be achieved. Efforts can also be taken by the senior management to identify areas that can have a favourable impact on cost. For example, upgrading facilities in the production line or storage areas could lead to cost savings.

(v) Assessment of profitability given certain parameters that can be implemented by the company.

Given the implementation of parameters in requirement (v) of the problem, the financials for the company can be as follows:

Particulars	₹
Raw material cost (refer note 1 below)	40,941
Add: Operating cost (corrugator machine)	6,000
Add: Printing costs	5,000
Add: Other costs	20,000
Current manufacturing cost (per ton)	71,941
Add: Shipping of goods to the warehouse	4,000
Add: Warehouse maintenance expense	25,000
Total cost of operations (per ton)	1,00,941
Add: Required margin	5,000
Sales price per ton of output	1,05,941

Note 1: Material Cost (with increase in usage of recyclable material in product mix)

Material	Product Mix	Market price per ton (₹)	Procurement Price per ton of Input (₹)
Kraft paper	55%	51,000	28,050
Recyclable paper	45%	15,000	6,750
Total procurement price per ton of raw material			34,800

Change in the product mix, to include cheaper recyclable paper, without compromising on quality has reduced procurement cost from ₹44,000 to ₹34,800 per ton of raw material. Since recyclable paper component increased substantially, the company used its bargaining power with its suppliers to get a better rate. This is mildly offset by an increase in the rate for kraft paper. Yet, the savings are substantial.

In addition, it is given in the problem that due to value analysis and re-engineering, the yield has improved from 50% to 85%. Therefore, instead of 2 tons of input only 1.17647..... ton of input is required (1 ton output / 85%). Consequently, the raw material cost has reduced from ₹88,000 per ton of output to just ₹40,941 per ton of output (1.17647... tons of raw material × ₹34,800 per ton).

Note 2: Shipping cost to warehouse improved through the usage of better transportation facilities.

Note 3: Operational cost of warehouse has reduced through use of better technology and optimization of space. Cost savings are ₹5,000 per ton of output.

Conclusion: If PX-2 is able to implement these parameters, it can easily turnaround and become profitable. The output can be priced at ₹1,05,941 per ton in order to get a profit of ₹5,000 per ton. This is lower than it nearest competitors offering of ₹1,10,000 per ton. Hence not only can PX-2 become profitable, it can also regain, if not expand its market share.

(vi) How has implementation of recommendations from the target costing study made PX-2 more environmentally responsible?

PX-2 has become more environmentally responsible by through the following measures:

(a) Improving the product input – output yield from 50% to 85% has reduced wastage of raw material. The quantum of Kraft paper/recyclable paper needed for production has reduced from 2 tons to 1.17647..... tons. Since paper is a product made from trees, it contributes towards reduction of cutting down trees / deforestation.

(b) Changing the product mix to include more paper that is recyclable contributes towards better utilization of scrap. Otherwise, such scarp discarded in landfills becomes unusable. Landfills require huge land resources, since waste has to be buried. Hence, better utility of recyclable products protects the environment, places lesser pressure on landfill resources and at the same time reduces cost of operations for the company. By changing the product mix, PX-2 has substantially reduced raw material cost from ₹88,000 to ₹40,941 per ton, a **50% saving!**

(c) Use of efficient transportation facilities reduces fuel emissions. This reduces the pressure for fuel that is derived from natural resources.

(d) Optimization of storage space conserves energy required to operate the warehouse. Again, this reduces pressure on resources like land and electricity.

These are areas where implementation of target costing study made PX-2 more environmentally responsible.

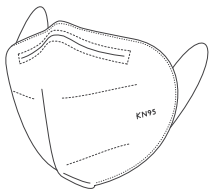
Question 2

About Problem	Target Verb/ (s)
Competitive Advantage, TOC, COQ	Advise

Gupta Surgical Products Limited (GSPL) is a renowned company for the manufacturing of a wide range of affordable surgical products. GSPL is promoted by Dr. Pooja Gupta who is a professor of medicine. GSPL is only privilege surgical equipment company which has its chain of own exclusive stores, which are selling products of GSPL, apart from a tie-up with the medical and chemist shops across the nation for the sale of their products. Although GSPL being an early mover of the industry was established around 25 years back when hardly two or three players exist in the market, but the growth phase of the industry is still continuing. Both the top and bottom line has an increasing trend, but the growth rate of the bottom line is relatively less than the rate in case of the top line, the possible reason is increasing competition. This results in the high cost of advertisement and marketing to keep market share intact. GSPL thinking to enhance the capacity of its plant and other facilities, but availability of fund is a critical issue; since the contraction in margin rate is witnessed for the last couple of years due to stiff competition, despite an increase in absolute amount; GSPL is not ready to commit incremental financial charge on an account of enhanced financial leverage, due to additional borrowing. Hence, GSPL fund their requirements internally.

In order to response proactively to the unfortunate possibility of wide-spread of Novel Corona Virus (COVID-19) in the country, the ministry of public health and welfare appeals all the surgical product manufacturers to scale-up and speed-up the production of surgical products which are useful for protection from contamination and useful for medical professionals.

GSPL is the oldest manufacturer of surgical gloves and face masks. GSPL is manufacturing only KN95 virus protection face mask (KN95) with particulate filtration efficiency more than 95%, which is approved by the regulator and ISO certified. KN-95 masks also recommended by WHO as standard equipment for safeguard. GSPL decided to charge the price of ₹90 for KN95 which is on the lower side to average price charged by other competitors ranging between ₹100-105. The cheaper face masks (blue colour, 3 layers at ₹5-10) are also available for the customer but they are not with the feature which KN95 provides.



Marketing division used to highlight the following features of KN-95 produced by GSPL, but these features more or less similar to competitor's product –

- Flat fold design for easy storage.
- Excellent filtration performance (clinically tested that filtration efficiency is more than 95%).
- Made of high quality thick 5-layer material.
- With exhalation valve.
- Washable (every mask manufacturer in the market claims this feature, but fiber significantly fell weak after wash which deteriorates efficiency. KN-95 has clinically proven result in its favour that even after a wash, if dried in sunlight for 5 minutes it will be resorted to using with the same efficiency as of new mask).
- With adjustable nose clip & self-elasticated ear loops.

With passage of time, condition worsen than expected, hence government relies upon the import of surgical equipment, but COVID-19 related conditions within such countries (from where surgical equipment including masks are imported) also turns unfavourable hence they

impose a temporary ban on the export of surgical equipment including mask. The government again urges domestic surgical equipment manufacturing companies to produce more and more such equipment. In order to motivate these manufacturers, the Ministry of finance came-up with schemes of easy credit, credit without guarantee, interest subvention and moratorium, and exemption from statutory contribution and deferment of duties, and taxes. The government is promoting the use of a home-made mask too.

Dr. Angel Gupta who is CEO of GSPL called a meeting of division heads, including 'Face Mask Division (FMD)' to look into opportunities emerging out of the present PESTLE scenario, and what GSPL can do to seize them with the purpose of enlisting core-competencies require and currently possessed. FMD is equipped with the latest technology and skilled staff who manufacture the KN-95 mask.

In such a meeting division head of FMD proudly mention that currently, they are producing one lac masks on monthly basis. He mentioned it is needless to say, we can sale even if produce more than this. He also briefs both the processes performed by FMD which are –

Cutting and spun bonding - Inner and outer fiber layers are cut-down and spun bonding using nozzles blowing melted threads of a thermoplastic polymer (polypropylene) to layer threads between 15-35 micrometres, which build up into cloth performed.

Stitching and finishing - The outer and inner fiber layers are bonded with output of spun bonding process using thermal techniques and then nose clip welded using mechanical techniques.

He also furnished the below-mentioned information pertaining to current operation aspects of these two processes –

Particulars	Cutting and spun bonding	Stitching and finishing
Monthly Capacity (in units)	1,15,000	1,00,000
Material Cost Per Unit (in ₹)	40	-
Other Operating Cost (in ₹)	10,00,000	6,00,000

FMD follows throughput accounting, hence material cost incurred during cutting and spun bonding operation is the only variable cost.

CEO wish to scale-up the level of capacity and production. She collected a bunch of ideas from division heads and the innovation team. She is from a medical background hence prior to furnishing a proposal to the board; She decided to check validity and viability with help of expert opinion/advice on the following available options–

1. Installing a machine costing ₹2 lacs, which will auto-cut the fiber sheet into requisite space, it will enhance the monthly capacity of cutting and spun bonding by 10% to the current level.
2. An automatic thermal bonding machine can be used which is expected to enhance the monthly capacity of stitching and finishing operation by 20,000 units. Such a machine is available as a monthly lease rental of ₹6 lacs.
3. An outsourcing agency offer to perform the cutting and spun bonding at a rate of ₹6 per unit if the order size is less than 10,000 units, and at a rate of ₹5 per unit of the order size is above 10,000 units. The maximum monthly order which such agency can serve is 20,000 units
4. The same outsourcing agency also offers to perform stitching and finishing process but with a maximum limit of 12,000 units during months period. For this, they will charge a uniform rate of ₹15 per unit.

In the same meeting the Quality Head mentioned that 1,000 units of KN-95 produced are found defective, which neither can be sold (even at subsidies rate) due to strict guidelines by the regulator nor can be reworked/ reprocessed. CEO is curious to know the loss if a defect is discovered at end of the cutting and spun bonding process/ at end of the stitching and finishing process.

Required

You are chief management accountant of GSPL. CEO asks you to draft a report addressing her with ADVISE on–

(i) Assessment of opportunities available for GSPL (considering its current strategic position), while countering the related threats.

(ii) Core competencies, which GSPL possess and can be exploits as Critical Success Factors to gain competitive advantage.

(iii) Viability of each option available with her based upon ideas from division heads and innovation team. Consider each option an independent scenario from others and presume defect is identified at end of the cutting and spun bonding process.

(iv) The cost of poor quality in both the possible cases.

The supporting calculations shall be shown at relevant places in report itself.

Solution

Report

Addressed to;
Office of CEO,
Gupta Surgical Products Limited (GSPL).
Dated – 04th Jan 2023

Report to assist management decisions of strategic importance regarding cost, pertaining to GSPL and FMD (in light of dynamics of the business environment emerging due to outbreak of COVID-19)

(i) Opportunities and related threats

In order to assess the strategic position, one among the major analytical tools is SWOT analysis. Strengths and weaknesses are internally generated, whereas opportunities and threats are emerging from the business environment external to the business boundary. Opportunities and threats are systemic in nature, usually uncontrollable, but can be responded. The length of opportunities and threats depends upon an event (continuing or once-in-while) and series of activities trailing to those events. The outbreak of COVID-19 is also one such event which impact the GSPL significantly because of the nature of business.

Enhanced market demand without the extra cost of advertisement – GSPL is a growing company, but completion too. Amidst the stiff competition, GSPL can see out-break of COVID-19 as an opportunity to sell more and more products. No doubt competitors will try hard to capture the significant share of enhanced market, but GSPL has the advantage of **cost leadership** which make their product affordable in the strategic segment in which they deal (KN-95, if we talk about mask specifically).

One can say enhanced demand is not permanent and it possesses severe threat, but see the option 2, 3, and 4 available, they all are such a nature where not capital cost involved. Machines are taken on lease or task is outsourced (no doubt length of lease and out-source agreement need to be decided carefully).

Another the threat which can be a highlight that the Government themselves is promoting the use of home-made mask too. KN-95 mask is approved by the regulator, ISO certified and recommended by WHO, whereas such a home-made mask obviously not.

Another threat, which can be considered that cheaper masks are also available despite that do not fall in segment (KN-95) in which GSPL deals, still apart from the counter the argument stated in the above point; GSPL can build their market by advertising the feature of 'truly washable' which make KN-95 actually reusable, and it's clinically proved. The reusable nature makes it further cheaper.

It's important here to note the cost leadership is also limited to relevant strategic segment not necessary to the entire market.

Easy availability of credit – GSPL is already considering the enhancement of capacity but finding it difficult due to the adverse effect of borrowing on financial leverage. Announcement from the ministry of finance, regarding schemes of easy credit, credit without guarantee, interest subvention and moratorium, exemption from statutory contribution, and deferment of duties and taxes for surgical equipment manufacturer are opportunities and well in time because the problem of reducing margin can also be addressed while enhancing the capacity without any adverse leverage effect. It is important to consider the length and eligibility criteria of these benefits.

(ii) **Core competencies as Critical Success Factors** – Core Competency is a unique proposition which help firm to stand ahead in the industry by serving value to its customers. Core Competency leads to either **cost leadership or product differentiation**, which is the primary source for a firm to gain **competitive advantage**.

The following are the core competencies which may help the GSPL to gain the **cost leadership position** (to cut down cost where possible, because GSPL is charging ₹90 which is on the lower side the rest of the competitors price which ranges between ₹100 to 105) to attain competitive advantage (enhanced market share).

- **Latest technology** – Division head of FMD said in the meeting itself the FMD (concerned division here) is equipped with the latest technology in order to manufacture the KN-95 mask.
- **Knowledge** – Knowledge is a key resource. Being the initial players who start manufacturing of surgical equipment, GSPL must have a wide knowledge of the industry. Being the oldest manufacturer of KN-95, the mask also possesses certain knowledge about products which capable of putting them ahead of others.
- **Well established marketing network and wider reach** – GSPL is only privilege surgical equipment company which has its chain of own exclusive stores, which are selling products of GSPL; apart from a tie-up with the medical and chemist shops across the nation for sale of their products.
- **Professional management, who know the products well** – Be it promoter or current CEO, being medical professionals are capable to understand the technical dimensions of the product, which place them in a better position to make correct choices/decision.
- **Skilled workforce** – Division head of FMD said in the meeting itself the FMD (concerned division here) is equipped with skilled staff which manufactures the KN-95 mask.
- **Clinically tested that it 'Truly Washable'** – The feature of being truly washable (that even after a wash, if dried in sunlight for 5 minutes it will be resorted to using with the same efficiency as of new mask) is clinically proven in the case of GSPL only.

Note – Availability of credit is not a core competency because this benefit is available to all surgical equipment manufacturers. Similarly recommended by WHO is also not a core competency because, this is plus to all KN-95 mask manufacturers. (External factors are systemic in nature).

(iii) **Viability of options available** (based upon ideas from division heads and innovation team) – the available options can be classified into two categories, options 1 and 2 are related to **process re-engineering** or **automation**; while options 3 and 4 are related to **outsourcing.** 1 and 3 are related to cutting and spun bonding process, whereas 2 and 4 are related to stitching and finishing process.

In order to access the viability of each such option the concept of the **bottleneck (theory of constraints)** and **throughput contribution** is relevant. Currently, the monthly production and sale are one lac units against the monthly capacity of 1,15,000 units (1,13,850 units after considering defective units) in the cutting and spun bonding process and 1,00,000 units in the stitching and finishing process. Hence the stitching and finishing process is bottleneck and operational at maximum possible capacity.

Automation Related

Auto cutting of fiber sheet – The cutting and spun bonding the process is not bottleneck activity, thus has spare capacity of 13,850 units after excluding defective products, it's not making sense to automate the process to enhance capacity further. **Hence it not advised to install the machine.**

Note – If defective units are 1,000 against the current production of 1,00,000 units, then against the production of 1,15,000 units, the defective units will be 1,150. Which means units get through the cutting and spun bonding process are 1,13,850 (1,15,000-1,150).

Automatic thermal bonding machine – Since the stitching and finishing process is the bottleneck activity, and operational at full capacity, hence any option to enhance capacity for which demand is available in the market at price more than relevant cost to be incurred; must be accepted. Since there is net monetary benefit of ₹92,500 (see table below), hence taking **automatic thermal bonding machine on lease is highly advisable.**

Statement of Cost-Benefit

Particulars	₹
Incremental Revenue* × (13,850 @ ₹90)	12,46,500
Less: Incremental Cost (material cost)(13,850 @ ₹40)	5,54,000
Less: Monthly Rental of Machine	6,00,000
Net Benefit	92,500

**Presuming additional sale will take place at the same price.*

Since the capacity of the cutting and spun bonding process is limited to 1,13,850 units (after considering defects), hence enhancing the capacity of stitching and finishing process beyond such 1,13,850 units is not worth. So, the machine will result in only 13,850 additional unit, if cutting and spun bonding process, hold status quo.

Outsourcing

Cutting and spun bonding process – The cutting and spun bonding process is not a bottleneck activity, thus already has spare capacity of 13,850 units, it's not making sense to outsource some of the unit to enhance to capacity further. Given become irrelevant in case. **Hence it not advised to outsource.**

Stitching and finishing process – Since the stitching and finishing process is the bottleneck activity, and currently operating at full capacity, hence any option to enhance capacity for which demand is available in the market at a price more than the relevant cost to be incurred; must be accepted. Since there is net monetary benefit of ₹4,20,000 (see table below), hence **outsourcing of 12,000 units for the stitching and finishing process is highly advisable.** Non-monetary implication of outsourcing can be considered.

Statement of Cost-Benefit

Particulars	₹
Incremental Revenue* (12,000 @ ₹90)	10,80,000
Less: Incremental Cost (material cost) (12,000 @ ₹40)	4,80,000
Less: Cost pertaining to outsourcing (12,000 @ ₹15)	1,80,000
Net Benefits	4,20,000

**Presuming additional sale will take place at the same price.*

(iv) **Cost of poor quality** – The cost of poor quality due to **non-conformance to quality**. This includes the cost of internal and external failures. The **defect which can't be repaired and sold at a reduced price is known as scrap** and loss due to scrap covered under internal failure cost.

If the defect is discovered at the end of cutting and spun bonding process

Against the 1,000 units of KN-95, which found defective at end of cutting and spun bonding process, material required to produce another 1,000 units of KN-95 shall be introduced to the cutting and spun bonding process; because cutting and spun bonding process has a spare capacity of 15,000 units beyond the

current level of production (Cutting and spun bonding process has a capacity of 1,15,000 units against the current production of 1,00,000). Hence additional 1,000 units can be processed but this cause cost equal to material cost (the only variable cost).

Hence in this way amount of loss will be ₹40,000/- i.e., (1,000 units @ ₹40 each)

If the defect is discovered at the end of stitching and finishing process.

The 1,000 units of KN-95, which found defective at end of the stitching and finishing process, will result in loss of revenue (throughput contribution and cost of material); because the stitching and finishing process is a bottleneck activity, which currently operational at maximum capacity. Since only 1,00,000 units on monthly basis can be processed in stitching and finishing process at maximum, hence identification of defective (causing scrap, because non-repairable and non capable of being sold at a reduced price) 1,000 units will result in only 99,000 units of KN-95 available for sale.

Hence, the amount of loss will be ₹90,000/- i.e. (1,000 units @ ₹90 each (since cost of material (40) and throughput contribution (50) already included in this 90 hence become irrelevant individually).

Further details can be tabled on a requisition basis.

Closure of Report

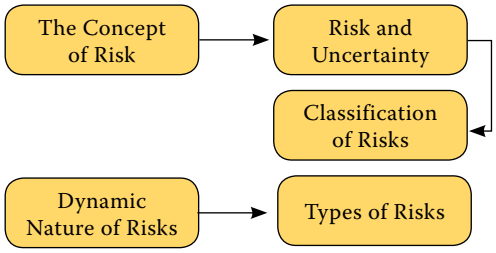
Chief Management Accountant,
Gupta Surgical Products Limited

RISK MANAGEMENT: A CAPSULE FOR QUICK REVISION

The subject "Risk Management" basically involves applying the knowledge and techniques of Risk Management to identify, measure, assess, quantify, monitor and mitigate risks in an organization. So, the Risk Management is basically a continuous process to keep identifying the risk inherent in an organization, monitoring it and taking steps to treat and mitigate it, wherever required. In this regard, an attempt has been made to convey the concepts of Risk Management to the students in a lucid and simple manner in the form of capsules.

CHAPTER 1: INTRODUCTION TO RISK

Chapter Overview



Introduction

Risk derives from the early Italian word "risco" which means danger or "risicare," which means "to dare" or French word "risqué". Risk is a choice rather than a fate. The actions companies dare to take are central to our definition of risk. Risk and reward are two sides of the same coin. Risk leaders choose their risks well. They look at external and internal risks in broad context. They integrate decisions with corporate strategy, and strike a healthy balance between risk management as an opportunity and a protection shield.

ICAI Guide on Risk Based Internal Auditing

Meaning of Risks - In a larger sense, risks are those uncertainties of outcome, whether an opportunity or threat, arising out of actions and events. While looking at them narrowly, risks are those uncertainties which impede the achievement of the objective.

Business Risk - Business risks impede the achievement of the organisation's goals and objectives.

SA 315 of ICAI defines the term **Significant risk** in the context of auditing as – An identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

ICAI's Standard of Internal Audit - Enterprise Risk Management defines Risk as an event which can prevent, hinder, and fail to further or otherwise obstruct the enterprise in achieving its objectives. A business risk is the threat that an event or action will adversely affect an enterprise's ability to maximize stakeholder value and to achieve its business objectives.

SA 315 of ICAI defines Business Risk as a risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

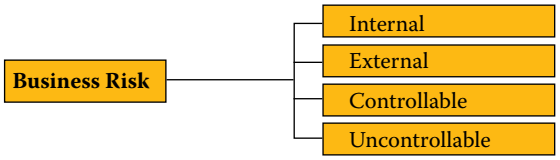
Occupational Health & Safety Advisory Services (OHSAS)

Occupational Health & Safety Advisory Services (OHSAS) defines risk as the combination of the probability of a hazard resulting in an adverse event, and the severity of the event.

Illustrative Corporate Risks

Corporate Functions	Risk Areas
Human Resources	Poor morale & talent retention
Sales & Marketing	Poor Customer loyalty & retention
Operations	Inability to Digitize/ automate processes
Treasury	Low return on investments
Information Technology	Hacking and unauthorized access
New Product development	Product failure
Treasury	Mismatch in cash flows
Finance & Accounts	Unreliable financial statements

Classification of Business Risk



Business Risks: Internal and External

Internal risks arise from events taking place within the business enterprise. Such risks arise during the ordinary course of a business. These risks can be forecasted and the probability of their occurrence can be determined. Hence, they can be controlled by the management significantly.

External risks arise due to events occurring outside the business organisation. Such events are generally beyond the control of the management. Hence, determining the likelihood of the resulting risks cannot be done with accuracy.

Business Risks: Controllable and Non-controllable

Controllable risks arise from the events taking place within the business enterprise. Such risks arise during the ordinary course of business. These risks can be forecasted and the probability of their occurrence can be determined.

Uncontrollable risks however, are those that would have a detrimental financial impact but cannot be controlled. Some uncontrollable risks that are common to many businesses include - Recessionary economy, new competitor locating nearby, and new technology.

ICAI's Standard of Internal Audit

Risk may be broadly classified into Strategic, Operational, Financial and Knowledge.

Strategic Risks	They are associated with the primary long-term purpose, objectives and direction of the business.
Operational Risks	They are associated with the on-going, day-to-day operations of the enterprise.
Financial Risks	They are related specifically to the processes, techniques and instruments utilised to manage the finances of the enterprise, as well as those processes involved in sustaining effective financial relationships with customers and third parties.
Knowledge Risks	They are associated with the management and protection of knowledge and information within the enterprise.

Open Group Standard

The Open Group suggests classifying risks with respect to effect and frequency in accordance with scales used within the organization. There are no hard and fast rules with respect to measuring effect and frequency.

Effect could be assessed using the following criteria as an example:

- **Catastrophic** infers critical financial loss that could result in bankruptcy of the organization.
- **Critical** infers serious financial loss in more than one line of business leading to a loss in productivity and no return on investment.
- **Marginal** infers a minor financial loss in a line of business and a reduced return on investment.
- **Negligible** infers a minimal impact on a line of business' ability to deliver services and/or products.

Frequency could be indicated as follows:

- **Frequent:** Likely to occur very often and/or continuously.
- **Likely:** Occurs several times over the course of a transformation cycle.
- **Occasional:** Occurs sporadically.
- **Seldom:** Remotely possible and would probably occur not more than once in the course of a transformation cycle.
- **Unlikely:** Will probably not occur during the course of a transformation cycle.

Potential scheme to assess corporate impact could be as follows:

- **Extremely High Risk (E):** The transformation effort will most likely fail with severe consequences.
- **High Risk (H):** Significant failure of parts of the transformation effort resulting in certain goals not being achieved.
- **Moderate Risk (M):** Noticeable failure of parts of the transformation effort threatening the success of certain goals.
- **Low Risk (L):** Certain goals will not be wholly successful.

The ICAI Guide on Risk Based Internal Audit

All risks have two attributes, viz.

- Likelihood of risk occurrence.
- Risk consequence.

Measurement of the likelihood of risk is normally against five levels on a scale of 5, viz.

- Remote (score 1).
- Unlikely (score 2).
- Possible (score 3).
- Likely (score 4).
- Almost certain (score 5).

Risk consequences can also be against five levels on a scale of 5, viz.

- Insignificant (score 1).
- Minor (score 2).
- Moderate (score 3).
- Major (score 4).
- Catastrophic (score 5).

Difference between Risk & Uncertainty

Uncertainty	Risk
The lack of complete certainty, that is, the existence of more than one possibility. The "true" outcome/state/result/value is not known.	A state of uncertainty where some of the possibilities involve a loss, catastrophe, or other undesirable outcome.
Measurement of uncertainty: A set of probabilities assigned to a set of possibilities.	**Measurement of risk:** A set of possibilities each with quantified probabilities and quantified losses.
Example: "There is a 60% chance this market will double in five years".	**Example:** "There is a 40% chance the proposed oil well will be dry with a loss of $12 million in exploratory drilling costs".

Complexity, Volatility, Ambiguity and Uncertainty

Complexity

- **Characteristics:** The situation has many interconnected parts and variables. Some information is available or can be predicted, but the volume or nature of it can be overwhelming to process.
- **Example:** you are doing business in many countries, all with unique regulatory environments, tariffs, and cultural values.
- **Approach:** Restructure, bring on or develop specialists, and build up resources adequate to address the complexity.

Volatility

- **Characteristics:** The challenge is unexpected or unstable and may be of unknown duration, but it's not necessarily hard to understand; knowledge about it is often available.
- **Example:** Prices fluctuate after a natural disaster takes a supplier off-line.
- **Approach:** Build in slack and devote resources to preparedness-for instances, stockpile inventory or overbuy talent. These steps are typically expensive; your investment should match the risk.

Ambiguity

Characteristics: Casual relationships are completely unclear. No precedents exist; you face "unknown unknowns."

Example: You decide to move into immature or emerging markets or to launch products outside your core competencies.

Approach: Experiment, understanding cause and effect requires generating hypotheses and testing them. Design your experiments so that lessons learned can be broadly applied.

Uncertainty

Characteristics: Despite a lack of other information, the event's basic cause and effect are known. Change is possible but not a given.

Example: A competitor's pending product launch muddies the future of the business and the market.

Approach: Invest in information-collect, interpret, and share it. This works best in conjunction with structural changes, such as adding information analysis networks that can reduce on-going uncertainty.

Categorization of Risks

Pure Risks are associated with uncertainties which may cause loss. In a pure risk situation, a loss occurs or no loss occurs – there is no possibility for gain. These uncertainties may be due to perils such as fire, floods, etc. or may arise from human action such as theft, accident etc.

Control risks are associated with unknown and unexpected events. They are sometimes referred to as uncertainty risks and they can be extremely difficult to quantify. Control risks are often associated with project management.

Speculative Risks have three possible outcomes: loss, no loss or gain. Examples of such risks include the decision to invest in some shares etc. The statistical techniques used in insurance cannot be applied to speculative risks. Further, these risks are deliberately taken with the hope of gain.

Internal and External factors of Risks

Internal Factors	External Factors
Controllable ■ Stability and financial position of the entity ■ Labour strikes ■ Machine failure ■ Staff morale **Uncontrollable** ■ Accidents ■ Attrition of people ■ Technological change ■ Frauds	**Controllable** ■ Compliance with regulatory changes **Uncontrollable** ■ Economic conditions ■ Floods ■ Earthquake ■ Market/environment

Type of Risks- Illustrative

- **Financial risk** - These risks are associated with the financial assets, structure and transactions of the particular industry.
- **Credit risk** - The risk of loss arising from outright default due to the inability or unwillingness of the customer or counterparty to meet their commitments. Credit risk is the probability of loss from a credit transaction. It is also called as default risk.
- **Liquidity risk** - It arises whenever the bank is unable to generate cash to meet out its liability payment obligations or increase in assets or its failure to manage the unplanned decreases or changes in the funding sources.
- **Market risk** - The risk of losses caused by adverse changes in the market variables such as interest rate, Foreign Exchange rate, equity price and commodity price.
- **Operational Risk**- The risk associated with the operations of an organization. It is the risk of loss resulting from failure of people employed in the organization, internal process, systems or external factors acting upon it to the detriment of the organization.
- **Strategic Risk** - The current and prospective impact on earnings, capital, reputation or good standing of an organization arising from its poor business decisions, improper implementation of decisions or lack of response to industry, economic or technological changes. Failure of strategies will adversely impact the business objectives and attainment of the goals.
- **Compliance Risk** – It includes material financial loss or loss of reputation which may occur as a result of its failure to comply with the laws includes regulations, rules, related self-regulatory organization, standards and code of conduct applicable to its business activities.
- **Regulatory Risk** - Regulatory Risk arises due to changes made in policies and procedures by the regulators viz, RBI, Central and State Governments, SEBI, IRDA, etc.
- **Reputation risk** – Adverse publicity regarding an entity's practices will lead to a loss of revenue or litigation. Any event which affects the name or brand image of the entity is Reputation Risk.
- **Legal risk** - Arises from the uncertainty due to legal actions or uncertainty in the application, interpretation of contracts, laws or regulations. Legal risk is the risk arising from failure to comply with statutory or legal requirements.
- **Management risk** – It means the risks associated with ineffective, destructive or underperforming management, which hurts shareholders and the company or fund being managed.
- **Foreign exchange risk** – Risk of loss that the entity may suffer on account of adverse fluctuations in the exchange rate movements in currencies.
- **Interest rate risk** – Risk where changes in the market interest rates might adversely affect the Net interest Income earnings. It is the threat that interest paid may be more than the interest collected resulting in financial loss.
- **Staffing risk** – Risk of not employing the right person for the right job. Poorly drafted job descriptions, inadequate background verifications and inexperienced personnel contribute to staffing risk.
- **Technology risk** – Risk of not keeping pace with the fast changing technologies for business operations. Usage of out-dated technologies could impact the business operations adversely thereby resulting in loss of reputation, market share, customers, etc.
- **Business continuity risk** – Risk arising from inability to restore operations immediately in the event of an incident / disaster.
- **Information (data security) risk** – Risk of unauthorized access to data. Poor access controls both at the network level and application level give rise to this risk.

- **Country risk** – Helps to address the issues of identifying, measuring, monitoring and controlling country exposure risks.
- **Fraud risk** – Risk of control failures, management override and deliberate acts of omission and commission that lead to financial losses.
- **Price risk** - Probability of loss occurring from adverse movement in the market price of an asset.
- **Process risk** – Inability of the management to meet its process related objectives on account of failed activities in a business process. It is a risk of loss resulting from failure of internal processes, people and systems or from external events.
- **Security Risk** - A person or situation which poses a possible threat to the security of something. Also, security arrangements risk means risk which arises from vulnerability of security systems.
- **Governance risk** - Refers to in-effective, un-ethical management of a company by its executives and managerial levels.
- **Safety risks** - These are the most common and will be present in most workplaces at one time or the other. They include unsafe conditions that can cause injury, illness and death.

CHAPTER 2: SOURCE AND EVALUATION OF RISKS

Chapter Overview

Identification and Sources of Risks → Quantification of Risk and various methodologies → Impact of Business Risk

Identify and assess the impact upon the stakeholder involved in Business Risk → Role of Risk Manager and Risk Committee in identifying Risk

Identification and Sources of Risk

Risk Identification

Meaning – It is the action or process of identifying some potential internal or external event, or threat or vulnerability or a fact that could cause damage to the entity or prevent it from achieving its objectives.

Inclusion - It includes documenting the potential risks in the form of a risk questionnaire or risk register and communicating the risks to the executive management.

Effectiveness - Risk identification is effective when the risk management team understands the business, industry or sector in which the business operates and the key management objectives or key performance indicators. Further, the risk management team should undertake a Strength, Weakness, Opportunity and Threat assessment exercise so as to document the factors that could give rise to potential risks in future.

Participants in the Risk Identification Process

- Business managers
- Project team
- Risk management team
- Subject matter experts
- Customers
- End users
- Other project managers, stakeholders, and
- Outside experts

Business Functions Assessment from Risk Perspective

Generally, business functions that can be assessed from a risk perspective as follows:

Strategic – These include business model risk factors in terms of product demand factors, availability of supply chain inputs at competitive rates, innovation, competition, financial stability and capital access, etc.

↕

Operational – These include process execution and day-to-day issues that the entity is exposed to.

↕

Financial – These concern the effective management and control of the finances of the organization and the effects of external factors such as availability of credit, working capital, foreign exchange rates, interest rate movement and other market exposures.

↕

Knowledge management – Factors contributing to knowledge risks include the unauthorised use or abuse of intellectual property/competitive technology. Internal factors may include loss of key staff.

↕

Compliance management – To manage compliances effectively entities undertake a detailed compliance risk assessment exercise wherein each applicable law is mapped for specific compliance obligation and the mitigating compliance action plan against it is documented.

Quantification of Risk and Various Methodologies

Risk assessment
The determination of quantitative or qualitative estimate of risk consequence related to a scenario or situation and an identified threat or hazard.

Risk Measurement
Once risks have been identified, they are assessed and measured in order to determine their probability of occurrence, costs, opportunity, social and eventual impact on the entity's profitability and capital.

Risk quantification
The process of evaluating and defining the cost and benefits associated with the risk consequences.

Qualitative Risk Assessment

Risk Probability and Impact assessment generally finds answers to the following questions –

- What is the probability that a risk will occur?
- What will it cost the business if it does happen?
- The Probability and Impact Matrix indicates which risks need to be managed.

Risk Impact Matrix

Impact			
	Grid I High impact & low probability; may be reviewed every quater	**Grid II** High impact & medium probability; needs qurterty review with real time monitoring	**Grid III** High impact & high probability; needs quarterly review with online monitoring
	Grid IV Medium impact & low probability; may be reviewed every six months	**Grid V** Medium impact & medium probability; may be reviewed every six months	**Grid VI** Medium impact & high probability; may be reviewed every quater
	Grid VII Low impact & low probability; may be reviewed annually	**Grid VIII** Low impact & medium probability; may be reviewed annually	**Grid IX** Low impact & high probability; may be reviewed every six months

Likelihood (probability)

Tools and Techniques for Risk Quantification

Judgment and intuition
In many situations, the management and auditors have to use their judgment and intuition for risk assessment.

The Delphi approach
A method for structuring a group communication process so that the process is effective in allowing a group of individuals as a whole to deal with a complex problem.

Scoring
First the risks in the business, system and their respective exposures are listed, and weights assigned then product of the risk weight with the exposure weight of every characteristic is computed. The sum of these weighted score gives us the risk and exposure score of the system. System risk is then ranked according to the scores obtained.

Quantitative techniques
These techniques involve the calculation of an annual loss exposure value based on the probability of the event and the exposure in terms of estimated costs.

Qualitative techniques
These techniques are most widely used approaches to risk analysis. Probability data is not required and only estimated potential loss is used.

Expected monetary value
It is the product of two numbers Risk event probability--an estimate of the probability that a given risk event will occur and Risk event value--an estimate of the gain or loss that will be incurred if the risk event does occur.

Simulation
Simulation ties together sensitivities and probability distributions.

Decision Tree
It is a diagram that depicts key interactions among decisions and associated chance events as they are understood by the decision maker.

Expert Judgement
It can often be applied in lieu of or in addition to the mathematical techniques described above.

Frequency of Loss
It measures the number of times losses occur during a particular period of time.

Scenario Analysis
It is extension of Sensitivity Analysis where only one variable at a time is analyzed. Here, we could see the combined effects of changes in more than one variable.

Risk Identification and Assessment Approaches

Some of the important techniques of risk identification are detailed hereunder:

Analysis of processes

Under this technique, material or significant business processes are flow charted.

Brainstorming

Under brainstorming a group of employees put forward their ideas or sensation of risk.

Questionnaires & Interviews

Focused on detecting the concerns of staff with respect to the risks or threats that they perceive in their operating environment.

Checklists

These are information aids to reduce the likelihood of failures from potential hazards, risks or controls that have been developed usually from past experience, either as a result of a previous risk assessment or as a result of past failures or incidents or history or industry learning.

"What-if" Technique (WIFT)

This is a structured, team exercise, where the expert facilitator utilizes a set of "indicators" or "hints" to stimulate participants to identify risks.

Fault Tree Analysis (FTA)

This method is similar to a form of creative thinking called reverse brainstorming. This technique is used for identifying and analyzing factors that can contribute to a specified undesired event (called the "top event").

Bow Tie Analysis

Bow tie analysis is a diagrammatic way of describing, linking and analyzing the pathways of a risk from causes to effects/ consequences.

Direct Observations

This relatively simple technique and is used daily in the workplace by staff who may observe risky situations and hazards regularly.

Incident Analysis

Recording incidents (that has already happened) in a register, conducting root cause analysis and periodically running some trend analysis reports to analyze incidents, which can potentially enable identification of new risks.

Surveys

It is similar to structured interviews but involves a larger number of people. It can be used to collect a broad set of ideas, thoughts and opinions across a range of areas covering risks and control effectiveness.

Workshops

Meeting of group of employees in a comfortable atmosphere, in order to identify the risks and assess their possible impact on the company.

Comparison with other organizations

The technique used for comparing one's own organization with the competitors.

Stakeholder analysis

It includes the process of identifying individuals or groups who have a vested interest in the objectives. It also involves engaging them to better understand the objective and its associated uncertainties.

Working groups

Compact working groups can be formed that could be cross functional, to surface detailed information about the risks i.e. source, causes, consequences, stakeholder impacted, existing controls.

Corporate knowledge

History of risks provides insight into future threats or opportunities through: -

- Experiential knowledge
- Documented knowledge
- Lessons learned

Risk Treatment Options

Sr. No	Risk action	Description
1	Avoid	Exiting the activities giving rise to risk. Risk avoidance may involve exiting a product line, declining expansion to a new geographical market, or selling a division.
2	Reduce/ Manage	Action is taken to reduce the risk likelihood or impact, or both. This, typically, involves any of the myriad of everyday business decisions. This involves addressing the root cause of the risk factor.
3	Transfer/ Share	Reducing the risk likelihood or impact by transferring or, otherwise, sharing a portion of the risk. Common techniques include purchasing insurance cover, outsourcing activities, engaging in hedging transactions.
4	Accept	No action is taken to affect the risk likelihood or impact. This is mainly in cases where the risk implications are lower than the Company's risk appetite levels.

Impact of Business Risk

Sr. No	Impact Areas	Nature of Impact
1	Strategy and business objectives	Delays, change management, failure to achieve objectives
2	Financial	Direct or indirect financial loss
3	Customer	Loyalty, relationship, payment terms, attrition
4	Employee	Morale, engagement, attrition
5	Vendor/ supplier	Loyalty, relationship, payment terms, attrition
6	Compliance	Delays, penalties, offences, defaults, imprisonment
7	Reputation/ Brand equity	Loss of confidence, public exposures, litigation, etc.

Classification of Risks on the basis of impacts

Risks can be classified on the basis of their impacts into following rating buckets:

Analyzing the Level of Risk

To analyze risks, we need to work out the likelihood of its happening (frequency or probability) and the consequences it would have (the impact) of the risks that are identified.

A risk analysis can be presented in the form of a matrix as follows:

Likelihood scale

Level	Likelihood	Description
4	Very likely	Happens more than once a year in the industry
3	Likely	Happens about once a year in the industry
2	Unlikely	Happens every 10 years or more in the industry
1	Very unlikely	Has only happened once in the industry

Consequences scale

Level	Consequence	Description
4	Severe	Financial losses greater than ₹5 Crores
3	High	Financial losses between ₹1 to 5 Crores
2	Moderate	Financial losses between ₹10 Lacs to 1 Crore
1	Low	Financial losses less than ₹10 Lacs

Once the level of risks are completed, we then need to create a risk rating table by multiplying Likelihood Scale with the Consequences Scale to evaluate the risk for making a decision about its severity and ways to manage it.

Risk rating table

Risk rating	Description	Risk Management Action
12-16	Severe	Needs immediate corrective action
8-12	High	Needs corrective action within 1 week
4-8	Moderate	Needs corrective action within 1 month
1-4	Low	Does not currently require corrective action

Identify and Assess the Impact upon the Stakeholders Involved in Business Risk

S. No.	Stakeholders	Nature of Impact
1	Owners, Boards & Management	Failure to achieve objectives, Delays, Change management, disruption, financial losses, etc.
2	Society	Loss of confidence, health hazards, direct or indirect financial losses, disruption in life style, etc.
3	Consumer	Health, financial losses, loss of confidence, etc.
4	Employee	Life, health, morale, engagement, attrition
5	Vendor/ supplier	Loyalty, relationship, payment terms, attrition
6	Government, Regulators	Revenue loss, delays in project implementations, loss of public confidence, etc.
7	Investors	Loss of confidence, lower returns, litigation, financial losses, etc.

Principles For Effective Implementation of Risk Management Recommended By OECD

Risk managers were often separated from management and not regarded as an essential part of implementing the company's strategy. Most important of all, boards were in a number of cases ignorant of the risk facing the company.

↓

The aim is to ensure that risks are understood, managed and, when appropriate, communicated.

↓

Effective implementation of risk management requires an enterprise-wide approach rather than treating each business unit individually.

↓

The board should also review and provide guidance about the alignment of corporate strategy with risk-appetite and the internal risk management structure.

↓

To assist the board in its work, it should also be considered good practice that risk management and control functions be independent of profit centers and the "chief risk officer" or equivalent should report directly to the board of directors along the lines.

↓

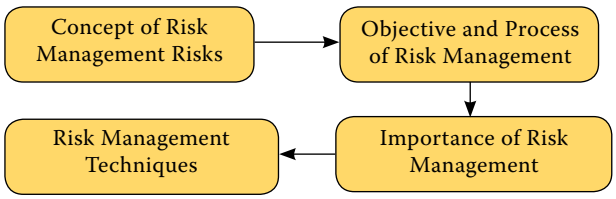
The process of risk management and the results of risk assessments should be appropriately disclosed.

↓

Corporate governance standard setters should be encouraged to include or improve references to risk management in order to raise awareness and improve implementation.

CHAPTER 3: RISK MANAGEMENT

Chapter Overview



Concept of Risk Management

Source	Views
Warren Buffet	Risk comes from not knowing what you are doing.
Theodore Roosevelt	Risk management is about people and processes and not about models and technology.
The Risk Management Standard, The Institute of Risk Management	Risk management is a central part of any organization's strategic management. It is the process whereby organizations methodically address the risks attaching to their activities with the goal of achieving sustained benefit within each activity and across the portfolio of all activities.
Thomas S. Coleman, Practical Guide Risk Management, CFA Institute	Risk management is the art of using lessons from the past to mitigate misfortune and exploit future opportunities—in other words, the art of avoiding the stupid mistakes of yesterday while recognizing that nature can always create new ways for things to go wrong.

Risk Attitude, Appetite, and Tolerance

Risk Attitude – It depends upon one's temperament such as whether a particular individual or an organization is risk-averse, risk-neutral, or risk-seeking.

Risk tolerance – Means how much risk an organization can tolerate or willing to withstand.

Risk appetite – The risk taking capacity and looks at how much risk one is willing to take.

Risks Appetite – Principles and Approach

Risk appetite can be complex

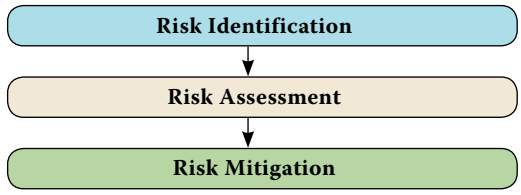
Risk appetite needs to be measurable

Risk appetite is not a single, fixed concept

Risk appetite should be developed in the context of an organization's risk management capability, which is a function of risk capacity and risk management maturity

Risk appetite must be integrated with the control culture of the organization

Objectives of risk management



Step by Step Process of Risk Management

Steps	Action	Principles
Step 1: Identify the Risk	Uncovering, recognizing and describing risks that might affect your project or its outcomes.	Risk identification – What can go wrong?
Step 2: Analyze the risk.	Determining the likelihood and consequence of each risk.	Risk analysis – How will it affect us?
Step 3: Evaluate or Rank the Risk.	Evaluating or ranking the risk by determining the risk magnitude, which is the combination of likelihood and consequence.	Risk control – What should we do?
Step 4: Treat the Risk.	Minimizing the probability of the negative risks as well as enhancing the opportunities by creating risk mitigation strategies, preventive plans and contingency plans.	Risk treatment – If something does happen, how will you pay for it?
Step 5: Monitor and Review the risk.	Reviewing the Risk Register and use it to monitor, track and update risks.	Risk Monitoring – How can we continuously look at foresight and hindsight?

Risk Management Techniques

Tolerate: The exposure may be tolerable without any further action being taken.

Transfer: For some risks, the best response may be to transfer them. This might be done by conventional insurance or by paying a third party to take the risk.

Terminate: Some risks can only be treatable, or containable to acceptable levels, by terminating the activity itself.

Treat: By far, a large number of risks are addressed in this way. The purpose of treatment is to continue with the activity giving rise to the risk and action (internal control) is taken to contain the risk to an acceptable level.

CA FINAL - PAPER 6B - FINANCIAL SERVICES AND CAPITAL MARKETS

The objective of the Elective Paper 6B – Financial Services and Capital Markets in the CA Final course is to enable the students to gain knowledge of financial services rendered by intermediaries and banks and their role and activities in the financial market in general and the capital market in particular. The purpose is also to help the students in acquiring such knowledge to address issues in practical scenarios.
In this respect, an attempt has been made to acquaint the students about Global Financial Markets, Capital Market – both Primary and Secondary, and Money Market in a pictorial form to help them to have a quick revision of the chapters. Furthermore, students may please note that this capsule should not be considered a substitute for the study material. Therefore, students are advised to refer to the November 2020 edition of the study material for Part A and July 2021 edition for Part B for May 2022 examination.

CHAPTER 1 – GLOBAL FINANCIAL MARKET

CHAPTER OVERVIEW

Introduction to Global Financial Market → Role of Financial Market in Economic Development of a country → Stakeholders in Financial Market → Indian Financial Market Scenario

MAJOR TYPES OF FINANCIAL MARKETS

Stock Market → Bond Market → Commodities Market → Derivative Market

IMPORTANCE OF FINANCIAL MARKETS

There are many social benefits that financial markets facilitate, including:

They provide individuals, companies, governments and quasi-government organisations with access to capital;

↓

People with surplus funds for investment get channels for investment and are assured of fair treatment as there is a regulator.

↓

Financial markets create jobs as there are many people involved in direct and indirect activities.

ROLE OF FINANCIAL MARKET IN ECONOMIC DEVELOPMENT OF A COUNTRY

Puts savings into more productive use

↓

Determines the price of securities

↓

Makes financial assets liquid

↓

Lowers the cost of transactions

STAKEHOLDERS IN FINANCIAL MARKET

Primary stakeholders in financial market

Shareholders → Lenders → Companies → Mutual fund Organisations/ holders/fund managers

Service providers in Financial Market considering international scenario

Merchant Banker

The functions of merchant banker include – submitting offer documents to SEBI, due diligence i.e. certifying that all the disclosures made in the draft prospectus or letter of offer are true and fair and will enable the investors to make an informed decision, etc.
In international scenario, especially in USA, top Merchant Bankers are Merrill lynch, Citigroup, Goldman Sachs, J.P. Morgan and Morgan Stanley. They provide services to top companies in the world.

Brokers

Stock Brokers are individuals who participate in the stock market on behalf of clients. They buy and sell shares on behalf of the clients on their instructions. In order to actively participate in the capital market, they should be SEBI registered.
Globally, margin financing is popular, in which, many large broking houses provide financing facilities to clients who borrow money to invest in stocks. Therefore, Stock exchanges monitor the extent to which brokers are lending in line with their net worth.

Underwriters

Underwriters are those persons who assume the risk of others. In capital market, in case of new issues, they assume risk by guaranteeing that in case the shares are not subscribed fully by the public, the unsubscribed portion will be subscribed by the underwriter itself.

Depositories

Depository is an institution which maintains investors account in electronic form. One of the main functions of the Depository is to transfer the ownership of shares from one investor to another whenever the trading of shares takes place.
There are two types of depositories in India which are known as NSDL (National Securities Depository Limited) and CSDL (Central Depository Services (India) Limited). **Globally**, depositories provide the same set of services as has been rendered by CDSL and NSDL.

Custodians

Custodians provide custodial services for safe keeping of securities. After liberalisation in 1991, **Foreign Institutional Investors (FIIs)** were allowed to invest in the Indian Capital Market. Most of the FII business in India is routed through foreign custodians.

Regulators in financial market

Securities and Exchange Board of India (SEBI)

SEBI was born in 1992. The basic objective was to protect the interest of investors in securities and promote the development of securities market.
Securities Exchange Commission (SEC) in USA performs more or less the same functions as given to SEBI. But the stark difference is the amount of penalty. SEC can impose an unlimited amount of fine which SEBI cannot.

Reserve Bank of India

The preamble of the Reserve Bank of India describes its main functions as to regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.
Federal Reserve (Fed) in the USA's policies is primarily driven by growth and employment figures, at the expense of inflation. On the other hand, we have the RBI, whose policies are primarily driven by inflation, at the expense of growth.

Insurance Regulatory and Development Authority of India (IRDAI)

The main aim of the Insurance Regulatory and Development Authority of India is to protect the interest of holders of Insurance policies to regulate, promote and ensure orderly growth of Insurance industry and for matters connected therewith or incidental thereto.
In USA, insurance is almost regulated by the individual state governments. In Canada, Office of the Superintendent of Financial Institutions Canada (OSFI) sets the minimum regulatory requirements and expectations to support policy holder and creditor protection, giving due regard to the need to allow institutions to compete effectively.

Pension Fund Regulatory and Development Authority (PFRDA)

To be a model Regulator for promotion and development of an organised pension system to serve the old age income needs of people on a sustainable basis.
The main law which governs the establishment, maintenance, and termination of pension plans in the United States is the Employee Retirement Income Security Act (ERISA).

Administrative authorities to facilitate the financial market

Association of Mutual funds of India (AMFI): The Association of Mutual Funds in India (AMFI) is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders.

Foreign Exchange Dealers Association of India (FEDAI): It's major activities include framing of rules, governing the conduct of inter-bank foreign exchange business among banks vis-à-vis public and liaison with RBI for reforms and development of forex market.

Fixed Income Money Market and Derivative Association of India (FIMMDA): FIMMDA is a voluntary market body for the bond, money and derivatives markets.

Association of Investment Bankers of India (AIBI): AIBI was promoted to exercise overall supervision over its members in the matters of compliance with statutory rules and regulations pertaining to merchant banking and other activities.

Internationally, International Association of Investment Bankers (IAIB) since its inception in 1994 has leveraged its collective expertise, best practice knowledge, industry insights, and global reach to assist clients in executing mergers, acquisitions, divestitures, and strategic partnerships.

CHAPTER 3 – CAPITAL MARKET - PRIMARY

CHAPTER OVERVIEW

Functions of Capital Market → Major constituents of Capital Market → Segments of Capital Market → Capital Market Instruments → Aspects Of Primary Market

Functions of Capital Market

Capital Market is basically a part of financial market where buying and selling of long term debt or equity takes place. The main role of capital market is providing a platform where long term funds are raised. The major functions are:

- To mobilise resources for investments.
- To facilitate buying and selling of securities.
- To facilitate the process of efficient price discovery.
- To facilitate settlement of transactions in accordance with the predetermined time schedules.

Segments of Capital Markets

Primary market is a market where buying and selling of new securities take place for the first time. In other words, the market, where the first public offering of equity shares or convertible securities by a company take place which is followed by the listing of a company's shares on a stock exchange is called a primary market. It is also known as 'initial public offering' (IPO). Issue of further capital by companies whose shares are already listed on the stock exchange also comes within the ambit of Primary market.

Secondary market is a market in which purchase and sale of securities which are already issued to the public for the first time and listed on the stock exchange takes place. Therefore, secondary markets are called stock exchanges and over-the-counter market. When the securities are transferred from the first holder to another, the securities are said to be traded in secondary markets.

Capital Market Instruments

Shares: Share is a type of security, which signifies ownership in a corporation and represents a claim on the part of the corporation's assets and earnings. As one acquires more shares, his or her ownership stake in the company becomes greater.

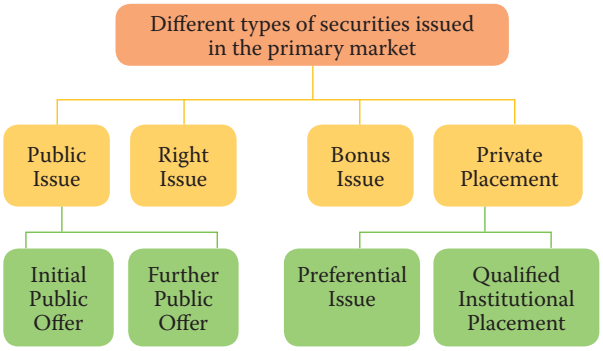
Preference Shares: These shares form part of the share capital of the company which carry a preferential right to be paid in case a company goes bankrupt or is liquidated. Preference shareholders have got very negligible voting rights. But they do have a higher claim on the assets and earnings of the company.

Debentures/ Bonds: One of the most popular long term debt securities among corporates is bond. In case of a bond issue, the buyer of bonds lends the required amount to the issuer of bonds.

American Depository Receipt (ADRs): An American Depository Receipt (ADR) is a negotiable receipt which represents one or more depository shares held by a US custodian bank, which in turn represent underlying shares of non-US issuer held by a custodian in the home country.
Global Depository Receipts (GDRs): Global Depository Receipts are negotiable certificates issued by a depository based outside India to non-resident investors with publicly traded equity shares or foreign currency convertible bonds of the issuer in India as underlying security.

Derivatives: A derivative is a financial instrument which derives its value from some other financial price. This 'other financial price' is called the underlying. The most important derivatives are futures and options.

Aspects of Primary Market



(1) Types of Offer Document

Draft offer document is an offer document filed with SEBI for specifying changes, if any, in it, before it is filed with the Registrar of Companies (ROCs).

Red herring prospectus is an offer document used in case of a book built public issue. It contains all the relevant details except that of price or number of shares being offered. It is filed with ROC before the issue opens.

Prospectus is an offer document in case of a public issue, which has all relevant details including price and number of shares or convertible securities being offered.

Letter of offer is an offer document in case of a Rights issue of shares or convertible securities and is filed with Stock exchanges before the issue opens.

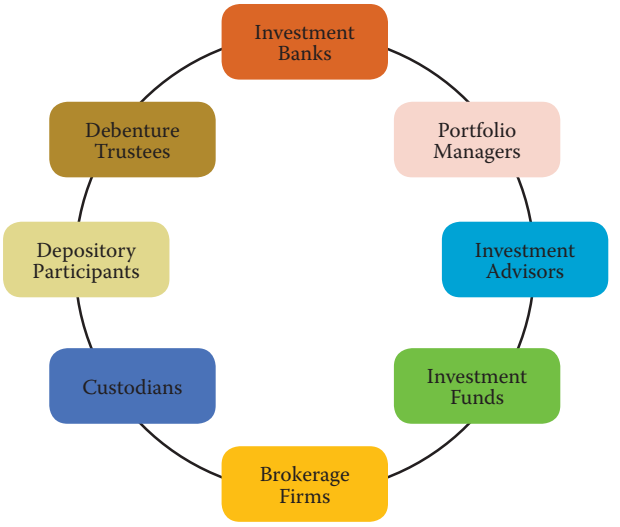
Abridged prospectus is an abridged version of offer document in public issue and is issued along with the application form of a public issue. It contains all the salient features of prospectus.

Abridged letter of offer is an abridged version of the letter of offer. It is sent to all the shareholders along with the application form.

Shelf prospectus is a prospectus which enables an issuer to make a series of issues within a period of 1 year without the need of filing a fresh prospectus every time. This facility is available to public sector banks, scheduled banks and Public Financial Institutions.

Placement document is an offer document for the purpose of Qualified Institutional Placement and contains all the relevant and material disclosures.

(2) Capital Market Intermediaries



(3) Applications Supported by Blocked Amount (ASBA)

ASBA is basically an application by investors for subscribing to an issue containing an authorisation to block the application money in a bank account. Therefore, one's money stays in one's bank account until allotment of the issue takes place. There is no hassle of refunds - in case of less or no allotment of shares. The advantage is that one gets to earn interest even on the blocked amount until it is debited for allotment.

(4) Green Shoe Option

It is an overallotment mechanism. Green Shoe Option is an option to allocate shares in excess of the shares which have already been issued to the public. It is a price stability mechanism to provide post listing price stability to an initial public offering.

(5) Anchor Investors

Anchor investors are Qualified Institutional Buyers (QIB) who purchases shares one day before the IPO opens. They help in arriving at a fair price and instil confidence in the minds of the investors. As the name suggests, they are supposed to 'anchor' the issue by agreeing to subscribe to shares at a fixed price so that other investors may know that there is demand for the shares offered.

(6) Private Placement of Shares

Private placement is the process of raising capital directly from institutional investors. A company that does not have access to or does not wish to make use of public capital markets can issue stocks, bonds, or other financial instruments directly to institutional investors. Institutional investors include mutual funds, pension funds, insurance companies, and large banks.

(7) Disinvestment

It means sale of equity shares of PSU's which leads to dilution of govt.'s shares in such PSU's. The disinvestment programme was initiated by the Govt. of India in 1992-94.
The purpose of the disinvestment programme of the Govt. of India was to garner funds which can be utilised for development purpose. Another purpose was to make the loss making PSUs come out of the doldrums and contribute to the Indian economy.

(8) Right Issue

The rights issue involves selling of securities to the existing shareholders in addition to their current holding at a discount.

(9) Exit Offers

With reference to capital market, the term 'exit offers' refers to delisting. Delisting is actually the reverse of listing. So, what is the meaning of the term listing? Listing is basically a platform provided to the newly issued securities of the company in which sale and purchase of the securities of a company takes place. On the other hand, delisting means to permanently remove the securities of a listed company from a stock exchange.

CHAPTER 4 – CAPITAL MARKET - SECONDARY

CHAPTER OVERVIEW

Functions of Secondary Market → Stock Market Organisation in India → Demutualisation of Stock Exchanges → Share Trading in Secondary Market

Functions of Secondary Market

Secondary market is a market where shares initially issued are traded. Trading of securities takes place when securities are purchased or sold. This market is also known as stock market. In India, secondary market consists of recognised stock exchanges operating under rules, regulations and guidelines approved by the government. Various functions are as follows:

Economic Indicator – Every major change in the economy either due to government policy or any major international event has a bearing on the secondary/stock market.

Valuation of Securities – Secondary market helps in the valuation of securities through its demand and supply.

Transaction in securities is safe in the secondary market – Transactions executed in the secondary market are safe because all the trading takes place in an electronic system which is highly secure.

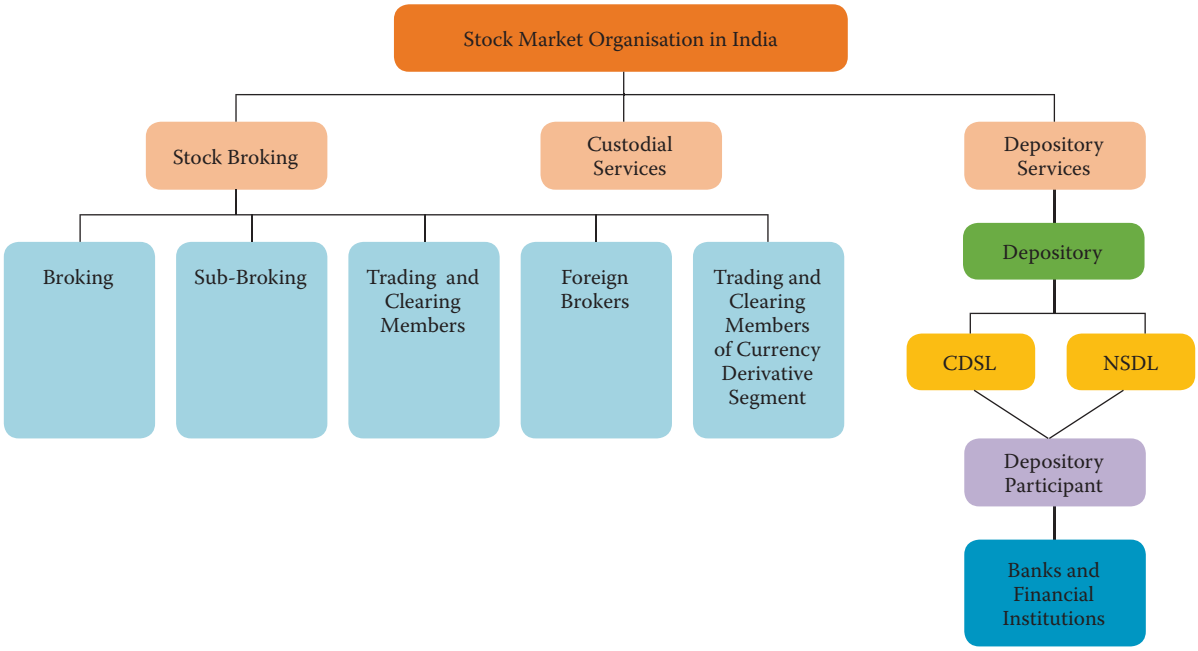
Contributes to economic growth – It contributes to economic growth through allocation of funds to the most efficient sector through the process of disinvestment to reinvestment.

Motivating people to invest in equity shares – Efficient secondary market motivates people to invest in the securities market.

It ensures safety and measure of fair dealing to protect investors' interest.

It induces companies to improve their performance since market price of shares showing at the stock exchanges is the indicator that reflects a company's performance and is easily available to the investors.

STOCK MARKET ORGANISATION IN INDIA



The stock market organisation in India as shown in the above diagram is discussed as below:

Stock Broking – Brokers are members of stock exchange. They enter into share trading transactions either on their own account or on behalf of their clients. They have to get registration from SEBI before starting their operations and have to comply with the prescribed code of conduct.

Custodians – The related services provided by them are as follows:

Maintaining accounts of the securities of a client.

Collecting the benefits/rights accruing to the client in respect of securities.

Keeping the client informed of the actions taken by issuer of securities.

Maintaining and reconciling records of the services as referred above.

Depository System – A major reform of the Indian stock markets has been the introduction of the depository system and scripless trading mechanism. The Depository Act was passed in 1996 to provide further fillip to the process.

The issuers should enter into an agreement with the depository to enable the investors to dematerialise the securities.

Demutualisation of Stock Exchanges

A demutualised stock exchange is basically a company form of organisation in which the company goes public and owners will be given equity shares. Advantages of Demutualisation are as follows:

- Enable stock exchanges to have more access to funds for investment in technology.
- Facilitate merger and acquisition of other exchanges and alliances with other stock exchanges.
- Benefit to members of the stock exchange as their asset becomes liquid and members get share of the profits made by exchanges through dividends.
- Makes operations of the stock exchanges transparent.
- Transparency brings better governance.

Share Trading in Secondary Market

Open a Bank Account: The first step towards investing in Indian stock market is to open a bank account. A bank account is required to hold the funds which would be investing in secondary market.

Open a Demat Account: Just as a bank account is required to hold the funds, a Demat Account is required to hold and trade the securities i.e. shares, debentures and mutual funds electronically.

Open a trading account: After opening a Demat account, a trading account is required to trade in securities market. A trading/ brokerage account allows you to purchase stocks, bonds, mutual funds, and other units by paying the broker to do the trading on your behalf.

Trading Mechanism: With the advent of technology, trading at stock exchanges are now taking place through an open electronic limit order book, in which order matching is done by the trading computer. The buy or sell orders placed by the investors are matched automatically with the order which is best for them.

Payment to Broker for purchase of shares/securities: The payment for the shares purchased is required to be done prior to the pay-in date for the relevant settlement or as otherwise provided in the Rules and Regulations of the Exchange.

Delivery of shares to the broker for sale: The delivery of shares has to be done prior to the pay-in date for the relevant settlement or as otherwise provided in the Rules and Regulations of the Exchange and agreed with the broker/sub-broker in writing.

Shelf prospectus is a prospectus which enables an issuer to make a series of issues within a period of 1 year without the need of filing a fresh prospectus every time. This facility is available to public sector banks, scheduled banks and Public Financial Institutions.

Receipt of money for a sale transaction and receipt of shares for a buy transaction: Brokers were required to make payment or give delivery within two working days of the pay-out day. However, as settlement cycle has been reduced from T+3 rolling settlement to T+2, the pay out of funds and securities to the clients by the broker will be within 24 hours of the pay-out. Recently, stock market has shifted to a shorter settlement cycle of T+1.

Buy Back of Shares

The buyback is a process in which a company uses its surplus cash to buy shares from the public. It is almost the opposite of initial public offer in which shares are issued to the public for the first time. In buyback, shares which have already been issued are bought back from the public. And, once the shares are bought back, they get absorbed and cease to exist.

Risk Management in Secondary Market

I. Trading Rules and Regulations

Strict rules and regulations have been framed to prevent unfair trading practices and insider trading. Stock exchanges impose different types of margins on brokers for individual stocks, depending upon the exposures taken by these brokers in these stocks, both on ownership basis and on behalf of clients.

II. Circuit Breakers to Curb Excess Volatility

Circuit Breaker is a temporary halt or suspension of trading in any particular stock or index for certain period of time. The move is basically resorted to curb excess volatility in the stock market.

Circuit Breaker

Trigger limit	Trigger Time	Market halt duration
10%	Before 1 p.m.	45 minutes
	At or after 1 p.m. upto 2.30 p.m.	15 minutes
	At or after 2.30 p.m.	No halt
15%	Before 1 p.m.	1 hour 45 minutes
	At or after 1 p.m. upto 2 p.m.	45 minutes
	On or after 2 p.m.	Remainder of the day
20%	Any time during market hours	Remainder of the day

III. Trading and Settlement

Rolling settlement is basically settlement of transaction in stock market in a certain number of days after the trade is agreed.

Rolling Settlement

Activity	Description of Activities	Day	Timings
Trading	Trading by investors	T day (i.e. Trading day)	
Clearing	National Securities Clearing Corporation Ltd. (NSCCL) confirms the trade from stock exchange. Then, NSCCL processes and downloads obligation files to brokers.	T+1	By 1.30 p.m.
Settlement	Pay-in of securities and funds to NSCCL. NSCCL gives pay out of securities and funds.	T+2	By 10.30 a.m. By 1.30 p.m.

As the stock market is shifted to T + 1 recently, it would mean that trades will be settled the day after the transaction. So, a buyer would get the shares in the demat account and the seller would get the sale proceeds the next day.

IV. National Securities Clearing Corporation Limited (NSCCL)

The NSCCL undertakes the counter party risk of each member and guarantees settlement. Settlement guarantee is a guarantee provided by the clearing corporation for the settlement of all trading of products in the stock exchange.

The organisations linked with Clearing Corporation in the clearing and settlement process are discussed as below:

Custodians/ Clearing Members

NSCCL takes trading information from the exchange and pass the trade details to custodians/ clearing members. Custodians confirm the obligations of the parties by netting.

Clearing banks

They act as a link between clearing corporation and clearing member. Every clearing member is required to maintain a clearing account with one of the clearing banks.

Depositories

They hold securities in dematerialised form for the investors in their beneficiary account. Every clearing member is required to maintain a clearing pool account with the depositories.

V. Market Making System

The job of the market maker is to provide liquidity to the stock market by providing a two way quote i.e. a buy and a sell quote. So, without the presence of market makers, very few trades could happen. Consequently, companies would have more limited access to capital.

VI. Securities Lending and Borrowing

Securities lending means lending of stocks, derivatives and other securities to investor or firm. Securities lending requires the borrower to pledge, whether cash, security or a letter of credit to the lender. When a security is lent, the title and the ownership are also transferred to the borrower.

VII. Straight Through Processing (STP)

The concept of Straight Through Processing is designed to complete the transaction without human intervention. Straight through processing (STP) is an initiative that financial companies use to optimise the speed at which they process transactions. This is performed by allowing information that has been electronically entered to be transferred from one party to another in the settlement process without manually re-entering the same pieces of information repeatedly over the entire sequence of events.

VIII. Margin Trading

Margin Trading is a facility given to the investors in which they can invest in shares by part financing from the bank. In other words, investors can provide some amount of money from their pocket to invest in shares, and rest of the amount is financed by the banks.

IX. Short Selling

Short Selling means selling shares without owning it. In other words, the task of short sellers is to borrow the shares (generally through the clearing corporation of an exchange) and sell them. The borrowed shares which have been sold are bought back when prices are lower. The shares are then returned back to the lender and the excess profit is pocketed by the short seller.

Indian Debt Market

Basically, debt market is a financial market where buying and selling of debt securities takes place.

Classification of Indian Debt Market

Government Securities Market (G-Sec Market)

- It consists of central and state government securities. It means that, loans are being taken by the central and state government. It is also the most dominant category in the Indian debt market.

Bond Market

- It consists of Financial Institution bonds, corporate bonds and debentures and Public Sector Unit bonds. These bonds are issued to meet financial requirements at a fixed cost and hence remove uncertainty in financial costs.

Benefits of an efficient Debt Market to the financial system and the economy

The debt market allows government to raise money to finance the development activities of the government.

It plays an important role in efficient mobilisation and allocation of resources in the economy.

The Government securities are issued to meet the short-term and long-term financial needs of the government, they are not only used as instruments for raising debt, but have emerged as key instruments for internal debt management, monetary management and short-term liquidity management.

The debt market also provides greater funding avenues to public sector and private sector projects and reduces the pressure on institutional financing.

It also enhances mobilisation of resources by unlocking illiquid retail investments like gold.

Reduction in the borrowing cost of the Government and enable mobilisation of resources at a reasonable cost.

Different types of risks with regard to debt securities

Default Risk: In default risk, an issuer of a bond may be unable to make timely payment of interest or principal on a debt security or to otherwise comply with the provisions of a bond indenture and is also referred to as credit risk.

Interest Rate Risk: It can be defined as the risk emerging from an adverse change in the interest rate prevalent in the market so as to affect the yield on the existing instruments.

Reinvestment Rate Risk: It can be defined as the probability of a fall in the interest rate resulting in a lack of options to invest the interest received at regular intervals at higher rates at comparable rates in the market.

Counter Party Risk: It is the normal risk associated with any transaction and refers to the failure or inability of the opposite party to the contract to deliver either the promised security or the sale-value at the time of settlement.

Price Risk: It refers to the possibility of not being able to receive the expected price on any order due to an adverse movement in the prices.

CHAPTER 5 – MONEY MARKET

CHAPTER OVERVIEW

Basics of Money Market → Money Market Participants → Money Market Instruments → CRR and SLR → Determination of Interest Rates → Government Securities Market → Recent Development in Money Market → Repo and Reverse Repo

Concept of Money Market

The money market may be defined as a centre in which financial institutions congregate for the purpose of dealing impersonally in monetary assets. In a wider spectrum, a money market can be defined as a market for short-term money and financial assets that are near substitutes for money. The term short-term means generally a period upto one year and near substitutes to money is used to denote any financial asset which can be quickly converted into money with minimum transaction cost.

Pre-Conditions for an Efficient Money Market

A well-developed money market has following characteristics–

- Uses a broad range of financial instruments (treasury bills, bills of exchange, etc).
- Channelises savings into productive investments (like working capital).
- Promote financial mobility in the form of inter sectoral flows of funds.
- Facilitate the implementation of monetary policy by way of open market operations.

Rigidities in the Indian Money Market

Markets are not integrated

Money market in India is not well integrated. There is a well-developed secondary capital market in India, which does not exist in money market.

Players restricted

Only Government, banks, FII, and big companies are involved in the money market. Retail investors are rarely interested in the money market, making it restricted to only corporates, the Government, and Foreign Institutional Investors (FII's).

Supply based-sources influence uses

Banks are generally the main sources of funds in the money market. Commercial Banks are the main supplier of funds in Money Market Instruments especially RBI which issues Treasury Bills on behalf of the Government of India.

Not many instruments

Unlike European Market, only few money market instruments are available in India i.e. Treasury bill, commercial papers, commercial bill, certificate of deposit and call/notice money in India.

Reserve requirements

There are fixed reserve requirements in case of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) which banks have to maintain at all times. CRR is the reserve which banks have to keep with RBI. Whereas, SLR is the reserve which banks have to keep with themselves, thus, restricting the flow of money market instruments.

Lack of transparency

There is lack of transparency in money market because the secondary market is not very well developed. Since, the transactions are done Over the Counter (OTC), there is lack of transparency and public information.

Commercial transactions are mainly in cash

Since most of the transactions are done through cash, the circulation of funds in money market instrument is restricted.

Heavy Stamp duty limiting use of exchange bills

In case of issuance of commercial bills, stamp duty is paid in case of bill of exchange, thus, limiting their use. Further, in case of Commercial Paper (CP), the stamp duty rates applicable to non-bank entities are five times higher than those applicable to banks.

Money Market Participants or Intermediaries

Reserve Bank of India (RBI)

RBI is the most important participant of money market which takes requisite measures to implement monetary policy of the country. As the Central bank, RBI regulates the money market in India and injects liquidity in the banking system, when it is deficient or contracts the same in opposite situation.

Scheduled Commercial Banks (SCBs)

SCBs form the nucleus of money market. They are the most important borrower/supplier of short-term funds. They mobilise the savings of the people through acceptance of deposits and lend it to business houses for their short-term working capital requirements.

Co-operative Banks

Functions similarly as the commercial banks.

Financial and Investment Institutions

These institutions (e.g. LIC, UTI, GIC, Development Banks etc.) have been allowed to participate in the call money market as lenders only.

Corporates

Companies create demand for funds from the banking system. They raise short-term funds directly from the money market by issuing commercial paper. Moreover, they accept public deposits and also indulge in inter-corporate deposits and investments.

Mutual Funds

Mutual funds also invest their surplus funds in various money market instruments for short periods. They are also permitted to participate in the Call Money Market. Money Market Mutual Funds have been set up specifically for the purpose of mobilisation of short-term funds for investment in money market instruments.

Discount and Finance House of India

The Discount and Finance House of India Limited (DFHI) has been set up by the Reserve Bank of India jointly with public sector banks and all–India financial institutions to deal in short-term money market instruments.

Money Market Instruments

Call/Notice Money

Call money market, or inter-bank call money market, is a segment of the money market where scheduled commercial banks lend or borrow on call (i.e., overnight) or at short notice (i.e., for period upto 14 days) to manage the day-to-day surpluses and deficits in their cash-flows.

Location: The core of the Indian money market structure is the inter-bank call money market which is centralised primarily in Mumbai, with sub-markets in Delhi, Kolkata, Chennai and Ahmedabad.

Duration: The activities in the call money are confined generally to inter-bank business, predominantly on an overnight basis, although a small amount of business, known as notice money was also transacted side by side with call money with a maximum period of 14 days.

Participants:

a. Those who can both borrow as well as lend in the market are RBI, Commercial Banks, Co-operative banks and Primary Dealers.

b. Non-bank institutions (other than PDs) are not permitted in the call/notice money market.

Treasury Bills

Treasury Bills (TBs) are one of the most popular money market instruments issued by the Reserve Bank of India on behalf of the Government of India. T-Bills are generally issued to ward off short-term mismatches in receipts and expenditure. Therefore, the purpose of issuing treasury bills is to tackle short term liquidity problems. Treasury bills are generally issued at discount and redeemed at par.

Form
- The treasury bills are issued in the form of promissory note in physical form or by credit to Subsidiary General Ledger (SGL) account or Gilt account in dematerialised form.

Eligibility
- TBs can be purchased by any person, firm, company, body corporate and institutions.

Repayment
- The treasury bills are repaid at par on the expiry of their tenor at the office of the Reserve Bank of India, Mumbai.

Availability
- All the treasury bills are highly liquid instruments available both in the primary and secondary market.

Day Count
- For treasury bills the day count is taken as 364 days for a year.

Minimum Amount of Bids
- TBs are issued in lots of ₹25,000.

Commercial Bills

A commercial bill is one which arises out of a genuine trade transaction, i.e. credit transaction. When the goods are sold, the seller draws a bill of exchange (BOE) on the buyer to pay a certain amount on a particular date. The buyer then accepts the BOE, signs it and sends it to the seller. The seller on the maturity date presents the BOE to the buyer and collects its payment. It is basically a negotiable instrument and issued for a short period generally ranging from 3 to 6 months.

Certificate of Deposits

Eligibility
- All scheduled banks (except RRBs and Local Area Banks) are eligible to issue CDs. It can be also be issued by select all India Financial Institutions.

Term
- The CDs can be issued by scheduled commercial banks (excluding RRBs) at a discount to face value for a period from 7 days to one year.

Denomi-nation
- The CDs can be issued for minimum amount of ₹1 lakhs to a single investor and multiples of ₹1 lakh thereafter. There is, however, no limit on the total quantum of funds raised through CDs.

Transfera-bility
- CDs issued in physical form are freely transferable by endorsement and delivery. Procedure of transfer of dematted CDs is similar to any other demat securities. There is no lock in period for the CDs.

Discount

- CDs may be issued at a discount on face value. Banks / FIs are also allowed to issue CDs on floating rate basis, provided the methodology of compiling the floating rate is objective, transparent and market-based.

Reserve Requirements

- Banks have to maintain appropriate reserve requirements, i.e., Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), on the issue price of the CDs.

Commercial Paper

CPs are unsecured and negotiable promissory notes issued by high rated corporate entities to raise short-term funds for meeting working capital requirements directly from the market instead of borrowing from banks.

Timing of CP: The timing of the launch of the CP issue would be indicated by RBI while giving its permission, to ensure an orderly approach to the market.

Denomination and size of CP
Denomination of CP note – ₹5 lacs or multiples thereof.
Maximum size of CP issue – 100% of the issuer's working capital (fund based) limits (determined by the consortium leader).

Period of CP
Minimum currency – 7 days from the date of issue.
Maximum currency – One year from the date of issue.

Mode of CP
CP has to be issued at a discount to face value. Discount rate has to be freely determined by the markets

Negotiability of CP: CP (being usance promissory note) would be freely negotiable by endorsement and delivery.

Underwriting/co-acceptance of CPs: The CP issue cannot be underwritten or co-accepted in any manner. Commercial Banks, however, can provide standby facility for redemption of CPs on the maturity date.

The issuer and the issue expenses: The CP issuer can be a company incorporated under the Companies Act subject to some requirements. The issue of CP would be subject to payment of stamp duty. All issue expenses such as dealer's fees, issuing and paying agent's fees, rating agency fees, charges levied by banks for providing redemption standby facilities and any other charges connected with the issue of CPs are to be borne by the issuer.

Cash Reserve Ratio and Statutory Liquidity Ratio

Cash Reserve Ratio

CRR is the amount of reserve which banks have to keep with Reserve Bank of India (RBI). The current CRR rate is 4%. However, this rate may change from time to time as per the discretion of the RBI. So, CRR is basically a fraction of the total amount of deposits collected from the customers and kept as reserve either in cash or as deposits with the central bank. CRR is prescribed according to the guidelines of the central bank of a country.

Statutory Liquidity Ratio (SLR)

SLR is the amount of reserve which banks have to keep it with themselves. Apart from Cash Reserve Ratio (CRR), banks have to maintain a certain portion of their deposits in the form of liquid assets like cash, gold and non-mortgaged securities. The current SLR rate is 18%. However, this rate may change from time to time as per the discretion of the RBI.

Money Market Instruments: G SEC (Government Securities)

The Reserve Bank of India issues securities on behalf of the Government. The term Government Securities includes Central Government Securities, State Government Securities and Treasury Bills. The different types of Government Securities are –

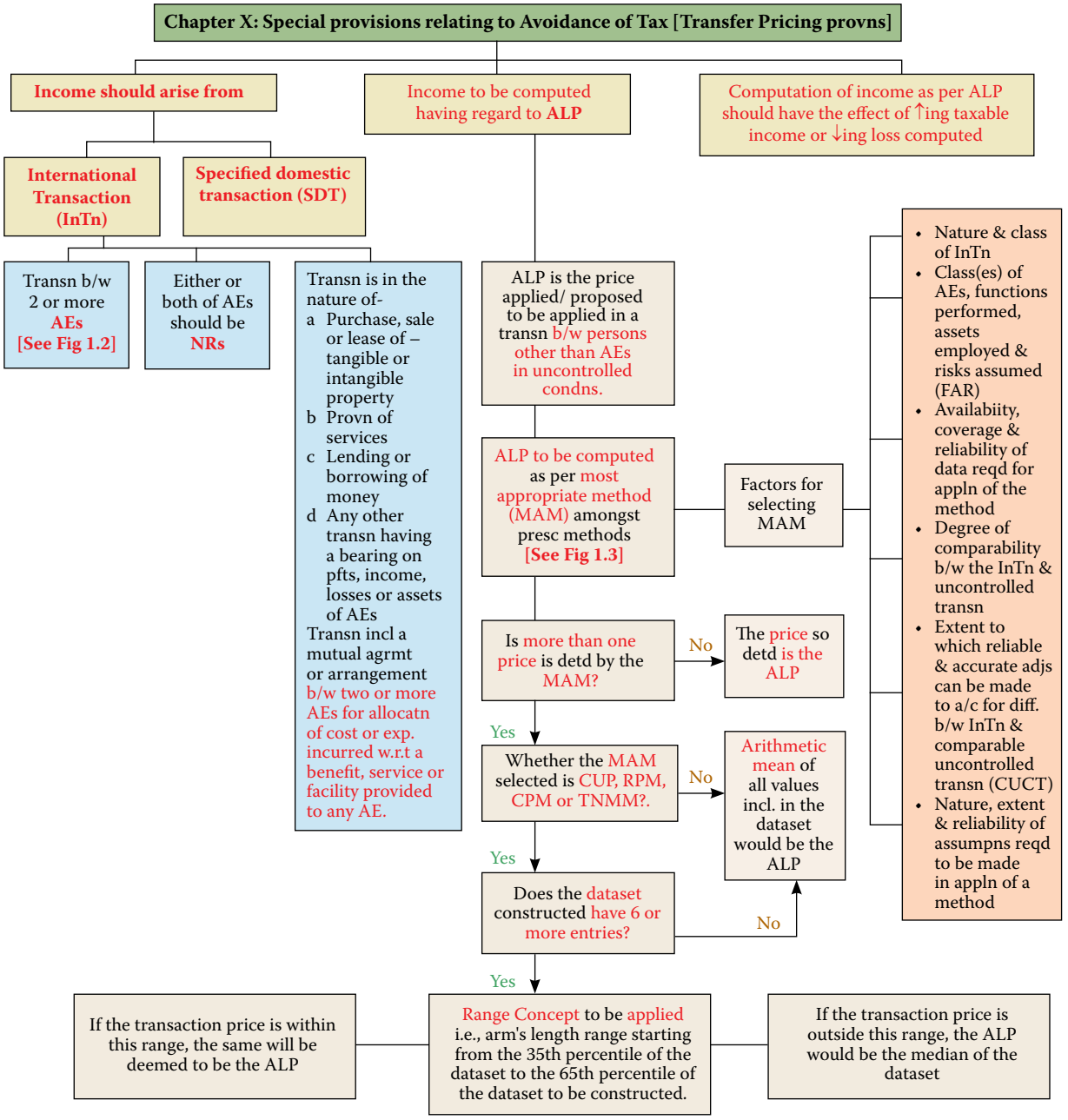
Dated Securities	Zero Coupon Bonds or Deep Discount Bonds	Floating Rate Bonds	Capital Indexed Bonds
Issued at par value	Issued at discount to face value	Issued at face value	Issued at face value
Interest or coupon rate is fixed at the time of issuances	Do not carry any interest	Interest rate is fixed % over a predetermined floating rate benchmark which may be MIBOR or INBMK (Indian Benchmark Swap) curve	Interest Rate is reckoned as a % over Inflation benchmark may be, WPI or CPI at the time of issuance.
The tenor of the security is fixed	The tenor of the security is fixed	The tenor of the security is fixed	The tenor of the security is fixed
The security is redeemed at face value on its maturity date	The security is redeemed at face value on its maturity date plus Zero coupon interest on the security	The security is redeemed at face value on its maturity date	The security is redeemed at face value on its maturity date

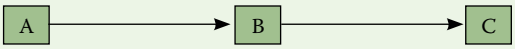
INTERNATIONAL TAXATION: A CAPSULE FOR QUICK RECAP

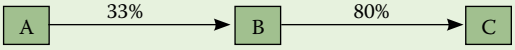
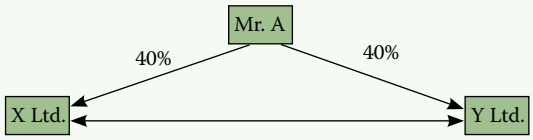
Over the years, consequent to globalisation, international taxation has become a key concern area for the business entities engaged in cross border transactions and the tax administration of the countries. Hence, considering its importance to the economy, a dedicated paper on international taxation was included in the syllabus of the CA course at the Final level as an elective paper under the New Scheme of Education and Training. It is noteworthy that at the Final level, the core Paper 7 on Direct Tax Laws and International Taxation also comprises of a separate part on international taxation for 30 marks.

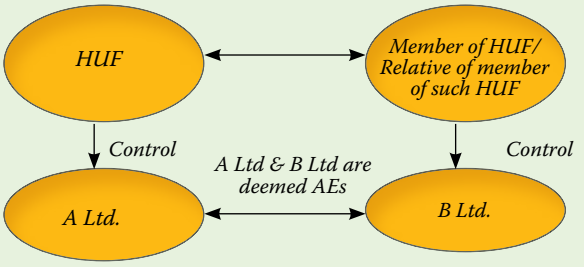
In this capsule, we have extensively used tables, flow charts and diagrams to help you recap the significant provisions, concepts and principles of international taxation. The capsule covers select chapters in international taxation. For comprehensive study, read the November, 2020 edition of the Study Material of Paper 6C: International Taxation and the webhosted Statutory Update and thereafter, solve the case studies webhosted at the BoS Knowledge Portal and the Mock Test Paper.

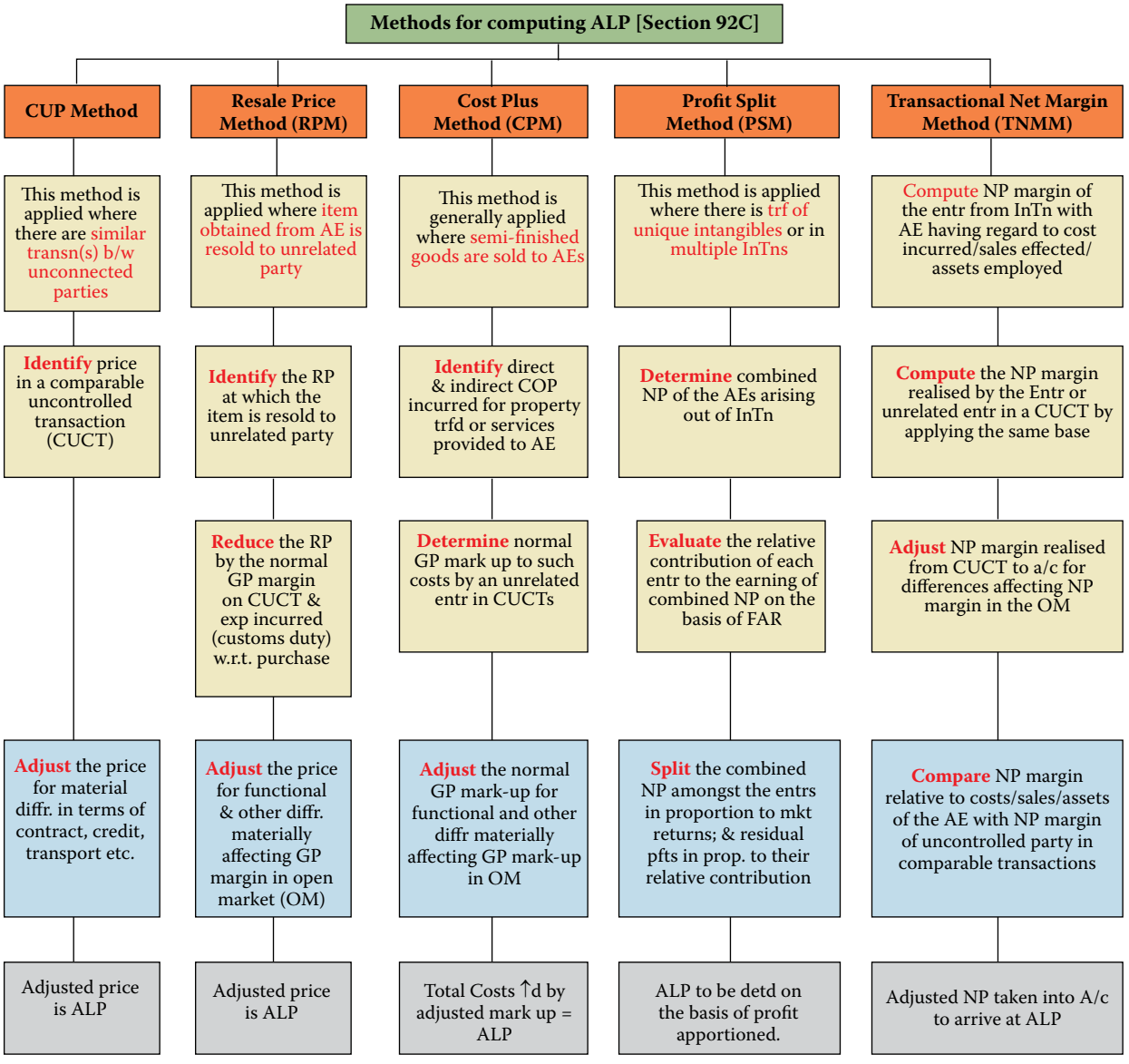
TRANSFER PRICING



Associated Enterprises (AEs) [Section 92A]		
	Condition	**Example**
(1)	An enterprise (entr) which participates, directly (DP) or indirectly (IDP), or through one or more intermediaries, in: • Management (mgt) of the other entr (OE), or • control of OE, or • capital of OE	*Where A Ltd. DP in mgt of B Ltd. and B Ltd. DP in mgt of C Ltd. In such situation, A Ltd. has DP in mgt of B Ltd. but has an IDP in mgt of C Ltd.*  *In such scenario, both B Ltd. and C Ltd. would be AEs of A Ltd.*
(2)	If one or more persons participates, directly or indirectly, or through one or more intermediaries in: • mgt of the two different entrs • control of two different entrs • capital of two different entrs Then, those two entrs are AEs.	*Mr. A directly has control in A Ltd. and B Ltd. In such a scenario, both A Ltd. & B Ltd. are AEs since they have a common person i.e. Mr. A, who controls both entities A Ltd. & B Ltd.*

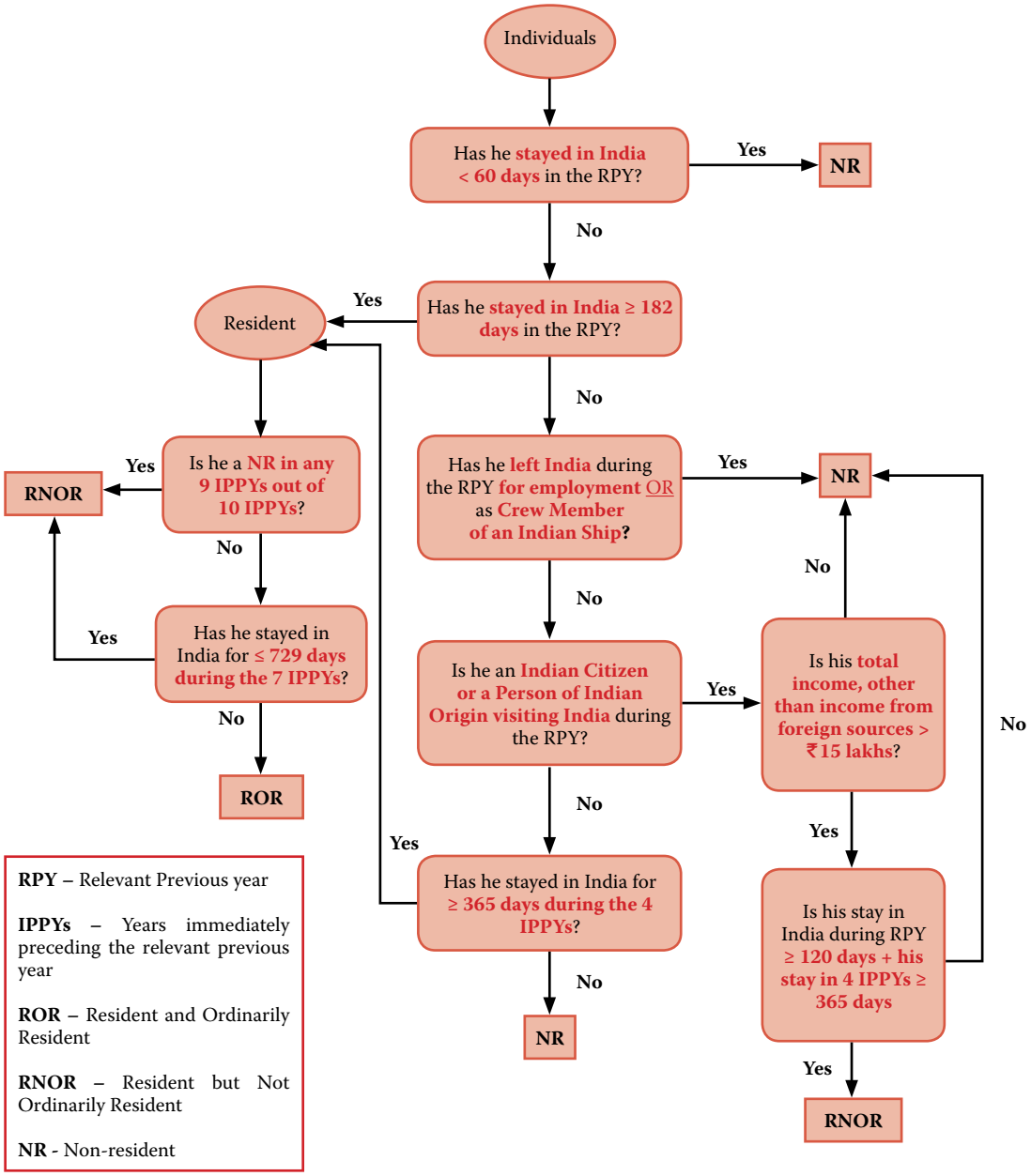
Deemed Associated Enterprises [Section 92A(2)]		
Condition	**Situation**	**Example**
Substantial Voting Power (VP)	**One entr holds 26% or more of the VP,** directly or indirectly, in the **other entr (OE).**	*A Ltd. holds 33% of VP in B Ltd. and B Ltd. holds 80% VP in C Ltd.*  *In above situation, A Ltd. holds more than 26% VP in B Ltd. directly and in C Ltd. indirectly (i.e. through B Ltd.). Therefore, both B Ltd. & C Ltd. are deemed AEs of A Ltd.*
Substantial VP in two entities by common person	Any person or entr **holds 26% or more of the VP,** directly or indirectly, in each of **two different entrs.**	*Mr. A holds 40% of shareholding in both X Ltd. and Y Ltd. where neither X Ltd. has any holding in Y Ltd. nor Y Ltd. has any holding in X Ltd.*  *In this situation, since Mr. A directly holds 40% of shareholding in both X Ltd. and Y Ltd., X Ltd. & Y Ltd. will be deemed AEs.*
Advancing of substantial sum of money	One entr advances loan to the OE of an amt of **51% or more** of the book value (BV) of **the total assets of OE**	*BV of total assets of Y Ltd. is ₹ 100 crores. X Ltd. advances loan of ₹ 60 crores to Y Ltd.* *Since, in this case, X Ltd. advances loan which is 60% of the BV of total assets of Y Ltd., X Ltd. & Y Ltd. are deemed AEs.*
Guaranteeing borrowings	One entr guarantees **10% or more** of the **total borrowings of the OE.**	*P Inc. has total loan of 1 million dollars from XYZ Bank of America. Out of that, A Ltd., an Indian company, guarantees 20% of total borrowings. In such case, P Inc. and A Ltd. would be deemed AEs.*
Appointment of majority directors of OE	One Entr appoints **more than half of the BoD** or members of the governing board (GB), or one or more executive directors (EDs) or executive members (EMs) of the GB of **OE.**	*X Ltd. has 15 directors on its Board. Out of that, Y Ltd. has appointed 8 directors. In such case, X Ltd. and Y Ltd. would be deemed AEs.*
Appointment of majority directors of two different entrs by same person(s)	**More than half of the directors** or members of the GB, or one or more of the EDs or members of the GB of each of the **two entrs** are appointed **by the same person(s).**	*Mr. A appointed 9 directors out of 15 directors of X Ltd. and appointed 2 EDs on the board of Y Ltd. In such case, since a common person i.e. Mr. A appointed more than half of the directors in X Ltd. and appointed 2 EDs in Y Ltd., both X Ltd. and Y Ltd. are deemed AEs.*
Dependence on intangibles w.r.t which OE has exclusive rights	The **manufacture (mfre) or processing of goods** or articles or business carried out by one entr is **wholly dependent (i.e. 100%) on the know-how,** patents, copyrights etc., or any data, documentation, drawing or specification relating to any patent, invention, model etc. of which the OE is the owner or in respect of which the OE has exclusive rights.	
Dependence on raw material (RM) supplied by OE	**90% or more of RMs and consumables** required for the mfre or processing of goods or articles or business carried out by one entr, **are supplied by the OE,** or by persons specified by the OE, where the prices and other conditions relating to the supply are influenced by such OE.	
Dependence on sale	The **goods or articles mfrd** or processed by one entr, **are sold to the OE** or to persons specified by the OE, and the **prices and other conditions** relating thereto are **influenced by such OE.**	
Control by common individual (indvl)	Where **one entr is controlled by an indvl,** the **OE** is also **controlled by such indvl** or his relative or jointly by such indvl and his relatives.	*Mr. A and Mr. B are relatives. Mr. A has control over X Ltd. and Mr. B has control over Y Ltd. In such a case, both X Ltd. and Y Ltd. would be deemed AEs.*

Control by HUF or member thereof	Where one entr is **controlled by an HUF** and the **OE is controlled** by a **member** of such HUF or by **relative of a member** of such HUF or jointly by such member and his relative.	
Interest in a firm, AOPs or BOIs	Where one entr is a firm, AOPs or BOIs, the **OE** holds **10% or more interest** in **firm/HUF/BOI.**	
Mutual interest relationship	There exists **b/w the two entrs,** any **relationship of mutual interest,** as may be **prescribed.**	



NON RESIDENT TAXATION

Determination of Residential Status of Individuals [Section 6(1) & 6(6)(a)]



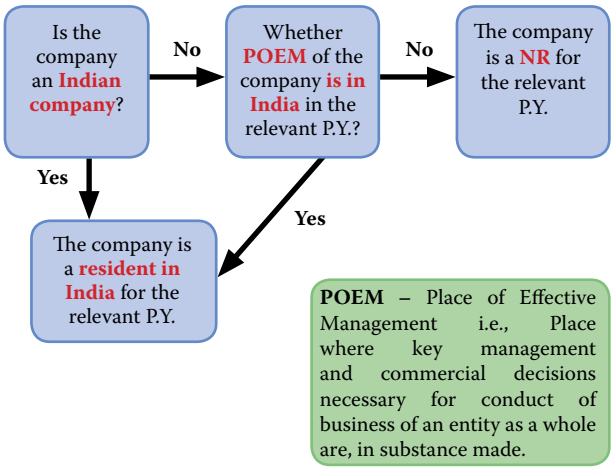
Deemed resident [Section 6(1A)]

An individual, **being an Indian citizen, having total income**, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], **exceeding ₹15 lakhs** during the previous year would be **deemed to be resident in India** in that previous year, **if he is not liable to pay tax in any other country** or territory by reason of his domicile or residence or any other criteria of similar nature.

Notes *– (1) If an individual **is a resident in India** in the previous year **as per section 6(1)**, the **provisions of deemed resident u/s 6(1A)** would **not apply to him**.*

*(2) A deemed resident would **always be a RNOR**.*

Determination of Residential Status of Companies [Section 6(3)]



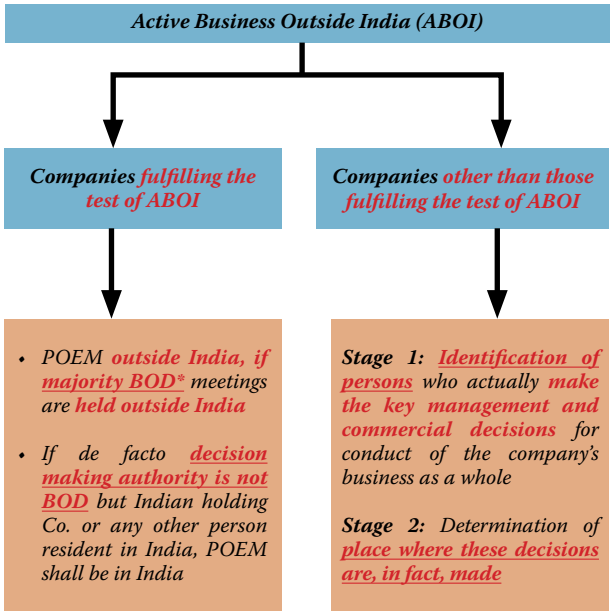
Determination of POEM on the basis of ABOI test

What is ABOI test? A company is said to be engaged in ABOI, if it fulfills the cumulative conditions:			
Its passive income* (wherever earned) is 50% or less of its total income	Less than 50% of its total assets are situated in India	Less than 50% of the total number of employees are situated in India or are residents in India	Payroll expenses incurred on such employees are less than 50% of its total payroll expenditure

** Passive income of a company shall be aggregate of:*

(i) Income from the transactions where both the purchase and sale of goods is from/ to its AEs; and

(ii) income by way of royalty, dividend, capital gains, interest (except for banking Cos and public financial institutions) or rental income whether or not involving AEs.



* BOD - Board of Directors

Scope of Total Income [Section 5]

SCOPE OF TOTAL INCOME [SECTION 5]: Whether the following incomes are to be included in Total Income?			
Particulars	**ROR**	**RNOR**	**NR**
Income received or deemed to be received in India during the relevant P.Y.	Yes	Yes	Yes
Income accruing or arising or deeming to accrue or arise in India during the relevant P.Y.	Yes	Yes	Yes
Income accruing or arising outside India during the relevant P.Y.	Yes, even if such income is not received or brought into India during the P.Y.	Yes, but only if such income is derived from a business controlled from or profession set up in India; Otherwise, No.	No

SUMMARY OF PRESUMPTIVE PROVISIONS APPLICABLE TO NON RESIDENTS				
Particulars	**44B**	**44BBA**	**44BB**	**44BBB**
Nature of business	**Shipping business**	**Operation of aircraft**	Business of providing services or facilities in connection with, or **supplying P & M on hire used,** or to be used, in the prospecting for, or **extraction or production of, mineral oils**	Business of **civil construction or the business of erection of P&M or testing or commissioning** thereof, in connection with **turnkey power projects** approved by the Central Government.
Eligible assessee	Non-resident	Non-resident	Non-resident	**Only Foreign Co.**
Presumptive income	**7.5%** of specified sum	**5%** of specified sum	**10%** of specified sum	**10%** of specified sum
Specified sum	(i) **Amount paid** or payable on account of **carriage of passengers, livestock, mail or goods** shipped **at/ from any port/ place in India**; and (ii) Amount **received or deemed to be received** in India on account of the carriage of passengers, livestock mail or goods shipped **at/ from any port/place outside India**		(i) Amount **paid or payable on account of the provision of such services** or facilities for the aforesaid purposes in India; and (ii) Amount **received or deemed to be received in India** on account of the provision of services or facilities for the aforesaid purpose outside India.	Amount **paid or payable on a/c of such civil construction, erection, testing or commissioning**
Option to declare lower profits	**Not available**		**Lower profits may be claimed** u/s 44BB and u/s 44BBB provided the assessee **maintains books of account** u/s 44AA and **gets them audited** u/s 44AB.	

Deduction of Head Office expenditure in case of Non-residents while computing Profit and gains from business or profession [Section 44C]

Lower of

5% of Adjusted Total Income	Amount of Head Office expenditure incurred by the Non-resident attributable to the business or profession in India
Meaning of Adjusted Total Income	**Meaning of Head Office expenditure**
Total Income, without giving effect to: (i) Head Office expenditure (ii) Unabsorbed depreciation (iii) Capital expenditure on family planning (iv) Losses carry forward: - Business loss u/s 72(1) - Speculative business Loss u/s 73(2) - LTCL/STCL u/s 74(1) - Loss from owning and maintaining race horses u/s 74A(3) (v) Deductions under Chapter VI-A from GTI	Executive and general administration expenditure incurred by the NR outside India, including: (a) Rent, rates, taxes, repairs or insurance of any premises outside India used for business or profession (b) Salary, wages, perquisites etc. to any employee or other person managing the affairs of any office outside India (c) Travelling expenditure by any employee or other person managing the affairs of any office outside India (d) Such other executive and general administration expenditure prescribed

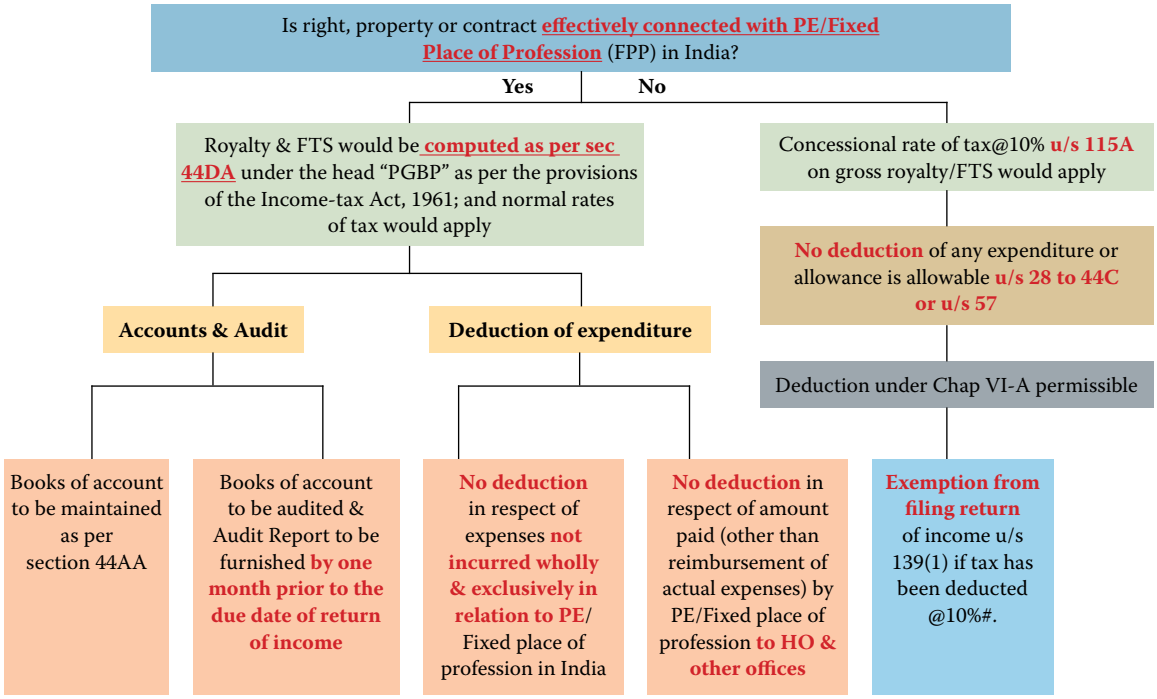
Special provisions for computing tax on income by way of dividend, interest etc. [Section 115A]

	Where the total income of a foreign company or a non-corporate non-resident includes any income by way of	Rate of Tax
(1)	Dividends	20%
(2)	Interest received from the Government or an Indian concern on moneys borrowed or debt incurred by the Govt./Indian concern in foreign currency, other than 3 and 4 mentioned below	20%
(3)	Interest received from an infrastructure debt fund referred to in section 10(47)	5%
(4)	Interest referred to in section 194LC received from an Indian company or business trust – - in respect of monies borrowed by an Indian company or business trust in foreign currency from sources outside India • Under a loan agreement between 1.7.2012 and *30.6.2023* or • by way of issue of long-term infrastructure bonds [LTIB] between 1.7.2012 and 30.9.2014 or • by way of issue of long-term bonds including LTIB between 1.10.2014 and *30.6.2023* as approved by the Central Govt. - in respect of monies borrowed from sources outside India by way of rupee denominated bond [RDB] on or before *30.6.2023* - ***in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or RDB between 1.4.2020 and 30.6.2023, which is listed only on a recognised stock exchange located in any IFSC***	5% ***4%***
(5)	Interest to a Foreign Institutional Investor or Qualified Foreign Investor [referred to in section 194LD] - payable between 1.6.2013 and *30.6.2023* on investment made in • RDB of an Indian company • Government security - ***payable between 1.4.2020 and 30.6.2023 on investment made in municipal debt security***	5%
(6)	Distributed income referred to in section 194LBA(2), - interest income of a business trust from a SPV, distributed by business trust to its non-resident unit holders - ***dividend income of a business trust received or receivable from a SPV exercising the option to pay tax at concessional rate under section 115BAA, distributed by business trust to its non-resident unit holders*** ***However, if the SPV has not exercised the option to pay tax at concessional rate under section 115BAA, dividend income would be exempt in the hands of unitholders. [SPV - Special Purpose Vehicle]***	5% ***10%***
(7)	Income received in respect of units purchased in foreign currency of a mutual fund specified under section 10(23D) or of the Unit Trust of India	20%

Notes:

1. **Special rates of tax** is applicable on the **above mentioned incomes**. The **remaining income** of the assessee will be chargeable to tax at **normal rates applicable to assessee**.
2. **No deduction** in respect of any expenditure or allowance shall be allowed **u/s 28 to 44C and section 57** in computing the above-mentioned income.
3. **Deduction** under **Chapter VI-A is not available** in respect of above-mentioned income. However, a unit of an IFSC can claim deduction u/s 80LA against above mentioned incomes.
4. **Exemption from filing return** of income u/s 139(1) would be available if **tax has been deducted from such incomes** and the **rate** of such **tax deduction** is **not less** than the **rate specified in the above table**.

Tax treatment of Royalty & Fees for Technical Services received from Government / Indian concern in pursuance of approved agreement



 # If tax has been deducted at a rate lower than 10% by availing the beneficial provisions of DTAA, then, no exemption would be available from filing return of income.

Special provisions for computing tax on income of Specified Fund or Foreign Institutional Investors from securities or capital gains arising from their transfer [Section 115AD]

(1)	(2)	(3)
S. No.	**Income**	**Rate of Tax**
(a)	Income received in respect of securities other than • income on units referred to in section 115AB i.e., units of Mutual Fund specified u/s 10(23D) or UTI • Interest referred u/s 194LD	20% in case of FII, 10% in case of specified fund
(b)	Interest referred u/s 194LD	5%
(c)	Income by way of Short term capital gains arising from the transfer of securities (other than Short term capital gains u/s 111A)	30%
(d)	Income by way of Short term capital gains u/s 111A	15%
(e)	Income by way of Long term capital gains arising from the transfer of securities (other than Long term capital gains u/s 112A)	10%
(f)	Income by way of Long term capital gains u/s 112A exceeding ₹1 lakh	10%
(g)	Other income of Specified Fund or FII	At normal rates of tax

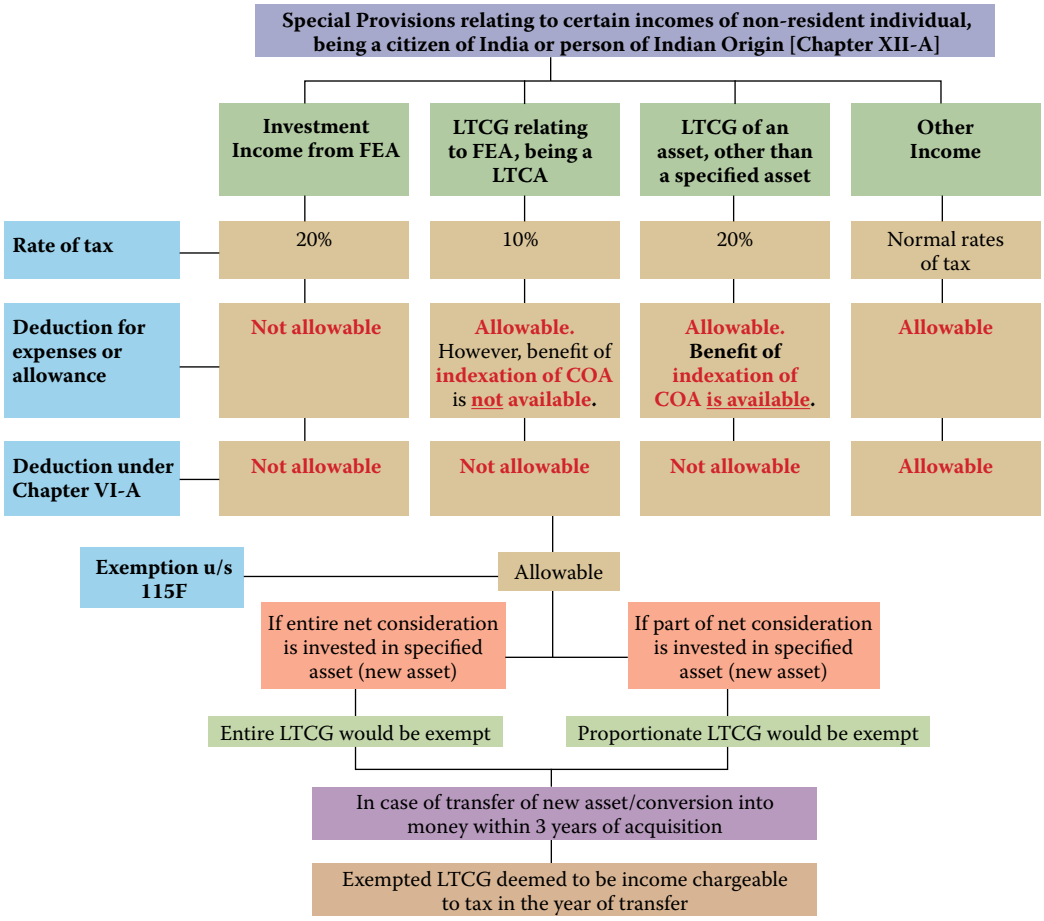
Notes:

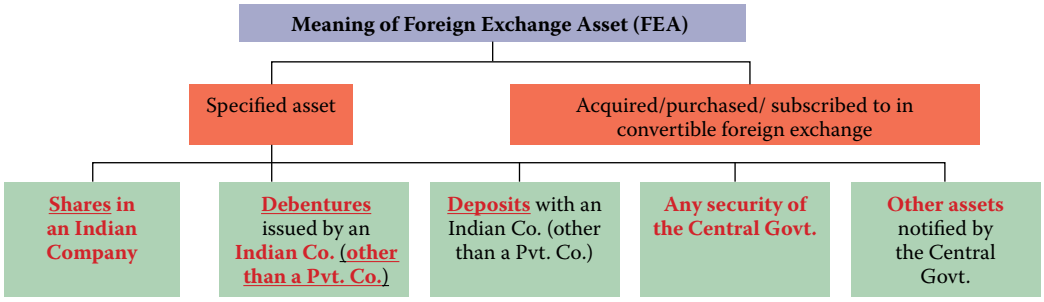
(1) *In case of specified fund, the provision of this section would apply only to the extent of income that is attributable to units held by non-resident (not being a permanent establishment of a non-resident in India) calculated in the prescribed manner.*

(2) *No deduction for any expenditure or allowance shall be allowed u/s 28 to 44C and 57 from income from securities (ref. to in (a) and (b) above).*

(3) *Deduction under Chapter VI-A is not allowable in case of income from securities, STCG or LTCG arising from transfer of securities.*

(4) *Conversion to foreign currency and indexation benefit would not be available while computing capital gains on transfer of securities.*





Withholding tax provisions relating to non-residents: A Summary

Section	Nature of payment	Rate of TDS
192	Salary	Normal Slab rates
192A	**Premature withdrawal from EPF**, aggregating **to ₹50,000 or more**	10%
194B	Income by way of **winnings from lotteries, crossword puzzles, card games and other games of any sort**, where payment to a person **> ₹10,000**	30%
194BB	Income by way of **winnings from horse races**, where payment to a person **> ₹ 10,000**	30%
194E	Income **referred to under section 115BBA** payable to non-resident sportsmen/sports association or an entertainer	20%
194G	**Commission** etc. **on the sale of lottery tickets**, where amount payable to a person **> ₹ 15,000**	5%
194LB	**Interest** payable **by infrastructure debt fund** to a non-corporate non-resident or foreign company	5%

Section	Nature of payment	Rate of TDS
194LBA(2)	**Distribution** of **any interest income**, received or receivable **by a business trust from a SPV**, to its unit holders.	5%
	Distribution of any dividend income, received or receivable **by business trust from a SPV exercising option** to pay tax at concessional rate under section 115BAA, to its unit holders. However, if the **SPV is not exercising the option to pay tax at concessional rate** under section 115BAA, dividend income would be exempt in the hands of unit holders and tax would not be deductible at source.	***10%***
194LBA(3)	Distribution of any **income received from renting or leasing or letting out any real estate asset directly owned** by the business trust, to its unit holders.	At the rates in force
194LBB	**Investment fund** paying income to a unit holder [other than income which is **exempt under section 10(23FBB)**].	
194LBC(2)	**Income in respect of investment made** in a securitisation trust (specified in Explanation to section 115TCA)	
194LC	**Interest payable by an Indian Company or a business trust** to a non-corporate non-resident or foreign company - in respect of money borrowed in foreign currency from a source outside India • under a **loan agreement between 1.7.2012 and 30.6.2023** or • by way of **issue of long-term infrastructure bonds** during the period **between 1.7.2012 and 30.9.2014** • by way of issue of **long term bonds** (including long term infrastructure bond) **between 1.10.2014 and 30.6.2023** as approved by Central Government or - in respect of **money borrowed from source outside India** by way of **rupee denominated bond on or before 30.6.2023**	5%
	Interest payable by an Indian company or a business trust to a non-corporate non-resident or foreign company, in respect of **monies borrowed** by it from a **source outside India by way of issue of any long-term bond or rupee denominated bond between 1.4.2020 and 30.6.2023**, which is listed only on a recognised stock exchange located in any International Financial Services Centre	4%
	Interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17.9.2018 to 31.3.2019	Nil (Since such interest is exempt u/s 10(4C), no tax is deductible u/s 194LC)
194LD	On **interest payable** - **between 1.6.2013 and 30.6.2023** on • **rupee denominated bond** of **an Indian Company** or • **Government securities** or - **between 1.4.2020 and 30.6.2023 on municipal debt securities** **to a Foreign Institutional Investor or a Qualified Foreign Investor**	5%
194N	On **withdrawal of cash in excess of ₹ 1 crore**	2% on amount exceeding ₹1 crore
	In case the recipient **has not filed ROI for all the 3 immediately preceding P.Y.s**, for which time **limit u/s 139(1) has expired**, such sum shall be the amt or agg. of amts, **in cash > ₹20 lakh** during the P.Y.	- @2% of the sum, where cash withdrawal > ₹20 lakhs ≤ ₹1 crore - @5% of sum, where cash withdrawal exceeds ₹ 1 crore
195	Any other sum payable to a non-resident	At the rates in force
196A	**Income on units of a mutual fund** specified under section 10(23D) or from the specified company referred to in section 10(35) payable to non-corporate non-resident or foreign company	20%
196B	**Income from units of a mutual fund or UTI** purchased in foreign currency (including long term capital gain on transfer of such units) **payable to an Offshore Fund**	10%
196C	**Income by way of interest or dividend on bonds** of an Indian company or public sector company sold by the Government and purchased by a non-resident in foreign currency or GDRs referred to in section 115AC (including long term capital gain on transfer of such bonds or GDRs) payable to a non-resident	10%
196D	**Income of Foreign Institutional Investors from securities** (not being income by way of interest referred to in section 194LD or capital gain arising from transfer of such securities)	20%
	Income of specified fund from securities [not being income by way of interest referred to in section 194LD or capital gain arising from such securities or income exempt u/s 10(4D)]	10%

Note: In all the above cases, the rate of tax would be increased by surcharge, wherever applicable, and health and education cess @4%.

DOUBLE TAXATION RELIEF

Double taxation means taxing the same income twice in the hands of an assessee.

This arises from the two basic rules that enables the country of residence as well as the country where the source of income exists to impose tax namely,

In order to avoid such double taxation, Double Tax Avoidance Agreements come into play.

- **Source Rule**: Income taxed in the Country in which it originates irrespective of whether the income accrues to a resident or NR
- **Residence Rule**: Income taxed in the Country in which the taxpayer is resident

DT Relief under the Income-tax Act, 1961

Bilateral Relief [Section 90/90A]

Agreement with foreign countries or specified territories

Objective

The Central Government may enter into an agreement with the Government of any country outside India or specified territory or specified assn outside India,—

- for the granting of relief in respect of doubly taxed income
- for the avoidance of double taxation of income without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance
- for exchange of information for the prevention of evasion or avoidance of income-tax
- for recovery of income-tax

Taxability

- Taxability of income would be detd based on DTAA or the Income-tax Act, 1961, whichever is more beneficial.

Charge of tax on foreign Company

- The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Tax Residency Certificate (TRC)

- In order to claim DT relief, the non-resident to whom such DTAA applies, has to obtain a TRC from the Government of that country or specified territory.
- The non-resident to also provide such other documents and information, as may be prescribed, for claiming treaty benefits.

Unilateral Relief [Section 91]

Countries with which no agreement exists

Applicability

- Assessee, who is a resident in India during the PY

Conditions

- The income accrues or arises to him outside India.
- The income is not deemed to accrue or arise in India during the PY.
- The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.
- The assessee has paid tax on the income in the foreign country.
- There is no agrmt for relief from DT between India and the other country where the income has accrued or arisen.

Computation of Relief

- Doubly taxed income x Indian rate of tax or Rate of tax in the said country, whichever is lower

TAXATION OF E-COMMERCE TRANSACTIONS

Equalisation Levy (EL) on Specified Services

6% of amount of consideration received or receivable

For **Specified Services** → **Meaning of Specified Services:**
(i) **Online advertisement**
(ii) Prov. for **digital advertisement space** or any other facility or service for online **advertisement**
(iii) Any other service notified by the Government

By **a NR not having PE in India or providing services not effectively connected with his PE in India**

From a resident in India carrying on business or profession **(or)** **From** a NR having PE in India

Does the **aggregate amount of such consideration** received or receivable for specified services by a NR **exceed ₹1 lakh** in the relevant PY?

Yes → EL is attracted

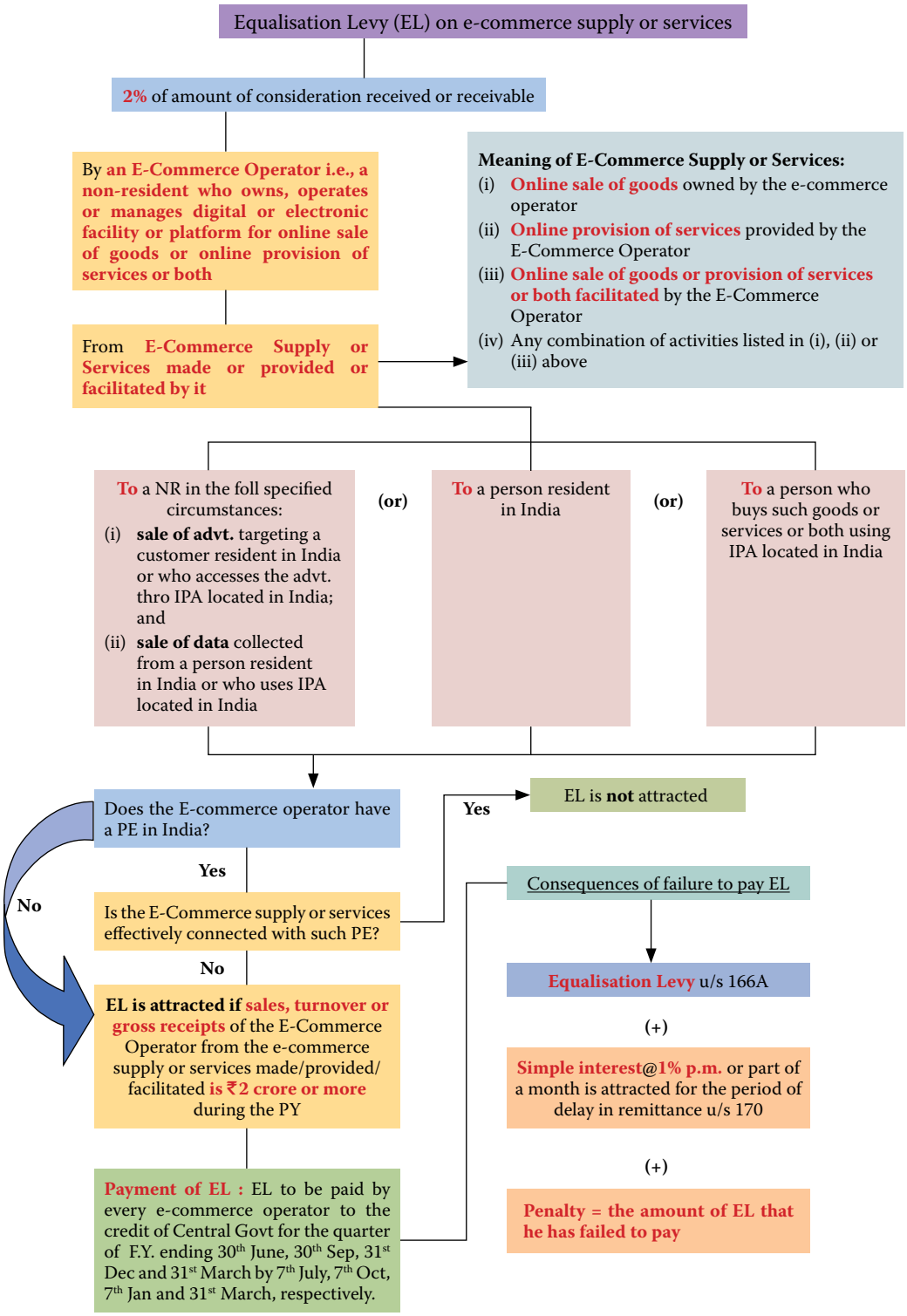
No → EL is not attracted

Deduction of EL
EL@6% is deductible from consideration paid or payable for specified services by a –
- resident carrying on business or profession; or
- NR having PE in India

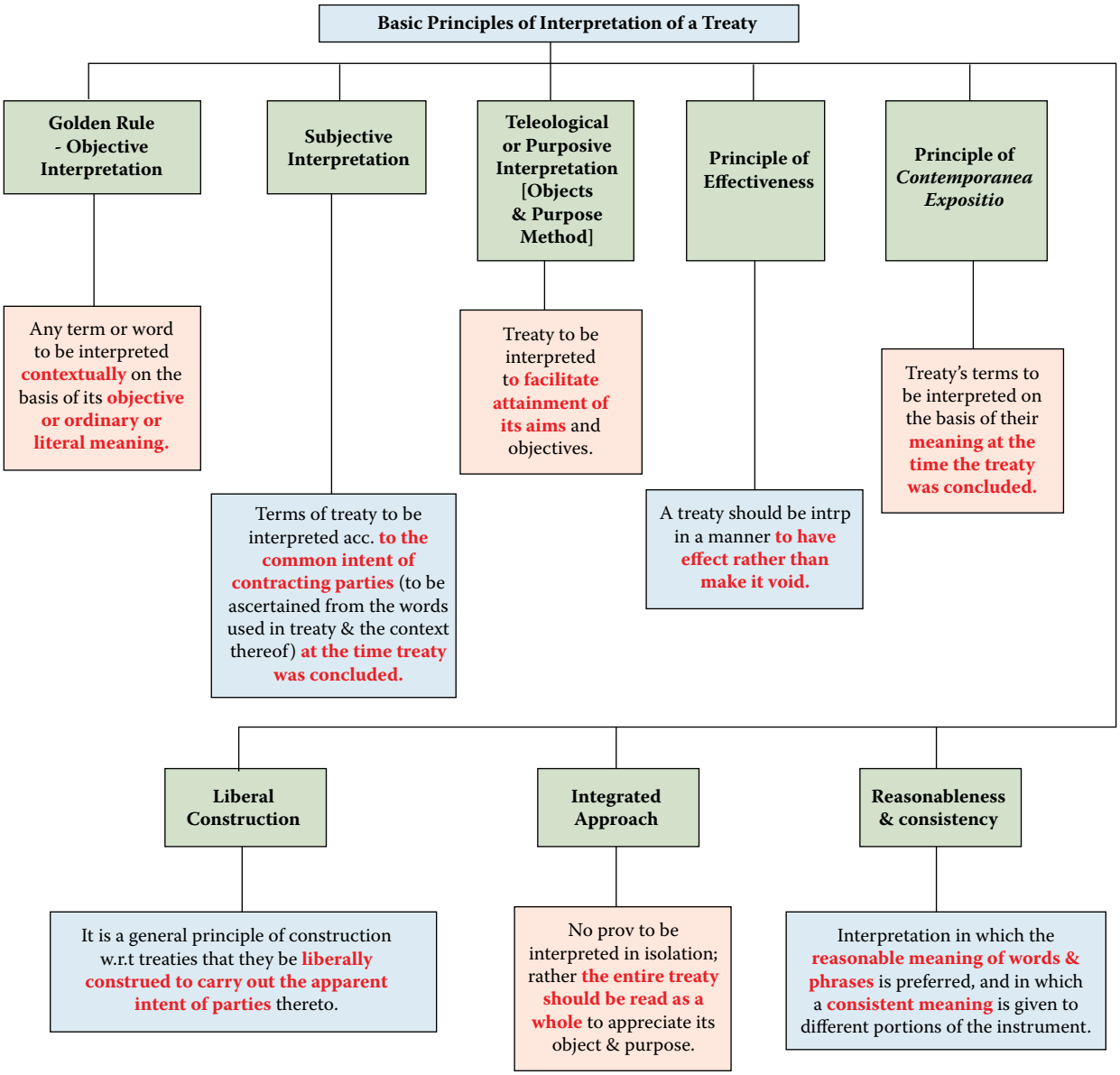
Remittance of EL
EL deducted during any month to be paid to the credit of the Central Government by the **7th of the next month**

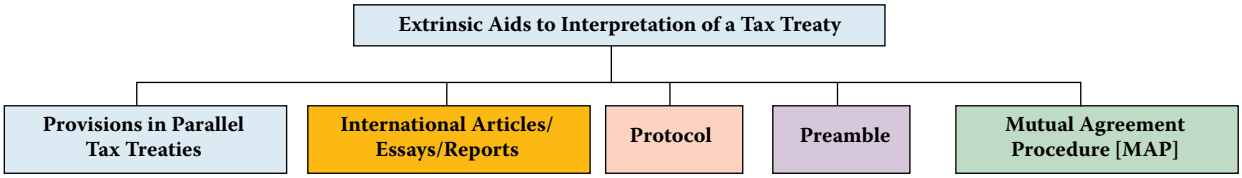
Consequences of failure to deduct EL

- The person liable to deduct EL has to, in any case, pay the EL to the credit of the Central Government by the 7th of the next month.
- Simple interest@**1% p.m.** or part of a month is attracted for the period of delay in remittance.
- **Penalty = the amount of EL deductible.**
- For delayed remittance, penalty@ **₹1,000 per day** of failure attracted, not exceeding the amount of EL not paid.


Equalisation Levy (EL) on e-commerce supply or services
2% of amount of consideration received or receivable
By an E-Commerce Operator i.e., a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both
From E-Commerce Supply or Services made or provided or facilitated by it
Meaning of E-Commerce Supply or Services:
(i) Online sale of goods owned by the e-commerce operator
(ii) Online provision of services provided by the E-Commerce Operator
(iii) Online sale of goods or provision of services or both facilitated by the E-Commerce Operator
(iv) Any combination of activities listed in (i), (ii) or (iii) above
To a NR in the foll specified circumstances:
(i) sale of advt. targeting a customer resident in India or who accesses the advt. thro IPA located in India; and
(ii) sale of data collected from a person resident in India or who uses IPA located in India
(or)
To a person resident in India
(or)
To a person who buys such goods or services or both using IPA located in India
Does the E-commerce operator have a PE in India?
Yes
No
Is the E-Commerce supply or services effectively connected with such PE?
Yes
EL is not attracted
No
EL is attracted if sales, turnover or gross receipts of the E-Commerce Operator from the e-commerce supply or services made/provided/ facilitated is ₹2 crore or more during the PY
Payment of EL : EL to be paid by every e-commerce operator to the credit of Central Govt for the quarter of F.Y. ending 30th June, 30th Sep, 31st Dec and 31st March by 7th July, 7th Oct, 7th Jan and 31st March, respectively.
Consequences of failure to pay EL
Equalisation Levy u/s 166A
(+)
Simple interest@1% p.m. or part of a month is attracted for the period of delay in remittance u/s 170
(+)
Penalty = the amount of EL that he has failed to pay

TAX TREATIES: OVERVIEW, FEATURES, APPLICATION AND INTERPRETATION





ECONOMIC LAWS

This capsule on Paper 6D: Economic Laws, Final (New) course is another step of Board of Studies in its endeavour to provide quality academic inputs to Final course students of Chartered Accountancy course. As students are aware that this is an open book examination and duration is 4 hours. The question paper would comprise five case studies of 25 marks each, out of which the student would be required to attempt any four. Students must divide their four hours between four case studies to be answered meticulously. Once the case studies have been opted, give them a comprehensively reading while attempting the same. Some of the illustrative case studies have been provided below for practice purpose. Students are suggested to solve the same in examination condition and check for the answers only after attempting the case studies.

CASE STUDY 1

Mr. M R Gulati is renowned and influential real estate agent. Mr. M R Gulati has over 30 year of experience in real estate business and enjoys good reputation, also due to standing of his father Late Mr. Rattan Mal Gulati, in education sector. Mr. Rattan Mal Gulati was managing trustee of Easy Key Educational Trust, along with other family members as stated below;

SN	Name	Relation to Mr. Rattan Mal Gulati	Status
1	Mr. Rattan Mal Gulati	Self	Managing Trustee
2	Mrs. Shashi Kala	Wife	Member Secretary
3	Mr. M R Gulati	Elder Son	Member Trustee
4	Mr. O P Gulati	Younger Son	Member Trustee
5	Mrs. Rita Gulati	Daughter-in-law (wife of Mr. M R Gulati)	Member Trustee
6	Mrs. Radha Gulati	Daughter-in-law (wife of Mr. O P Gulati)	Member Trustee
7	Mr. Alok	Grand-Son (Son of Mrs. Rita & Mr. M R Gulati)	Member Trustee

Easy Key Educational Trust runs group of agriculture colleges. Rita and Radha are cousin from Mohanty family with political background, which supports the businesses of Gulati Family, where ever possible.

Post to death of Mr. Rattan Mal Gulati last year, Ms. Alka admitted as member trustee to Easy Key Education Trust and Mr. M R Gulati took charge as managing trustee. Ms. Alka is daughter of Mrs. Radha & Mr. O P Gulati; she is studying Agriculture Economics and Business Administration in one of dual degree programme of Kansas State University, Manhattan, United States. Mr. O P Gulati remitted US $ 260,000 to Ms. Alka through authorised person for tuition fee and personal expenditure.

On 21st birthday of Ms. Alka, both the parent Mrs. Radha & Mr. O P Gulati, decided to visit to Ms. Alka in States, to congratulate her and on same day there is 25th Wedding Anniversary of Mrs. Radha & Mr. O P Gulati. While passing by streets in Manhattan Mrs. Radha, find Jewelry showroom which offers latest design and exciting offers. Mr. O P Gulati agrees to buy gold for Mrs. Radha, who was fond of jewelry and from investment prospective. Price offered by Gold smith is US$ 45 per gram, which is cheaper than prevailing prices of gold in India. Therefore, Mr. O P Gulati apart from purchase of 70 grams of gold ornaments (jewelry) and 20 grams gold in form of gold coins; he also purchased latest gizmo device, which is not yet launched in India. On arrival to India, both Mrs. Radha & Mr. O P Gulati, pass through green channel; without making any disclosure/declaration to custom authority.

Mr. Pandey, a child-hood friend of Mr. M R Gulati approached him, and explained about financial crisis in his business and make a proposal to Mr. M R Gulati for sale of his ancestral land situated in Vikas-Khand (which now declared as an Industrial town, with tax holiday) at price below the market prevailed prices of similar land. Mr. M R Gulati, with intention to develop elite corporate plaza named 'G Square' where Board Meetings, Trade Conferences, Conventions, Workshops can be held, plans to buy land from Mr. Pandey. After negotiation, price for land settled at INRs 4 crore, out of which he paid INRs 1 crore in cash and balance INRs 3 crore in form of account payee cheque. Said cash of INRs 1 crore later deposited in joint personal account of Mrs. and Mr. Pandey in parts by Mr. Pandey. Mr. M R Gulati asked Mr. Pandey to register the plot in favour of Mr. Alok, and wish that his son should join his business.

To arrange fund for purchase of land situated in Vikas-Khand, Mr. M R Gulati sold one of his earlier acquired property for INRs 5 Crore. After making payment of INRs 4 crore with residual amount of INRs 1 crore, Mr. M R Gulati start a housing project named 'Paradise' which comprises 6 flats (1 building of 3 floors with 2 flat at each floor) in 650 Square Meters.

Advance equal to 25% of estimated (due to escalation clause) price collected from customer who booked the flats, and 20% of these advance amounts used to complete one of already existing ongoing project by Mr. M R Gulati and remaining amount kept in separate bank account. Project Paradise is not registered with Real Estate Regulatory Authority yet. Looking into the high demands among buyers, Mr. M R Gulati decided to enlarge the project by 4 flats, resultantly increase the floors from 3 to 5. Installment also collected as and when become due, and duly accounted for in books of accounts and acknowledgment is also provided to allottees. Mr. Rahman, who is friend to family of Mr. M R Gulati, is also qualified lawyer by qualification but hotelier by profession, told Mr. M R Gulati about registration requirements of project under Real Estate (Regulation and Development) Act, 2016; and Mr. M R Gulati applied for same. In mean time Mr. M R Gulati using his influence took permission from Municipal Corporation of city for increase of floor.

Mr. Alok who is fickle minded young-star, graduated from top notch B-School willing to start his business of solar panels, he asked his father to help him with funds in establishing the business. Mr. M R Gulati helped the son to establish the business in form of private company with name 'Power Sun Private Limited' by allowing him to use the Vikas-Khand land, in order to avail tax benefit. Mr. Alok raised a loan from financial institution at relatively high interest rate. Due to his capricious nature, no experience in business of solar panel and stiff economic conditions; business went into losses. Situation of debt trap arises in second year of operation. Liquidity and solvency position of business of Mr. Alok is this much bad that he is unable to pay-off trade creditor, despite multiple month long reminders from vendors. One of unpaid operational creditor sent the demand notice under IBC, 2016 to Power Sun Private Limited on 15th November, 2019.

Ms. Alka came back to India after completing her academic programme; she joined the governing body of group of agriculture colleges operated by Easy Key Educational Trust. She planned for strategic restructuring of the business. She decided to attain dominance in market and beat the competition by acquisition of the only another agriculture college operational in state. New programmes are also launched which are research based and featuring industry immersion as unique selling point. She ensured that all the group agriculture colleges of group must be accredited from ICAR. Down the line having aspiration, that these affiliated colleges either must emerge as autonomous colleges or become research based universities. Due to monopoly in agriculture courses, all fees apart from tuitions fee doubled from upcoming academic year.

Questions

Part A- Multiple Choice Questions (2 Marks each)

1. What will be amount of penalty, in regard to excess remittances in USD to United States done by Mr. O P Gulati:
   (a) USD 260,000
   (b) USD 200,000
   (c) USD 60,000
   (d) USD 30,000
2. If the price of each flat is INRs 50 lakhs, then how much will be maximum amount of advance to book flat
   (a) INRs 1,50,000
   (b) INRs 5,00,000
   (c) INRs 6,00,000
   (d) INRs 6,50,000
3. Out of the following acts of Mr. M R Gulati, which can be held as offence under Real Estate (Regulation and Development) Act, 2016
   i. Not applied for registration of the project at earlier stage (prior to extension of floors)
   ii. Receive the advance and installments without/prior registration of Project.
   iii. Use 20% of Fund for completion of other already on-going existing project
   (a) Only ii
   (b) Both i and ii
   (c) Both i and iii
   (d) Both ii and iii
4. In how many days 'Power Sun Private Limited' need to respond demand notice of operational creditor served on 15th November 2019
   (a) latest by 22nd November 2019
   (b) latest by 23rd November 2019
   (c) Latest by 25th November 2019
   (d) latest by 15th December 2019
5. Can Mr. Alok be held as Benamidar under Prohibition of Benami Property Transactions Act, 1988?
   (a) Yes, because consideration paid by Mr. M R Gulati, but property registered in his name
   (b) Yes, because he is party to transaction
   (c) No, because he is son of Mr. M R Gulati, who paid the consideration
   (d) No, because he didn't participate in negotiation of price and payment there-of.

Part B- Descriptive Questions

6. Is the act of Mrs. Radha & Mr. O P Gulati, on arrival to India, without making any disclosure and pass through green channel along with the article purchased from Manhattan, United States, constitute an offence under the Prevention of Money Laundering Act, 2002. **(5 Marks)**
7. 'Power Sun Private Limited' find it difficult to run the operations further and it is already defaulting in making payment to both financial and operational creditors. So, if 'Power Sun Private Limited' wants to initiate insolvency resolution process, examine whether it can initiate the process? **(6 Marks)**
8. Ms. Alka is highly passionate about implementing the strategies, that she learned during her business administration classes. Is any of her actions or implication of strategies adopted by her is in contravention to provisions of the Competition Act, 2002? Advise **(4 Marks)**

Answers

Part A

1. (d) USD 30,000
   Reason - Amount involved in contravention is USD 10,000 because amount permissible by Schedule III of Foreign Exchange Management (Permissible Current Account Transactions) Regulations 2000 is USD 250,000. Hence amount of penalty will be USD 30,000 (i.e. 3 times of USD 10,000) [Section 13 of Foreign Exchange Management Act, 1999]
2. (b) INRs 5,00,000
   Reason – Maximum amount of advance to book flat is INRs 5,00,000 (i.e. 10% of 50,00,000) [Section 13 (1) of Real Estate (Regulation and Development) Act, 2016]
3. (b) Both i and ii
   Reason - Section 3 require prior registration, if area of land for proposed project is more than 500 square meters or there are more than 8 units; Since area is 650 square meters, hence project require prior registration. No amount should be received from allottee prior to registration of project. Hence both i and ii shall be constituted as offence.

   Section 4(2) (l) d require 70% of amount realized for project from allottee need to be kept in separate bank

account and will be used for that projects according to degree of completion withdrawal from said account can be made. Here in this case 80% deposited into separate account, hence not an offence.

4. (c) Latest by 25th November 2019
Reason – Section 8(2) of Insolvency and Bankruptcy Code, 2016 provides, that corporate debtor shall, within a period of ten days of the receipt of the demand notice, bring to the notice of the operational creditor that either the litigation is pending or payment of unpaid operational debt done.
5. (c) No, because he is son of Mr. M R Gulati, who paid the consideration
Reason –By virtue of 2 (9) (A) (iii) - Property registered in name of child will not be considered as Benami transaction. Hence this property is not a Benami property and Mr. Alok is not Benamidar.
6. As per section 3 of the Prevention of Money Laundering Act, 2002, whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the **proceeds of crime** including its concealment, possession, acquisition or use and projecting or claiming it as untainted property, shall be guilty of offence of money-laundering.

Further as per section 2(u) "proceeds of crime" means any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a **scheduled offence** or the value of any such property or where such property is taken or held outside the country, then the property equivalent in value held within the country or abroad.

Further as per paragraph 12 of part A of schedule to the Prevention of Money Laundering Act 2002, offences under the section 135 of Customs Act, 1962 regarding evasion of custom duty; and as per part B of schedule to the Prevention of Money Laundering Act 2002, offences under the section 132 of Customs Act, 1962 regarding False declaration, false documents, are considered as scheduled offence under the Prevention of Money Laundering Act, 2002.

Since baggage item are also subject to duty beyond certain limit and gold and jewelry purchased by Mrs. Radha & Mr. O P Gulati either not permitted as baggage through green channel and not filling declaration leads to evasion of duty. Hence, if no declaration made to custom officer on arrival at airport will constitute as scheduled offence.

Hence act of Mrs. Radha & Mr. O P Gulati, on arrival to India; without making any disclosure/declaration to custom authority and pass through green channel along with the article purchased from Manhattan, United States, constitute an offence under the Prevention of Money Laundering Act, 2002.

7. As per section 6 of the Insolvency and Bankruptcy Code, 2016, where any corporate debtor commits a default, a financial creditor, an operational creditor or the corporate debtor itself may initiate corporate insolvency resolution process in respect of such corporate debtor in the manner as provided under the section 7, 9, & 10 of the Code. Hence, yes 'Power Sun Private Limited' being a corporate debtor can initiate insolvency resolution process against itself as per section 10 of the Code.

Initiation of corporate insolvency resolution process 'Power Sun Private Limited': Application shall be filed in form and manner with such fee as may be prescribed for initiating corporate insolvency resolution process with the Adjudicating Authority.

- Furnish the information relating to its books of account and such other documents relating to such period as may be specified; and the resolution professional proposed to be appointed as an interim resolution professional.
- The Adjudicating Authority shall, within a period of fourteen days of the receipt of the application, by an order either admit the application, if it is complete; or reject the application, if it is incomplete. Before rejecting an application, give a notice to the applicant to rectify the defects in his application within seven days from the date of receipt of such notice from the Adjudicating Authority.
- The corporate insolvency resolution process shall commence from the date of admission of the application.

However, 'Power Sun Private Limited' shall not be entitled to make an application to initiate corporate insolvency resolution process in terms of section 11 of the Code under any of the following situations:

- If already undergoing a corporate insolvency resolution process; or completed corporate insolvency resolution process twelve months preceding the date of making of the application
- If violated any of the terms of resolution plan which was approved twelve months before the date of making of an application
- If a liquidation order already has been made.

8. As per sub-section 1 to section 4 of the Competition Act, 2002, no enterprise or group shall abuse its **dominant position.**

Further as per explanation (a) to section 4 "dominant position" means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market; or (ii) affect its competitors or consumers or the relevant market in its favour.

Further as per section 4(2)(a)(ii), there shall be an abuse of dominant position if an enterprise or a group, directly or indirectly, imposes unfair or discriminatory price in purchase or sale of goods or service.

In given case, decision by Ms. Alka to attain dominance by acquisition of the another agriculture college operational in state, is not in contravention to provisions of the Competition Act, 2002.

But increasing all the fees apart from tuitions fee to double due to monopoly which comes out of dominance over market by killing the competition, is in contravention to provisions of the Competition Act, 2002.

[Note – Acquiring dominance is not offence, but abuse of dominance is an offence.]

CASE STUDY 2

In the year 2001, Keshav and Tanishk formed Ketan Builders and Constructions Private Limited (KBCPL) having registered office in Karol Bagh, New Delhi. The company provided spacious and plush homes with well-designed landscapes, gymnasiums along with multi-tiered security and recreational spaces involving more than one lac sq. ft. in Faridabad and Gurugram.

Their construction business was flourishing day-by-day. 'KBCPL' was now a brand which could attract persons from all walks of life i.e. professors, advocates, engineers, professionals, businessmen, government employees holding responsible positions, etc. Expanding business required Keshav and Tanishk to appoint Radhika and her husband Ratnesh, both architects by profession, as directors in the company. Radhika was the younger sister of Tanishk.

Time was passing on. It was in the month of July, 2015, that the KBCPL launched yet another project in Greater Noida whose completion date was given as June, 2018. This project involved construction of residential units, office spaces and a mall. The modus operandi was to invest around ₹ 1200 crore for developing the township at Greater Noida under 'committed returns plan'.

The 'committed returns plan' required the home-buyers to pay 80% percent of the total sale consideration up-front at the time of execution of the MOU and the promoters of KBCPL would undertake to pay 12% of the 'advance money' so received each month to the investors as 'committed returns' from the date of execution of the MOU till the time actual physical possession of residential units/office space, etc., was to be handed over to the buyer. The home-buyers also had the option to choose the construction-linked payment plan and possession-linked payment plan.

In comparison to construction and possession linked payment plan, the 'committed returns plan' proved to be an attractive one for the home-buyers belonging to different strata of society. Like many others, Aayush, by profession a computer engineer and working for a reputed MNC engaged in developing customized software, was also interested in this plan and applied for a residential unit as well as an office space. Aayush, who always wanted to be a self-employed person in the long run, kept some future plans in mind while applying for the office space.

Under the 'committed returns plan', Aayush was required to make a payment of ₹ 80.00 lacs (i.e. 80% of the cost of ₹ 1.00 crore for a 4BHK apartment and an office space in the mall). He discussed the matter with his father Ramashankar who arranged ₹ 65.00 lacs by raising loan against his fixed deposits. Remaining ₹ 15.00 lacs were arranged by Aayush as gold loan by pledging the jewelry of his wife Meera. According to the MOU entered by Aayush with the company, he would be paid ₹ 80,000 per month through NEFT from October, 2015 onwards till the handing over of the fully constructed property. The difference of ₹ 20.00 lacs (i.e. ₹ 1.00 crore minus ₹ 80.00 lacs) would be paid by Aayush when he will be having the possession of the apartment as well as office space.

Everything seemed to be fine in the first year of launching the project as the KBCPL paid the 'committed returns' to the home-buyers without any default but stopped the same thereafter without assigning any reason. Similar to the others, Aayush also noticed the default but comforted himself by assuming that the 'committed returns' would start soon after sometime.

There was, however, no ray of hope and the default continued unhindered. Further, Aayush learned from certain other home-buyers that no construction activities were in sight at the earmarked plot. He made up his mind to visit the site personally and found the unthinkable revelations true. Aayush got extremely worried at the changed scenario. He contacted the officials of the company but received no reply. At a later date, when Aayush confronted the company officials, he was informed that the possession would be given within the next two years; but the time passed without anything concrete to happen.

Sensing dark clouds looming large over his head, he discussed the worrying matter with his uncle's lawyer, Vansh Agarwal. His uncle, Rajinder Kumar, was an exporter, exporting readymade leather bags of various sizes to South Africa, catering to latest fashion trends.

Vansh informed Aayush that due to some significant amendments in Insolvency and Bankruptcy Code, 2016 (IBC, 2016) home-buyers were also the financial creditors of the builders and developers. The premise of this amendment was based on an important fact that the home-buyers were also a reckoning force as other financial creditors; but they were being left high and dry when it came to playing a role in the decision-making process relating to initiation of insolvency resolution process against the defaulting builder/developer. Accordingly, he could also be referred to as a financial creditor and could initiate insolvency proceedings against the company as it had failed to pay back monthly 'committed returns' to him including non-delivery of apartment and office space at the stipulated time. The other investors could also sail in the same boat as they had the similar fate.

Vansh further clarified that 'debt' in this case was disbursed against the consideration for 'time value of money' which is the main ingredient that is required to be satisfied in order for an arrangement to qualify as financial debt and for the lender to qualify as a financial creditor under the scheme of IBC. This acted as silver lining for Aayush.

In the meantime, Aayush came across a public announcement through which claims from 'Financial Creditors' as well as other creditors of KBCPL were invited. On further enquiry, he gathered that the company had defaulted in repayment of a term loan of ₹ 100 crore which was obtained from National Bank of India. Accordingly, the Hon'ble National Company Law Tribunal (NCLT), Delhi, on the application of National Bank of India, had ordered the commencement of Corporate Insolvency Resolution Process (CIRP) against KBCPL. As mentioned in the public announcement, Aayush submitted his claim along with proof thereof in 'Form C' through the specified e-mail.

Questions

Part A - Multiple Choice Questions (2 Marks each)

1. In the given case study, National Bank of India filed an application for corporate insolvency resolution process (CIRP) with National Company Law Tribunal, Delhi against KBCPL for default in repayment of term loan. If everything was in perfect order, from which date the corporate insolvency resolution process would have commenced?
   (a) From the date of submission of the application.
   (b) From the date of admission of the application.
   (c) From the date of ascertaining the existence of default by the NCLT.
   (d) From the date of appointment of Insolvency Resolution Professional (IRP).

2. Suppose Radhika had given a loan of ₹ 15,00,000 to KBCPL which remained outstanding when Corporate Insolvency Resolution Process was ordered. As financial creditor whether she could be a part of Committee of Creditors (CoC) after she submitted her claim in 'Form C'.
   (a) Yes, she could be a part of Committee of Creditors (CoC) as she had given loan to KBCPL which was more than ₹ 5,00,000.
   (b) No, she being a director of KBCPL, could not be a part of Committee of Creditors (CoC).
   (c) Yes, she could be a part of Committee of Creditors (CoC), if Interim Resolution Professional (IRP) permitted her despite the fact that she was a director of KBCPL.
   (d) Yes, she could be a part of Committee of Creditors (CoC), if Interim Resolution Professional (IRP) sought permission of minimum 75% of the shareholders of the company carrying voting rights.
3. In the case study, Ketan Builders and Constructions Private Limited had demanded advance payment of 80% of the project cost from the intending home-buyers. After coming into force of Real Estate (Regulation and Development), Act, 2016 (RERA), maximum how much advance money can be demanded by a builder.
   (a) Not more than 5%
   (b) Not more than 10%
   (c) Not more than 15%
   (d) Not more than 20%
4. Suppose the application for Corporate Insolvency Resolution Process against KBCPL filed by National Bank of India with the National Company Law Tribunal, Delhi is adjudged as incomplete in respect of certain matters. It was intimated to National Bank of India through notice issued on 24th October 2018. The said notice was received by National Bank of India on 26th October, 2018. The time period within which the defects must be rectified by National Bank of India, so that insolvency process may be started by the National Company Law Tribunal, Delhi.
   (a) latest by 31st October, 2018
   (b) latest by 2nd November, 2018
   (c) latest by 5th November, 2018
   (d) latest by 10th November, 2018
5. In the given case study, Aayush, as 'financial creditor', could also move an application for corporate insolvency resolution process because non-payment of debt by KBCPL was much more than the minimum amount stipulated for triggering a default against the company. Indicate that minimum amount by choosing the correct option:
   (a) ₹ 50,000
   (b) ₹ 1,00,000
   (c) ₹ 10,00,000
   (d) ₹ 20,00,000

Part B- Descriptive Questions

6. In this case study Aayush, who is a home-buyer, has been categorized as a 'financial creditor'. You are required to answer the following:
   (a) Mention the provisions which enable a 'home-buyer' to be considered as a 'financial creditor'. **(5 Marks)**
   (b) 'Identify when a 'financial creditor' can also be categorised as an 'operational creditor'? **(5 Marks)**
7. In the given case study, suppose Aayush having developed a customized software for KBCPL. Despite repeated reminders, KBCPL did not settle his invoice of ₹ 5,00,000 raised in this respect. Ultimately, Aayush proceeded to file application for initiating Corporate Insolvency Resolution Process (CIRP) against KBCPL with the National Company Law Tribunal (NCLT), Delhi. What could have been the documents which Aayush might have furnished along with application filed for initiating Corporate Insolvency Resolution Process (CIRP)? **(5 Marks)**

Answers

Part A

1. (b) From the date of admission of the application.
   Reason: According to Section 7 (6), the corporate insolvency resolution process shall commence from the date of admission of the application.
2. (b) No, she being a director of KBCPL, could not be a part of Committee of Creditors (CoC).
   Reason: Refer First Proviso to Section 21 (2) which states that a financial creditor, who is a related party of the corporate debtor, shall not have any right of participation or voting in a meeting of the Committee of Creditors (CoC). Radhika being a director of the company was a 'related party' in terms of Section 5 (24).
3. (b) Not more than 10%
   Reason: Refer Section 13 (1) of the Real Estate (Regulation and Development), Act, 2016 which states that a promoter shall not accept a sum more than ten per cent of the cost of the apartment, plot, or building as the case may be, as an advance payment or an application fee, from a person without first entering into a written agreement for sale with such person and register the said agreement for sale, under any law for the time being in force.
4. (b) latest by 2nd November, 2018
   Reason: According to Proviso to Section 7 (5), any defect in the application needs to be rectified within 7 days of receipt of notice from the Adjudicating Authority. As the notice of NCLT was received by National Bank of India on 26th October, 2018, so it needs to be rectified within 7 days of receipt of notice i.e latest by 2nd November, 2018
5. (b) ₹ 1,00,000
   Reason: Refer Section 4 (1) which states that the insolvency and liquidation in respect of corporate debtors shall be triggered where the minimum amount of the default is ₹ 1,00,000.

Part B

6 (a). In order to categorise the home-buyers as 'financial creditors', Section 5 (8) of the Insolvency and Bankruptcy Code, 2016, which defines the term 'financial debt', was amended by the *Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 w.e.f. 06-06-2018.* The amendment involved inserting Explanation (i) in Clause (f) of Section 5 (8) as under:

Explanation (i) - 'any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing'.

By inserting above-mentioned Explanation (i) in Section 5 (8) (f), the law makes it clear that the 'financial debt' includes any amount which is raised from an allottee under a real estate project. Further, such amount shall be deemed to be an amount having the commercial effect of a borrowing. The phrase 'commercial effect of a borrowing' means that the

borrower has borrowed money for the purpose of business activities.

The payment made by Aayush to KBCPL for purchasing an apartment and office space is, therefore, a 'financial debt' and accordingly, Aayush is a 'financial creditor'.

(b). According to Section 5 (20) of the Insolvency and Bankruptcy Code, 2016, the term 'operational creditor' means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred.

Further, according to Section 5 (21) the term 'operational debt' means a claim in respect of the provision of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority.

In order to categorise, Aayush as 'operational creditor' also, in addition to 'financial creditor', he should have made provision of goods, for example, supply of construction material to KBCPL and the payment for which remains unpaid. Or else, he should have made provision of certain services but the company, till date, has not honoured the invoice raised by him. Another limb of operational debt is 'employment dues' i.e. Aayush was/is in the employment of the company but his employment dues are still pending.

7. As required by Section 9 (3) of the Insolvency and Bankruptcy Code, 2016, Aayush by having developed a customized software for KBCPL, provided a service to KBCPL. Thus, he acts as an operational creditor. So, by section 9 of the IBC, operational creditor will be regulated for initiation of CIRP against Corporate Debtor. As per sub-section 9(3), Aayush as an 'operational creditor' might have furnished the following documents along with the application for CIRP:
   (a) a copy of the invoice demanding payment or demand notice delivered by the operational creditor to the corporate debtor.
   (b) an affidavit to the effect that there is no notice given by the corporate debtor relating to a dispute of the unpaid operational debt.
   (c) a copy of the certificate from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available. [this requirement under (c) is not mandatory w.e.f. 06-06-2018]
   (d) a copy of any record with information utility confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available; and
   (e) any other proof confirming that there is no payment of an unpaid operational debt by the corporate debtor or such other information, as may be prescribed.

CASE STUDY 3

Rajath and his two sons, Lokesh and Ramesh are the promoters of **RAJATH BEVERAGES LTD (RBL).** Rajath is the Chief Managing Director (CMD) of the Company.

Lokesh looks after finance and marketing; Ramesh takes care of production and human resources.

Production unit is located in Patna, Bihar. The business of the Company is manufacturing and selling of mineral water. The company was formed with a small investment of ₹ 25 Lacs initially as a private limited company, however, later converted into an unlisted Limited Liability Company. The promoters, through their hard work and business competence ensured that RBL is profitable.

Lokesh is an ambitious as well as a shrewd business man. He always tried to beat the competition through flexibility in pricing of his products. Sometimes he even sold some of the products at prices below the costs. He always looked for new avenues for business development, diversification and expansion, for which Ramesh ably assisted him by providing him with the required feasibility reports, analysis and technical information.

Years passed. Board of Directors of RBL decided to go for public issue and listing of its Equity Shares, mainly for expansion, initially with setting up a new large scale mango juice preparation plant. The public offer was a great success and the required shares were duly allotted.

A new large scale mango juice manufacturing plant was established in Patna, location next to the existing mineral water unit. First year of operation was just breakeven. However, unfortunately, the second year of operation turned out to be negative for the Mango Juice Unit due to bad monsoons and bad weather. There was scarcity in supply of mangoes, mango pulp and some other basic raw materials required for production of mango juice during the year 2017 in Bihar. Consequently, all the mango juice manufacturing units in Bihar, through their trade association, entered into an Understanding for price fixing with the sole purpose of defeating competition during the time of scarcity. However, the said Understanding was not in writing and also not intended to be enforced by legal proceedings.

In due course of time, RBL entered into a joint venture agreement with **RAMAN PULP PRIVATE LIMITED (RPPL)** of Punjab to ensure continuous supply of mango pulp and some other raw materials to its mango juice manufacturing unit. With this JV and some other continuous supplies arrangements, RBL could gradually reach an advantageous position in Bihar for local sales of Mango Juice within the State. Production and sales of RBL increased by more than 10 times within a short period of time.

RBL also entered into various distribution agreements with different retail distributors within the state of Bihar to sell its products only in the area exclusively identified or allocated to each of them. Different agreements relating to prices, quantities, bids and market sharing with the competitors and other non-competing entities were also entered into by RBL.

RBL enhanced its production efficiency, introduced various cost saving measures, and could substantially increase its market share in the sale of its products over a period of time. Many of the bankers, financial institutions and potential investors approached the Company, offering further financial assistance/ investment. With all the productive measures, RBL could achieve the position of strength in Bihar market to operate independently of competitive forces. RBL soon also diversified into other segments of businesses in Beverages.

However, the continuing business competition also resulted in the Commission receiving formal information from one of the Trade Associations in Bihar that there is abuse of dominance by RBL by contravening various provisions of the relevant law. The Commission initiated an enquiry and was of the opinion that

there exists a prima facie case and directed the Director General (DG) to cause an investigation to be made into the matter and report the findings to the Commission.

After due investigation, the DG submitted his Report to the Commission within the specified period. However, the allegations against RBL of the contravention of the law could not be substantiated during investigation and were found to be mainly because of the business competition. The Report of the DG recommended that there is no contravention, since there is no appreciable adverse effect on competition.

The Commission forwarded copies of the Report to both the parties. After due consideration of the objections and suggestions, the Commission agreed with the recommendations of the DG, closed the matter and passed the appropriate Orders.

Questions

Part A- Multiple Choice Questions (2 Marks each)

1. Board of Directors of RBL decided to go for public issue and listing of its Equity Shares, for business expansion, initially with setting up a new large scale mango juice preparation plant. The public offer was a great success and the required shares were duly allotted. In the context of above case, which one of the following statement is correct?
   (a) Shares cannot be considered as "goods", since nothing has to do with manufacturing, processing, or mining.
   (b) Shares can be considered as "goods" at the share application stage, since application monies are paid for acquisition of shares.
   (c) Shares can be considered as "goods" only during their purchase or sale i.e. trading in the Stock market or otherwise.
   (d) Shares can be considered as "goods" after allotment.

2. RBL also entered into a joint venture agreement with RAMAN PULP PRIVATE LIMITED (RPPL) of Punjab to ensure continuous supply of mango pulp and some other raw materials to its mango juice manufacturing unit. Joint Venture agreement between RBL and RPPL:
   (a) Is an anti-competitive agreement, since resulted in increased turnover for one company, as against others
   (b) Not to be considered anti- competitive, since it enhanced the production efficiency of RBL
   (c) Is anti- competitive, since RBL could reach advantageous position in Bihar because of this Agreement
   (d) The agreement between RBL and RPPL is void and inoperative ab- initio since resulted in more sales to one Company as compared to others in Bihar.

3. The continuing business competition also resulted in the Commission receiving formal information from one of the Trade Associations in Bihar that there is abuse of dominance by RBL by contravening various provisions of the relevant law. The composition of the said Commission, which received the formal information hereinabove, as per the relevant law shall be:
   (a) Chair Person and not less than 2 and not more than other 6 members, to be appointed by the State Government.
   (b) Commissioner and not less than 3 and not more than 5 members, to be appointed by the Central Government
   (c) Chair Person and not less than 2 and not more than other 6 members, to be appointed by the Central Government.
   (d) Chief Executive officer and not less than 3 and not more than 5 members, to be appointed by the State Government

4. All the mango juice manufacturing units in Bihar, through their trade association, entered into an Understanding for price fixing with the sole purpose of defeating competition during the time of scarcity. However, the said Understanding was not in writing and also not intended to be enforced by legal proceedings. The Oral Understanding entered into by Trade Association of Bihar in the aforesaid case:
   (a) Is only an arrangement, not enforceable
   (b) Can be converted into a written Agreement at a later date and can be enforceable only thereafter.
   (c) a valid Agreement
   (d) a valid Agreement only if all the parties involved therein confirm it in writing at a later date.

5. Lokesh tried to beat the competition sometimes even by selling some of the products at prices lesser than costs. The sale of goods or provision of services, at a price below the cost, as may be determined by the regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors is termed as:
   (a) Monopolistic price
   (b) Minimum Retail Price (MRP)
   (c) Eliminatory Price
   (d) Predatory Price

Part B- Descriptive Questions

6. With all the productive measures, RBL could achieve the position of strength in Bihar market to operate independently of competitive forces. *"An enterprise has the legal right to grow its business and achieve the position of strength to the maximum extent possible, unless such position has been intentionally exploited to gain undue advantages".* Analyze the statement with reference to the provisions of the relevant law in India, including the factors which the Commission will consider to determine the facts. **(5 Marks)**

7. The Commission initiated an inquiry and was of the opinion that there exists a *prima facie* case and directed the Director General to cause an investigation to be made into the matter and report the findings to the Commission.
   (a) Instead of any directions by the Commission, is there any possibility of a Director General to *suo motu* initiate investigation in the above case under any of the provisions of the relevant Indian law? **(1 Mark)**
   (b) Imagine in the aforesaid case, the Commission passes an Order directing the division of the enterprise, RBL. *"The Order of the Commission may provide for any or all the matters on division of enterprise enjoying position of strength as stated under the law".* Enumerate the provisions of the relevant Law on the matters that may be provided for in the Order? **(3 Marks)**
   (c) The Articles of Association of RBL provides that the Managing Director and the Directors are entitled to claim compensation to the extent mentioned therein, if there is division of enterprise for any reasons and in case they cease to hold their office(s) in consequence thereof. Is Ramesh, one of the directors of RBL, on cessation of his office entitled to claim compensation, because of the position stated in point (b) above i.e. Commission passing an Order for division of enterprise? **(1 Mark)**

8. In the above case, RBL has entered into various types of agreements with various entities. *"Any Agreement at different stages or levels of the production chain in different markets for trade in goods or provision of services shall be*

void, if it causes or is likely to cause an appreciable adverse effect on competition in India". Identify and enumerates such Agreements. **(5 Marks)**

Answers

Part A

1. (d)

Reason: Refer to Section 2 (i) (B) of the Competition Act, 2002

2. (b)

Reason: Refer to Provision to Section 3 (3) of the Competition Act, 2002

3. (c)

Reason: Refer to Section 8 of the Competition Act, 2002

4. (c)

Reason: Refer to Definition in Section 2 (b) of the Competition Act, 2002

5. (d)

Reason: Refer to Explanation (b) to Section 4 of the Competition Act, 2002

Part B

6. "An enterprise has the legal right to grow its business and achieve the position of strength to the maximum extent possible, unless such position has been exploited to gain undue advantages".

It may be noted that attaining the position of strength or "dominant position" is not prohibited; Every enterprise has the freedom and legal right to grow up; but it is only the "abuse of dominant position" in an area, affecting the competition and as such prohibited under the Competition Act, 2002. Mere achieving of the position of strength in Bihar market by RBL to operate independently of competitive forces does not come under the area of prohibition under any of the Indian laws.

Abuse of dominant position impedes fair competition between firms, exploits consumers and makes it difficult for the other players to compete with the dominant undertaking on merit.

Under Section 4 Explanation (a) of the Competition Act, 2002, **"dominant position"** means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to—

(i) Operate independently of competitive forces prevailing in the relevant market; or

(ii) affect its competitors or consumers or the relevant market in its favor.

Section 4 (1) of the Competition Act, 2002 expressly prohibits any enterprise or group from abusing its dominant position. There shall be **"abuse of dominant position"** if an enterprise or group

(a) directly or indirectly, imposes unfair or discriminatory-
   (i) condition in purchase or sale of goods or services or
   (ii) price in purchase or sale (including predatory price) of goods or services or

(b) limits or restricts production of goods or provision of services or market there for or technical or scientific development relating to goods or services to the prejudice of consumers or

(c) indulges in practice or practices resulting in denial of market access in any manner or

(d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which by their nature or according to commercial usage have no connection with the subject of such contracts or

(e) uses its dominant position in one relevant market to enter into, or protect, other relevant market.

For the purpose of determining whether an enterprise enjoys dominant position or not under Section 4, the Competition Commission of India (CCI) shall have due regard to all or any of the following factors viz,

(i) Market Share of the enterprise;

(ii) Size and Resource of the enterprise;

(iii) Size and importance of the competitors;

(iv) Economic power of the enterprise including commercial advantages over competitors;

(v) Vertical integration of the enterprises or sale or service network of such enterprises;

(vi) Dependence of consumers on the enterprise;

(vii) Monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government or a public sector undertaking or otherwise;

(viii) Entry barriers including barriers such as regulatory barriers, financial risk, high capital cost entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;

(ix) Countervailing buying power;

(x) Market structure and size of market;

(xi) Social obligations and social costs;

(xii) Relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;

(xiii) Any other factor, which the Commission may consider relevant for the inquiry.

It may be noted that the Commission shall have due regard to the "relevant geographic market" and "relevant product market" for determining as to what constitutes a "relevant market"

For determining the "relevant geographic market" the Commission shall have due regard to all or any of the following factors, viz.,

(i) Regulatory trade barriers;

(ii) Local specification requirements;

(iii) National procurement policies;

(iv) Adequate distribution facilities;

(v) Transport costs;

(vi) Language;

(vii) Consumer preferences;

(viii) Need for secure, regular supplies or rapid after-sales service.

Similarly, while determining "relevant product market", the Commission shall have due regard to all or any of the following factors viz.,

(i) Physical characteristics or end use of goods;

(ii) Price of goods or service;

(iii) Consumer preferences;

(iv) Exclusion of in-house production;

(v) Existence of specialized producers;

(vi) Classification of industrial products.

7. (a) No. The role of the Director General is actually to assist the Competition Commission in the effective discharge of its duties. The Director General would be able to act only if so directed by the CCI, but will not have any suo motu powers for initiating investigations. Under Section 16, the Central Government may, by notification, appoint a Director General for the

purposes of assisting the Commission in conducting inquiry into contravention of any of the provisions of the Competition Act, 2002 and for performing such other functions as are, or may be, provided by or under the Act.

(b) Section 28 of the Competition Act, 2002 deals with the provisions relating to division of enterprise enjoying dominant position.

The Commission may, notwithstanding anything contained in any other law for the time being in force, by Order in writing, direct division of an enterprise enjoying dominant position to ensure that such enterprise or group does not abuse its dominant position.

The Order of the Commission referred to above may provide for all or any of the following matters, viz.,-

(i) The transfer or vesting of property, rights, liabilities or obligations;

(ii) The adjustment of contracts either by discharge or reduction of any liability or obligation or otherwise;

(iii) The creation, allotment, surrender or cancellation of any shares, stocks or securities;

(iv) The formation or winding up of an enterprise or the amendment of the memorandum of association or articles of association or any other instruments regulating the business of any enterprise;

(v) The extent to which, and the circumstances in which, provisions of the Order affecting an enterprise may be altered by the enterprise and the registration thereof;

(vi) Any other matter, which may be necessary to give effect to the division of the enterprise or group.

(c) Notwithstanding anything contained in any other law for the time being in force or in any contract or in any Memorandum or Articles of Association, an officer of a Company, who ceases to hold office as such in consequence of the division of an enterprise, shall not be entitled to claim any compensation for such cesser. [Section 28 (3) the Competition Act, 2002]. As such, Ramesh is not entitled to claim any compensation.

8. Any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services shall be a void agreement if it causes or is likely to cause an appreciable adverse effect on competition in India, including-

Tie in arrangement: includes any agreement, requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;

Exclusive supply agreement: includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person.

Exclusive Distribution agreement: includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods.

Refusal to deal: includes any agreement, which restricts or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought.

Resale price maintenance: includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.

CA FINAL - PAPER 6D - ECONOMIC LAWS

This capsule on Paper 6D: Economic Laws, Final (New) course is another step of the Board of Studies in its endeavour to provide quality academic inputs to Final course students of Chartered Accountancy course. As students are aware that this is an open book examination and the duration is 4 hours. The question paper would comprise of five case studies of 25 marks each, out of which the student would be required to attempt any four. Students must divide their four hours between four case studies to be answered meticulously. Once the case studies have been opted, give them a comprehensively reading while attempting the same. Some of the illustrative case studies have been provided below for practice purpose. Students are suggested to solve the same in examination condition and check for the answers only after attempting the case studies.

CASE STUDY 1

Ms. Drishel Patel is a young dynamic IT professional and currently resides in America. She holds the NRI status. Ms. Drishel works for Blip LLC, which has a wholly owned subsidiary Blip India Private Limited (here-in-after referred to as Blip). Blip deals in the mobile operating system. Blips' operating system 'Diordna' is widely popular among the mobile phone manufacturers in India. Blip also offers proprietary applications and services (such as Blip Maps, Blip Internet Explorer, and Blip Tube, etc.). Blips Mobile Services (BMS) is a bundled suite of Blips' applications and services and such apps and services are not available in isolation. In trade parlance, the mobile OS is different from OS designed for desktop as they have additional handheld use features. 80% of mobile phone, which are in use has Diordna as an operating system.

If a mobile manufacturer wants to manufacture a 'bare' Diordna mobile, it needs to only pass technical tests and accept the Diordna License Agreement; but in bare Diordna mobile manufacturer are not permitted to include any of BMS such as Blip Maps, Blip Internet Explorer, Blip Tube. If a manufacturer wants to manufacture a mobile having Diordna with pre-installed BMS, he has to enter into two additional agreements with Blip i.e. Mobile Application Distribution Agreement and Anti Fragmentation Agreement. BMS couldn't be availed directly by the end-users, in case it is not pre-installed.

Ms. Drishel got married to Mr. Joe Harris around a year back. The marriage took place in a traditional saptapadi ceremony in the backyard of Harris' residence where only close relatives were present. Marriage was registered six months later due to a widely observed lockdown to prevent the widespread of COVID-19.

Indian traditions have a deep-rooted impact on Harris family because the grandmother of Joe is from India. Joe's grandfather is also influenced by Indian culture, hence willing to migrate to India along with Joe's grandmother to spend the rest of their life. Considering this in the month of January 2021, Drishel and Joe acquired a luxurious apartment in joint name in India, so that Joe's grandparent can stay there comfortably. Half of the consideration was paid by Ms. Drishel out of the Non-Resident Account maintained by her, and the remaining half by Joe through proper banking channel, and that too in the manner prescribed. To identify the flat and fulfill the legal requirement for registration of the same, Ms. Drishel took the help of her elder cousin Mr. Arya Patel, who is permanently residing in India.

Mr. Arya along with two of his friends owns a cement manufacturing company in India called 'Strong Cement Private Limited' (SCPL). The SCPL supplies cement to various builders and retail consumers through a network of stockist and retailers. An understanding has been reached among the manufacturers of cement to control the price and supply of cement, but the understanding is not in writing and it is also not intended to be enforced by legal proceedings.

Rock Solid Private Limited (RSPL) is the substantial supplier of clay, slate, blast furnace slag, silica sand which are essential raw materials of cement, and a shortage of same observed in the market. Mr. Arya on behalf of SCPL has executed a supply agreement with RSPL on 20th October 2020 wherein it is provided that RSPL will not supply these raw materials to any other cement manufacturer, against this the purchase commitment has been made from SCPL for all their (RSPL) output at price mentioned in such agreement.

Solid Cement Limited (SCL) who is another cement manufacturer is not happy with the RSPL, because RSPL has not supplied the slate and silica power to SCL against the PO (Purchase Order) placed by SCL dated 18th October 2020, hence board of directors of SCL is considering taking legal remedy against RSPL in the capacity of the consumer. SCL has borne loss on account of the stock-out situation emerged from the non-availability of raw material. It was found that only half of the consideration was paid and 30 days credit was available for making payment of the remaining balance, regarding which payment promise is made by SCL.

Mr. Alok who is co-owner in SCPL with Mr. Arya, conducts the market study and concluded that the RMC (Readymix Concrete) segment has favourable opportunities because currently competition is relatively less in RMC and RMC based block segments. Moreover, RMC based block has wide acceptance as an economical replacement of the brick-based structure. Hence SCPL must diversify into the RMC segment. Mr. Arya expresses his concerns over the availability of funds for the same. Mr. Anil the third member of SCPL, advices both the co-owners to float capital through the capital market. After numerous rounds of discussions, SCPL decided to go for public issue and listing of its equity shares, largely for business expansion, initially with setting up a new large scale RMC plant.

Mrs. Patel, the mother of Ms. Drishel, who also resides with her daughter and son-in-law in States and holds NRI status, acquired two immovable properties (one farmhouse for residential purposes and another an agricultural land, because she studied botany during her master and willing to develop botanical garden there) in their native place situated near to Rajkot district of Gujarat in India in the year 2020-2021 for total consideration equivalent to USD 470,000. She made payment for the same out of her non-resident account.

Multiple Choice Questions

1. Whether the understanding reached among the manufacturers of cement be termed as an agreement
   (a) No, because it is not in writing
   (b) No, because it is not intended to be enforced by legal proceedings
   (c) No, because it is not in writing and also not intended to be enforced by legal proceedings
   (d) Yes

2. The agreement is executed among SCPL and RSPL on 20th October 2020, can be categorised as
   (a) Exclusive supply agreement
   (b) Tie-in arrangement
   (c) Refuse to deal agreement
   (d) None of these

3. Can SCL assume the position of the consumer for the purpose of competition laws?
   (a) No, because only half of the consideration paid by SCL
   (b) No, because SCL is not buying slate and silica sand for personal use or direct resale
   (c) No, because only an individual can be a consumer
   (d) Yes

4. Which of the following statements is correct regarding the acquisition of immovable property in India by Mrs. Patel?
   (a) Mrs. Patel is not allowed to acquire any sort of immovable property in India
   (b) Mrs. Patel is not allowed to acquire farmhouse and agricultural land in India
   (c) Mrs. Patel may acquire the farmhouse, but not agricultural land in India
   (d) Mrs. Patel may acquire both the farmhouse and agricultural land in India

5. SCPL decided to go for public issue and listing of its equity shares, largely for business expansion, initially with setting up a new large scale RMC plant. In the context of shares, which one of the following statements is correct under the Competition Act, 2002?
   (a) Shares can't be considered as "goods" because nothing has to do with manufacturing, processing or mining.
   (b) Shares shall be considered as "goods" only if fully paid-up.
   (c) Shares shall be considered as "goods" after the application made for shares since application monies are paid for the acquisition of shares.
   (d) Shares shall be considered as "goods" after allotment.

Descriptive Questions

1. Decide, whether Blip has dominance and does it abused its dominant position? Support your decision with legal backing.

2. In the light of the given facts, evaluate the following situations in terms of the FEMA, 1999:
   (i) Can Mr. Joe acquire immovable property in India, independently?
   (ii) Is the acquisition of a flat by Drishel and Joe jointly, valid as per the provisions of the Foreign Exchange Management Act and relevant regulations made thereunder?
   (iii) Can Joe acquire another property which is agricultural land, in joint ownership with Drishel for investment purposes?

Answer to MCQs

1. (d): Reason - As per section 2(b) of the Competition Act, 2002 'agreement' includes any arrangement or understanding or action in concert whether or not, is formal or in writing, or is intended to be enforceable by legal proceedings.

In view of the above definition, an understanding reached among the cement manufacturers to control the price and supply of cement will be an 'agreement' even though the understanding is not in writing and not intended to be enforceable by legal proceedings.

2.(c) : Explanation to sub-section 4 of section 3 of the Competition Act, 2002 describe five prohibited vertical agreements, and here relevant among those are;

Tie in arrangement includes any agreement, requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods;

Exclusive supply agreement includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person.

Refusal to deal includes any agreement, which restricts or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought.

3.(d): The term 'consumer' is defined in section 2(f) of the Competition Act, 2002. Consumer means any person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, whether such purchase of goods is for resale or for any commercial purpose or for personal use.

4. (b): As per regulation 3 of Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018, an NRI may acquire immovable property in India other than agricultural land/ farmhouse/ plantation property subject to two conditions;

a. Consideration, if any, for transfer, shall be made out of funds received in India through banking channels by way of inward remittance from any place outside India or funds held in any non-resident account maintained in accordance with the provisions of the Act, rules, or regulations framed thereunder.
b. Provided further that no payment for any transfer of immovable property shall be made either by traveler's cheque or by foreign currency notes or by any other mode other than those specifically permitted under this clause.

Since Mrs. Patel holds the status of NRI, hence not allowed to acquire farmhouse and agricultural land in India

5.(d): Goods under section 2 (i) of the Competition, Act 2002 means goods as defined in the Sale of Goods Act, 1930 and includes, products manufactured, processed, or mined; debentures, stocks, and shares after allotment; in relation to goods supplied, distributed, or controlled in India, goods imported into India.

Answers to Descriptive Questions

1. Facts in the given case are more or less similar to the case (No. 39 of 2018, Competition Commission of India dated 16.04.2019) of Umar Javeed and Google LLC, wherein legal issue is about dominance and its abuse and also the act of Google found in violation of Section 4(2) of the Competition Act, 2002.

   In the said case, CCI observed to form a prima facie view about the alleged abusive conduct, it would be first appropriate to define the relevant market and to determine the dominance of accused enterprise therein if any. In the present case, it is clearly mentioned that mobile OS due to additional handheld use features are different from OS designed for desktop hence all OS for other devices such as desktop or laptop shall be excluded from the relevant market. Blip appears to be dominant in the relevant market as 80% of mobile phones, which are in use have Diordna as the operating system.

   The signing of the Mobile Application Distribution Agreement and Anti Fragmentation Agreement is a pre-condition for mobile manufacturers to pre-install BMS (while using Diordna as OS). Further, BMS is also a bundled suite of Blips' applications and services. In this manner Blip reduced the ability of device manufacturers to develop viable alternatives with selected applications and services out of the BMS suite, hence dis-incentivize them. Thereby restricting technical development to the prejudice of consumers in violation of Section 4 of the Competition Act, 2002.

   While reading Section 4 with Section 32 of the Competition Act, 2002, it is important to note that the conduct of Blip to tie or bundle applications and services is an attempt to eliminate effective competition from the market. There exists an element of coercion as the mobile manufacturers are coerced to purchase the BMS suite altogether which results in consumer harm through a reduction in choice of products.

2. As per regulation 6 of the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018, a person resident outside India, not being a Non-Resident Indian or an Overseas Citizen of India, who is a spouse of a Non-Resident Indian or an Overseas Citizen of India may acquire one immovable property (other than agricultural land/ farmhouse/ plantation property), jointly with his/ her NRI/ OCI spouse, subject to following conditions
   (1) The consideration for the transfer, shall be made out of funds received in India through banking channels by way of inward remittance from any place outside India or funds held in any non-resident account maintained in accordance with the provisions of the Act and the regulations made by the Reserve Bank;
   (2) No payment for any transfer of immovable property shall be made either by travellers' cheque or by foreign currency notes or by any other mode other than those specifically permitted under this clause;
   (3) The marriage has been registered and subsisted for a continuous period of not less than two years immediately preceding the acquisition of such property;
   (4) The non-resident spouse is not otherwise prohibited from such acquisition.

   Following are the answers in the light of the stated provisions:
   (i) No, Mr. Joe (a person resident outside India, not being a Non-Resident Indian or an Overseas Citizen of India) can't acquire immovable property in India, independently.
   (ii) No, the acquisition of a flat by Drishel and Joe, jointly is not aligned (hence legally invalid, and amount to violation) to the provisions of FEMA and relevant regulations made thereunder, because marriage has been registered and subsisted for a continuous period of fewer than two years immediately preceding the acquisition of such property.
   (iii) No, Joe can't acquire another property being agricultural land in joint ownership with Drishel for investment purposes because;
   - The acquisition of agricultural land, farmhouse, and plantation property is specifically prohibited; and
   - The time since the marriage took place and subsisted is less than two years; and
   - There is a maximum ceiling limit of owning one property

CASE STUDY 2

Rajeshwari Industries Limited (here-in-after referred to as RIL) manufactures a wide range of electronic heaters under the brand 'Glen'. Glen, which was a popular name among the retailers and customers till a few years back, has been losing the market share; the major reason for same is stiff competition from emerging competitors who are offering a complete range of electronic products and also offers free delivery at customers address.

To sustain the market share RIL decided to expand the product range and improve outbound logistic facilities for which it requires more funds. RIL took a term loan of ₹3.5 crore from National Bank (here-in-after referred to as bank). Since the newly developed products, fails to make much impact in the market, hence RIL faces a financial crunch and not in a position to serve the financial debt.

A pandemic causes another jolt to the financial health of the business, hence on 15th April, 2020 (the due date for payment of instalment), RIL conveyed to the bank its inability to repay the remaining outstanding loan amount. As of 15th April, 2020,

the total outstanding amount against RIL is ₹46 lakh (including interest).

The officers from the recovery cell and the concerned branch of the bank warns the RIL that default may result in insolvency proceedings against the RIL. The RIL pleaded that default is not wilful, instead, this RIL said it really willing to continue its business operations and repay the loan amount as and when the business conditions improve. But it seems, it will not be in a position to repay the loan at-least in the year to come.

Mr. Anonymous, an employee in the IT and ERP department at RIL uses his workstation to hack the IT server of security and intelligence services of the country, such as the research and analysis wing, and capture the top-secret information. The information which he captured, if leaked; can put the defence and sovereignty of India at severe risk. Mr. Anonymous also indulge in funding and other arrangements for a terror attack in the financial capital of India 'Mumbai'. Indian authorities caught hold of Mr. anonymous while he was transmitting such top-secret information through the internet and took him to custody.

One of the executive directors at RIL, Mr. Mohan Bhave sought some funds into his bank account to acquire any immovable property in Mumbai for ₹ 2.5 crore. He has around ₹1.25 crore in his bank accounts and for the balance amount he ask to his friend Mr. Maan in Country M. The friend transferred money to Mr. Ganpat's Account in Country G. Mr. Ganpat transferred the half of funds to Ms. Bhosle in Country B and remaining half to Ms. Indrani in Country I. Ms. Bhosle and Ms. Indrani, in turn, transferred the funds to Mr. Kavir in Country K and Ms. Sonam in Country S, respectively.

Rocky, the son of Mr. Mohan Bhave is a rock star and singing sensation across the South Asian and European countries. Rocky performed numerous successful tours abroad. Rocky has acquired immovable properties abroad from the consideration he accepts from organisers of his shows, he recently buys a luxurious yacht.

Rocky accepted said money from Mr. Kavir (in Country K) and Ms. Sonam (in Country S) as an advance for his singing performance at their functions/parties, with the understanding that on a later date prior to the show date Mr. Kavir and Ms. Sonam express their inability to arrange functions/parties and request to cancel the performance; and money will be forfeited by Mr. Rocky. In this way, Mr. Mohan Bhave will get money to acquire the immovable property.

Rocky was arrested by the officers of the Enforcement Directorate at Delhi Airport on his return to India for an offence relating to the possessing and disposal of illegally acquired foreign exchange and taken before the Additional Chief Metropolitan Magistrate, New Delhi on the very next date. Enforcement Officer moved the application to seek 'judicial remand' (detention) on the ground that it was necessary to complete the investigation.

Office of director conducts an inquiry under section 13 of Prevention of Money-Laundering Act, 2002. Mr. Gulati is an officer of the concerned reporting entity and summoned to attend the proceeding. Mr. Gulati joined the reporting entity just 3 months back whereas the principle matter of inquiry is older than that, hence Mr. Gulati finds the summon unjustified. Mr. Gulati has to attend a global business conference as a guest speaker which is falling on same day and date which is mentioned in summon.

Multiple Choice Questions

1. Can the bank file the insolvency proceedings against RIL?
(a) No, the bank can't take the RIL to insolvency proceedings.
(b) Yes, the bank can take the RIL to insolvency proceedings because the default is considered as default, willingness is irrelevant.
(c) Yes, the bank can take the RIL to insolvency proceedings because the amount of default exceeds ₹1 lakh
(d) No, the bank can't take the RIL to insolvency proceedings because the amount of default is less than the threshold limit of ₹50 lakh.

2. At what stage, is the laundering process when it reached the hands of Mr. Kavir?
(a) Integration
(b) Layering
(c) Stratifying
(d) Splitting

3. What shall be the punishment for the wrongdoing done by Mr. Anonymous?
(a) Fine or rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years.
(b) Fine and rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years.
(c) Fine and rigorous imprisonment for a term which shall not be less than three years but which may extend to ten years.
(d) Fine upto ₹ 5 lakh and rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years.

4. Who has the authority to provisionally attach the property of Mr. Mohan Bhave?
i. Director
ii Deputy Director
iii Deputy Director authorised by the Director
iv Judicial Magistrate
(a) i, ii, and iv
(b) i, iii, and iv
(c) i and ii
(d) i and iii

5. Within how many days, the authority who provisionally attached the property has to file a complaint with Adjudicating Authority?
(a) Within 14 days from the attachment
(b) Within 30 days from the attachment
(c) Within 45 days from the attachment
(d) Within 60 days from the attachment

Descriptive Questions

1. Examine the legal position of the stated situations in the light of the given facts under the Prevention of Money Laundering Act, 2002, whether Enforcement Directorate is competent to arrest and take judicial remand of an arrested person? Whether the Magistrate before whom a person arrested is

produced has jurisdiction to authorise the detention of that person?

2. Advise the Banks officials who consulted you 'is the amount of default is significant criteria to invoke application under the Insolvency and Bankruptcy Code for Insolvency Resolution and Liquidation for Corporate Persons?'

3. Comment can Mr. Gulati be summoned? Whether a Mr. Gulati is bound to attend the proceeding in person? State the nature of proceeding taken here under the case study ?

Answer to MCQs

1.(a): A new section 10A inserted (vide Insolvency and Bankruptcy Code (Second Amendment) Act 2020, subsequent to an ordinance dated 5th June 2020) considering the possible adverse impact of the pandemic on businesses, which read as notwithstanding anything contained in sections 7, 9, and 10, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after 25th March 2020 for a period of six months or such further period, not exceeding one year from such date, as may be notified in this behalf. It is also provided that no application shall ever be filed for initiation of corporate insolvency resolution process of a corporate debtor for the said default occurring during the said period.

Moreover, Ministry of Corporate Affairs vide notification S.O. 1205(E) dated 24th March 2020, in the exercise of the powers conferred by the proviso to section 4 of the Insolvency and Bankruptcy Code, 2016, the Central Government hereby specifies one crore rupees as the minimum amount of default for the purposes of the said section.

Thus, since the default is taken place after 24th March 2020 (falling in the specified period under section 10A) and the amount of default of the company is less than ₹ 1 crore, hence bank can't drag the RIL for insolvency proceedings.

Note- Vide SO 3265 (E) dated 24th Sep 2020 application of section 10A extended by a further period of 3 months from 25th Sep 2020. Further, vide SO 4638 (E) dated 22nd Dec 2020 application of section 10A once again extended by a further period of 3 months from 25th Dec 2020 (Hence period specified under section 10A ranges from 25th March 2020 to 24th March 2021)

2.(b) : Money laundering is a single process, however; its cycle can be broken down into three distinct stages

- Placement is the first and the initial stage when the crime money is injected into the formal financial system.
- Layering is the second stage, in this money injected into the system is layered and moved or spread over various transactions in different accounts and different countries. Thus, it will become difficult to detect the origin of the money.
- Integration is the third and final stage, in this money enters the financial system in such a way that original association with the crime is sought to be obliterated so that the money can then be used by the offender or person receiving as clean money.

Thus, from the above, when funds reached Mr. Kavir, it is difficult to detect the origin of the money, thus, it is the stage of layering.

3.(b): Section 4 of the Prevention of Money Laundering Act 2002 provides for the Punishment for Money-Laundering - Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine.

But where the proceeds of crime involved in money-laundering relate to any offence specified under paragraph 2 of Part A of the Schedule (i.e. Offences under the Narcotic Drugs and Psychotropic Substances Act, 1985), the maximum punishment may extend to ten years instead of seven years.

Since, offence committed by Mr. Anonymous 'waging or attempting to wage war or abetting waging of war, against the Government of India', is covered under paragraph 1 of Part A of the Schedule, hence he will be liable to fine and imprisonment for a term which shall not be less than three years but which may extend to seven years.

4.(d): Section 5(1) of the Prevention of Money Laundering Act 2002, provides where the Director or any other officer not below the rank of Deputy Director authorised by the Director for the purposes of this section, has reason to believe (the reason for such belief to be recorded in writing), on the basis of material in his possession, that

(a) Any person is in possession of any proceeds of crime; and

(b) Such proceeds of crime are likely to be concealed, transferred, or dealt with in any manner which may result in frustrating any proceedings relating to the confiscation of such proceeds of crime under this Chapter,

He may, by order in writing, provisionally attach such property for a period not exceeding one hundred and eighty days from the date of the order, in such manner as may be prescribed.

5.(b): Section 5(5) of the Prevention of Money Laundering Act 2002 provides that the Director or any other officer who provisionally attaches any property under sub-section (1) shall, within a period of thirty days from such attachment, file a complaint stating the facts of such attachment before the Adjudicating Authority.

Answers to Descriptive Questions

1. The facts given in the case are similar to the case of Directorate of Enforcement vs. Deepak Mahajan (SC, Criminal Appeal No. 537 of 1990 dated 31.01.1994) wherein while disposing of the SLP (Special Leave Petition), the hon'ble apex court answered the important question of law 'Whether the Directorate of Enforcement fall within the definition of 'Police Officer' under Section 167 of CrPC (Criminal Procedure Code) or not?' The Supreme Court stated that the pre-requisite of arrest that 'it should have been effected only by a police officer and no one else' and 'there must necessarily be records of entries of a case diary', may be dispensed to invoke Section 167(1) of CrPC (Criminal

Procedure Code). Hence the Supreme Court stated that the Enforcement Officer can be termed as 'police officer' for the purpose of arrest.

Hence in the given case Enforcement Directorate is competent to arrest and take judicial remand of an arrested person.

Further, the Supreme Court held that "sub-sections (1) and (2) of Section 167 are squarely applicable with regard to the production and detention of a person arrested under the provisions of Section 35 of FERA (now the corresponding provision of FEMA) and Section 104 of Customs Act and that the Magistrate has jurisdiction under Section 167(2) to authorise the detention of a person arrested by an authorized officer of the Enforcement under FERA (now the FEMA) and taken to the Magistrate in compliance of Section 35(2) of FERA (now the corresponding provision of FEMA).

Hence in a given case, against the application of the enforcement officer, the Magistrate before whom a person arrested is produced has jurisdiction to authorise the detention of that person.

2. Yes, the minimum amount of default is significant criteria to invoke the application under the Insolvency and Bankruptcy Code for insolvency resolution and liquidation for corporate persons.

Section 4 of the Code read as 'This Part (PART II dealing with insolvency resolution and liquidation for corporate persons) shall apply to matters relating to the insolvency and liquidation of corporate debtors where the minimum amount of the default is one crore rupees.

There is a proviso to section 4 which read as 'the Central Government may, by notification, specify the minimum amount of default of higher value which shall not be more than one crore rupee'

It is important to note here, that Ministry of Corporate Affairs vide notification S.O. 1205(E) dated 24th March 2020, in the exercise of the powers conferred by the proviso to section 4 of the Insolvency and Bankruptcy Code, 2016, the Central Government hereby specifies one crore rupees as the minimum amount of default for the purposes of the said section.

Prior to 24th March 2020, this threshold limit was one lakh instead of one crore.

3. Section 50 of the Prevention of Money Laundering Act 2002, deals with the power of authorities, which they can exercise; especially while conducting any inquiry or any proceeding.

As per sub-section 2 of section 50, the Director, Additional Director, Joint Director, Deputy Director, or Assistant Director shall have the power to summon any person whose attendance he considers necessary whether to give evidence or to produce any records during the course of any investigation or proceeding under this Act. Hence, Mr. Gulati can be summoned.

As per Sub-section 3 to section 50, all the persons so summoned shall be bound to attend in person or through authorised agents, as such officer may direct, and shall be bound to state the truth upon any subject respecting which they are examined or make statements, and produce such documents as may be required.

Hence, Mr. Gulati is bound to attend the proceeding; but if the office of the director directs or authorises he can attend the meeting through authorised agents rather than in person.

Further, as per Sub-section 4 of section 50, every proceeding under Sub-section (2) and (3) shall be deemed to be a judicial proceeding within the meaning of section 193 and section 228 of the Indian Penal Code.

CASE STUDY 3

XYZ Limited (Corporate Debtor) is undergoing the Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code, 2016 (Code or IBC) which was commenced on 17th July, 2019 and is under a moratorium. The Resolution Professional of the Corporate Debtor invited expression of interest (EoI) by publishing relevant form in the newspapers and subsequently received two expressions of interest from prospective Resolution Applicants (Resolution Applicant 1 and Resolution Applicant 2).

One of directors at XYZ Limited who gave a personal guarantee against the borrowings of XYZ Limited has credence that after the declaration of moratorium under section 14 of IBC, legal action against him is barred too.

Pursuant to the regulations, the Resolution Professional had sent an information memorandum, evaluation matrix, and request for a resolution plan to both the prospective Resolution Applicants.

Resolution Applicant 1 had filed its resolution plan on 20th October 2019 and the Resolution Professional had rejected that resolution plan on 1st November 2019 on the ground that it is in violation of the provisions of the Code pertaining to ineligibility of the Resolution Applicant. The Resolution Applicant 1 protested the decision of the Resolution Professional, by filing an application before the Adjudicating Authority with a prayer to direct the Resolution Professional to accept the Resolution Plan filed by the Resolution Applicant 1. In reply to the application filed by the Resolution Applicant 1 before the Adjudicating Authority, the Resolution Professional made the following submissions in his counter-affidavit filed with the Adjudicating Authority:

- Resolution Applicant 1 meets the following ineligibilities:
  - The directors of one of the subsidiaries of the Resolution Applicant 1 are declared as wilful defaulters
  - The step-down subsidiary of the RA has been declared as Non-Performing Asset and it remained as a Non-Performing Asset for more than one year.
- The Resolution Applicant 1 had filed an affidavit as required under the Code and the Regulations made thereunder but had failed to disclose the above-mentioned ineligibilities in the affidavit thereby misleading the Resolution Professional.
- Since Resolution Applicant 1 meets the ineligibility criteria as stipulated by the Code, the instant application filed by the Resolution Applicant 1 be dismissed.

In response to the submissions made by the Resolution Professional, Resolution Applicant 1 stated that as on the date of submission of resolution plan with the resolution professional it does not meet any of the above-stated ineligibilities and that the Resolution Professional has analysed the position as on the Insolvency Commencement Date instead of the date of submission of the resolution plan and hence his arguments do not hold any water. The matter was pending before the Adjudicating Authority.

On the other hand, the resolution plan received from the other Resolution Applicant, i.e. Resolution Applicant 2 was forwarded by the Resolution Professional to the Committee of Creditors for their consideration and evaluation on 1st November 2019. During the evaluation, it was observed that the resolution plan submitted by Resolution Applicant 2 meets the criteria prescribed for combinations under the provisions of the Competition Act, 2002. Accordingly, Resolution Applicant 2 filed an application before the Competition Commission of India for its approval of the proposed combination as per the submitted resolution plan.

On 15th November 2019, the Competition Commission of India summoned Resolution Applicant 2 for a hearing on the approval of said combination. During the hearing, the Competition Commission of India raised various questions to understand if such a combination has any appreciable adverse effect on relevant product market and relevant geographic market in India. Accordingly, Resolution Applicant 2 had filed its reply to the Competition Commission of India both orally during the hearing as well as in writing on November 20, 2019. Having heard the Resolution Applicant 2 and also having gathered relevant information to understand whether the combination causes an appreciable adverse effect on competition in the relevant market in India or not; the competition commission of India had passed its order approving the combination on 3rd February, 2020.

On 1st January 2020, the committee of creditors negotiated with the Resolution Applicant 2 for modifications in the resolution amount which was duly agreed to by the resolution applicant, and post-modification of resolution plan, the revised resolution plan of the Resolution Applicant 2 has been evaluated by the members of the committee of creditors. On 10th January, 2020 the Committee of Creditors decided to vote on the resolution plan of Resolution Applicant 2 as one hundred and eighty days from the insolvency commencement date is set to conclude on 13th January, 2020. Accordingly, the committee of creditors had voted on the resolution plan submitted by Resolution Applicant 2 and approved the same with the voting share of 85%. Post approval of resolution plan by the Committee of Creditors, the Resolution Professional filed the same with the Adjudicating Authority on 13th January, 2020.

Multiple Choice Questions

1. While examining the ineligibility of resolution applicants pursuant to the provisions of the Code, which among the following statements are incorrect:
   i. The ineligibility shall be as on the date of submission of the Resolution Plan by the Resolution Applicants
   ii. The ineligibility shall be as on the insolvency commencement date
   iii. The ineligibility may be removed if the overdue amounts relating to Non-Performing Accounts are paid before submission of the resolution plan
   (a) i only
   (b) ii only
   (c) i and iii
   (d) ii and iii

2. Pursuant to the provisions of the Insolvency and Bankruptcy Code, 2016, what shall be time to obtain the approval of the Competition Commission of India?
   (a) After submission of resolution plan but before the approval of the same by Committee of Creditors
   (b) Before the submission of the resolution plan
   (c) After approval of Committee of Creditors
   (d) After submission of resolution plan but before filing the plan with the Adjudicating Authority

3. Who among the following can file an application to the Adjudicating Authority for extension of the period of CIRP?
   (a) Committee of Creditors after passing a resolution with more than 66% of voting share in their meeting
   (b) Any stakeholder interested in the affairs of the Corporate Debtor
   (c) Resolution Professional upon instructions do so by resolution passes at the meeting of the Committee of Creditors by 66% voting share
   (d) Resolution Professional at its own

4. Which among the following are the duties of the Resolution Professional?
   i. To present to the Committee of Creditors, only those resolution plans which confirm the conditions prescribed under the Code
   ii. To present all resolution plans to the Committee of Creditors
   iii. To obtain approval of the Competition Commission of India for the resolution plans approved by the Committee of Creditors
   (a) i only
   (b) ii only
   (c) i and iii
   (d) ii and iii

5. Which of the following shall be considered to ascertain as to whether the Resolution Applicant and the Corporate Debtor meet the definition of combination under the Competition Act, 2002?
   i. Assets
   ii. Net Worth
   iii. Turnover
   iv. Control
   (a) i, ii, and iv
   (b) i and iii
   (c) ii, iii, and iv
   (d) i, iii, and iv

Descriptive Questions

1. Clarify how the Competition Commission of India

investigates combinations (to regulate) before giving its approval under section 31 of the Competition Act, 2002.

2. One of the directors at XYZ Limited who gave a personal guarantee against the borrowings of XYZ Limited has credence that after the declaration of moratorium under section 14 of IBC, legal action against him is barred too. Is the credence of the director valid? Apart from provisions from the bare act, support your opinion with settled judicial precedent.

Answer to MCQs

1. (b) : The opening line of section 29A of the Insolvency and Bankruptcy Code 2016, and then further of clause 'c' in it clearly states 'at the time of submission of resolution plan' hence point i is correct and point ii is incorrect.

Further first proviso to section 29A (c), provided that the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to nonperforming asset accounts before submission of resolution plan hence point iii also correct.

2.(a) : Proviso to section 31 (4) of the Insolvency and Bankruptcy Code 2016, provides where the resolution plan contains a provision for combination, as referred to in section 5 of the Competition Act, 2002, the resolution applicant shall obtain the approval of the Competition Commission of India under that Act prior to the approval of such resolution plan by the committee of creditors.

3.(c): As per section 12 (2) of the Insolvency and Bankruptcy Code 2016, the resolution professional shall file an application to the Adjudicating Authority to extend the period of the corporate insolvency resolution process beyond one hundred and eighty days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of sixty-six percent of the voting shares.

4.(b) : Section 25 (2) shall be read along with section 30 (3) of the Insolvency and Bankruptcy Code 2016, the combined reading of these signifies that the resolution professional shall present all resolution plans at the meetings of the committee of creditors.

Further as per section 30 (6), the resolution professional shall submit the resolution plan as approved by the committee of creditors to the Adjudicating Authority.

Extra reference note for students

As per proviso to section 31 (4), where the resolution plan contains a provision for combination, as referred to in section 5 of the Competition Act, 2002, the resolution applicant shall obtain the approval of the Competition Commission of India under that Act prior to the approval of such resolution plan by the committee of creditors.

5.(d): Section 5 of the Competition Act 2002, provide the thresholds relating to the value of assets and amount of turnover, beyond which the merger and acquisition resulting in a gain of control over enterprise by another enterprise either individually or in group constituted as a combination.

Extra reference note for students

It is important to note here that, under section 20 (3) of the Competition Act 2002, the Central Government shall at the expiry of every two years, in consultation with the Commission, by notification, enhance or reduce the value of assets or the value of turnover mentioned above (for purpose of section 5 'combination'), on the basis of the wholesale price index or fluctuations in the exchange rate of rupee or foreign currencies. *Vide notification number S.O. 675(E) dated 4th March 2016, in the exercise of the powers conferred by section 20 (3) the Central Government enhances, the value of assets and the value of turnover, by hundred percent from the date of publication of this notification in the Official Gazette. The publication date is also 4th March 2016.

Hence w.e.f. 4th March 2016 above table (threshold under section 5) shall be read as;

Threshold applicable to		Enterprises Level	Group Level
In India	Joint Assets	₹2,000 Cr	₹ 8,000 Cr
	Joint Turnover	₹ 6,000 Cr	₹ 24,000 Cr
In India and Outside	Joint Total Assets	US$ 1000 Million	US$ 4000 Million
	Minimum Indian Component	₹1000 Cr	₹ 1000 Cr
	Joint Total Turnover	US$ 3000 Million	US$ 12000 Million
	Minimum Indian Component	₹3000 Cr	₹ 3000 Cr

Answers to Descriptive Questions

1. Section 6 (1) of the Competition Act 2002, simply prohibits the person or enterprise from entering into a combination that causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

Further, the review process for a combination under the Act involves mandatory notification to the Commission of the proposed combination. To give effect to this section 6 (2) provide, any person or enterprise proposing to enter into a combination shall give notice (as prescribed in section 30) to the Commission in the specified form disclosing the details of the proposed combination within 30 days of the approval of the proposal relating to merger or amalgamation by the board of directors or of the execution of any agreement or other document in relation to the acquisition, as the case may be.

Further, as per section 20 (1), the Commission may, upon its own knowledge or information relating to acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of section 5 or merger or amalgamation referred to in clause (c) of that section, inquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India. Here it worth noting that the Commission shall not initiate any inquiry under this subsection after the expiry of one year from the date on which such combination has taken effect

Further section 20 (2) [inquiry in response to notice under section 6(2)] read with section 31 (framing of opinion to pass an order) and the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 the Commission shall form firstly prima facie opinion as to whether the combination is likely to cause or has caused an appreciable adverse effect on competition within the relevant market in India or not. For this, investigation by director-general can be ordered under section 29.

Section 20 (4) laid down factors to be considered by the Commission while evaluating the appreciable adverse effect of Combinations on competition in the relevant market include the following:

(a) Actual and potential level of competition through imports in the market;
(b) Extent of barriers to entry into the market;
(c) Level of concentration in the market;
(d) Degree of countervailing power in the market;
(e) Likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
(f) Extent of effective competition likely to sustain in a market;
(g) Extent to which substitutes are available or are likely to be available in the market;
(h) Market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
(i) Likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
(j) Nature and extent of vertical integration in the market;
(k) Possibility of a failing business;
(l) Nature and extent of innovation;
(m) Relative advantage, by way of the contribution to the economic development, by any combination having or likely to have an appreciable adverse effect on competition;
(n) Whether the benefits of the combination outweigh the adverse impact of the combination if any.

2. The Director of XYZ Limited, hold credence that section 14 of the Insolvency and Bankruptcy Code, 2016 (IBC) would apply to the personal guarantor as well, as a result of which proceedings against the personal guarantor and his property would have to stay if moratorium declared.

Clause (b) section 14 (3) of the Insolvency and Bankruptcy Code, 2016 (IBC), read as the provisions of sub-section (1) shall not apply to a surety in a contract of guarantee to a corporate debtor. It important here to note that sub-section (1) gave power to Adjudicating Authority to declare a moratorium.

The validity of directors' credence can be denied based on the State Bank of India vs. V. Ramakrishnan (Supreme Court, Civil Appeal No. 3595 of 2018), wherein the facts are largely similar to the present case.

The Hon'ble Supreme Court first considers the fact that different provisions of the Insolvency and Bankruptcy Code are applicable to the insolvency of different categories of persons. Section 96 and 101 of the Code provide for separate provision for a moratorium for the personal guarantor, whereas section 14 deals with corporates.

Court also observed that different provisions of law brought into effect on different dates and some of the provisions were not yet enforced (on the date of the judgment). Provisions pertaining to sections 96 and 101 have not been brought into force.

Further, the apex court makes observations on relevant sections. The court observed that Section 14 of the Code authorizes Adjudicating Authority to pass an order of moratorium during which there is the prohibition on the institution of suits or continuation of pending suits against the corporate debtor, transfer of property of the corporate debtor, or any action to foreclose or enforce any security interest.

The apex court also consider the following facts importantly

- Report of Insolvency Law Committee dated 26.03.2018 clarified that the period of moratorium under section 14 is not applicable to personal guarantors,
- Amendment Ordinance dated 6th June 2018, which amended the provision of section 14 and proviso clearly states that the moratorium period envisaged in section 14 is not applicable to a personal guarantor to a corporate debtor. (Note – this ordinance later enacted as act 26 of 2018 – and enforced w.r.e.f. 6th June 2018)

Hence, as the provisions of section 96 and 101 have not been brought into force, the personal guarantor is not entitled to a moratorium period under the Insolvency and Bankruptcy Code.

Hence, the credence of the Director of XYZ Limited that 'that section 14 of the Insolvency and Bankruptcy Code, 2016 (IBC) would apply to the personal guarantor as well' is not tenable. (Even before 6th June 2018 when sub-section 3 to section 14 substituted).

CASE STUDY 4

Mr. Aman Chawla belongs to Delhi based business family and has ancestral roots in Kharar, a Town in the Sahibzada Ajit Singh Nagar (Mohali) district in the state of Punjab (around 15 KMs away from Chandigarh). Chawla family owns the chain of restaurants, snacks points, and Ice-Cream parlours across the nation. Few of these are owned properties, but a large number are leased properties. The holding company is Chawla Snacks and Refreshment Limited (CSRL). Mr. Aman is an electrical engineer, joined an MNC in the role of system engineer after college. But Mr. Aman is inspired by constructing the buildings, towers, landscapes, hence decided to quit the job to pursue his passion.

Despite the Chawla family owning a major stake in the business, the business model is unlike to autocratic monarchy. It is managed professionally and listed on the stock exchange. Family members (father, grand-mother and elder brother of Mr. Aman) are part of the Board of Directors, whereas few other

family members are also engaged with CSRL but in form of employment (or in a professional capacity).

Mr. Aman joined his brother-in-law, Mr Vivek, in his construction business, Mr. Aman assists Mr. Vivek in ongoing projects, and one among them is Rishi Enclave whose centre of attraction is state of art yoga centre which will be one of its type in the world apart from the common area which is turned into with mesmerising landscapes. The project is located near Jolly Grant Airport on out-skirt of the holy town of Rishikesh. Rishi Enclave (Project) consists of 120 units of 2BHKs, 3BHKs (Flats and Floors), and Independent Houses or Villas in totality. The project is registered under the RERA. All 120 units' subscribed/ booked by allottees except 2 Flats kept by Mr. Vivek (promoter). Mr. Tirlochan Negi booked 3 floors one in his own name, another one in the name of his daughter in law and the third one in name of his company. Mr Dabral also booked a flat and a villa (both in his name). Rest all allottee booked one unit each. Soon allottees form a residential association. Considering the latest NGT decisions and amendments in policy about the environment (applicable for civil construction in hill or foothill area concerning the height of the building), certain structural changes relating to the height and common area landscape is required in sanctioned plan of the project. Mr. Vivek is of opinion since the alteration in sanctioned plan enforced by changes in policy matter hence the approval of allottees is not required.

Mr. Aman recently visited Kharar after a long time to meet his friends Mr. Onkar Singh and Mr. Dipan Ahuja of early childhood. They all admitted that the town has developed substantially especially the townships and Skyscrapers as tri-city (Mohali, Chandigarh, and Panchkula) turns into metropolitan and hub of service entities. The lifestyle of people also improves. Mr. Onkar is settled in Canada and holding a Canadian passport and citizenship as his family migrate there when he was in school only. In Canada, he own a transport business. Currently, he is on a visit to India to attend the marriage of a relative. Mr. Dipan Ahuja is a supplier of construction materials and planning to venture into the solar panel business under make in India drive, considering the enhancing role of solar energy for household and commercial uses. Mr. Dipan believes Mr. Aman (considering his electrical engineering background) should join him in his solar panel venture.

The ancestral property of Mr. Onkar' family has been unoccupied for a long, hence turned into a mud house. Mr. Onkar offered Mr. Aman to develop residential apartments on such property after the name of his grand-father 'Satnam Apartments'. A chunk of land on the backside of such property is also available for sale at a reasonable price because it has no connectivity. Mr. Aman found it a good idea to develop the residential apartments as backside land can be acquired at a cheaper rate than prevailing in the market. Mr. Onkar talked to his father [property inherited, hence registered in his name in land revenue records after the death of grandfather (who was resident in India) of Mr. Onkar] and ready to transfer (sale) the property for INRs 2.5 Crore. The Father of Mr. Onkar is a resident outside India who never registered as OCI. Mr. Aman after communicating with Mr. Vivek agreed to deal.

Mr Aman heard about the importance of keeping capital low to generate more wealth and attain high ROI (Return on Investment). He decided to borrow money from a private investor from the States (US) based on showing growth prospect in his business to his investor. The investor was a good friend of Mr. Dipan and originally from Mohali named Mr. Tarun and settled in Philadelphia (Pennsylvania, US). Mr. Tarun agreed to invest US$1 Million in the said real estate project.

The money got transferred from an overseas branch in Philadelphia of some Indian bank (through banking channel) to the Kharar branch (Mohali, India). The Branch Manager in India is the friend of an elder brother of Mr. Aman and was excited to get one project in Mohali and thus approved the investment without any opinion from any Finance Professional.

CSRL witnessed the bad jolts (of financial turbulence) as revenue vanished and reserves are socked to meet maintenance costs of properties & employee cost due to lock-down and afterword restrictions. The financial cost and lease rentals not only erode the working capital but also forces the CSRL to land into a debt trap situation wherefrom meeting financial obligations seems near to impossible. The only way left to management is restructuring of business hence board decided to shut a few points and parlours (to reduce lease rental obligation, and free-up one-two owned properties so that sale proceed can be infused as working capital)

One of the properties sold by CSRL, acquired by Ms. Vijeta in name of her mother-in-law (as she is a senior citizen female – to bear less registration cost in form of stamp duty), consideration for which is paid out of the known sources of the Mr. Vijeta.

Despite the best efforts made by management at CSRL, still, the bottom line is in deep red; resulting in default in repayment of financial debts and such default continues since the 2nd quarter of Fiscal 2020-21. Management gave assurance to financial creditors that soon it will overcome the solvency issue and they already took corrective measures. On 19th, March 2021, one of the financial creditors moved an application for initiation of corporate insolvency resolution proceeding (CIRP) whose outstanding claim is of INRs 120 lakh. On 26th March 2021, another financial creditor file an application to NCLT for initiation of CIRP against CSRL in their case amount of default is INRs 35 lakh and such default took place in the 3rd Quarter of fiscal 2020-21.

Multiple Choice Questions

1. Regarding the state of art yoga centre and common area situated in Rishi Enclave, which of the following statement is correct;
   (a) Promoter will keep the possession and title both
   (b) Promoter may handover physical possession of these to the association of allottees or competent authority as per the local laws
   (c) In absence of any local law promoter shall hand over within thirty days after obtaining the occupancy certificate.
   (d) In absence of any local law promoter shall hand over within thirty days after obtaining the completion certificate.

2. State the legal position of mother-in-law of Ms. Vijeta as benamidar in the case study-
   (a Yes, the mother-in-law of Ms. Vijeta is benamidar
   (b) No, the mother-in-law of Ms. Vijeta is not benamidar as she is covered under the exceptions stated

(c) No, mother-in-law of Ms. Vijeta is not benamidar as consideration is paid out of the known source of Ms Vijeta
(d) Both b and c above.

3. Which of the following statements is correct regarding the acquiring, holding, owning and transfer of property, in a case by the father of Mr. Onkar in India-
(a) Being a person resident outside India he can acquire, hold, own and transfer any immovable property in India, but with RBI permission only
(b) Being a person resident outside India he can acquire, hold, own and transfer any immovable property in India, but only in joint ownership with any person resident in India
(c) Being a person resident outside India he can acquire, hold, own and transfer any immovable property in India, if inherited by him from the person who was a resident of India
(d) Being a person resident outside India he can acquire, hold, own and transfer any immovable property in India, if inherited by him when he himself was resident in India

4. Whether the application moved on 19th March 2021 can be admitted by NCLT to initiate CIRP against CSRL-.
(a) Yes, because CSRL made default in repayment of financial debts
(b) Yes, because the amount of default is more than one crore
(c) No, because management gave assurance to financial creditors that soon it will overcome the solvency issue and they already took corrective measures
(d) No, because an application for initiation of CIRP shall not be filled.

5. Whether the application moved on 26th March 2021 can be admitted by NCLT to initiate CIRP against CSRL.
(a) Yes, because CSRL made default in repayment of financial debts
(b) Yes, because the application for initiation of CIRP may be filled by the financial creditor as a period of suspension of section 7 is over.
(c) No, because the amount of default is less than one crore
(d) No, because default occurred during a period of suspension.

Descriptive Questions

1. Mr. Vivek is of opinion since the alteration in sanctioned plan enforced by changes in policy matter hence the approval of allottees is not required. Are the changes in sectioned plan minor in nature? Evaluate the opinion of Mr. Vivek in the context of the provision contained in the RERA 2016? Support your answer with reason and calculation if any.

2. What would be your opinion related to the repatriation of funds in India as an Investment of US$1 million into the real estate project in Kharar (Mohali, India)?

3. Can the father of Mr. Onkar repatriate the sale proceed of ancestral property inherited by him to Canada from India? Elucidate in the light of the relevant provision of applicable law, the stated legal issue.

Answer to MCQs

1. (d) : Reason - As per section 17 (2) of the Real Estate (Regulation and Development) Act 2016, it shall be the responsibility of the promoter to handover the necessary documents and plans, including common areas, to the association of the allottees or the competent authority, as the case may be, as per the local laws:
Provided that, in the absence of any local law, the promoter shall hand over the necessary documents and plans, including common areas, to the association of the allottees or the competent authority, as the case may be, within thirty days after obtaining the completion certificate.

2.(a): Reason – As per clause (9) to section 2 of the Prevention of Benami Property Transaction Act 1988, the transaction is a benami transaction under sub-clause (A) because the same is not covered under exception iv. Since the transaction is benami hence the property become benami under section 2 (8), hence benamidar under 2 (10).

3.(c): Reason – As per section 6(5) of the Foreign Exchange Management Act, 1999 a person resident outside India may hold, own, transfer or invest in any immovable property situated in India if such property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.
Here is worth noting that regulation 3 and 6 of the Foreign Exchange Management (Acquisition and transfer of immovable property in India) Regulation 2018 gave the right to NRI and OCI (in case of regulation 3) and with the exclusion of other than agriculture land/farmhouse/ plantation property (both in case of regulation 3 and 6)

4.(d): Reason – As per section 10A of the Insolvency and Bankruptcy Code 2016 notwithstanding anything contained in sections 7, 9 and 10, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after 25th March 2020 for a period of six months or such further period, not exceeding one year from such date, as may be notified in this behalf.
On 24th September 2020 vide S.O. 3265(E) the Central Government hereby notifies a further period of three months from the 25th September 2020 for the purposes of section 10A. Hence application can't be filled under section 7 by the financial creditor till 24th March 2021.

5.(d): Reason – As per section 10A of the Insolvency and Bankruptcy Code 2016 notwithstanding anything contained in sections 7, 9 and 10, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after 25th March 2020 for a period of six months or such further period, not exceeding one year from such date, as may be notified in this behalf.
Further the proviso to said section provided that no application shall ever be filed for initiation of corporate insolvency resolution process of a corporate debtor for the said default occurring during the said period.

On 24th September 2020 vide S.O. 3265(E) the Central Government hereby notifies a further period of three months from the 25th September 2020 for the purposes of section 10A.

Hence application can't be filled under section 7 by a financial creditor for the default that occurred till 24th March 2021.

Candidates also advised to note the explanation provided to section 7(1), for the purposes of subsection (1) to section 7, a default includes a default in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the corporate debtor. Hence option C is not correct and mind it 10A is an overriding section.

Answers to descriptive questions

1. The Real Estate (Regulation and Development) Act 2016 (herein-after RERA) under its section 14 provides the adherence to sanctioned plan and project specifications by the Promoter.

Sub-section 1 provides the proposed project shall be developed and completed by the promoter following the sanctioned plans, layout plans and specifications as approved by the competent authorities.

Sub-section 2 has an overriding effect and its clause (i) provide the promoter shall not make any additions and alterations in the sanctioned plans, layout plans and specifications and the nature of fixtures, fittings and amenities described therein in respect of the apartment, plot or building, as the case may be, which are agreed to be taken, without the previous consent of that person who agrees to take one or more of the said apartment, plot or building, as the case may be.

Here it is worth noting that the promoter may make such minor additions or alterations as may be required by the allottee, or such minor changes or alterations as may be necessary due to architectural and structural reasons duly recommended and verified by an authorised Architect or Engineer after proper declaration and intimation to the allottee.

For this clause, "minor additions or alterations" excludes structural change including an addition to the area or change in height, or the removal of part of a building, or any change to the structure, such as the construction or removal or cutting into of any wall or a part of a wall, partition, column, beam, joist, floor including a mezzanine floor or other support, or a change to or closing of any required means of access ingress or egress or a change to the fixtures or equipment, etc.

Since in the given case certain structural changes (in the sanctioned plan of the project) relating to height is required, hence the changes in sectioned plan are not minor in nature.

Further clause (ii) of Sub-section 2 provides the promoter shall not make any other alterations or additions in the sanctioned plans, layout plans and specifications of the buildings or the common areas within the project without the previous written consent of at least two-thirds of the allottees, other than the promoter, who have agreed to take apartments in such building.

It is worth noting here that for this clause, the allottees, irrespective of the number of apartments or plots, as the case may be, booked by him or booked in the name of his family, or in the case of other persons such as companies or firms or any association of individuals, etc., by whatever name called, booked in its name or booked in the name of its associated entities or related enterprises, shall be considered as one allottee only.

In the given case all 120 units' subscribed/booked by allottees except 2 Flats kept by Mr. Vivek (promoter). Out of 118, Mr. Tirlochan Negi booked 3 floors one in his own name, another one in the name of his daughter in law and the third one in name of his company, whereas Mr. Dabral booked a flat and a villa (both in his name); rest all allottee booked one unit each. Hence the total number of allottee for purpose of section 14(2)(ii) is 115 (118-2-1) considering Mr Tirlochan (3) and Mr Dabral (2) as a single allottee each. At least 2/3 allottee shall be 77 (2/3rd of 115 – round up to next whole integer), whose previous written consent is required; before making changes to sanctioned plan.

Hence the opinion of Mr. Vivek in the context of the provision contained in RERA, 2016 is untenable and incorrect.

2. Investments are considered as capital account transactions, hence governed by section 6 of the Foreign Exchange Management Act, 1999 read with The Foreign Exchange Management (Permissible Capital Account Transactions) Regulations 2000 (herein-after regulations).

Clause (b) of regulation 4 of such regulations describe the prohibitions. Although regulation 4 (b) (iv) provides no person resident outside India shall invest in India, in any form, in any company or partnership firm or proprietary concern or any entity, whether incorporated or not, which is engaged or proposes to engage in real estate business. But explanation 1 provides a certain exclusion from real estate business, explanation read as 'for this regulation, 'real estate business shall not include development of townships, construction of residential/commercial premises, roads or bridges and real estate investment trusts (REITs) registered and regulated under the SEBI (REITs) Regulations, 2014.

Hence repatriation of funds in India as Investment into the real estate project (construction of residential apartments) in Kharar (Mohali, Kharar) can be seen as a permissible capital account transaction under clause (a) to schedule II of regulations.

3. As per clause (a) to regulation 8 of the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018, a person referred to in sub-section (5) of Section 6 of the Act, or his successor shall not, except with the general or specific permission of the Reserve Bank, repatriate outside India the sale proceeds of any immovable property referred to in that sub-section.

Whereas section 6(5) of the Foreign Exchange Management Act, 1999 provides a person resident outside India may hold, own, transfer or invest in any immovable property situated in India if such property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

Since in the given case father of Mr. Onkar acquired the property through inheritance from his father who was resident in India, hence fall within the scope of section 6 (5). Therefore with the permission of RBI, he can repatriate the sale proceed of ancestral property inherited by him to Canada from India.

CA FINAL - PAPER 6D - ECONOMIC LAWS

This capsule on Paper 6D: Economic Laws, Final (New) course is another step of the Board of Studies in its endeavour to provide quality academic inputs to Final course students of Chartered Accountancy course. This is an open book examination and duration is 4 hours. The question paper would comprise of five case studies of 25 marks each, out of which the student would be required to attempt any four. Students must divide their four hours between four case studies to be answered meticulously. Once the case studies have been opted, give them a comprehensive reading while attempting the same. Some of the illustrative case studies have been provided below for practice purpose. Students are suggested to solve the same in examination condition and check for the answers only after attempting the case studies.

CASE STUDY 1

Nadus (P) Ltd. is engaged in the business of real estate since 12 years. The company is founded by two friends, Mr. Mayur Agarwal and Mr. Neerav Sutaria, who are also its directors. Mr. Urmil Dave, brother in law of Mr. Mayur, is the manager of the company.

It had acquired 10% shares of a company in Egypt, named Belashom LLC which is engaged in the construction of commercial premises. Recently, it had received some bonus shares from the said company.

Belashom LLC was looking for a commercial property in India for opening its branch office in order to expand its business. For that purpose, Mr. Franklin, an international real estate agent in Egypt was contacted by Belashom LLC and he told that one of his clients in India, a private limited company named Autukya (P) Ltd., wanted to sale, one of its commercial properties in India.

After going through the details of the said property, Belashom LLC became interested in such property and it was decided to send Mr. James, a director of Belashom LLC to India to meet the client of Mr. Franklin in India and finalise the deal for the property.

Mr. Neerav who was on a visit to meet his old friend in Bhutan, came to know that Mr. James was going to visit India. So he shortened his trip and came to India bringing 30,000 INR in form of currency notes with denominations of ₹100 and 20,000 INR in form of currency notes with denominations of ₹500, respectively, received as a gift from his friend.

Mr. James visited India bringing with him, some amount of Egyptian Pounds (EGP) as follows:-

Particulars	EGP
Currency Notes	90,000
Bank Notes	30,000
Travelers Cheque	22,500

Mr. Neerav accompanied him. Mr. James met the representative of Autukya (P) Ltd., Mr. Rajiv and after two rounds of discussion between them; the deal for the property was finalized for ₹650 lakhs. Autukya (P) Ltd. remitted 4,50,000 EGPs to Mr. Franklin as commission amount out of its EEFC account. All the expenses incurred by Mr. James in INR on account of his boarding, lodging and travelling in India were paid by Nadus (P) Ltd., which was going to be reimbursed later on by Belashom LLC.

Nadus (P) Ltd. was developing a real estate project in Mihan area of Nagpur City named 'Suvas'. It had made certain agreements with real estate agents mainly operating in that area which required the said agents to promote and negotiate deals, only, for the units in Suvas and not for any other real estate project in Mihan area and for entering into such agreement, a lumpsum amount was paid to such agents in cash.

Vikrama Builders (P) Ltd.'s business was affected due to such arrangement of Nadus (P) Ltd. and so it filed a complaint with the authority under RERA against such arrangement. The case was assigned to Mr. Sumit Joshi, a RERA member. Mr. Sumit, in order to understand the arrangement being made by Nadus (P) Ltd. with the real estate agents, contacted his close friend, Mr. Aman who was a real estate agent, and asked him to enter into an agreement with Nadus (P) Ltd. as normal and then provide him all the details of such agreement.

Mr. Aman did the same and provided all the details to Mr. Sumit. Mr. Sumit discussed the matter with the other members of the authority under RERA in the meeting of the authority and it was decided that such agreements made by Nadus (P) Ltd. affected competition in the relevant market and so the case was referred to the Competition Commission of India. However, the required quorum was not present throughout the said meeting of the authority under RERA.

The CCI on receipt of such reference from the authority under RERA initiated an inquiry into the matter and formed an opinion on the existence of prima facie case and directed the Director General to cause an investigation into the matter.

The Director General, during the investigation, received certain evidences on affidavit from few employees of Nadus (P) Ltd. Certain books and papers of Nadus (P) Ltd. were also called for by the Director General which he kept in his custody for 2 months.

The Director General found that the Company Secretary of Nadus (P) Ltd., Mrs. Ridhima Sen, had assisted in drafting the impugned agreements with the real estate agents. Mr. Urmil, the manager, however, pleaded before the Director General, that though he knew of such agreements being entered into by Nadus (P) Ltd., he never gave his consent to such an act of the company.

The copy of the report of investigation was forwarded by the CCI to Nadus (P) Ltd. and the authority under RERA, respectively.

After making further inquiry, the CCI closed the matter and passed a cease and desist order as well as a penalty order to pay an amount equivalent to 25% of the revenue earned by Nadus (P) Ltd. by making such anti-competitive agreements with the real estate brokers.

On the basis of the given facts, answer the following questions:

Multiple Choice Questions

1. Whether Mr. Neerav has validly brought INR currency notes into India?
   (a) No, Mr. Neerav has brought in excess ₹25,000 from the prescribed limit.
   (b) Yes, as there is no restriction of bringing any amount into India from Nepal or Bhutan.
   (c) No, Mr. Neerav has brought INR currency notes with denominations of ₹500.
   (d) Yes, if Mr. Neerav has provided declaration in respect of the same to the Custom Authorities.

2. Whether it was necessary for Mr. James to provide any declaration to the Custom Authorities of India in respect of the Egyptian Pounds brought by him into India, if 1 USD = 15 EGPs?
   (a) No, as Mr. James is a person resident outside India
   (b) Yes, as the amount of currency notes exceeded $ 5,000 in equivalent
   (c) No, as the aggregate of EGPs in all forms did not exceed $ 10,000 in equivalent
   (d) No, as there is no restriction in bringing foreign exchange, without any limit, in any form in India.

3. Whether it was mandatory for the CCI to forward the copy of the report of investigation to Nadus (P) Ltd. and the authority under RERA, respectively?
   (a) Yes, as based upon such report, Nadus (P) Ltd. would have been able to draft its response to the CCI and because of reference of the authority under RERA, such investigation was caused to be made.
   (b) It was optional for the CCI to forward the copy of the report of investigation to Nadus (P) Ltd. but it was mandatory to forward the same to the authority under RERA.
   (c) It was optional for the CCI to forward the copy of the report of investigation to Nadus (P) Ltd. and in case of the authority under RERA, report was only required to be forwarded if it was required by such authority.
   (d) It was mandatory for the CCI to forward the copy of the report of investigation to Nadus (P) Ltd. as it was the party under investigation and in case of the authority under RERA, report was only required to be forwarded if it was required by such authority.

4. Whether the Director General was having the authority to exercise such powers as were exercised by him during the investigation?
   (a) He was having the authority to exercise such powers only if the prior permission of the CCI was obtained in that regard.
   (b) He was having the power to receive evidences on affidavit but was not having the power to keep the books and papers of Nadus (P) Ltd. in his custody.
   (c) He was having the power to receive evidences on affidavit as well as to keep the books and papers of Nadus (P) Ltd. in his custody, respectively.
   (d) He was having the power to receive evidences on affidavit but for keeping the books and papers of Nadus (P) Ltd. in his custody, prior permission of the CCI was required.

5. Which of the following persons would be deemed to be guilty of the contravention committed by Nadus (P) Ltd. of the provisions of the Competition Act, 2013?
   (a) Nadus (P) Ltd., Mr. Mayur, Mr. Neerav and Mrs. Ridhima, respectively.
   (b) Nadus (P) Ltd. only.
   (c) Nadus (P) Ltd., Mr. Mayur and Mr. Neerav, respectively.
   (d) Nadus (P) Ltd., Mr. Mayur, Mr. Neerav, Mr. Urmil and Mrs. Ridhima, respectively.

Descriptive Questions

6. (i) Whether Nadus (P) Ltd. was having any prohibition on making investment in Belashom LLC?
   (ii) Whether Nadus (P) Ltd. was required to take any permission for receiving bonus shares from Belashom LLC?

7. (i) Whether Nadus (P) Ltd. was permitted to make payment for meeting expenses of Mr. James in India?
   (ii) Whether Autukya (P) Ltd. was required to have any permissions for remitting the amount of commission to Mr. Franklin, if 1 USD = 15 EGPs and 1 USD = ₹75?

8. (i) Whether any action can be taken against Mr. Sumit for inducing his friend, Mr. Aman to enter into an agreement with Nadus (P) Ltd.?
   (ii) Whether the authority under RERA was having the power to make reference to the Competition Commission of India in respect of the case of Nadus (P) Ltd.?

ANSWERS TO CASE STUDY 1

1. **(c)** As per **Master Direction No. 17 – Import of Goods and Services:**
   (i) Any person resident in India who had gone out of India on a temporary visit, may bring into India at the time of his return from any place outside India **(other than from Nepal and Bhutan)**, currency notes of Government of India and Reserve Bank of India notes up to an amount not exceeding ₹25,000 (Rupees twenty five thousand only).
   (ii) **A person may bring into India from Nepal or Bhutan,** currency notes of Government of India and Reserve Bank of India for any amount in denominations up to ₹100/-.
   Mr. Neerav came to India bringing 30,000 INR in form of currency notes with denominations of ₹100 and 20,000 INR in form of currency notes with denominations of ₹500, respectively, received as a gift from his friend.
   It can be said that Mr. Neerav has not validly brought 20,000 INR in form of currency notes with denominations of ₹500 into India.

2. **(b)** As per **Master Direction No. 17 – Import of Goods and Services:**
   Import of Foreign Exchange into India: A person may–

(i) **Send into India,** without limit, foreign exchange in any form (other than currency notes, bank notes and travelers cheques);

(ii) **Bring into India** from any place outside India, without limit, foreign exchange (other than unissued notes), subject to the condition that such person makes, on arrival in India, a declaration to the Custom Authorities at the Airport in the Currency Declaration Form (CDF) annexed to these Regulations;

Provided further that it shall not be necessary to make such declaration where the aggregate value of the foreign exchange in the form of currency notes, bank notes or travelers cheques brought in by such person at any one time does not exceed USD 10,000 (US Dollars ten thousand) or its equivalent and/or the aggregate value of foreign currency notes (cash portion) alone brought in by such person at any one time does not exceed USD 5,000 (US Dollars five thousand) or its equivalent.

Here, it is given that 1 USD = 15 EGPs and Mr. James has brought with him following Egyptian Pounds (EGP):-

Particulars	EGP	Converted to USD
Currency Notes	90,000	6,000
Bank Notes	30,000	2,000
Travelers Cheque	22,500	1,500
Total	1,42,500	9,500

Thus, it was necessary for Mr. James to provide declaration to the Custom Authorities of India in respect of the Egyptian Pounds brought by him into India as the amount of currency notes exceeded $ 5,000 in equivalent.

3. **(b)** As per Section 26 of the Competition Act, 2002, the Commission may forward a copy of the report of the Director General to the parties concerned.

The Commission shall forward a copy of the report of the Director General to Central Government or the State Government or the statutory authority if the investigation is caused to be made based on reference received from them.

Thus, it was optional for the CCI to forward the copy of the report of investigation to Nadus (P) Ltd. but it was mandatory to forward the same to the authority under RERA.

4. **(c)** As per Section 41 of the Competition Act, 2002, the Director General shall assist the commission in investigating into any contravention of the provisions of this Act or any rules or regulations made thereunder when so directed by the Commission.

The Director General shall have all the powers as are conferred upon the commission under section 36(2) i.e. power vested with the civil court.

The power vested with inspector under sections 217 (Production of documents and evidence) and 220 (Seizure of documents by the inspector) of the Companies Act, 2013, shall available to Director General while investigating or any other person investigating under his authority.

Thus, the Director General was having the power to receive evidences on affidavit, as powers of a civil court are vested upon him as well as to keep the books and papers of Nadus (P) Ltd. in his custody, as he has been vested with the powers of an inspector under Section 217 of the Companies Act, 2013.

Note: As per Section 217(3) of the Companies Act, 2013, the inspector shall not keep in his custody any books and papers produced under sub-section (1) or sub-section (2) for more than one hundred and eighty days and return the same to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced.

5. **(d)** As per Section 48 of the Competition Act, 2002, where a company committing contravention of any of the provisions of this Act or of any rule, regulation, order made or direction issued thereunder, then following shall be deemed to be guilty of the contravention; hence liable to be proceeded against and punished accordingly;

Every person who, at the time the contravention was committed, was in charge of, and was responsible to the company for the conduct of the business of the company, as well as the company.

Any such person who is liable to any punishment, if he proves that the contravention was committed without his knowledge or that he had exercised all due diligence to prevent the Commission of such contravention, then he will not be punishable.

Where it is proved that the contravention has taken place with the consent or connivance of or is attributable to any neglect on the part of, any director, manager, secretary or other officers of the company, then he also be deemed to be guilty of that contravention and shall be liable to be proceeded against and punished accordingly.

For the purposes of this section, company means a body corporate and includes a firm or other association of individuals, and director in relation to a firm, means a partner in the firm.

Here, the persons that would be deemed to be guilty of the contravention committed by Nadus (P) Ltd. of the provisions of the Competition Act, 2002 would be- Nadus (P) Ltd., Mr. Mayur, Mr. Neerav, Mr. Urmil and Mrs. Ridhima, respectively.

Mr. Mayur, Mr. Neerav and Mr. Urmil are the persons responsible to the company for the conduct of the business of the company. Though Mr. Urmil never gave his consent to such an act of the company, however, he was having the knowledge of such agreements being entered into by Nadus (P) Ltd.

Mrs. Ridhima assisted Nadus (P) Ltd. in drafting the impugned agreements with the real estate agents and so it can be said that contravention has taken place due to her connivance.

6. **(i) As per Regulation 5 of the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004-**

(a) Indian Parties are prohibited from making investment (or financial commitment) in foreign entity engaged in real estate (meaning buying and selling of real estate or trading in Transferable Development Rights (TDRs) but does not include development of townships, construction

of residential/commercial premises, roads or bridges) or banking business, without the prior approval of the Reserve Bank.

(b) An overseas entity, having direct or indirect equity participation by an Indian Party, shall not offer financial products linked to Indian Rupee (e.g. non-deliverable trades involving foreign currency, rupee exchange rates, stock indices linked to Indian market, etc.) without the specific approval of the Reserve Bank.

Here, in the given case, Nadus (P) Ltd. had made investment i.e. acquired 10% shares of Belashom LLC, an Egyptian company which is engaged in the construction of commercial premises.

As per the aforesaid provisions, there is prohibition in investing in real estate company abroad but real estate, for this purpose, does not include construction of residential/commercial premises, etc.

Thus, Nadus (P) Ltd. was not having any prohibition on making of investment in Belashom LLC.

(ii) As per Regulation 4 of the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004-

General permission has been granted to persons resident in India for purchase / acquisition of securities in the following manner:

(a) out of the funds held in RFC account;

(b) as bonus shares on existing holding of foreign currency shares; and

(c) when not permanently resident in India, out of their foreign currency resources outside India.

General permission is also available to sell the shares so purchased or acquired.

In the instance case study, Nadus (P) Ltd. had received some bonus shares from the Belashom LLC for which general permission has been granted. So, Nadus (P) Ltd. was not required to take any permission for the same.

7. **(i) As per Master Direction No. 17 – Import of Goods and Services,** a person resident in India may make payment in rupees towards meeting expenses on account of boarding, lodging and services related thereto or travel to and from and within India of a person resident outside India who is on a visit to India.

As per Section 2(v) of the FEMA, 1999, person resident in India, inter-alia, means any person or body corporate registered or incorporated in India.

Here in the case study, all the expenses incurred by Mr. James in INR on account of his boarding, lodging and travelling in India were paid by Nadus (P) Ltd. for which it was going to be reimbursed later on by Belashom LLC.

As per the aforesaid provisions, Nadus (P) Ltd. being a person resident in India, was given general permission for incurring such expenses.

(ii) As per Schedule III (Transactions which are prohibited)-Foreign Exchange Management (Current Account Transactions) Rules, 2000, remittance of commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India exceeding USD 25,000 or five percent of the inward remittance whichever is more, by persons other than individuals shall require prior approval of the Reserve Bank of India, irrespective of whether it is made through EEFC account or not.

In the given case, the deal for the commercial property was finalized for ₹650 lakhs and Autukya (P) Ltd. remitted 4,50,000 EGPs to Mr. Franklin as commission amount, out of its EEFC account.

5% of inward remittance from sale of property = ₹650 lakhs*5% = ₹32.5 lakhs which is equivalent to USD 43,333.33 (₹32,50,000/₹75) and commission amount remitted = 4,50,000 EGPs which is equivalent to USD 30,000 (4,50,000/15).

Thus, Autukya (P) Ltd. was not required to have prior permission of RBI for remitting the amount of commission to Mr. Franklin as the amount remitted is well within the prescrided limit of 5% of inward remittance.

8. **(i) As per Section 90 of the Real Estate (Regulation and Development) Act, 2016,** no suit, prosecution or other legal proceedings shall lie against the appropriate Government or the Authority or any officer of the appropriate Government or any member, officer or other employees of the Authority for anything which is in good faith done or intended to be done under this Act or the rules or regulations made thereunder.

Here, complaint was filed with the authority under RERA by Vikrama Builders (P) Ltd. against Nadus (P) Ltd. in respect of the arrangements being made by it with the real estate agents. The case was assigned to Mr. Sumit Joshi, a RERA member and Mr. Sumit, in good faith, in order to understand the arrangements being made by Nadus (P) Ltd. with the real estate agents took help of his friend, Mr. Aman.

Thus, no action can be taken against Mr. Sumit who induced his friend, Mr. Aman to enter into an agreement with Nadus (P) Ltd. as it was done in good faith by Mr. Sumit.

(ii) As per Section 38 of the Real Estate (Regulation and Development) Act, 2016, where an issue is raised relating to agreement, action, omission, practice or procedure that—

(a) has an appreciable prevention, restriction or distortion of competition in connection with the development of a real estate project; or

(b) has effect of market power of monopoly situation being abused for affecting interest of allottees adversely, then the Authority, may *suo motu*, make reference in respect of such issue to the Competition Commission of India.

Here, the issue was related to the arrangements being made by Nadus (P) Ltd. with the real estate agents which affected the competition in the relevant market and thus, the authority under RERA was having the power to make reference to the Competition Commission of India in respect of the case of Nadus (P) Ltd.

CASE STUDY 2

Prahasti Ltd. is an unlisted public company, situated in Chennai, Tamil Nadu, with seven directors on its Board and it has share capital of ₹10 crore with 150 shareholders. It is engaged in the business of cloth garments manufacturing and wholesaling. Also, it exports outside India.

As part of its export trade policy, it provides trade samples free of cost to the prospective customers and if it receives an export order of delivering more than 1000 cloth garments, then it has to export further 50 cloth garments worth ₹2 lakhs free of cost to the customer.

Recently, in the month of June, it had received an export order of delivering 1500 cloth garments to a company in Germany for which the full export value declared was ₹63,00,000 (70,000 Euros). However, the said company returned 200 pieces of clothes worth ₹8,40,000 back to Prahasti Ltd. in the month of July. Remaining export value was realized by it and repatriated through the authorised dealer in India.

Also, in order to have business security, there is an exclusive distribution agreement entered into between different exporters of cloth garments in Tamil Nadu exporting in Europe whereby each exporter has been allocated different markets of Europe in which they are allowed to do business.

One of the directors of Prahasti Ltd., Mr. Karan, had withdrawn 50,000 Euros equivalent to $ 60,000, for the purpose of business trip to Germany and Italy, respectively, for which he was going to be reimbursed by Prahasti Ltd. but however due to the reason of Covid-19 pandemic, the trip was cancelled and so after utilizing 20,000 Euros for studies for her daughter in Germany, he returned back the remaining amount to the authorised dealer within 140 days.

Prahasti Ltd. was expanding its business for the same purpose, one another corporate office was being searched by the company in Chennai city only. One of its employees, Mr. Raj was searching online for a property and he visited a website, named 'propertylelo.com', whereby Mr. Raj was asked to enter certain details which were then going to be disclosed with certain promoters of real estate projects in Chennai for which the promoters were charged by the website. Also after taking permission of a director by Mr. Raj, on payment of some fees, a virtual 3D tour of a real estate project was arranged by the said website. The said website portal was not registered as a real estate agent.

The company found a property near its location but came to know later that the registration of such real estate project was revoked by the authority under RERA. The authority under RERA decided to hand over the task of the remaining development works of the said real estate project to the competent authority as the association of allottees had refused to do the same and at that time, 45 days had passed from the date of receipt of order of revocation of registration by the promoter.

In case of one of the debtors of Prahasti Ltd. named Tamprabha Ltd., corporate insolvency resolution process was initiated against it by one of its operational creditor. Mr. Dev Sharma, was appointed as the Interim Resolution Professional (IRP) who is partner of Sharma & Co., a law consulting firm which had transactions of following amounts with Tamprabha Ltd. during the last 5 financial years:-

Financial Year	Turnover of Sharma & Co. (₹)	Total amount of Transactions with Tamprabha Ltd. during each F.Y. (₹)
2016-17	220 lakhs	10 lakhs
2017-18	180 lakhs	8 lakhs
2018-19	200 lakhs	9 lakhs
2019-20	190 lakhs	9 lakhs
2020-21	150 lakhs	8 lakhs

All the financial creditors of Tamprabha Ltd. were related parties and it had 15 operational creditors. Mr. Dev was appointed as the resolution professional (RP) and he sanctioned a transaction of supply of goods to an associate company of Tamprabha Ltd. during the insolvency process for which approval of the committee of creditors was not obtained by him.

The resolution plan of Tamprabha Ltd. contained a provision of combination as per Section 5 of the Competition Act, 2002 and it was approved by the prescribed authorities. As a result of the implementation of the resolution plan, there was change in the entire management of Tamprabha Ltd. and its control has been handed over to persons who have not been its related parties and against whom no legal proceedings are going on under any statue.

Also, Tamprabha Ltd. was liable for an offence committed under the provisions of the Companies Act, 2013, prior to the commencement of corporate insolvency resolution process.

In the light of enumerated facts, answer the following:

Multiple Choice Questions

1. On expiry, how many further days from the date of receipt of order of revocation of registration by the promoter, the decision of the authority under RERA for carrying out of the remaining development works should have taken effect?
   (a) days
   (b) 60 days
   (c) 45 days
   (d) It shall be immediately effective

2. Is there any contravention of the provisions of the FEMA, 1999, by Karan?
   (a) No, as Mr. Karan has utilized the foreign currency amount for a permissible transaction and within the limits as per the 'LRS'.
   (b) Yes, as Mr. Karan has not utilized the foreign currency amount for the purpose for which it was acquired.
   (c) No, as Mr. Karan after utilizing the foreign currency amount for a permissible transaction, has surrendered the remaining amount with the authorised dealer within the specified period.
   (d) No, as Mr. Karan was eligible to utilize the foreign currency amount for any other permissible transaction as the business trip was cancelled due to a genuine reason and not because of default on his part.

3. Whether Mr. Dev has validly sanctioned the transaction of supply of goods by Tamprabha Ltd.?
   (a) No, he was required to take prior approval of the

committee of creditors before sanctioning such transaction.

(b) No, due to applicability of order of moratorium by the Adjudicating Authority, such a transaction should have not taken place.

(c) Yes, the IBC, 2016, itself has given authority to the resolution professional to undertake such actions necessary for the continued business operations of the corporate debtor.

(d) Yes, provided the transaction was conducted at arm's length price.

4. Which authorities would have approved the resolution plan of Tamprabha Ltd. and in what sequence?
   (a) Committee of Creditors and then Adjudicating Authority, respectively.
   (b) Committee of Creditors, Adjudicating Authority and then Competition Commission of India, respectively.
   (c) Committee of Creditors, Competition Commission of India and then Adjudicating Authority, respectively.
   (d) Competition Commission of India, Committee of Creditors and then Adjudicating Authority, respectively.

5. Mr. Dev Sharma would have been ineligible to be appointed as the Interim Resolution Professional of Tamprabha Ltd. if:-
   (a) Sharma & Co. would have entered into transaction(s) of further amount of ₹1 lakh or more with Tamprabha Ltd. during any of the last 3 financial years.
   (b) Sharma & Co. would have entered into transaction(s) of further amount of ₹1 lakh or more during F.Y. 2018-19 and transaction(s) of further amount of ₹50,000 or more during F.Y. 2019-20 with Tamprabha Ltd., respectively.
   (c) Sharma & Co. would have entered into transaction(s) of further amount of ₹3 lakhs or more with Tamprabha Ltd. during any of the last 5 financial years.
   (d) Sharma & Co. would have entered into transaction(s) of further amount of ₹28 lakhs or more with Tamprabha Ltd. during any of the last 3 financial years.

Descriptive Questions

6. **(i)** Whether Prahasti Ltd. needs to furnish declaration in case of goods which are exported free of cost as per its trade policy?
   (ii) Whether Prahasti Ltd. can be said to have realized full export value with respect to the export order from the company in Germany?

7. Whether the agreement made between different exporters of cloth garments in Tamil Nadu can be considered as an anti-competitive agreement?

8. Whether the website portal named 'propertylelo.com' would be required to be registered as a real estate agent? (Please support your answer on the basis of a relevant case law)

9. **(i)** What would have been the constitution of committee of creditors of Tamprabha Ltd.?
   (ii) Whether Tamprabha Ltd. would be prosecuted for the offence committed under the provisions of the Companies Act, 2013, prior to the commencement of corporate insolvency resolution process?

ANSWERS TO CASE STUDY 2

1. **(a)** As per Section 8 of the RERA, 2016, upon lapse of the registration or on revocation of the registration under this Act, the Authority, may consult the appropriate Government to take such action as it may deem fit including the carrying out of the remaining development works by competent authority or by the association of allottees or in any other manner, as may be determined by the Authority.
   It is provided that no direction, decision or order of the Authority under this section shall take effect until the expiry of the **period of appeal** provided under the provisions of this Act.
   Time period for filing appeal is 60 days from the date of receipt of order by the aggrieved person as per Section 44 of the Act.
   Here, 45 days had passed from the date of receipt of order of revocation of registration by the promoter, so, after expiry of further 15 days, the decision of the authority under RERA for carrying out of the remaining development works should have taken effect.

2. **(b)** As per the provisions of the FEMA, 1999, if any person, other than an authorized person, who has acquired or purchased foreign exchange for any purpose mentioned in the declaration made by him to authorized person.
   - Does not use it for such purpose, or
   - Does not surrender it to the authorized person within the specified period, or
   - Uses the foreign exchange so acquired or purchased for any other purpose for which purchase or acquisition of foreign exchange is not permissible under the provisions of the Act or the rules or regulations or direction or order made there under,

   Such person shall be deemed to have committed contravention of the provisions of the Act.

3. **(a)** As per Section 5(24) of the IBC, 2016, an associate company is considered as a related party of the corporate debtor.
   According to section 28 of the Code, the resolution professional, during the corporate insolvency resolution process, shall not **undertake any related party transaction** without the prior approval of the committee of creditors.
   Thus, Mr. Dev has not validly sanctioned the transaction of supply of goods to an associate company of Tamprabha Ltd. during the insolvency process because approval of the committee of creditors was required to be obtained by him for such transaction as aforesaid.

4. **(d)** As per Section 31 of the IBC, 2016, if the Adjudicating Authority is satisfied that the resolution plan as approved by the committee of creditors meets the requirements as per section 30(2), it shall by order approve the resolution plan.
   Where the resolution plan contains a provision for combination, as per section 5 of the Competition Act, 2002, the resolution applicant shall obtain the approval of the Competition Commission of India under that Act prior to the approval of such resolution plan by the committee of creditors.
   On reading of the aforesaid provisions, the authorities and the sequence of approval that can be derived is:- Competition Commission of India, Committee of Creditors and then Adjudicating Authority, respectively.

5. **(a)** As per Regulation 3 of the Insolvency and Bankruptcy (Insolvency Resolution process for Corporate Persons) Regulation, 2016, an insolvency professional shall be eligible for appointment as a resolution professional for a corporate insolvency process if he is not an employee or proprietor or a partner of a legal or consulting firm that has or had any transaction with the corporate debtor amounting to five per cent or more of the gross turnover of such firm in the last three financial years.

Financial Year	Turnover of Sharma & Co. (₹)	Total amount of Transactions with Tamprabha Ltd. during each F.Y. (₹)
2018-19	200 lakhs	9 lakhs
2019-20	190 lakhs	9 lakhs
2020-21	150 lakhs	8 lakhs
Total	**540 lakhs**	**26 lakhs**

Here, 5% of ₹540 lakhs comes to ₹27 lakhs and Sharma & Co. has already rendered transaction(s) amounting to Rs. 26 lakhs to Tamprabha Ltd. So, Mr. Dev Sharma would have been ineligible to be appointed as the Interim Resolution Professional of Tamprabha Ltd. if Sharma & Co. would have entered into transaction(s) of further amount of ₹1 lakh or more with Tamprabha Ltd. during any of the last 3 financial years.

Note: Resolution Professional includes an Interim Resolution Professional as per Section 5(27) of the IBC, 2016.

6. **(i) Legal Position:** As per Regulation 4 of the Foreign Exchange Management (Export of Goods and Services) Regulations, 2015, export of goods / software may be made without furnishing the declaration in the following cases, inter-alia, namely:

(a) trade samples of goods and publicity material supplied free of payment.

(b) by way of gift of goods accompanied by a declaration by the exporter that they are not more than five lakh rupees in value.

Given Case and Analysis: As part of its export trade policy, Prahasti Ltd. provides trade samples **free of cost** to the prospective customers and if it receives an export order of delivering more than 1000 cloth garments, then it exports extra 50 cloth garments worth ₹2 lakhs free of cost which is less than value of ₹5 lakhs as prescribed.

Thus, Prahasti Ltd. is not required to furnish declaration in case of aforesaid goods which are exported free of cost as per its trade policy.

(ii) Legal Position: As per Regulation 4 of the Foreign Exchange Management (Export of Goods and Services) Regulations, 2015, unless otherwise authorised by the Reserve Bank, the amount representing the full export value of the goods exported shall be paid through an authorised dealer in the manner specified in the Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2000 as amended from time to time.

Explanation—For the purpose of this regulation, re-import into India, within the period specified for realisation of the export value, of the exported goods in respect of which a declaration was made under Regulation 3, shall be deemed to be realisation of full export value of such goods.

As per Regulation 9 of the Foreign Exchange Management (Export of Goods and Services) Regulations, 2015, the amount representing the full export value of goods / software/ services exported shall be realised and repatriated to India **within nine months or within such period** as may be specified by the Reserve Bank, in consultation with the Government, from time to time, from the date of export, provided.

Given Case and Analysis: Full export value declared by Prahasti Ltd. was ₹63,00,000 in respect to export order from the company in Germany.

However, Prahasti Ltd. re-imported 200 pieces of clothes worth ₹8,40,000 from the said company in the month of July i.e. within the period specified for realisation of the export value. So, it shall be deemed to be realisation of full export value of such goods as per explanation to the Regulation 4 as aforesaid.

Also, remaining export value had been realized by Prahasti Ltd. and repatriated through the authorised dealer in India.

Thus, it can be said that Prahasti Ltd. has realized full export value with respect to the export order from the company in Germany.

7. **Legal Position:** As per Section 3 of the Competition Act, 2002, it shall be unlawful for any enterprise or association of enterprises or person or association of persons to **'enter' into any agreement** in respect of production, supply, storage, distribution, acquisition or control of goods or provision of services, which causes or is likely to cause an **appreciable adverse effect on competition within India;** and such agreements **shall be void**.

Sub-section 5 to the said section 3 protects the right of specific persons by restricting the application of section 3 to their rights, hence become exceptions to section 3.

One of such exceptions is:- **Any agreement or part there-of shall not be considered as anti-competitive,** hence not void **to the extent it is exclusively related** to production, supply, distribution or control of goods or provision of services for **purpose of export of goods from India**.

Given Case and Analysis: Here, in the given case, the agreement entered into between different exporters of cloth garments in Tamil Nadu exporting in Europe is for the purpose of export goods from India and hence cannot be considered as an anti-competitive agreement as it has been covered by the exception as aforesaid.

8. **Legal Position:** The facts in the given case are similar to the case law with citation, MahaRera Order in the Suo Moto Enquiry No.17/2018 dated 03.10.2019, where in it was decided that a digital portal needs to be registered as a real estate agent if it carries out the following functions:-

1. Portals when they collect the details of the viewer and share them with advertiser/seller and also disclose the information of promoters to buyers, they introduce the parties to the sale transaction.

2. If the portal simply provide the information about the real estate project, its offering for sale to the public at large, then they are simply the agencies engaged for advertisement and when an individual is targeted by contacting and persuading him by the portals for sale and purchase of listed properties they come under the legal definition of negotiation.

3. Web Portals introduce the buyer and seller with each other, they provide the information of the project to the buyer, they arrange virtual tour of the project and also provide other information useful for taking an informative decision. Hence, they facilitate the sale of the real estate project.

4. Once any monetary gain is derived for the purpose of performing any act of the real estate agent by whichever name it amounts the receipt of the fees under the RERA.

5. The Parliament has not carved out any exceptions to the applicability of the provisions of RERA, Hence, we hold that RERA overrides section 79 of the IT Act.

Given Case & Analysis: Here, in the website, named 'propertylelo.com', Mr. Raj was asked to enter certain details which were then going to be disclosed with certain promoters of real estate projects in Chennai for which such promoters were charged by the website.
Accordingly, Mr. Raj has been introduced to the sale transaction and he would be contacted by such promoters for a property deal. Due to this, the website has earned monitory gain for exchange of information of prospective buyers with the promoters.
Also, on payment of some fees by Mr. Raj on permission of director, a virtual 3D tour of a real estate project was arranged by the said website. This type of facility helps in taking an informative decision to the prospective buyer.
Thus, it can be said that the website portal named 'propertylelo.com' would be required to be registered as it carries out the functions of the real estate agent as explained above.

9. **(i) Legal Position:** As per Regulation 16 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, where the corporate debtor has no financial debt or **where all financial creditors are related parties of the corporate debtor,** the committee shall be set up in accordance with this Regulation.
The committee formed under this Regulation shall consist of members as under –
(a) 18 largest operational creditors by value:
Provided that if the number of operational creditors is less than 18, the committee shall include all such operational creditors;
(b) 1 representative elected by all workmen; and
(c) 1 representative elected by all employees.

Given Case & Analysis: Here, all the financial creditors of Tamprabha Ltd. were related parties and it had 15 operational creditors, so the committee of creditors constituted would have been as follows:
(a) All the 15 operational creditors (as it has less than 18 operational creditors);
(b) 1 representative elected by all workmen; and
(c) 1 representative elected by all employees.

(ii) Legal Position: As per Section 32A(1) of the Insolvency and Bankruptcy Code, 2016, notwithstanding anything to the contrary contained in this Code or any other law for the time being in force, the liability of a corporate debtor for an offence committed prior to the commencement of the corporate insolvency resolution process shall cease, and the corporate debtor shall not be prosecuted for such an offence from the date the resolution plan has been approved by the Adjudicating Authority under section 31, if the resolution plan results in the change in the management or control of the corporate debtor to a person who was not-
(a) a promoter or in the management or control of the corporate debtor or a related party of such a person; or
(b) a person with regard to whom the relevant investigating authority has, on the basis of material in its possession, reason to believe that he had abetted or conspired for the commission of the offence, and has submitted or filed a report or a complaint to the relevant statutory authority or Court:
Provided that if a prosecution had been instituted during the corporate insolvency resolution process against such corporate debtor, it shall stand discharged from the date of approval of the resolution plan subject to requirements of this sub-section having fulfilled.

Given Case & Analysis: Here, it is given that, as a result of the resolution plan, there was change in the entire management of Tamprabha Ltd. and its control has been handed over to persons who have not been its related parties and against whom no legal proceedings are going on under any statue.

It appears from the given facts that conditions as demonstrated in section 32A(1) has been satisfied by Tamprabha Ltd. and thus, the liability of Tamprabha Ltd. for an offence committed under the provisions of the Companies Act, 2013, prior to the commencement of the corporate insolvency resolution process shall cease, and it shall not be prosecuted for such an offence from the date the resolution plan has been approved by the Adjudicating Authority under section 31.

CASE STUDY 3

The Adjudicating authority under the Insolvency and Bankruptcy Code, 2016, had received different applications during the July month, in respect of certain corporate persons, as follows:-

Sr. No.	Details of the Applicant	Details relating to the Application
1	Ukrin Ltd., operational creditor of Kaptcha Ltd., corporate debtor	Ukrin Ltd. submitted a withdrawal application on 26th May for consideration by the Committee of Creditors which was approved by it, by a vote of 92%, on 1st June and Mr. Tanmay, the Interim Resolution Professional, then submitted such application to the Adjudicating authority on 5th June on behalf of Ukrin Ltd.
2	Certain allottees of Trees Estate Ltd., corporate debtor	30 allottees out of 310 allottees of Trees Estate Ltd. jointly filed an application for initiating corporate insolvency resolution process against it, as the said allottees, on the basis of model apartment had purchased the properties in the project and according to them it was not as per model displayed and the promoter company refused to return the investment amount of such allottees. (Note 1)
3	Turf Enterprise, an operational creditor of JLC (P) Ltd.	Turf Enterprise filed an application along with the relevant enclosures on 10th June for initiating corporate insolvency resolution process against JLC (P) Ltd. (Note 2)
4	Mr. Ravi, Resolution Professional of Saath Ltd., corporate debtor	Mr. Ravi filed an application for declaring two undervalued transactions entered into by Saath Ltd. as void and to reverse the effect of such transactions. (Note 3)
5	KC & Sons, an operational creditor of FAL Ltd.	KC & Sons filed an application for obtaining liquidation order against FAL Ltd. on the ground that FAL Ltd. had contravened the resolution plan approved by the Adjudicating Authority because as per the said plan, FAL Ltd. had to pay 60% of pending dues to KC & Sons as a full & final settlement amount but it had paid only 20% of its pending dues as a full & final settlement amount. (Note 4)
6	Mr. Rohan, Interim Resolution Professional of Tadan Ltd., corporate debtor	Mr. Rohan made an application along with a list of financial creditors for appointment of authorised representative to act on behalf of such creditors during the corporate insolvency resolution process. (Note 5)
7	TLF (P) Ltd., a secured creditor of Anmoli Ltd.	TLF (P) Ltd. filed an application for realizing the secured asset of Anmoli Ltd. during the liquidation proceedings for which it faced resistance from Mr. Raj, director of Anmoli Ltd. (Note 6)

Notes:

1. Such allottees then filed a complaint against Trees Estate Ltd. with the Real Estate Regulatory Authority under Section 31 of the Real Estate (Regulation & Development) Act, 2016. The said authority under RERA passed an order imposing maximum penalty upon the promoter company, Trees Estate Ltd. with a direction to compensate the said 30 allottees by returning their cumulative investment amount of ₹20 crores along with total interest of ₹2 crores. The estimated cost of the real estate project was ₹200 crores. Trees Estate Ltd. filed an appeal with the Appellate Tribunal against the said order of Real Estate Regulatory Authority.

2. It was found by the Adjudicating authority that JLC (P) Ltd. had notified vide an e-mail to Turf Enterprise within 10 days of the demand notice, of the dispute that existed, and the said matter was going to be referred for arbitration by JLC (P) Ltd. and accordingly, the Adjudicating authority passed a penalty order with a fine amount of ₹70,000 against Turf Enterprise, after opportunity of being heard, for willful non-disclosure of such fact of notice of dispute and also rejected its application.

3. One of such transactions was entered by Saath Ltd. before 19 months preceding the insolvency commencement date with Janam Ltd. which involved supplying of goods by Saath Ltd. for ₹4.4 crores which Saath Ltd. would have normally sold for 4.6 crores in its ordinary course of business. Saath Ltd. and Janam Ltd. were having two directors in common.
   The other transaction was entered by Saath Ltd. before 17 months preceding the insolvency commencement date with Mr. Mahesh which involved sale of property of Saath Ltd. for ₹15 crore, the stamp duty value of which was ₹35 crore. Mr. Mahesh is a house worker of Mr. Sunil, the director of Saath Ltd. There was a case under the Prohibition of Benami Property Transactions Act, 1988, going against Mr. Mahesh and Mr. Sunil, due to acquisition of such property in the name of Mr. Mahesh and it was held that Mr. Mahesh was the 'benamidar' and Mr. Sunil was the 'beneficial owner' and the property was ordered to be confiscated and consequently has been disposed off.

4. Adjudicating authority passed the liquidation order of FAL Ltd. on the basis of application of KC & Sons. However, KC & Sons, afterwards, filed a suit against FAL Ltd. in the City Civil Court for realizing its dues as per the resolution plan approved by the Adjudicating authority under the Insolvency and Bankruptcy Code, 2016.

5. Mr. Rohan had offered names of three insolvency professionals to such class of financial creditors to act as its

authorised representative who belonged to three different states:- Gujarat, Maharashtra and Rajasthan, respectively. The highest number of such creditors of Tadan Ltd. belonged to the state of Gujarat.

6. The application of TLF (P) Ltd. was approved by the Adjudicating authority and TLF (P) Ltd. was permitted to realize its security interest in the asset. Accordingly, TLF (P) Ltd. enforced its security interest and yielded amount of ₹2 crores in excess of its debts due from Anmoli Ltd.

Apart from the aforesaid applications received by the Adjudicating authority during the July month there were few other applications received by it in respect of certain corporate persons which could not be disposed of within the time periods as specified in the IBC, 2016, for which the reasons were recorded in writing by the Adjudicating authority.

Answer the following questions in the light of the given informations:

Multiple Choice Questions

1. Till what date the Committee of Creditors should have considered the withdrawal application submitted by Ukrin Ltd. and till what date, such application should have been submitted with the Adjudicating authority for approval by Mr. Tanmay?
   (a) 2nd June and 9th June, respectively.
   (b) 31st May and 5th June, respectively.
   (c) 9th June and 12th June, respectively.
   (d) 2nd June and 4th June, respectively.

2. Whether the application filed by the 30 allottees of Trees Estate Ltd. can be considered to be admissible by the Adjudicating authority?
   (a) No, as an application is already with the authority under RERA, so simultaneously two proceedings cannot be initiated for the same matter.
   (b) Yes, as the amount of default involved is more than ₹1 crore.
   (c) No, as the application is filed jointly by lesser number of allottees than prescribed.
   (d) Yes, such application can be admitted as the RERA Act provides an additional remedy to the homebuyer which will not bar other remedies available to the homebuyer.

3. What minimum fine amount should have been imposed on Turf Enterprise by the Adjudicating authority and what amount of maximum fine it could have imposed on Turf Enterprise?
   (a) Adjudicating authority should have imposed minimum fine of ₹1 lakh on Turf Enterprise and maximum fine of ₹3 lakhs could have been imposed by it.
   (b) Adjudicating authority should have imposed minimum fine of ₹1 lakh on Turf Enterprise and maximum fine of ₹1 crore could have been imposed by it. However, it possesses the discretion to impose a lower amount of fine.
   (c) Adjudicating authority should have imposed minimum fine of ₹1 lakh on Turf Enterprise and maximum fine of ₹5 lakhs could have been imposed by it.
   (d) Adjudicating authority should have imposed minimum fine of ₹1 lakh on Turf Enterprise and maximum fine of ₹1 crore could have been imposed by it.

4. Whether the names offered by Mr. Rohan for appointment as authorised representative can be considered proper and till what time the Adjudicating authority should have appointed such authorised representative?
   (a) Yes, as one name is from Gujarat and other two names belong to such states which are nearby to Gujarat. The Adjudicating authority should have appointed such authorised representative prior to the first meeting of the committee of creditors.
   (b) No, all the three names offered should have been from Gujarat. The Adjudicating authority should have appointed such authorised representative prior to the first meeting of the committee of creditors.
   (c) No, all the three names offered should have been from Gujarat. The Adjudicating authority should have appointed such authorised representative prior to the formation of the committee of creditors.
   (d) Yes, as at least one name offered should have been from Gujarat. The Adjudicating authority should have appointed such authorised representative prior to the formation of the committee of creditors.

5. Who can extend the time period for disposing of the few other applications received by the Adjudicating authority during the July month?
   (a) The President of the National Company Law Tribunal can extend the time periods specified in the Act but not exceeding ten days.
   (b) The Chairperson of the National Company Law Appellate Tribunal can extend the time periods specified in the Act but not exceeding seven days.
   (c) The Chairperson of the National Company Law Tribunal can extend the time periods specified in the Act but not exceeding ten days.
   (d) The Chairperson of the National Company Law Appellate Tribunal can extend the time periods specified in the Act but not exceeding seven days.

Descriptive Questions

6. For contravention of which provisions the penalty would have been imposed by the authority under RERA upon the promoter company, Trees Estate Ltd. and of what amount? Also, how much amount of pre-deposit would have been made by it for filing the appeal with the Appellate Tribunal?

7. (i) Whether the two transactions entered by Saath Ltd. can be said to have entered within the relevant period for considering them as undervalued transactions?
   (ii) Whether the two transactions entered into by Saath Ltd., as aforesaid, can be considered as undervalued transactions as contemplated by Mr. Ravi in the application filed with the Adjudicating Authority?

8. Whether KC & Sons should have instituted a suit against FAL Ltd. in the City Civil Court and whether such court can entertain such suit?

9. What shall be done by TLF (P) Ltd. with respect to amount of ₹2 crores yielded in excess of its debts due from Anmoli Ltd. and before realizing such security interest by TLF (P) Ltd., what kind of verification would have been made by the liquidator?

ANSWERS TO CASE STUDY 3

1. **(d)** Withdrawal of application shall be pursuant to Section 12A of the Code read with Regulation 30A of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

   Once application is admitted and after Constitution of CoC but before issue of Invitation for Expression of Interest ("EoI"):- An application for withdrawal made by the Applicant shall be firstly considered by the CoC, within **seven days** of its receipt. Such withdrawal of application shall be approved by the CoC with ninety percent voting share, upon which the resolution professional shall submit such withdrawal application along with the approval of the committee, to the Adjudicating Authority on behalf of the applicant, within **three days** of such approval

   Ukrin Ltd. submitted a withdrawal application on 26th May for consideration by the Committee of Creditors. So, the Committee of Creditors should have considered such application by 2nd June i.e. 7 days from 26th May.

   The Committee of Creditors approved such application by a vote of 92% on 1st June. So, Mr. Tanmay should have been submitted with the Adjudicating authority for approval by 4th June i.e. 3 days from 1st June.

2. **(c)** Section 7 of the IBC, 2016:-

   A financial creditor either by itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred.

   Provided further that for financial creditors who are allottees under a real estate project, an application for initiating corporate insolvency resolution process against the corporate debtor **shall be filed jointly by not less than one hundred of such allottees under the same real estate project or not less than ten per cent. of the total number of such allottees under the same real estate project, whichever is less.**

   Here, 30 allottees out of 310 allottees of Trees Estate Ltd. jointly filed an application for initiating corporate insolvency resolution process against it. But as the proviso above, 100 allottees or 31 allottees (10% of 310) whichever is less, should have jointly filed such application.

   So, the application filed by the said 30 allottees of Trees Estate Ltd. is not admissible by the Adjudicating authority as it is filed jointly by lesser number of allottees than prescribed.

3. **(d) As per Section 76 of the IBC, 2016:-** Where an operational creditor has **wilfully or knowingly concealed** in an application under section 9 the fact that the corporate debtor had **notified him of a dispute in respect of the unpaid operational debt** or the full and final payment of the unpaid operational debt.

   Such operational creditor or person, as the case may be, shall be punishable with imprisonment for a term **which shall not be less than one year but may extend to five years or with fine which shall not be less than one lakh rupees but may extend to one crore rupees,** or with both.

4. **(b)** As per section 21(6A) of the IBC, 2016, where a financial debt is owed to a class of creditors other than the creditors covered above, the IRP shall make an application to the AA along with the list of all financial creditors, with the name of an insolvency professional to act as their authorised representative appointed by the Adjudicating Authority **prior to the first meeting of the committee of creditors**.

   Authorised Representative from the State or Union Territory having highest number of creditors in class

   The Interim Resolution Professional shall offer the names of three insolvency professionals to be voted upon by the class of creditors, who must be from the State or Union Territory, which has the highest number of creditors in the class as per records of the corporate debtor.

   Where such State or Union Territory does not have adequate number of insolvency professionals, the insolvency professionals having addresses in a nearby State or Union Territory, as the case may be, shall be considered.

   Here, the highest number of such creditors of Tadan Ltd. belonged to the state of Gujarat. So, all the three names offered should have been from Gujarat by Mr. Rohan.

5. **(a)** As per Section 64 of the IBC, 2016, where an application is not disposed of or an order is not passed within the period specified in this Code, the National Company Law Tribunal or the National Company Law Appellate Tribunal, as the case may be, shall record the reasons for not doing so within the period so specified; and **the President of the National Company Law Tribunal** or the Chairperson of the National Company Law Appellate Tribunal, as the case may be, may, after taking into account the reasons so recorded, **extend the period specified in the Act but not exceeding ten days.** No injunction shall be granted by any court, tribunal or authority in respect of any action taken, or to be taken, in pursuance of any power conferred on the National Company Law Tribunal or the National Company Law Appellate Tribunal under this Code.

6. Section 12 of the Real Estate (Regulation & Development) Act, 2016, contains provisions which deal with the obligations of a promoter regarding veracity of the advertisement or prospectus.

   Accordingly, where any person makes an advance or a deposit on the basis of the information contained in the notice, advertisement or prospectus, or on the basis of any model apartment, plot or building, as the case may be, and sustains any loss or damage by reason of any incorrect, false statement included therein, he shall be compensated by the promoter in the manner as provided under this Act.

   However, **if the person affected by** such incorrect, false statement contained in the notice, advertisement or prospectus, or **the model apartment**, plot or building, as the case may be, intends to withdraw from the proposed project, **he shall be returned his entire investment along with interest at such rate as may be prescribed and the compensation in the manner provided under this Act.**

   In the given case, the 30 allottees on the basis of model apartment had purchased the properties in the project and according to them it was not as per model displayed and the promoter company refused to return the investment amount of such allottees.

Thus, for contravention of provisions of section 12, as aforesaid, the promoter company, Trees Estate Ltd. would have been penalized.

As per Section 61 of the Real Estate (Regulation & Development) Act, 2016, **if any promoter contravenes any other provisions of this Act,** other than that provided under section 3 or section 4, or the rules or regulations made thereunder, **he shall be liable to a penalty which may extend up to five per cent of the estimated cost of the real estate project as determined by the Authority.**

Here it is given, that the authority under RERA passed an order imposing maximum penalty upon the promoter company, Trees Estate Ltd. and the estimated cost of the real estate project was ₹200 crores, so the amount of penalty would have been 5% of ₹200 crores = **₹10 crores.**

As per Section 43 of the Real Estate (Regulation & Development) Act, 2016, any person aggrieved by any direction or decision or order made by the Authority or by an adjudicating officer under this Act may prefer an appeal before the Appellate Tribunal having jurisdiction over the matter.

Where a promoter files an appeal with the Appellate Tribunal, it shall not be entertained, without the promoter first having deposited with the Appellate Tribunal atleast thirty per cent. of the penalty, or such higher percentage as may be determined by the Appellate Tribunal, or the total amount to be paid to the allottee including interest and compensation imposed on him, if any, or with both, as the case may be, before the said appeal is heard.

Explanation—For the purpose of this sub-section "person" shall include the association of allottees or any voluntary consumer association registered under any law for the time being in force.

In the given case, the authority under RERA has imposed a penalty on Trees Estate Ltd. as well as directed to it to compensate the said 30 allottees by returning their cumulative investment amount of ₹20 crores along with total interest of ₹2 crores.

Thus, the amount of pre-deposit that would have been made by Trees Estate Ltd. for filing the appeal with the Appellate Tribunal would be:-

- 30% of ₹10 crore = ₹3 crore or such higher percentage as may be determined by the Appellate Tribunal and;
- The total amount to be paid to the allottee including interest and compensation imposed on him i.e. ₹20 crores + ₹2 crores = ₹22 crores.

7. **(i)** As per Section 46 of the IBC, 2016, in an application for avoiding a transaction at undervalue, the liquidator or resolution professional shall determine :
   a) That the transaction was entered within the period of one year preceding the insolvency commencement date; or
   b) That the transaction was made with a **related party within a period of two years** preceding the insolvency commencement date.

   The Adjudicating Authority may require an independent expert to assess evidence relating to the value of the transactions

   In case of transaction entered by Saath Ltd. with Janam Ltd.

   Transaction was entered by Saath Ltd. before 19 months preceding the insolvency commencement date with Janam Ltd. and Saath Ltd. and Janam Ltd. were having two directors in common.

   As per Section 5(24) of the IBC, 2016, related party, in relation to a corporate debtor, inter-alia, means any person who is associated with the corporate debtor on account of having more than two directors in common between the corporate debtor and such person.

   As, Saath Ltd. and Janam Ltd. were having two directors in common, Janam Ltd. would be considered as related party in relation to Saath Ltd. and the transaction took place within 2 years preceding the insolvency commencement date.

   Thus, the said transaction can be said to have entered within the relevant period for considering it as an undervalued transaction.

   In case of transaction entered by Saath Ltd. with Mr. Mahesh

   Transaction was entered by Saath Ltd. before 17 months preceding the insolvency commencement date with Mr. Mahesh. Mr. Mahesh is a house worker of Mr. Sunil, the director of Saath Ltd. There was a case under the Prohibition of Benami Property Transactions Act, 1988, going against Mr. Mahesh and Mr. Sunil, due to acquisition of such property in the name of Mr. Mahesh and it was held that in the order passed that Mr. Mahesh was the 'benamidar' and Mr. Sunil was the 'beneficial owner'.

   As per Section 5(24) of the IBC, 2016, Related party, in relation to a corporate debtor, inter-alia, means — a director or partner or a relative of a director or partner of the corporate debtor

   Now, as per the order passed under the provisions of the Prohibition of Benami Property Transactions Act, 1988, Mr. Mahesh was considered as the 'benamidar' and Mr. Sunil was considered as the 'beneficial owner' and thus, it can be said that, in substance, the transaction was entered by Saath Ltd. with Mr. Sunil and not with Mr. Mahesh and Mr. Sunil being a director of Saath Ltd. would be considered as the Related party in relation to Saath Ltd.

   Also, the transaction took place within 2 years preceding the insolvency commencement date.

   Thus, the said transaction can be said to have entered within the relevant period for considering it as an undervalued transaction.

   (ii) As per Section 45 of the IBC, 2016, a transaction shall be considered undervalued where the corporate debtor —
   (a) makes a gift to a person; or
   (b) enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor,

   and such transaction has not taken place in the ordinary course of business of the corporate debtor.

   In case of transaction entered by Saath Ltd. with Janam Ltd.

Though the transaction has not taken place in the ordinary course of business of the corporate debtor but the consideration for such supply of goods does not appear to be significantly lesser than the value of the consideration provided by the corporate debtor as consideration charged by Saath Ltd. was ₹4.4 crores which it would have normally sold for 4.6 crores.

Thus, transaction entered by Saath Ltd. with Janam Ltd. cannot be said to be an undervalued transaction even though it has been entered into with a related party within the relevant period.

In case of transaction entered by Saath Ltd. with Mr. Mahesh

Here, Saath Ltd. had sold a property to Mr. Mahesh for ₹15 crore, the stamp duty value of which was ₹35 crore. It can be said that consideration charged is significantly less than the value of the consideration provided by the corporate debtor, Saath Ltd.

Further, Mr. Mahesh is a house worker of Mr. Sunil, the director of Saath Ltd. and also an order under the Prohibition of Benami Property Transactions Act, 1988 was passed against them. So, such transaction also does not appear to take place in the ordinary course of business of the corporate debtor, Saath Ltd.

Thus, the transaction entered by Saath Ltd. with Mr. Mahesh can be said to be an undervalued transaction.

8. As per Section 33(5) of the IBC, 2016, subject to section 52, when a liquidation order has been passed, no suit or other legal proceeding shall be instituted by or against the corporate debtor.

   Provided that a suit or other legal proceeding may be instituted by the liquidator, on behalf of the corporate debtor, with the prior approval of the Adjudicating Authority.

   Thus, KC & Sons should not have instituted a suit against FAL Ltd. in the City Civil Court due to the restrictions as mentioned in the aforesaid provision.

   As per Section 63 of the IBC, 2016, no civil court or authority shall have jurisdiction to entertain any suit or proceedings in respect of any matter on which National Company Law Tribunal or the National Company Law Appellate Tribunal has jurisdiction under this Code.

   Civil court not to have jurisdiction.

   Here, in the given case, the Adjudicating authority i.e. the NCLT was having the jurisdiction over the matter with respect to non-payment to KC & Sons as per the resolution plan by FAL Ltd. and thus, the City Civil court cannot entertain such suit as it is not having the jurisdiction to do the same.

9. As per Section 52(7) of the IBC, 2016, where the enforcement of the security interest yields an amount by way of proceeds which is in excess of the debts due to the secured creditor, the secured creditor shall—

   (a) account to the liquidator for such surplus; and

   (b) tender to the liquidator any surplus funds received from the enforcement of such secured assets.

   Thus, TLF (P) Ltd. should account to the liquidator surplus sum of ₹2 crores yielded in excess of its debts due from Anmoli Ltd. as well as tender the same to the liquidator.

   As per Section 52(7) of the IBC, 2016, before any security interest is realised by the secured creditor, the liquidator shall verify such security interest and permit the secured creditor to realise only such security interest, the existence of which may be proved either—

   (a) by the records of such security interest maintained by an information utility; or

   (b) by such other means as may be specified by the Board.

   Thus, before realizing such security interest by TLF (P) Ltd. the liquidator should have verified the security interest as aforesaid.

CASE STUDY 4

Mapple Inc. is an American MNC that designs and markets consumer electronics, computer software and personal computers, etc. Mapple India is the Indian subsidiary of Mapple Inc. through which it markets and sells its products in India. XPhone and Sintel are leading mobile service providers in India, jointly having more than 30 crore Indian subscribers that account for almost 52% market share in the GSM market. In total, there are around 20 service providers in India but none of them individually holds more than 30% of the total market share.

Particular models of iPhones – iPhone 3G and iPhone 3GS, were manufactured by Mapple Inc., launched in India during August 2008 and March 2010, respectively. During the fiscal year, 2010, worldwide sales of iPhones were 73.5 million.

Mobile services in India can be offered through two competing technologies i.e. GSM and CDMA and that, SIM cards of each of these cellular services are compatible only with those handsets which deploy their respective technologies and thus not able to substitution. iPhones are based on GSM technology. Handsets can be broadly classified as smartphones and featured phones. While acknowledging that iPhone is a unique product, there are certain smartphones offered by other brands such as Nokia, Blackberry, and Samsung that have advanced features and which could be considered as substitutes for the iPhone.

Mapple Inc. and Mapple India entered into some exclusive contracts/agreements with XPhone and Sintel respectively, for the sale of iPhones in India, even prior to its launch. XPhone and Sintel are both, cellular data and GSM network service providers functioning in India. As a result of the agreements, XPhone and Sintel got exclusive selling rights for an undisclosed number of years. The iPhones sold by XPhone and Sintel came in the compulsorily locked form, thereby meaning, that the handset purchased from either of them shall work only on their respective networks and none other.

Mapple Inc. permitted iPhone users only those applications on their iPhones that have been approved by them and available through their own online application store namely 'App Store'.

Further, no other third-party applications can be run on iPhone unless the same has been approved by Mapple Inc. If however, the operating system of jail broken iPhone is upgraded, the iPhone gets re-locked and all the third-party applications are deleted by the servers of Mapple Inc. permanently. XPhone and Sintel refused to accept any iPhone for repairs at their authorized service centers if the same is not purchased from them. However, an unlocked iPhone can be purchased from abroad. Also, a consumer who has purchased a locked iPhone in India and has paid the unlocking fees is free to choose the network operator of his choice after unlocking the iPhone.

Out of the total market share for smartphones in India, Mapple India had a market share of 1.5% in the year 2008; less than 1% in 2009 and 2010 respectively, and 2.4% in 2011. Additionally, at the time of the launch of the iPhone in India, there were about 250 million GSM mobile subscribers which subsequently rose to about 600 million in the year 2011.

An allegation by Ms. Rekha:

Ms. Rekha was one of the biggest fans of iPhones. After it was launched in India, she purchased an iPhone but was extremely disappointed when she realized, that, there were so many restrictions for using such iPhone which did not appear, value for money. When she investigated more into this, she found out that Mapple India was taking undue advantage of the dominant position that it enjoyed in the market. She then approached the CCI, to file a complaint against such abuse, in violation of section 4 of the Competition Act, 2002. In her complaint, she made the following allegations -

Mapple India enjoys a dominant position in the relevant market for smartphones, both in India as well as internationally, as iPhone, being the largest selling smartphone in the world. The informant also averted that XPhone and Sintel jointly enjoyed a dominant position in the relevant market for GSM mobile telephony services in India. The informant further submitted that XPhone and Sintel have abused their dominant positions by imposing unfair conditions on the purchasers of Mapple iPhones.

Reply by Sintel to the report of CCI:

It fails to consider that any dispute in relation to a telecommunication service is actionable under the Telecom Regulatory Authority of India Act, 1997, and the Competition Act, 2002 cannot be invoked as the CCI does not have any jurisdiction on the matters of cellular service providers in India when TRAI is the regulatory body. The bundled offer was in compliance with the guidelines of TRAI.

The informant failed to make any averment of having purchased Mapple iPhone 3G/3GS to show that she had any interest in the matter and has the locus standi to file the information.

The informant also failed to state that she had purchased iPhone 3G and 3GS from the grey market in India or abroad and consequently it is inexplicable as to how she has a grievance in this regard.

Mapple iPhone 3GS is being sold since June 2011 without its network being locked. For this reason, the issue raised in the information filed by Ms. Rekha is infructuous. The practice of locking the network onto the Mapple iPhone, even though in accordance with international practice, has long been discontinued in India.

Reply by XPhone to the report of CCI:

The agreement was non-exclusive and iPhones were available in India through a number of other distributors/channels and XPhone, being a telecom service provider provided the best tariff plans to its customers and XPhone never imposed any restrictions on its customers with respect to using unlocked phones and therefore, there it can be said that there is no violation.

The tariff plans, as were provided to iPhone customers were the same and if not, even better than the normal plans offered to other subscribers. Further, the tariff plans, as approved by Mapple Inc. were filed with the TRAI in August 2008 and were in full compliance with the TRAI regulations. Additionally, it is important to note that, even if an iPhone specific plan was published, the customers always had complete freedom to choose from other plans which were not iPhone specific and rather the customer were spoilt for choice, given the range of plans available to them. Therefore, there is no question of XPhone, being discriminating with iPhone customers vis-à-vis its other customers.

The concept of "collective dominance" is not recognized under section 4 of the Competition Act. Both, Sintel and XPhone are separate legal entities, with no structural links and with completely different boards of directors and management. Therefore, the question of "collective dominance" does not arise.

iPhones are easily available in the open market and without any network locking. More importantly, even the iPhones bought through XPhone distribution channels were unlocked as and when a request was made after following the due process. Further, the TRAI's MNP (mobile number portability) regulations give a right to the customer to move from one service provider to another freely, and consequently, the same customer can unlock his phone without any hassle. These facts clearly indicate that the allegations in the information are mere speculations and should be dismissed outright.

Answer the following questions:

Multiple Choice Questions

1. The relevant market(s) that the Director-General will identify while making the inquiry is/are
   I. Smart Phones in India
   II. GSM cellular service in India
   III. Smart Phones in America and India
   (a) Only I
   (b) I and II
   (c) II and III
   (d) I, II, and III

2. The iPhones sold by XPhone and Sintel came in the compulsorily locked form, thereby meaning, that the handset purchased from either of them shall work only on their respective networks and none other. This is in the nature of
   (a) Exclusive supply agreement
   (b) Horizontal agreement
   (c) Tie in agreement
   (d) Refusal to deal
3. Whether the contention of Sintel that CCI does not have jurisdiction on the matters of cellular service providers in India when TRAI is the regulatory body is correct?
   (a) Yes, TRAI has sole jurisdiction as the industry regulator, CCI does not have jurisdiction

(b) No, both have the jurisdiction; but TRAI can supersede and has primacy being industry regulator over CCI.
(c) No, both are special Acts and primacy have to be given to the respective objectives of both the regulators under their respective statutes.
(d) Can't say, as information on TRAI regulations is not provided.

4. Assuming that iPhone is not purchased by Miss Rekha from the Mapple store. Can she file a case, in the forum under the Competition Act 2002?
(a) No, as Ms. Rekha has purchased iPhone from the grey market i.e. through distributors and thus, has no right to file a case
(b) No, as Ms. Rekha has not suffered any loss due to tie-up agreement made by Mapple India with XPhone and Sintel respectively
(c) Yes, as Ms. Rekha has used the iPhone and availed the cellular services, so she indirectly gets affected
(d) Yes, not only Ms. Rekha but any person can file such a case

5. The chairperson and other members of the CCI office shall be appointed by:
(a) Central Government
(b) Relevant State Government
(c) High Court
(d) Central Government and the selection committee

Descriptive Questions

6. Whether there can be a case of abuse of dominant position against Mapple India, XPhone, and Sintel respectively?

7. Is there an appreciable adverse effect on competition due to the agreement made by Mapple India with XPhone and Sintel respectively?

8. Briefly states the duties of the CCI and the orders that can be passed by it after the establishment of infringement of section 3 or section 4 respectively?

ANSWERS TO CASE STUDY 4

1. (b) I and II

2. (c) Tie in agreement

3. (c) No, both are special Acts and primacy has to be given to the respective objectives of both the regulators under their respective statutes
The honorable apex court in the Civil Appeal no. 11843 of 2017 **(CCI vs Bharti Airtel Ltd)** recognised that the TRAI Act and the Competition Act are both special Acts and primacy has to be given to the respective objectives of both the regulators under their respective statutes. CCI's jurisdiction is not excluded by the presence of sectoral regulators and to that end, the CCI enjoys primacy with respect to issues of competition law.

4. (c) Yes, as Ms. Rekha has used the iPhone and availed the cellular services, so she indirectly gets affected

5. (a) Central Government

6. Legal Position: As per section 19(4) of the Competition Act 2002, the Commission (CCI) shall, while inquiring whether an enterprise enjoys a dominant position or not, have due regard to all or any of the following factors, namely:—
a. market share of the enterprise;
b. size and resources of the enterprise;
c. size and importance of the competitors;
d. economic power of the enterprise including commercial advantages over competitors;
e. vertical integration of the enterprises or sale or service network of such enterprises;
f. dependence of consumers on the enterprise;
g. monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;
h. entry barriers including barriers such as regulatory barriers, financial risk, the high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;
i. countervailing buying power;
j. market structure and size of the market;
k. social obligations and social costs
l. relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;
m. any other factor which the Commission may consider relevant for the inquiry.

The dominant position has been defined under explanation (a) to Sec 4 as a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to operate independently of competitive forces prevailing in the relevant market; or affect its competitors or consumers or the relevant market in its favour.

Analysis of the case

Mapple India had a market share of 1.5% in the year 2008; less than 1% in 2009, and 2010 respectively and 2.4% in 2011. Prima facie, these percentages of market share don't suggest anything that tantamounts to the existence of dominance.

XPhone and Sintel are leading mobile service providers in India, jointly having more than 30 crore Indian subscribers that account for almost 52% market share in the GSM market. As regards the dominance of XPhone and Sintel in the relevant market, since both are two separate entities without the evidence of having any horizontal agreement or cartelization between them that could be deemed as anti-competitive. Hence, on the basis of section 19(4) conditions that neither Sintel nor XPhone, individually, have any adequate market power so as to be deemed dominant.

Also, the argument that XPhone and Sintel hold nearly 52% of the market share in the GSM services in India cannot be accepted for the fact that they are horizontal competitors who fight for greater market share. Moreover, there is no allegation, *qua* these OPs that they have indulged in anti-competitive conduct among themselves for a common cause.

Conclusion

Thus, it can be concluded that since dominance does not get

established, there can be no case for abuse of dominance against all the three aforesaid entities under Section 4 of the Act.

7. According to Section 3(1) of the Act, "No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India".

   Section 3(4) of the Act, highlights anti-competitive agreements between vertically related enterprise as "Any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including —
   (a) tie-in arrangement;
   (b) exclusive supply agreement;
   (c) exclusive distribution agreement;
   (d) refusal to deal;
   (e) resale price maintenance,

   shall be an agreement in contravention of sub-section (1) if such agreement causes or is likely to cause an appreciable adverse effect on competition in India".

   Further, what constitutes appreciable adverse effect on competition has been provided for in Section 19(3) of the Act.

   In the above case, some kind of 'tie-in arrangement' can be seen which has an adverse implication on the purchaser of iPhones in terms of their ability to choose and switch between various cellular service providers and data plans. However, none of following - Mapple India / Sintel / XPhone, have a dominant position in their respective market, and that there has been no intentions and evidence to show that the market has been foreclosed to competitors or that entry-barriers have been erected for new entrants in any of the markets by any of the opposite parties. Mapple India had a share of less than 3% in the market of smartphones during the period 2008-11. Furthermore, the share of GSM subscribers using Mapple iPhone to total GSM subscribers in India is minuscule (less than 0.1%). No operator has more than 30% market share, in an otherwise competitive mobile network service market. As none of the impugned operators, (XPhone / Sintel) have market-share exceeding 30%, that smartphone market in India is less than a tenth of the entire handset market, and that Mapple iPhone has less than 3% share in the smartphone market in India, it is highly improbable that there would be an AAEC in the Indian market for mobile phones.

   Moreover, the lock-in arrangement of the iPhone to a particular network was only for a specific period and not perpetual, a fact known to prospective customers. It is difficult to construe consumer harm from entering into a 'tie-in arrangement' by the horizontally related enterprises. It is observed that there is no restriction on consumers to use the network services of XPhone and Sintel to the extent that the network services can be availed on any mobile handset, even an unlocked iPhone purchased from abroad. Also, a consumer who has purchased a locked iPhone in India and paid the unlocking fees is free to choose the network operator of his choice.

   Also, there is no evidence to show that entry barriers have been created for new entrants in the markets i.e. in the smartphone market and mobile services market by any of the impugned parties. Similarly, existing competitors have not been driven out from the market, or that the market itself has been foreclosed. Hence, the belief that the tie-in arrangement has caused serious harm appears untrue. Hence, there appears no appreciable adverse effect on competition due to agreement by Mapple India with XPhone and Sintel respectively.

8. As per section 18 of the Competition Act 2002, the duties of the Commission are as follows:
   (a) To eliminate practices having an adverse effect on competition,
   (b) To promote and sustain competition in markets in India,
   (c) To protect the interests of consumers and
   (d) To ensure freedom of trade carried on by other participants in markets in India.

   As per section 27 of the Competition Act 2002, where after an inquiry under section 19 regarding alleged contravention of entering into an anti-competitive agreement or abuse of dominance as per procedure detailed in section 26, if Commission find the allegation true and contravention of section 3(1) or 4(1) respectively, it may pass all or any of the following orders-

   Cease and desist order - direct any enterprise or association of enterprises or person or association of persons, as the case may be, involved in such agreement, or abuse of dominant position, to discontinue and not to re-enter such agreement or discontinue such abuse of dominant position, as the case may be.

   Impose penalty - as it may deem fit which shall be not more than ten percent of the average of the turnover for the last three preceding financial years, upon each of such person or enterprises which are parties to such agreements or abuse.

   Modification of the terms of such agreements - Agreements shall stand modified to the extent and in the manner as may be specified in the order by the Commission;

   To abide - Which direct the enterprises concerned to abide by such other orders as the commission may pass and comply with the directions, including payment of costs if any.

   Such other order or issue such directions as it may deem fit.

   In case any agreement referred to in section 3 has been entered into by a cartel, the Commission may impose upon each producer, seller, distributor, trader, or service provider included in that cartel, a penalty of up to three times of its profit for each year of the continuance of such agreement or ten percent of its turnover for each year of the continuance of such agreement, whichever is higher.

FINAL (NEW) ELECTIVE PAPER 6E: GLOBAL FINANCIAL REPORTING STANDARDS

The objective of this elective paper is to develop an understanding of the key concepts and principles of International Financial Reporting Standards and to acquire the ability to apply such knowledge to address issues and make computations in practical case scenarios.

In a pursuit to provide quality academic inputs to the students to help them in grasping the intricate aspects of the subject and practising the case studies, the Board of studies has decided to bring forth a crisp and concise capsule. The four capsules of Final Paper 1 Financial Reporting published in July, 2018, May, 2019, August, 2019 and October, 2019 are also relevant for this paper. For a comprehensive revision, students should refer to these capsules along with the amendments notified after their release, if any. However, those capsules should be read with reference to IFRS. Also students are advised to refer the announcement webhosted on the website at the link https://resource.cdn.icai.org/58128bos47461.pdf for understanding the applicability of IFRS in this paper.

In this Journal, we have provided three case studies on IFRS for practice purpose. Each case study deals with more than one IFRS. These case studies should be solved under examination conditions to evaluate your understanding and preparation level.

GFRS CASE STUDY 1

Buildwell Ltd. is a diversified business group operating in multiple business segments across Europe, United States and Asia Pacific. It maintains its books of accounts and publishes its annual consolidated financial statements as per under International Financial Reporting Standards.

The Central Finance team has been working on closing the books of accounts and generating consolidated financial statements for the year ended 31st March 2019. You are the Finance Controller and your assistants want your views on the follwing transactions for finalization of financial statements .

On 1 April 2018, Buildwell Ltd. completed the manufacture of some inventory at a total cost of ₹ 8,00,000. In order to be suitable for sale in the ordinary course of business, the completed inventory needed to be stored in controlled conditions for a two-year period. The inventory is expected to sell for ₹ 12,00,000 after the two-year storage period. On the same day, Buildwell Ltd. sold the inventory to Black Ltd., a bank for ₹ 8,10,000. For this sale, Black Ltd. charged Buildwell Ltd. an administration fee of ₹ 10,000. Buildwell Ltd. retained physical custody of the inventory and ensured that the inventory is stored in the appropriate conditions.

As per the agreement with Black Ltd., Buildwell Ltd. would indemnify Black Ltd against any losses caused by theft or inappropriate storage of the inventory. Buildwell Ltd. has the option to repurchase the inventory on 31 March 2020 for ₹ 9,33,120. On 1 April 2018, Black Ltd .would have required an annual return of 8% on loans made to customers such as Buildwell Ltd.

On 1 April 2017, Buildwell Ltd. had granted share appreciation rights to 200 senior executives. Each executive will receive 2,000 rights on 31 March 2020 provided he or she continues to be employed by Buildwell Ltd. on 31 March 2020

On 1 April 2017, the directors estimated that all the executives would remain employed by Buildwell Ltd. for the three-year period ending on 31 March 2020. However, 10 executives left in the year ended 31 March 2018. On 31 March 2018, the directors believed that a further 10 executives would leave in the following two years.

Five executives actually left in the year ended 31 March 2019 and the directors now believe that seven more directors will leave in the year ended 31 March 2020. Since 1 April 2017, the fair value of the share appreciation rights has fluctuated as follows:

Date	Fair value of one right ₹
1 April 2017	1.60
31 March 2018	1.80
31 March 2019	1.74

One of the directors of Buildwell Ltd., Mr. Ben Jones has informed Central Finance team that on 1 January 2019, his spouse acquired a controlling interest in one of Buildwell Ltd.'s major suppliers, Candour Ltd.

Mr. Jones seemed to think that this would have implications on the financial statements of Buildwell Ltd. However, your assistant in Central Finance team is not clear about its implications/ treatment while finalizing the financial statements.

Buildwell Ltd. has been purchasing goods from Candour Ltd. ₹ 1.5 million per month of the year ended 31 March 2019. As per the financial statements of Buildwell Ltd., this is a significant amount. While checking all the purchase transactions it was found that all the purchases from Candour Ltd. were made at normal market rates.

Buildwell Ltd. intends to open a new retail store under its Retail division at a new location in the next few weeks. As per the financial records of the Company, a substantial sum of money has been spent on a series of television advertisements to promote this new store.

Buildwell Ltd. paid for advertisements costing ₹ 8,00,000 before 31 March 2019 out of which ₹ 5,00,000 relates to advertisements shown before 31 March 2019 and ₹ 3,00,000 to advertisements shown in April 2019. Since 31 March 2019, Buildwell Ltd. has paid ₹ 4,00,000 for further advertisements.

The assistant of Central Finance team felt that all these expenses should be written off as expenses in the year ended 31 March 2019. While going through the profitability projections of the Division presented to the Board, it becomes evident that a charge of ₹ 1.2 million would adversely affect the profitability against 2019 projected profits.

In your weekly finance meeting, one of your new assistants, a newly qualified Chartered Accountant says that these costs can be carried forward as intangible assets. On getting this idea you connect with the Marketing Director and he shares with you the market research report related to this store. According to the market research report, the new store is supposed to be highly successful.

On 1 April 2018, Buildwell Ltd. had also leased a machine from Donovan Ltd. on a three-year lease. The expected future economic life of the machine on 1 April 2018 was eight years. If the machine breaks down, then under the terms of the lease, Donovan Ltd. would be required to repair the machine or provide a replacement.

Donovan Ltd. agreed to allow Buildwell Ltd. to use the machine for the first six months of the lease without the payment of any rental as an incentive to Buildwell Ltd. to sign the lease agreement. After this initial period, lease rentals of ₹ 2.10,000 were payable six-monthly in arrears, the first payment falling due on 31 March 2019.

On 1 June 2018, Buildwell Ltd. decided to dispose of the business and current and non-current assets of one of its divisions

related to Speciality chemicals business which it had acquired several years ago. This disposal does not involve Buildwell Ltd. withdrawing from a particular market sector. The carrying values on 1 June 2018 of the assets to be disposed of were as follows:

Particulars	₹ Million
Goodwill	10.0
Property, Plant and Equipment	20.0
Patents and trademarks	8.0
Inventories	15.0
Trade Receivables	10.0

None of the assets of the business had suffered impairment as at 1 June 2018. At that date the inventories and trade receivables of the business were already stated at no more than their recoverable amounts.

Buildwell Ltd. offered the business for sale at a price of ₹ 46.5 million, which was considered to be reasonably achievable. Buildwell Ltd. estimated that the direct costs of selling the business would be ₹ 5,00,000. These estimates have not changed since 1 June 2018 and Buildwell Ltd. estimates that the business will be sold by 31 March 2019 at the latest.

One of the subsidiaries of Buildwell Ltd. submitted to Central Finance team its Summarized Statement of Profit or Loss and Statement of Financial Position.

Summarized Statement of Profit or Loss

Particulars		Amount (₹)
Net sales		2,52,00,000
Less:	Cash cost of sales	(1,92,00,000)
	Depreciation	(6,00,000)
	Salaries & wages	(24,00,000)
	Operating expenses	(14,00,000)
	Provision for taxation	(8,80,000)
Net Operating Profit		7,20,000
Non-recurring income – profit on sale of equipment		1,20,000
		8,40,000
Retained earnings and profit brought forward		15,18,000
		23,58,000
Dividends declared and paid during the year		(7,20,000)
Profit & loss balance as on 31st March 2019		16,38,000

Summarized Statement of Financial Position

Assets	31st March 2018	31st March 2019
Non Current Assets		
Property, Plant and Equipment:		
Land	4,80,000	9,60,000
Buildings and Equipment	36,00,000	57,60,000
Current Assets		
Cash	6,00,000	7,20,000
Inventories	16,80,000	18,60,000
Trade Receivables	26,40,000	9,60,000
Advances	78,000	90,000
Total Assets	90,78,000	1,03,50,000
Liabilities & Equity		
Share capital	36,00,000	44,40,000
Surplus in profit & loss	15,18,000	16,38,000
Trade Payables	24,00,000	23,40,000
Outstanding expenses	2,40,000	4,80,000
Income tax payable	1,20,000	1,32,000
Accumulated	12,00,000	13,20,000
Total	90,78,000	1,03,50,000

The original cost of equipment sold during the year 2018-2019 was ₹ 7,20,000.

Analyze the transactions mentioned above and show the treatment in line with relevant IFRS .

I. Multiple Choice Questions

1 Calculate the current liability of leased machine from Donovan Ltd to be shown in the Statement of Financial Position as at 31 March 2019.
(a) ₹ 70,000
(b) ₹ 1,40,000
(c) ₹ 3,50,000
(d) ₹ 4,20,000

2. Compute the value of Speciality chemical division's Goodwill at the date of classification after re-measurement.
(a) ₹ 7.3 million
(b) ₹ 10 Million
(c) ₹ Nil
(d) ₹ 8 million

3. Calculate the closing balance of Speciality chemical division's asset – Property, Plant and Equipment at the period end.
(a) ₹ 21 million
(b) ₹ 17.36 million
(c) ₹ 6 million
(d) ₹ 15 million

4. Suppose financial statements of Buildwell Ltd. included an investment in associate at ₹ 66,00,000 in its consolidated statement of financial position at 31 March 2018. At 31 March 2019, the investment in associate had increased to ₹ 67,50,000. Buildwell Ltd.'s pre-tax share of profit in the associate was ₹ 4,20,000, with a related tax charge of ₹ 1,80,000. The net amount was included in the consolidated income statement for the year ended 31 March 2019.
There were no impairments to the investment in associate, or acquisitions or disposals of shares during the financial year.
What is the amount of the cash flow related to investment in associate for inclusion in the Consolidated Statement of cash flows for the year ended 31 March 2019?
(a) Cash inflow of ₹ 90,000
(b) Cash inflow of ₹ 2,40,000
(c) Cash outflow of ₹ 90,000
(d) Cash inflow of ₹ 4,20,000

5. Buildwell Ltd.'s another subsidiary reported net income of ₹ 25 million, which equals the company's comprehensive income. The company has no outstanding debt. Using the following information from the comprehensive statement of financial position (₹ in millions), what cashflow should the Buildwell Ltd.'s subsidiary report, as financing activity in the statement of cash flows?

Extract of Statement of Financial Position

	31.03.2018 (₹)	31.03.2019 (₹)
Equity share capital	100	100
Further issue of equity shares	100	140
Retained earnings	100	115

	31.03.2018 (₹)	31.03.2019 (₹)
Total shareholders' equity	300	357

(a) Issuance of equity shares ₹ 240 million; dividends paid ₹ 10 million
(b) Issuance of equity shares ₹ 100 million; dividends paid ₹ 10 million
(c) Issuance of equity shares ₹ 140 million; dividends paid ₹ 10 million
(d) Issuance of equity shares ₹ 40 million; dividends paid ₹ 10 million

II. Descriptive Questions

6. With respect to 'sale of inventory by Buildwell Ltd. to Black Ltd', how much amount should be recognized in the Statement of profit or loss and Statement of financial position for the year ended 31 March 2019. Also show the classification of calculated amount as current or non-current in the Statement of financial position.
7. With respect to 'Grant of share appreciation rights by Buildwell Ltd. to its executives', how much amount should be recognized in the Statement of profit or loss and Statement of financial position for the year ended 31 March 2019. Also show the classification of calculated amount as current or non-current in the Statement of financial position.
8. How the effect of acquisition of controlling interest in Candour Ltd. by Mr. Ben Jones is to be reflected in the financial statements for the year ending 31 March 2019.
9. What would be the treatment of expenditure incurred by Buildwell Ltd. against the advertisements or opening a new retail store?
10 Work out a cash flow statement for the year ended 31 March 2019.

ANSWER TO CASE STUDY 1

I. Answers to Multiple Choice Questions

1 Option (a)

Justification:

In accordance with the principles of IFRS 16 – Leases – the lease of the machine is an operating lease because the risks and rewards of ownership of the machine remain with Donovan Ltd. The lease is for only three years of the eight-year life and Donovan Ltd is responsible for breakdowns, etc.

Therefore, Buildwell Ltd will recognize lease rentals as an expense in the statement of profit or loss. IFRS 16 stipulates that this should normally be done on a straight-line basis.

The total lease rentals payable over the whole lease term are ₹ 10,50,000 (₹ 2,10,000 x 5). Therefore the charge for the current year is ₹ 3,50,000 (₹ 10,50,000 x 1/3).

The difference between the charge for the period (₹ 3,50,000) and the rent actually paid (₹ 2,10,000) will be shown as a liability in the statement of financial position at 31 March 2019. This amount will be ₹ 1,40,000.

₹ 70,000 (2 x ₹ 2,10, 000 – ₹ 3,50, 000) of this liability will be current and ₹ 70,000 non-current.

2 Option (c)

3 Option (d)

Justification for 2 & 3:

Pursuant to the provisions of *IFRS 5, Non-current Assets Held for Sale and Discontinued Operations* the business would be regarded as held for sale from 1 June 2018. The held for sale criteria apply because the business is being actively marketed at a reasonable price and the sale is expected to be completed within one year of the date of classification. Given this classification, IFRS 5 requires that the assets be separately classified under current assets in the statement of financial position. No further depreciation would be charged on these assets.

The assets will be measured at the lower of their current carrying amounts at the date of classification and their fair value less costs to sell. In this case, the total carrying amount after re-measurement will be ₹ 46 million (₹ 46.5 million – ₹ 0.5 million).

The impairment loss of ₹ 17 million (₹ 63 million – ₹ 46 million) will first be allocated to goodwill taking its carrying amount to nil.

None of the remaining impairment loss will be allocated to inventories or trade receivables since their recoverable amounts are at least equal to their existing carrying amounts.

The remaining impairment loss of ₹ 7 million (₹ 17 million – ₹ 10 million) will be allocated to the property, plant and equipment and the patents on a pro-rata basis.

The closing carrying amounts of the property, plant and equipment and the patents will be ₹ 15 million and ₹ 6 million respectively.

4 Option (a)

Justification:

Statement of investment in associates

Particulars	Amount (₹)
Opening balance of investment in Associate	66,00,000
Add: Share of profit in Associate [4,20,000-1,80,000]	2,40,000
Less: Cash flow (dividend paid by Associate) (balancing figure)	(90,000)
Closing balance of investment in Associate	67,50,000

5 Option (d)

Justification:

Issuance of equity shares including further issue of equity shares (240 – 200) = ₹ 40 million

Dividends paid worked out as under:

Particulars	₹ in million
Opening retained earnings	100
Add: Net income	25
Less: Cash dividend paid (balancing figure)	(10)
Closing retained earnings	115

Hence, cash dividend paid ₹ 10 million.

II. Answers to Descriptive Questions

6 The transaction related to revenue is governed by the principles of IFRS 15 – *Revenue from contracts with customers.*

One of the conditions imposed by IFRS 15 for recognizing the revenue from the sale of goods is that the control of ownership has to be passed to the 'buyer'.

Since Buildwell Ltd. continue the custody of the goods and the fact that it has the option to repurchase it on 31 March 2020 makes the probability high that the control is to be continued with Buildwell Ltd. only. Accordingly, based on the circumstances of the case, it is apparent that this is a financing transaction.

Therefore, the goods will remain in inventory at cost – being their manufactured cost of ₹ 8,00,000 plus one year's storage costs (or their net realisable value, whichever is lower). The net proceeds of ₹ 8,00,000, being a financial liability, is accounted for under the principles of IFRS 9 'Financial Instruments'.

Under IFRS 9, most financial liabilities are measured at amortized cost using the effective interest method. The finance cost for the period would be ₹ 64,000 (₹ 8,00,000 x 8%). This would be shown in the Statement of profit or loss.

The closing financial liability would be ₹ 8,64,000 (₹ 8,00,000 + ₹ 64,000). This would be shown as a current liability since the 'repurchase' occurs on 31 March 2020 – 12 months after the reporting date.

7 Under the principles of IFRS 2 – Share-based Payment – granting of share appreciation rights (SARs) to executives is a cash-settled share-based payment. Cash-settled share-based payments create a liability in the statement of the financial position as they will ultimately be redeemed in cash. The liability is recognised based on the fair value of the SAR at the reporting date and the expected number of rights which will vest. Under the principles of IFRS 2, this liability is built up over the vesting period.

Therefore the liability at 31 March 2019 would be ₹ 4,12,960 (2000 x (200 – 10 – 5 – 7) x ₹ 1.74 x 2/3).

Since the rights are not exercisable until after 31 March 2020, the liability would be shown as a non-current liability.

The charge to profit or loss would be ₹ 1,96,960 ie the difference between the closing liability (₹ 4,12,960) and the opening liability (₹ 2,16,000). This charge would be shown as an operating cost.

Note: The liability at 31 March 2018 would have been ₹ 2,16,000 (2,000 x (200 – 10 – 10) x ₹ 1.80 x 1/3).

8 In accordance with *IAS 24 'Related Party Disclosures'*, effective 1 January 2019, Candour Ltd. would be regarded as a related party of Buildwell Ltd. This is because Candour Ltd. is controlled by the close family member of one of Buildwell Ltd.'s key management personnel (Refer para 9 of IAS 24).

This means that from 1 January 2019, the purchases from Candour Ltd. would be regarded as related party transactions.

As per the provisions of para 18 of IAS 24, transactions with related parties need to be disclosed in the notes to the financial statements, together with the nature of the relationship. It is irrelevant whether or not these transactions are at normal market rates. As per para 23 of the standards, disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.

The disclosure is required to state that Candour Ltd., controlled by the spouse of a director, supplied goods to the value of ₹ 4.5 million (3 x ₹ 1.5 million) in the current accounting period.

9 Under *IAS 38* 'Intangible Assets', intangible assets can only be recognised if they are identifiable and have a cost which can be reliably measured.

These criteria are very difficult to satisfy for internally developed intangibles.

For these reasons, IAS 38 specifically prohibits recognizing advertising expenditure as an intangible asset.

The fact that how successful the store is likely to be, does not affect this prohibition.

Therefore, your assistant in Central Finance team is correct in principle that such costs should be recognised as an expense.

However, the costs would be recognised on an accruals basis based on the satisfaction of the performance obligation.

Therefore, out of ₹ 8,00,000 of the advertisements paid for before 31 March 2019, ₹ 5,00,000 would be recognised as an expense and ₹ 3,00,000 as a pre-payment in the year ended 31 March 2019.

₹ 4,00,000 of advertisement cost paid since 31 March 2019 would be charged as expenses in the year ended 31 March 2020.

10 Cash Flow statement for the year ended 31st March 2019

(Indirect method)

Particulars	₹	₹
Cash flow from operating activities:		
Net Profit before taxes and extraordinary items (7,20,000+8,80,000)	16,00,000	
Add: Depreciation	6,00,000	
Operating profit before working capital changes	22,00,000	
Increase in inventories	(1,80,000)	
Decrease in debtors	16,80,000	
Advances	(12,000)	
Decrease in sundry creditors	(60,000)	
Increase in outstanding expenses	2,40,000	
Cash generated from operations	38,68,000	
Less: Income tax paid (Refer W.N.4)	(8,68,000)	
Net cash from operations		30,00,000
Cash from investing activities:		
Purchase of land	(4,80,000)	
Purchase of building & equipment (Refer W.N.2)	(28,80,000)	
Sale of equipment (Refer W.N.3)	3,60,000	
Net cash used for investment activities		(30,00,000)
Cash flows from financing activities:		
Issue of share capital	8,40,000	
Dividends paid	(7,20,000)	
Net cash from financing activities:		1,20,000
Net increase in cash and cash equivalents		1,20,000
Cash and cash equivalents at the beginning		6,00,000
Cash and cash equivalents at the end		7,20,000

Working Notes:

1. Building & Equipment Account

Particulars	₹	Particulars	₹
To Balance b/d	36,00,000	By Sale of assets	7,20,000
To Cash/bank (purchases)(bal fig)	28,80,000	By Balance c/d	57,60,000
	64,80,000		64,80,000

2. Building & Equipment Accumulated Depreciation Account

Particulars	₹	Particulars	₹
To Sale of asset (acc. depreciation)	4,80,000	By Balance b/d	12,00,000
To Balance c/d	13,20,000	By Profit & Loss A/c (provisional)	6,00,000
	18,00,000		18,00,000

3. Computation of sale price of Equipment

Particulars	₹
Original cost	7,20,000
Less Accumulated Depreciation	(4,80,000)
Net cost	2,40,000
Profit on sale of assets	1,20,000
Sale proceeds from sale of assets	3,60,000

4. (Provision for tax Account)

Particulars	₹	Particulars	₹
To Bank A/c	8,68,000	By Balance b/d	1,20,000
To Balance c/d	1,32,000	By Profit & Loss A/c (provisional)	8,80,000
	10,00,000		10,00,000

GFRS CASE STUDY 2

Bean Ltd is a diversified group having multiple business interests in many countries. The group publishes its financial statements as per International Financial Reporting Standards.

During closure of books for the year ended 31st March 2019, certain transactions were highlighted by the group finance team. The Finance Controller is confused on the treatment of these transactions under International Financial Reporting Standards and needs your assistance.

On 1 October 2017, Bean Ltd purchased 8 million of Charlie Ltd.'s 12 million equity shares. The acquisition was financed by a cash payment of ₹ 2.00 per share. Out of this ₹ 2 per share, ₹ 1.20 per share being payable on 1 October 2017 and ₹ 0.80 being payable on 30 September 2018. Any discounting calculations should be performed using a cost of capital of 8% per annum.

A share exchange took place of 1 equity share in Bean Ltd for every 2 shares acquired in Charlie Ltd. The market value of Charlie Ltd.'s share was ₹ 3.90 per share on 1 October 2017. The market value of Bean Ltd.'s per share was ₹ 4 on 1 October 2017 and ₹ 4.20 on 31 March 2018.

On 30 September 2018, Bean Ltd further issued 1 share for every 8 shares acquired in Charlie Ltd provided the profits after tax of Charlie Ltd exceeds ₹ 5 million. The fair value of this consideration on 1 October 2017 is 4 million. Estimates indicate that this share issue is likely to be made.

Bean Ltd incurred acquisition costs of ₹ 6,00,000. ₹ 3,50,000 of these costs were external due diligence costs, ₹ 1,00,000 were spent on Bean Ltd.'s best estimate of management time spent in negotiating the acquisition and ₹ 1,50,000 were costs incurred in connection with the issue of Bean Ltd's shares.

The directors of Bean Ltd carried out a fair value exercise on 1 October 2017 and the following matters emerged:

- The net assets of Charlie Ltd that were recognized in Charlie Ltd's own financial statements were ₹ 30 million based on their carrying values in the individual financial statements of Charlie Ltd.
- On 1 October 2017, the carrying value of Charlie Ltd's freehold property was ₹ 15 million. The property had been purchased on 1 October 2007 for ₹ 17.5 million and the building element of the property (allocated cost ₹ 10 million) was being depreciated over its estimated useful economic life of 40 years.
- On 1 October 2017, the market value of the property was ₹ 22 million, of which ₹ 12 million related to the buildings element. The original estimate of the useful economic life of the buildings is still considered valid.
- On 1 October 2017, Charlie Ltd was engaged in contracts with three different customers under which they supplied goods to each customer for a five year period from 1 October 2017. The directors of Bean Ltd believe that this creates an intangible asset with a fair value of ₹ 7.5 million.
- In addition the directors of Bean Ltd believe that the fair value of the assembled workforce of Charlie Ltd creates an intangible asset with a fair value of ₹ 15 million. The average remaining working life of the employees of Charlie Ltd at 1 October 2017 is 15 years. None of these intangible assets has been recognised in the individual financial statements of Charlie Ltd.
- At 1 October 2017 Charlie Ltd was engaged in a legal dispute with a customer. The directors of Charlie Ltd consider that the case can be successfully defended and have made no provision for legal costs in its financial statements. The directors of Bean Ltd estimated that the fair value of the claim at 1 October 2017 was ₹ 6,00,000. Events since 1 October 2017 have reduced this estimate to ₹ 5,00,000 by 31 March 2018.

Due to the acquisition of Charlie Ltd the directors of Bean Ltd intend to reorganise the group, starting in June 2019. The estimated cost of this reorganisation is ₹ 20 million.

For the year ended 31 March 2018, Charlie Ltd reported a post-tax profit of ₹ 6 million (accruing evenly over the period) and paid a dividend of ₹ 1.5 million on 31 December 2017 out of post-acquisition profits.

The retained earnings of Bean Ltd at 31 March 2018 were ₹ 18 million. This figure includes the dividend received from Charlie Ltd but does not include any other adjustments to its own earnings that are required as a result of the acquisition of Charlie Ltd.

The acquisition costs of ₹ 6,00,000 referred above have been charged to retained earnings by Bean Ltd. Bean Ltd has no subsidiaries other than Charlie Ltd and no associates or joint venture entities.

The goodwill on acquisition of Charlie Ltd had not suffered any impairment at 31 March 2018.

On 1 April 2018, Bean Ltd began joint construction of a pipeline with another investor. Bean Ltd and the other investor have signed a contract that provides for joint operation and ownership of the pipeline. All of the ongoing expenditure, comprising maintenance plus borrowing costs, was to be shared equally. The pipeline was completed and ready for use on 1 October 2018, at which date its estimated useful economic life was 20 years.

The pipeline was first used on 1 January 2019. The total cash cost of constructing the pipeline was ₹ 40 million. This cost was partly financed by a loan of ₹ 10 million taken out on 1 April 2018.The loan carries interest at an annual rate of 10% with interest payable in arrears on 31 March each year. Between 1 January 2019 and 31 March 2019, it was necessary to spend ₹ 400,000 on maintenance costs.

On 1 April 2018, Bean Ltd purchased some land for ₹ 10 million (including legal costs of ₹ 1 million) in order to construct a new factory. Construction work commenced on 1 May 2018. Bean Ltd incurred the following costs in connection with its construction:

- Preparation and leveling of the land – ₹ 3,00,000.
- Purchase of materials for the construction – ₹ 6.08 million in total.
- Employment costs of the construction workers – ₹ 2,00,000 per month.
- Overhead costs incurred directly on the construction of the factory – ₹ 1,00,000 per month.
- Ongoing overhead costs allocated to the construction project using Bean Ltd's normal overhead allocation model – ₹ 50,000 per month.
- Income received during the temporary use of the factory premises as a car park during the Construction period – ₹ 50,000.
- Costs of relocating employees to work at the new factory – ₹ 3,00,000.
- Costs of the opening ceremony on 31 January 2019 – ₹ 1,50,000.

The factory was completed on 30 November 2018 (which is considered as substantial period of time) and production began on 1 February 2019. The overall useful life of the factory building was estimated as 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building.

At the end of the 40-year period, Bean Ltd has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The directors estimate that the cost of demolition in 40 years' time (based on prices prevailing at that time) will be ₹ 20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of Re.1 payable in 40 years' time at an annual discount rate of 8% is 4.6 paise.

The construction of the factory was partly financed by a loan of ₹ 17.5 million taken out on 1 April 2018. The loan was at an annual rate of interest of 6%.

During the period 1 April 2018 to 31 August 2018 (when the loan proceeds had been fully utilised to finance the construction), Bean Ltd received investment income of ₹ 1,00,000 on the temporary investment of the proceeds.

On 1 April 2018, Bean Ltd raised loan finance from European investors. The investors subscribed for 50 million €1 loan notes at par. Bean Ltd incurred incremental issue costs of €1 million. Interest of €4 million is payable annually on 31 March, starting on 31 March 2019. The loan is repayable in € on 31 March 2028 at a premium and the effective annual interest rate implicit in the loan is 10%. The appropriate measurement basis for this loan is amortized cost. Bean Ltd uses INR as its functional currency.

Relevant exchange rates are as follows:

- 1 April 2018 – €1 = ₹ 82.00.
- 31 March 2019 – €1 = ₹ 85.00
- Average for year ended 31 March 2019 – €1 = ₹ 83.00

On 1 April 2017, Bean Ltd granted share options to 200 senior executives. The options will vest on 31st March 2020 subject to the following conditions:

- Each executive will be entitled to 1,000 options if the cumulative profit in the three-year period from 1 April 2017 to 31st March 2020 exceeds ₹ 30 million. If the cumulative profit for this period is between ₹ 35 million and ₹ 40 million, then 1,500 options will vest. If the cumulative profit for the period exceeds ₹ 40 million, then 2,000 options will vest.
- If an executive leaves during the three-year vesting period, then management would forfeit any rights of share options to those executives.
- Notwithstanding the above, no options will vest unless the share price at 31st March 2020 exceeds ₹ 5.

Details of the fair value of the shares and share options at relevant dates are as follows:

Date	Fair value of Bean Ltd.'s each share (₹)	Fair value of each option (₹)
1 April 2017	4.00	0.50
31 March 2018	4.00	0.60
31 March 2019	4.00	0.75

The estimate of the cumulative profit for the three-year period was revised each year as follows:

Date	Expected profit for the three-year period ₹ million
1 April 2017	32
31 March 2018	39
31 March 2019	45

On 1 April 2017, none of the senior executives were expected to leave in the three-year period from 1 April 2017 to 31 March 2020 and none left in the year ended 31 March 2018. However, 10 executives left unexpectedly on 31 December 2018. None of the other executives are expected to leave before 31 March 2020. Bean Ltd correctly reflected this arrangement in its financial statements for the year ended 31 March 2018.

I. Multiple choice questions

1. Computation of goodwill under full goodwill method follows:
   (a) Fair value of net assets on acquisition plus Fair value of consideration minus fair value of non-controlling interest
   (b) Fair value of consideration plus fair value of non-controlling interest minus fair value of net assets
   (c) Fair value of consideration plus fair value of non-controlling interest plus fair value of net assets on acquisition
   (d) Fair value of consideration minus fair value of non-controlling interest minus fair value of net assets.
2. At the end of the 40-year period, Bean Ltd. has a legally enforceable obligation to demolish the factory and restore the site to its original condition. Cost of demolition recognised as a provision would be:
   (a) ₹ 20.0 million
   (b) ₹ 9.2 million
   (c) ₹ 0.92 million
   (d) ₹ 10.0 million.
3. Pursuant to IAS 21, which of the following factors will not be used in determining the entity's functional currency?
   (a) The currency that primarily influences the prices at which goods and services are sold
   (b) The currency in which the costs of the entity are mainly denominated
   (c) The currency which is used mostly for international trading in that industry
   (d) The currency in which funds from financing are generated.
4. Calculate the closing balance of loan finance at period end which the Bean limited has raised from European investors.
   (a) ₹ 4,241.5 million
   (b) ₹ 4,141.7 million
   (c) ₹ 4,165.0 million
   (d) ₹ 4,084.7 million.
5. Calculate the exchange difference of loan finance from European investors to be recognized in profit or loss for the given period.
   (a) Gain-₹ 156.8 million
   (b) Loss-₹ 156.8 million
   (c) Loss-₹ 223.5 million
   (d) Gain-₹ 223.5 million.

II. Descriptive Questions

6 Compute the fair value of consideration related to acquisition of Charlie Ltd and thereon Compute the goodwill on acquisition of Charlie Ltd as initially measured at 1 October 2017.

7 Compute the balance of retained earnings that will be shown in the consolidated Statement of financial position of Bean Ltd at 31 March 2018.

8 Show treatment on Joint Arrangement with respect to borrowing cost, cost of asset, its depreciation and Statement of Profit or Loss for the year ending 31 March 2019.

9 Compute the carrying amount of the factory as at 31 March 2019, depreciation and carrying amount as at 31 March 2019.

10 Compute treatment related to share based payment to be included under Statement of Profit & Loss, comprehensive income and statement of financial position at 31 March 2019.

Note: Your figures should be supported by appropriate explanations and workings.

ANSWER TO CASE STUDY 2

Answers to Multiple Choice Questions

1 Option (b)

2 Option (c)

Justification:

Demolition cost recognised as a provision - Where an obligation must recognize as part of the initial cost.

The present value of Re.1 payable in 40 years' time at an annual discount rate of 8% is 4.6 paise. Hence, the working is as under:

USD 20 Million x 4.6/100 = ₹ 0.92 million

3 Option (c)

4 Option (a)

5 Option (b)

Justification for 4 & 5:

The initial measurement of the loan in € is €49 million (€50 million – €1 million).

The finance cost in € is €4•9 million (€49 million x 10%).

The closing balance of the loan in € is €49.9 million (€49 million + €4•9 million – €4 million).

IAS 21, 'The Effect of Changes in Foreign Exchange Rates', stipulates that foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized.

Therefore, the loan would initially be recorded at ₹ 4,018 million (€49 million x ₹ 82).

The finance cost would be recorded at an average rate for the period since it accrues over a period of time.

The finance cost would be ₹ 406.7 million (€4.9 million x ₹ 83).

The actual payment of interest would be recorded at ₹ 340 million (€4 million x ₹ 85).

The loan balance is a monetary item so it is translated at the rate of exchange at the reporting date. So the closing loan balance is ₹ 4,241.5 million (€49.9 million x ₹ 85).

The exchange differences that are created by this treatment are recognized in profit or loss.

In this case, the exchange difference is

((₹ 4,018 million + ₹ 406.7 million – ₹ 340 million) – ₹ 4,241.5 million) = ₹ 156.8 million. This exchange loss is taken to Statement of profit or loss.

Answers to Descriptive Questions

6. Statement of computation of original goodwill on acquisition of Charlie Ltd

Particulars	₹ in million
Fair value of consideration given (W.N.1)	35.88
Share of fair value of net assets acquired (8/12 x 43.9) (W2)	(29.27)
Goodwill	6,61

Working Notes:

1. Computation of purchase consideration

Particulars	₹ in million
Immediate cash payment – actual amount paid (8 million x ₹ 1.20)	**9.6**
Deferred cash payment – present value of actual amount payable (8 million x Re.0.80 x 0.9259)	**5.93**
Share exchange – 4 million shares issued at a market value of ₹ 4 per share (4 million x ₹ 4 per share)	**16.00**
Contingent consideration – included as share issue is probable. Present value is implied in the share price.	**4.00**
Acquisition costs – direct costs of the acquisition other than the costs of issuing shares	**0.35**
Total	**35.88**

2. Computation of fair value of net assets acquired

Particulars	₹ in million
As per financial statements of Charlie Ltd	**30.00**
Adjustment for property – Market value exceeds carrying value	**7.00**
Adjustment for customer relationships – an identifiable intangible asset with a measurable fair value	**7.50**
Adjustment for workforce – as per IAS 38, 'Intangible assets' assembled workforce fails the control test	**Nil**
Adjustment for re-organization – as per IFRS 3 'Business combinations' it must be treated as post acquisition items	**Nil**
Adjustment for contingency claim (fair value as on 1 October 2017)	**(0.60)**
Fair value of net assets acquired	**43.90**

7. Statement of computation of retained earnings as at 31st March 2018:

Particulars	₹ in million
Bean Ltd – as given	18.00
Interest charge on deferred cash consideration (5.93 x 8% x 6/12)	(0.2372)
Re organisation provision – Per IAS 37, Provisions, Contingent Liabilities and Contingent Assets- an intention is not an obligation	Nil
Add back acquisition costs – In accordance with IFRS 3, 350 included in cost of investment and 150 deducted from share premium	0.50
Total (A)	**18.2628**
Charlie Ltd (6.00 x 6/12) – only post-acquisition earnings included	3.00
Dividend paid out of post-acquisition profits	(1.50)
Extra depreciation on building (W.N.1))	(0.075)
Amortization of customer relationship asset : 7.5 x 1/5 x 6/1	(0.75)
Reduction in fair value of contingency claim	0.10
A post acquisition item	0.775
Total (B) (0.775 x 8/12)	0.517
Total consolidated retained earnings (A+B)	**18.78**

Working Note:

Statement showing excess depreciation on building at 31st March 2018

Particulars	₹ in million
New depreciation on revised value (12.00 x 1/30 x 6/12)	0.200
Depreciation charge on previous value (10.00 x 1/40 x 6/12)	(0.125)
Excess depreciation charge	0.075

8. As provided in IFRS 11 'Joint Arrangements' this is a joint arrangement, because two or more parties have joint control of the pipeline under a contractual arrangement.

The arrangement will be regarded as a joint operation because Bean Ltd and the other investor have rights to the assets and obligations for the liabilities of this joint arrangement.

This means that Bean Ltd and the other investor will each recognize 50% of the cost of constructing the asset in property, plant and equipment.

The borrowing cost incurred on constructing the pipeline should, under the principles of IAS 23, 'Borrowing Costs,'

be included as part of the cost of the asset for the period of construction.

In this case, the relevant *borrowing cost* to be included is ₹ 5,00,000 (₹ 1,00,00,000 x 10% x 6/12).

The total cost of the asset is ₹ 4,05,00,000 (₹ 4,00,00,000 + ₹ 5,00,000).

₹ 2,02,50,000 is included in the property, plant and equipment of Bean Ltd and the same amount in the property, plant and equipment of the other investor.

The depreciation charge for the year ended 31 March 2019 will therefore be ₹ 10,12,500 (₹ 4,05,00,000 x 1/20 x 6/12).

₹ 5,06,250 will be charged in the Statement of profit or loss of Bean Ltd and the same amount in the Statement of profit or loss of the other investor.

The other costs relating to the arrangement in the current year totaling ₹ 9,00,000 (finance cost for the second half year of ₹ 5,00,000 plus maintenance costs of ₹ 4,00,000) will be charged to the Statements of profit or loss of Bean Ltd and the other investor in equal proportions – ₹ 4,50,000 each.

9. Computation of the cost of the factory

Particulars	₹ in million
Purchase of land - both the purchase of the land and the associated legal costs are direct costs of constructing the factory	**10.00**
Preparation and leveling - A direct cost of constructing the factory	**0.300**
Cost of materials - A direct cost of constructing the factory	**6.08**
Employment costs of construction workers - A direct cost of constructing the factory for a seven-month period	**1.40**
Direct overhead costs - A direct cost of constructing the factory for a seven-month period	**0.70**
Allocated overhead costs - Not a direct cost of construction	**Nil**
Income from use as a car park - Not essential to the construction so recognised directly in profit or loss	**Nil**
Relocation costs - Not a direct cost of construction	**Nil**
Opening ceremony - Not a direct cost of construction	**Nil**
Finance costs - Capitalize the interest cost incurred in an eight-month period (purchase of land would not trigger off capitalization since land is not a qualifying asset. Infact, the construction started from 1 May 2018)	**0.6125**
Investment income on temporary investment of the loan proceeds - Must offset against the amount capitalized	**(0.10)**
Demolition cost recognised as a provision - Where an obligation must recognize as part of the initial cost	**0.92**
Total	**19.9125**

Computation of accumulated depreciation

Particulars	₹ in million
Total depreciable amount 9.9125 All of the net finance cost of 0.5125 (0.6125-0.10) has been allocated to the depreciable amount	
Depreciation of roof : 9.9125 x 30% x 1/20 x 4/12	0.04956
Depreciation of remainder : 9.9125 x 70% x 1/40 x 4/12	0.05782
Total depreciation	**0.10738**

Computation of carrying amount

Particulars	₹ in million
Total depreciable amount	19.9125
Depreciation	0.10738
Carrying amount	**19.80512**

10 In accordance with IFRS 2, 'Share based payment' amount included in Statement of financial position as at 31 March 2019

Particulars	₹ in million
Number of executives - Expected to continue till 31.3.2020	190 Nos
Options vesting for each executive - Used expected number based on latest estimates as a non-market vesting condition	2000
Impact of expected share price - This is a market-based vesting condition and is ignored for this purpose	**None**
Fair value of option - Used fair value on grant date as per IFRS 2	**₹ 0.50**
Proportion of vesting	**2/3**
Included in equity – (190 x 2,000 x ₹ 0.50 x 2/3)	**₹ 1,26,667**

Amount included in Statement of profit or loss and other comprehensive income for the year ended 31 March 2019

Particulars	₹ Amount
Cumulative amount recognised in equity at 31 March 2019	1,26,667
Amount recognised in previous years – (200 x 1,500 x ₹ 0.50 x 1/3)	(50,000)
Included in current year's profit or loss	**76,667**

GFRS CASE STUDY 3

RK Super Markets Ltd. owns a chain of retail stores across 16 different locations in the twin cities of Hyderabad and Secunderabad. For the year ended 31st March 2019, your firm of chartered accountants has been engaged for the stock audit assignment which comprises of the following:

(a) Physical stock take at all store locations

(b) Verification of inventory valuation reports submitted by each store-in-charge and approval of the same

(c) Report to management regarding the final inventory value as on 31st March 2019 and

(d) Report to the statutory auditors based on the final inventory valuation report after the changes as surfaced during the stock audit

A team of 32 articled assistants and four chartered accountants have been deployed by your firm to carry out the assignment. The physical stock take began at store location at 6 am and went on till 10 pm, as the management couldn't afford to close the stores for more than one working day. The assignment was executed well on the day of physical stock take and the team along with the CAs gathered for the queries and observations for the next 3 days.

Retail method of valuation is applied to most of the stock items except for the items mentioned below which have been valued on the basis of FIFO or Weighted Average Cost.

Following observations were made by the team:

Store No. E004

I - Expired items:

Personal care category – Hand wash packs containing 20 units each (15 packs) had an expiry date of February, 2019. Cost-to-company (CTC) of each pack (20 units each) is ₹ 1,200. The same has been valued as inventory at net realisable value (NRV) from the respective supplier with 2% more than the cost, because the supplier has an obligation to take back the expired stock.

The similar observation was made in the following stores which had the stock from the same lot:

Store No.	No. of packs
E001	14
S003	18
W002	**17**
N001	**11**
N002	**13**
N003	**09**

II – Quantity mismatch: (compiled across all the stores)

Item code	Category	Description	Reported Qty	Actual Qty	₹ Cost per UoM*
R-510101	Snacks	Biscuits	1,689 boxes	1,589 boxes	1,190
R-511012	Snacks	Namkeen	851 boxes	681 boxes	1,890
R-522104	Beverages	Coke	1,809 cases	1,691 cases	1,300
S-144109	Grains	Wheat	1851 gunny bags	1681 gunny bags	630
S-143118	Cooking Oil	Soyabean 5 Ltr	5,140 cans	5,014 cans	585
D-189107	Hygiene	Detergent Soap	2,018 boxes	1,973 boxes	705
D-125109	Hygiene	Dishwash Bars	1,619 boxes	1,508 boxes	647
D-119120	Hygiene	Sanitary Pads	1,819 boxes	1,718 boxes	1,200
P-121113	Kitchenware	NS Kadhai	561 units	516 units	329
P-713114	Baby care	Diapers	819 packs	759 packs	490

*Unit of measurement

III – Valuation policies and actual observations (compiled for each test case based on samples)

1. Stock held under safe custody for free items to be claimed by customers (on offers) have been valued at zero. Customers have a right to claim the free item within 14 days from date of invoice. If the time limit of 14-day exceeds, the claim is foregone by the customer. Majority of the free items require online registration by the buyers for participation in the contest conducted by the respective brand which needs to be done by the buyers within 3 days from the date of invoice.

   Observations:

   (a) Few items were found written "Not for sale. This item needs to be given free along with ……". The cost of such items was included in the list of miscellaneous goods with a value of ₹ 5.8 Lacs.

   (b) Few items under this category were found damaged. The replacement cost of such items would be ₹ 1.5 Lacs.

2. Grains and pulses are valued at cost on FIFO basis except for rice which is valued on weighted average cost basis.

   Observations:

   (a) Following discrepancies were observed in the valuation of rice –

Quantity (gunny bags)	Weighted avg. cost per Unit	Value of inventory as per WAC formula	Value of inventory as reported
156	₹ 719	1,12,164	1,25,174
107	₹ 926	99,082	1,02,182
101	₹ 1,139	1,15,039	1,29,017
114	₹ 2,619	2,98,566	3,19,105

   (b) Discrepancies pertaining to other grains and pulses were as follows:

Quantity (gunny bags)	Cost per Unit based on FIFO calculation	Value of inventory as per FIFO	Value of inventory as reported
162	₹ 2019	3,27,078	3,41,658
171	₹ 1630	2,78,730	2,94,975
139	₹ 2618	3,63,902	3,77,941
181	₹ 1325	2,39,825	2,58,649
152	₹ 2214	3,36,528	3,51,880

3. Snacks and Beverages are valued at weighted average cost.
   Observations:
   (a) Following discrepancies were noted in the valuation of snacks

Quantity (boxes)	Weighted avg. cost per box	Value of inventory as per WAC formula	Value of inventory as reported
166	₹ 703	1,16,698	1,20,018
167	₹ 653	1,09,051	1,13,727
171	₹ 813	1,39,023	1,42,443
169	₹ 809	1,36,721	1,40,101
170	₹ 715	1,21,550	1,24,270

   (b) Valuation of beverages also had the following deviations

Quantity (12-bottles pack)	Weighted avg. cost per pack	Value of inventory as per WAC formula	Value of inventory as reported
301	₹ 612	1,84,212	1,87,523
315	₹ 615	1,93,725	1,98,765
319	₹ 627	2,00,013	2,04,798
325	₹ 630	2,04,750	2,10,925
311	₹ 633	1,96,863	2,03,705

IV – Other observations:

Two items of inventory belong to the own brand of the company. They get the items manufactured from various housewives on per unit cost basis. Following process is followed in respect of such own-brand items:

1. Daliya (broken wheat) is procured from housewives who process the whole wheat given by the company. Cost of tools required for the same are borne by the housewives which is a nominal investment of ₹ 3,000 each.
2. Turmeric powder is also procured in the similar manner where raw turmeric is given to housewives who process the same to return in powder form.
3. Packaging of both these products is done at company's central packing location in Kondapur village near Hyderabad.
4. The stock of wheat with housewives on the date of valuation was 1200 kgs and that of raw turmeric 150 kgs. The stage of completion of process at the place of housewives can't be determined.
5. The payment of housewives' work is done based on return of goods, after the process and quality check at the central packing location on daily basis, at the rate of ₹ 6 / kg of Daliya and ₹ 25 / kg of turmeric powder.
6. Goods that are packed for final sale from the stores are despatched on weekly basis to the respective stores.
7. Rent of ₹ 60,000 per month paid for the packing location is amortised over the number of units packed during the month. A normal capacity per day is 150 kgs of turmeric powder packed into 200 grams each and 1200 kgs of daliya packed into 500 grams and 1 kg in the ratio of 2:1 of total stock produced. No. of working days in a year should be assumed as 300 days, though the total days of the year should be considered as 360 days.
8. The packing unit has 20 workers and a quality manager. The average salary cost of the packing unit is ₹ 3,25,000 per month. Depreciation of packing tools and other miscellaneous assets at the packing unit is ₹ 1,80,000 per annum.
9. Direct cost of packaging works out to ₹ 1.5 per packing unit of turmeric powder and ₹ 2.15 and ₹ 3.25 of Daliya packing units of 500 grams and 1 kg pack respectively.

On the date of physical verification, the packing unit had a stock of five days as per normal capacity of each product.

I. Multiple Choice Questions

Choose the best option from the given choices for each of the question or statement below:

1. In personal care category, hand-wash item has been _____ by _____ keeping in view the valuation principles in IFRS.
   (a) Undervalued, ₹ 2,328
   (b) Undervalued, ₹ 2,823
   (c) Overvalued, ₹ 2,328
   (d) Overvalued, ₹ 1,18,728
2. Since the company has a right to return the expired goods to respective suppliers, it will be treated as
   (a) Expense
   (b) Loss of inventory
   (c) Other Current Asset – Receivables from the Suppliers
   (d) Income
3. The replacement cost of goods that need to be given as free items to customers shall be treated as _____ as per the principles of IFRS.
   (a) Provision
   (b) Contingent liability
   (c) Loss of inventory
   (d) Expense
4. The inventory cost of turmeric powder and daliya of RK brand shall not include the following:
   (a) Cost of manpower at the packing unit
   (b) Cost of tools used by the housewives in processing the goods
   (c) Depreciation of packing tools and other assets at the packing centre
   (d) Rent of the packing centre.
5. During the year, the packing unit was closed for a month due to unforeseen circumstances. Due to which the normal capacity utilisation for the year was 11 months /12 months instead of 100%. Will it have any impact of the amount of depreciation allocated to packed units? How will the depreciation amount be allocated during the year?
   (a) No. Total depreciation of ₹ 1,80,000 will be allocated to the packed units
   (b) Yes. Depreciation of ₹ 1,65,000 will be allocated to the packed units and ₹ 15,000 will be recognised as expenses
   (c) Yes. Total depreciation of ₹ 1,80,000 will be recognised as expenses
   (d) No. Depreciation of ₹ 1,62,000 will be allocated to the packed units and ₹ 18,000 will be recognised as expenses

II. Descriptive Questions

6. Based on the deviations observed during the physical stock take, calculate the amount by which closing inventory is overvalued at RK Super Markets Ltd. Exclude the stock of own-brand goods.
7. News of health threat in particular brand noodles were going viral on social media since 29th March 2019. On 2nd April 2019, the Supreme Court ordered a ban on the sale of such noodles with immediate effect until the investigations are complete which in all probability would take around 6 months' time. However, the existing stock will not be useful for sale. Line no. 2 and 3 in snacks category given in 3(a) refer to two different varieties of the noodles of that brand. What will be the treatment of that stock if the NRV is zero and the cost of safe disposal is ₹ 20,000? As per the agreement with the supplier the goods once sold by the supplier will be under the risk of the retailer.
8. If the average cost of raw material for daliya and turmeric powder is ₹ 27.25 per kg and ₹ 105.50 per kg what is the value of inventory of turmeric powder and daliya of RK brand assuming that the cost of packing material in stock on the valuation date was ₹ 21,907 and ₹ 14,148 respectively for daliya and turmeric powder and allocation of fixed overheads is done in the ratio of 2:1 for daliya and turmeric?

ANSWER TO CASE STUDY 3

Answers to Multiple Choice Questions

1. Option (d)

Justification:

As per para 6 of IAS 2, inventories are assets:

(a) Held for sale in the ordinary course of business;

(b) In the process of production for such sale; or

(c) In the form of materials or supplies to be consumed in the production process or in the rendering of services.

Expired items are held for return to respective vendors and does not fit into any criteria above for recognition as inventory.

Hence, the entire valuation done at NRV is overvalued inventory calculated as below:

Total expired stock of Hand wash packs is (15 + 14 +18 +17+ 11 +13 +9) = 97 packs

Total cost of 97 packs = ₹ 1,200 per pack x 97 packs = ₹ 1,16,400

Valuation done at NRV = ₹1,16,400 x 102% = ₹ 1,18,728

2. Option (c)

Justification:

Since the company has a contractual right to return the expired goods at cost + 2%, the entire amount of expired stock in the category at the NRV shall be recognised as receivables from supplier.

3. Option (a)

Justification:

As per para 10 of IAS 37, a provision is a liability of uncertain timing or amount. Further, para 14 says, a provision shall be recognised when:

a) An entity has a present obligation (legal or constructive) as a result of a past event;

b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

c) A reliable estimate can be made of the amount of the obligation.

In the instant case, it is not clear as to how many customers will actually do the needful to claim the free item and within the prescribed time limit. However, the maximum amount of liability that may arise assuming all customers will do the needful can be estimated reliably. Hence a provision should be recognised.

4. Option (b)

Justification:

Para 10 of IAS 2 specifies that the cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Further, para 12 also elaborates on the examples of cost of conversion. Accordingly, in the instant case the cost of tools owned by the housewives does not fit in since the cost is not incurred by the company hence not forming part of the cost of inventory.

5. Option (b)

Justification:

Para 13 of IAS 2 clarifies that the amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred.

Accordingly, the rate of allocation per unit will remain same based on the normal capacity. Any unallocated depreciation due to idle plant is to be recognised as an expense during the year.

In the instant case depreciation for the whole year is ₹ 1,80,000 and hence the per unit allocation cost of depreciation would be:

Particulars		
Depreciation per annum	(given) (a)	₹ 1,80,000
Normal capacity	Refer Working Note (b)	8,25,000 packs
Depreciation per packing unit	(a) / (b) = (c)	0.21818
Actual production units	(8,25,000 / 12) x 11 (d)	7,56,250
Depreciation allocated	(c) x (d) = (e)	1,65,000 (approx.)
Unallocated depreciation recognised as expense	(a) – (e) = (f)	15,000

Calculation of normal capacity:

Turmeric powder – (150 kg x 1,000 grams) / 200 grams each = 750 packs

Daliya 1,200 kg in the ratio of 2:1 = 800 kg and 400 kg

500 grams packs = (800 kg x 1,000 grams) / 500 grams each = 1,600 packs

1 kg packs = (400 kg x 1,000 grams) / 1,000 grams each = 400 packs

Total no. of packed units = 2,750 per day x 300 days = 8,25,000 packs

II. Answers of Descriptive Questions

6. As per para 9 of IAS 2, inventories shall be measured at the lower of cost and net realisable value.

Based on the audit observations, below is the calculation of overvaluation of inventory of RK Super Market Ltd. of all stores in toto:

Category/Item	Valuation as per IFRS principles	Valuation done by the company	Over-valuation (in ₹)
Personal care – hand-wash	Zero (Refer MCQ 1)	1,18,728	118,728
Due to quantity mismatch		(W.N.1)	10,43,457
Not-for-sale items (free)	Zero	580,000	5,80,000
Rice (W.N.2)	624,851	675,748	50,627
Grains & pulses (W.N.3)	15,46,063	16,25,103	79,040
Snacks (W.N.4)	623,043	640,559	17,516
Beverages (W.N.5)	979,563	10,05,716	26,153
Total			**19,15,521**

Working Notes:

1. Valuation difference due to quantity mismatch:

Item code	Category	Description	Reported Qty (1)	Actual Qty (2)	Difference	₹ Cost per UoM (3)	Difference [(1) – (2)] x (3)
R-510101	Snacks	Biscuits	1,689 boxes	1,589 boxes	100 boxes	1,190	1,19,000
R-511012	Snacks	Namkeen	851 boxes	681 boxes	170 boxes	1,890	3,21,300
R-522104	Beverages	Coke	1,809 cases	1,691 cases	118 cases	1,300	1,53,400
S-144109	Grains	Wheat	1,851 gunny bags	1,681 gunny bags	170 gunny bags	630	1,07,100
S-143118	Cooking Oil	Soyabean 5 Ltr	5,140 cans	5,014 cans	126 cans	585	73,710
D-189107	Hygiene	Detergent Soap	2,018 boxes	1,973 boxes	45 boxes	705	31,725
D-125109	Hygiene	Dishwash Bars	1,619 boxes	1,508 boxes	111 boxes	647	71,817
D-119120	Hygiene	Sanitary Pads	1,819 boxes	1,718 boxes	101 boxes	1,200	1,21,200
P-121113	Kitchenware	NS Kadhai	561 units	516 units	45 units	329	14,805
P-713114	Baby care	Diapers	819 packs	759 packs	60 packs	490	29,400
						Total	**10,43,457**

2. Overvaluation of Rice gunny bags

Valuation of Rice gunny bags as per IFRS principles (1,12,164 + 99,082 + 1,15,039 + 2,98,566) = ₹ 6,24,851

Valuation of Rice gunny bags done by the company (1,25,174 + 1,02,182 + 1,29,017 + 3,19,105) = ₹ 6,75,478

Overvaluation = Valuation done by the company - Valuation as per IFRS = ₹ 6,75,478 – ₹ 6,24,851 = ₹ 50,627

3. Overvaluation of Grains and pulses gunny bags

Valuation of Grains and pulses gunny bags as per IFRS principles (3,27,078 + 2,78,730 + 3,63,902 + 2,39,825 + 3,36,528) = ₹ 15,46,063

Valuation of Grains and pulses gunny bags done by the companies (3,41,658 + 2,94,975 + 3,77,941 + 2,58,649 + 3,51,880) = ₹ 16,25,103

Overvaluation = Valuation done by the company - Valuation as per IFRS

= ₹ 15,46,063 – ₹ 16,25,103 = ₹ 79,040

4. Overvaluation of Snacks boxes

Valuation of Snacks boxes as per IFRS principles (1,16,698 + 1,09,051 + 1,39,023 + 1,36,721 + 1,21,550) = ₹ 6,23,043

Valuation of Snacks boxes done by the companies (1,20,018 + 1,13,727 + 1,42,443 + 1,40,101 + 1,24,270) = ₹ 6,40,559

Overvaluation = Valuation done by the company - Valuation as per IFRS

= ₹ 6,40,559 – ₹ 6,23,043 = ₹ 17,516

5. Overvaluation of Beverages packs

Valuation of Beverages packs as per IFRS principles (1,84,212 + 1,93,725 + 2,00,013 + 2,04,750 + 1,96,863) = ₹ 9,79,563

Valuation of Beverages packs done by the companies (1,87,523 + 1,98,765 + 2,04,798 + 2,10,925 + 2,03,705) = ₹ 10,05,716

Overvaluation = Valuation done by the company - Valuation as per IFRS

= ₹ 10,05,716 – ₹ 9,79,563 = ₹ 26,153

7. Para 3 of IAS 10 defines Events after the reporting period as those events that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company. Further it identifies two types of events –

(a) Adjusting events – those that provide evidence of conditions that existed at the end of the reporting period; and

(b) Non-adjusting events – those that are indicative of conditions that arose after the reporting period.

Further, para 8 states that an entity shall adjust the amounts recognized in its financial statements to reflect adjusting events after the reporting period.

Since news for health threat in noodles brand went viral on 29th March, 2019 and Supreme Court ordered ban on 2nd April, 2019 ie before the authorisation of the financial statements, this is an adjusting event. Therefore, the item of inventory shall be written down to NRV which is zero.

Also, a liability should be recognised for safe disposal of such item to the tune of ₹ 20,000.

So, the carrying amount of inventory should be reduced by ₹ 2,48,074 (1,09,051 + 1,39,023) assuming that correction is done as per principles of valuation laid down in IAS 2.

8. Inventory valuation of own-brand products – RK (in ₹)

Particulars	Working / reference	Daliya	Turmeric Powder
Raw material for processing with housewives (1 day stock)	1,200 kg x 27.25 150 kg x 105.5	32,700	15,825
Finished Goods (5 days stock)	(W.N.2)	2,23,200	1,03,500
Packing material	(Given)	21,907	14,148
Allocation of fixed overhead ₹ 69,167 (W.N.3)	2:1	46,111	23,056
	Total	**3,23,918**	**1,56,529**

Working Notes:

1. Stock of finished goods (in ₹)

Particulars	Stock per day	Stock of 5 days
Turmeric powder (200 gms pack)	750	3,750
Daliya (500 gms pack)	1,600	8,000
Daliya (1 kg pack)	400	2,000
	2,750	13,750

2. Raw material, processing cost (paid to housewives) and packing material cost for finished goods (in ₹)

Particulars	Working/ reference	Per day		For 5 Days	
		Daliya	Turmeric	Daliya	Turmeric
Raw material for Daliya	1,200 x 27.25	32,700		1,63,500	
Raw material for Turmeric powder	150 x 105.5		15,825		79,125
Processing cost for Daliya	1,200 x 6	7,200		36,000	
Processing cost for Turmeric powder	150 x 25		3,750		18,750
Packing material for Daliya	(1,600 x 2.15) + (400 x 3.25)	4,740		23,700	
Packing material for Turmeric powder	750 x 1.5		1,125		5,625
				2,23,200	1,03,500

So, raw material and processing cost of Daliya for 5 days is ₹ 2,23,200 and

Raw material and processing cost of Turmeric Powder for 5 days is ₹ 1,03,500

3. Calculation of fixed overheads

a. Rent of packing centre = ₹ 60,000 per month

Number of units packed in a year = 8,25,000 packs (as computed for MCQ 5)

Number of units packed in a month = 8,25,000 / 12 months = 68,750 packs

Number of units packed in 5 days = (68,750 packs / 25 days) x 5 days = 13,750 packs

Rent for 5 days = (₹ 60,000 / 68,750 packs) x 13,750 packs = ₹ 12,000

b. Direct labour = (3,25,000/30 days) x 5 days = ₹ 54,167

c. Depreciation of miscellaneous assets

= 13,750 packs x 0.21818 (as computed for MCQ 5)

= ₹ 3,000

Total fixed overheads to be allocated = ₹ 12,000 + ₹ 54,167 + ₹ 3,000

= ₹ 69,167

CA FINAL - PAPER 7 - DIRECT TAX LAWS AND INTERNATIONAL TAXATION

Direct Tax Laws is one of the dynamic subjects of the chartered accountancy course. Every year, substantial changes brought in through the Annual Finance Act. In addition, notifications are issued from time to time by the CBDT to give effect to the provisions of the Act and circulars are issued to clarify the provisions of the Act. For May, 2023 and November, 2023 examinations, the direct tax laws as amended by the Finance Act, 2022 is applicable; and the relevant assessment year is A.Y.2023-24. This capsule on direct tax law gives an overview of select key topics, namely, deductions from gross total income and special scheme for taxation of companies, business trusts, investment fund and securitisation trusts. For detailed study, read the October, 2021 edition of the Study Material of Final Paper 7 Direct Tax Laws and International Taxation alongwith Supplementary Study Paper, 2022.

DEDUCTIONS FROM GROSS TOTAL INCOME – CHAPTER VI-A

I Deductions in respect of certain payments			
Section	**Eligible Assessee**	**Eligible Payments**	**Permissible Deduction**
80C	Individual or HUF	**Contribution to PPF, Payment of LIC premium, etc.** Sums paid or deposited in the previous year by way of - Life insurance premium - Contribution to PPF/ SPF/ RPF and approved superannuation fund - Repayment of housing loan taken from Govt., bank, LIC, specified employer etc. - Tuition fees to any Indian university, college, school for full-time education of any two children - Term deposit for a fixed period of not less than 5 years with schedule bank - Subscription to notified bonds of NABARD - Five year post office time deposit - Senior Citizen's Savings Scheme Account etc. - Contribution by CG (Central Government) employee to additional account (Tier II A/c) of NPS referred to u/s 80CCD	Sum paid or deposited, subject to a maximum of ₹1,50,000
80CCC	Individual	**Contribution to certain pension funds** Any amt paid or deposited to keep in force a contract for any annuity plan of LIC of India or any other insurer for receiving pension from the fund.	Amt paid or deposited, subject to a **maximum of ₹1,50,000**
80CCD	Individuals employed by the CG or any other employer; Any other individual assessee	**Contribution to Pension Scheme of CG** An individual employed by the CG on or after 1.1.2004 or any other employer or any other assessee, being an individual, who has paid or deposited any amt in his account under a notified pension scheme [to his individual pension account [Tier I A/c] under NPS & Atal Pension Yojana]	**Employee's Contribution/ Individual's Contribution** In case of a salaried individual, dedn of own contribution u/s 80CCD(1) is restricted to 10% of his salary. In any other case, dedn u/s 80CCD(1) is restricted to 20% of gross total income. Further, additional dedn of upto ₹50,000 is available u/s 80CCD(1B). **Employer's Contribution** The entire employer's contribution would be included in the salary of the employee. The dedn of employer's contribution u/s 80CCD(2) would be restricted to 14% of salary, where the employer is the CG or State Government; and 10%, in case of any other employer.
Note – As per section 80CCE, maximum permissible dedn u/s 80C, 80CCC & 80CCD(1) is ₹1,50,000. However, the limit ₹1.50 lakh u/s 80CCE does not apply to dedn u/s 80CCD(2) and 80CCD(1B).			

<table>
<tr><td>80D</td><td>Individual or HUF</td><td>Medical Insurance Premium
(1) Any premium paid, otherwise than by way of cash, to keep in force an insurance on the health of –
<table><tr><td>in case of an individual</td><td>self, spouse and dependent children</td></tr><tr><td>in case of HUF</td><td>family member</td></tr></table>(2) In case of an individual contribution, otherwise than by way of cash, to CGHS or any other scheme as notified by CG.
(3) Any premium paid, otherwise than by way of cash, to keep in force an insurance on the health of parents, whether or not dependent on the individual.
Notes:
(i) Any amt paid, otherwise than by way of cash, on account of medical expd incurred on the health of the assessee or his spouse, dependent children or his parent, who is a senior citizen and no amt has been paid to effect or to keep in force an insurance on the health of such person.
(ii) Payment, including cash payment, for preventive health check up of himself, spouse, dependent children and parents.</td><td>Maximum ₹25,000 (₹50,000, in case the individual or his or her spouse is a senior citizen)
Maximum ₹25,000 (₹50,000, in case either or both of the parents are senior citizen(s))
Amt paid subject to a cap of ₹50,000 (in case one parent is a senior citizen, in respect of whom insurance premium is paid, and the other is a senior citizen on whom medical expd is incurred, the total dedn cannot exceed ₹50,000)
Amt paid subject to a cap of ₹5,000, in aggregate (subject to the overall individual limits of ₹25,000/ ₹50,000, as the case may be)</td></tr>
<tr><td>80DD</td><td>Resident Individual or HUF</td><td>Maintenance including medical treatment of a dependant disabled
Any amt incurred for the medical treatment (including nursing), training and rehabilitation of a dependent disabled
and / or
Any amt paid or deposited under the scheme framed in this behalf by the LIC or any other insurer or Administrator or Specified Company and approved by Board.
Meaning of Dependant
<table><tr><td>(1)
In case of</td><td>(2)
Dependant</td></tr><tr><td>An individual</td><td>Spouse, children, parents, brothers, sisters</td></tr><tr><td>A HUF</td><td>Any member</td></tr></table>Persons mentioned in column (2) should be wholly or mainly dependant on the person mentioned in corresponding column (1) for support and maintenance. Such persons should not have claimed dedn u/s 80U in computing TI of that year.</td><td>Flat deduction of ₹75,000. In case of severe disability (i.e., person with 80% or more disability) the flat dedn shall be ₹1,25,000.</td></tr>
<tr><td>80DDB</td><td>Resident Individual or HUF</td><td>Dedn for medical treatment of specified diseases or ailments
Amt paid for specified diseases or ailment
<table><tr><td>Assessee</td><td>Amount spent</td></tr><tr><td>An individual</td><td>For himself or his dependant being spouse, children, parents, brothers or sisters wholly or mainly dependant on the individual for support and maintenance</td></tr><tr><td>A HUF</td><td>For any member</td></tr></table></td><td>Actual sum paid or ₹40,000 (₹1,00,000, if the payment is for medical treatment of a senior citizen), whichever is less,
minus
the amt received from the insurance company or reimbursed by the employer.</td></tr>
<tr><td>80E</td><td>Individual</td><td>Interest on loan taken for higher education
Interest on loan taken from any financial institution (FI) or approved charitable institution.
Such loan is taken for pursuing his higher education or higher education of his or her relative i.e., spouse or children of the individual or the student for whom the individual is the legal guardian.</td><td>The dedn is available for interest payment in the initial A.Y (year of commencement of interest payment) and seven A.Y. immediately succeeding the initial A.Y.
(or)
until the interest is paid in full by the assessee, whichever is earlier.</td></tr>
</table>

80EE	Individual	**Dedn for interest on loan borrowed from any FI [bank/ housing finance company (HFC)] for acquisition of residential house property**	Dedn of upto ₹50,000 would be allowed in respect of interest on loan taken from a FI. **Conditions:** Loan should be sanctioned during P.Y. 2016-17 Loan sanctioned ≤ ₹35 lakhs Value of house ≤ ₹50 lakhs The assessee should not own any residential house on the date of sanction of loan.
80EEA	Individual	**Dedn in respect of interest payable on loan taken from a FI (bank or HFC) for acquisition of residential house property** (In case the property is self-occupied, the dedn would be over and above the dedn of ₹2 lakhs u/s 24)	Dedn of upto ₹1,50,000 would be allowed in respect of interest payable on loan taken from a FI for acquisition of house property. **Conditions:** • Loan should be sanctioned by a FI during the period between **1st April 2019 to 31st March 2022**. • Stamp Duty Value of house ≤ ₹45 lakhs • The individual should not own any residential house on the date of sanction of loan. • The individual should not be eligible to claim dedn u/s 80EE.
80EEB	Individual	**Dedn in respect of interest payable on loan taken from a FI (bank or certain NBFCs) for purchase of electric vehicle**	Dedn of upto ₹1,50,000 would be allowed in respect of interest payable on loan taken for purchase of electric vehicle. Loan should be sanctioned by a FI during the period from 1.4.2019 to 31.3.2023
80G	All assessees	**Donations to certain funds, charitable institutions etc.** **There are four categories of dedns –**	

	Category	Donee
(I)	100% dedn of amt donated, without any qualifying limit	Prime Minister's National Relief Fund, National Children's Fund, Swachh Bharat Kosh, National Defence Fund, PM CARES Fund etc.
(II)	50% dedn of amt donated, without any qualifying limit	Prime Minister's Drought Relief Fund, Jawaharlal Nehru Memorial Fund, Indira Gandhi Memorial Trust, Rajiv Gandhi Foundation.
(III)	100% dedn of amt donated, subject to qualifying limit	Government or local authority, institution for promotion of family planning etc.
(IV)	50% dedn of amt donated, subject to qualifying limit	Government or any local authority to be used for charitable purpose, other than promotion of family planning, notified temple, church, gurudwara, mosque etc.

Calculation of Qualifying limit for Category III & IV donations:

Step 1: Compute adjusted total income, i.e., the gross total income as reduced by the following:

1.	Dedns under Chapter VI-A, except u/s 80G
2.	Short term capital gains taxable u/s 111A
3.	Long term capital gains taxable u/s 112 & 112A

Step 2: Calculate 10% of adjusted total income.
Step 3: Calculate the actual donation, which is subject to qualifying limit
Step 4: Lower of Step 2 or Step 3 is the maximum permissible dedn.
Step 5: The said dedn is adjusted first against donations qualifying for 100% dedn (i.e., Category III donations). Thereafter, 50% of balance qualifies for dedn u/s 80G.
Note *- No dedn shall be allowed for donation in excess of ₹2,000, if paid in cash.*

80GG	Individual not in receipt of house rent allowance	**Rent paid for residential accommodation**	Least of the following is allowable as dedn: (1) 25% of total income; (2) Rent paid – 10% of total income (3) ₹5,000 p.m. No dedn if any residential accommodation is owned by the assessee/ his spouse/ minor child/ HUF at the place where he ordinarily resides or performs the duties of his office or employment or carries on his business or profession.

80GGA	Assessee not having income chargeable under the head "PGBP"	**Donation made for scientific research or to National Urban Poverty Eradication Fund etc.** - any sum paid to a research association which has, as its object the undertaking of scientific research or to a University/ college/ institution [approved u/s 35(1)(ii)] to be used for scientific research. - any sum paid to a research association which has as its object the undertaking of research in social science or statistical research or to a University/ college/ institution [approved u/s 35(1)(iii)] to be used for research in social science or statistical research. - any sum paid to the National Urban Poverty Eradication Fund set up and notified by the CG for the purposes of section 35CCA(1)(d). ***Note** - No dedn shall be allowed for donation in excess of ₹2,000, if paid in cash.*	
80GGB	Indian company	**Contributions to political parties** Any sum contributed by it to a registered political party or an electoral trust.	Actual Contribution (otherwise than by way of cash)
80GGC	Any person, other than local authority and an artificial juridical person funded by the Govt.	**Contributions to political parties** Amt contributed to a registered political party or an electoral trust.	Actual contribution (otherwise than by way of cash)
II Deductions in respect of Certain Incomes			
As per section 80AC, furnishing return of income on or before due date is mandatory for claiming deduction in respect of certain incomes. Refer table no 2 for deduction under sections 80-IA to 80-IE.			
Section	**Eligible Assessee**	**Eligible Income**	**Permissible Deduction**
80JJA	An assessee whose GTI includes profits and gains derived from the business of collecting and processing or treating bio-degradable waste	Dedn in respect of profits and gains derived from the business of collecting and processing or treating of bio-degradable waste - (1) for generating power; or (2) producing bio-fertilizers, bio-pesticides or other biological agents; or (3) for producing bio-gas; or (4) making pellets or briquettes for fuel or organic manure.	Dedn is allowable for an amt equal to the whole of such profits and gains for a period of 5 consecutive A.Ys. beginning with the A.Y. relevant to the P.Y. in which the business commences.
80JJAA	An assessee to whom section 44AB applies, whose Gross total income includes profits and gains derived from business	**Dedn in respect of employment of new employees**	30% of additional employee cost incurred in the P.Y. Dedn is allowable for 3 A.Ys. including A.Y. relevant to the P.Y. in which such employment is provided. ***Note:** For conditions to be satisfied, read Chapter 11 of Module 2 of the Study Material.*
80M	A domestic company	**Dedn in respect of inter-corporate dividend** Any income by way of dividends received from any other domestic company or foreign company or a business trust.	Amt of dividend received from other domestic company or foreign company or business trust or the amt of dividend distributed by such domestic company on or before the due date i.e., one month prior to the date of furnishing return of income, whichever is less.
80QQB	Resident individual, being an author	**Royalty income, etc., of authors of certain books other than text books** Consideration for assignment or grant of any of his interests in the copyright of any book, being a work of literary, artistic or scientific nature or royalty or copyright fee received as lumpsum or otherwise.	Income derived in the exercise of profession or ₹3,00,000, whichever is less. In respect of royalty or copyright fee received otherwise than by way of lumpsum, income to be restricted to 15% of value of books sold during the relevant P.Y.
80RRB	Resident individual, being a patentee	**Royalty on patents** Any income by way of royalty on patents registered on or after 1.4.2003	Whole of such income or ₹3,00,000, whichever is less.
III Deductions in respect of Other Income			
Section	**Eligible Assessee**	**Eligible Income**	**Permissible Deduction**
80TTA	Individual or HUF, other than a resident senior citizen	**Interest on deposits in savings account** Interest on deposits in a savings account with a bank, a co-operative society or a post office (not being time deposits, which are repayable on expiry of fixed periods)	Actual interest subject to a maximum of ₹10,000.
80TTB	Resident senior citizen (i.e. an individual of the age of 60 years or more at any time during the previous year)	**Interest on deposits** Interest on deposits (both fixed deposits and saving accounts) with banking company, co-operative society engaged in the business of banking or a post office.	Actual interest or ₹50,000, whichever is less.
IV Other Deductions			
Section	**Eligible Assessee**	**Condition for deduction**	**Permissible Deduction**
80U	Resident Individual	**Dedn in case of a person with disability** Any person, who is certified by the medical authority to be a person with disability.	Flat dedn of ₹75,000, in case of a person with disability. Flat dedn of ₹1,25,000, in case of a person with severe disability (80% or more disability).

TABLE NO 2
DEDUCTIONS UNDER SECTION 80-IA TO 80-IE

Section	Eligible Business		Year of commencement of eligible business	Period of Deduction	Quantum of Deduction
80-IA	(1)	(i) Developing; or (ii) Operating and maintaining; or (iii) Developing, operating and maintaining any infrastructure facility	On or after 1.4.1995 but not later than 1.4.2017	**Infrastructure Facility of road, or a bridge or a rail system or a highway project or a water supply project:** 10 consecutive A.Ys. out of 20 years beginning from the year in which the enterprise develops or begins to operate the eligible business. **Other eligible businesses:** 10 consecutive A.Ys. out of 15 years beginning from the year in which the enterprise develops or begins to operate the eligible business.	100% of the profits and gains derived from such business for 10 consecutive A.Ys.
	(2)	(i) Develops; or (ii) Develops and operates; or (iii) Maintains and operates an industrial park	**Industrial parks:** Notified by the CG for the period on or after 1.4.1997 & ending on 31.3.2011.		
	(3)	Power undertakings	**Generation or Generation and distribution:** Set up b/w 1.4.1993 & 31.3.2017. **Transmission or distribution:** Start transmission during the period from 1.4.1999 & 31.3.2017. **Renovation and modernisation of existing network:** Undertakes substantial renovation and modernisation during the period on or after 1.4.2004 & ending on 31.3.2017.		
	(4)	Undertaking owned by an Indian Company set up for Reconstruction or revival of a power generating plant	Company formed on or before 30.11.2005 and begins to generate or transmit or distribute power before 31.3.2011 and notified before 31.12.2005 by CG.		
80-IAB	Development of Special Economic Zones (SEZs)		Develops SEZ, notified on or after 1.4.2005 but before 1.4.2017.	10 consecutive A.Ys. out of 15 years beginning from the year in SEZ has been notified.	100% of the profits and gains derived from such business.
80-IAC	A business carried out by an eligible start-up engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation		The company or LLP is incorporated during the period 1.4.2016 - 31.3.2023	3 consecutive A.Ys. out of 10 years beginning from the year in which company or LLP, incorporated. Total turnover should not exceed ₹100 crores in the P.Y. relevant to the A.Y. for which dedn is claimed	100% of the profits and gains derived from such business.
80-IB	(1)	An industrial undertaking, being a co-operative society including a small scale industrial undertaking (SSI) in Jammu and Kashmir	Begins to manufacture or production of any article or thing or operate cold storage plant during the period 1-4-1993 and 31-3-2012.	Not exceeding 12 consecutive A.Ys.	100% of the profits and gains derived from such industrial undertaking for the initial 5 A.Ys. and thereafter 25% of such profits and gains.

	(2)	**Commercial production of mineral oil or commercial production of natural gas in licensed blocks**	**Commercial production of mineral oil:** On or after 1.4.1997 but not later than 31.3.2017 **Commercial production of natural gas:** On or after 1.4.2009 but not later than 31.3.2017	7 consecutive A.Ys. including the initial A.Y.	100% of the profits and gains from such business
	(3)	**Processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains**	**Processing, preservation and packaging of meat or meat products or poultry or marine or dairy products:** On or after 1.4.2009 **Other eligible businesses:** On or after 1.4.2001	10 consecutive A.Ys. beginning with the initial A.Y.	100% of the profits and gains derived from such business for 5 A.Ys. beginning with the initial A.Y. 25% (30% in case of company) for remaining 5 years
80-IBA	**Developing and building** **(i) housing projects [Section 80-IBA(1)]; or** **(ii) rental housing project [Section 80-IBA(1A)]** **notified by the CG on or before 31.3.2022 and fulfilling the specified conditions**		Housing Project referred u/s 80-IBA(1) is approved after 1.6.2016 but on or before 31.3.2022 and the project is completed within 5 years from the date of approval by the competent authority	-	100% of the profits and gains derived from such housing project.
80-IE	**Undertaking begun or begins, in any of the North-Eastern States** (i.e., the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura) - (1) to manufacture or produce any eligible article or thing; (2) to undertake substantial expansion to manufacture or produce any eligible article or thing; (3) to carry on any eligible business.		between 1.4.2007 and ending before 1.4.2017	10 consecutive A.Ys. commencing with the initial A.Y.	100% of the profits and gains derived from such business

CONCESSIONAL RATE OF TAX IN RESPECT OF CERTAIN DOMESTIC COMPANIES

Sections 115BAB and 115BAA provides for concessional rates of tax and exemption from minimum alternate tax (MAT) in respect of certain domestic companies. The provisions of these two sections are tabulated hereunder -

(1)	(2)	(3)	(4)
S.No.	**Particulars**	**Section 115BAB**	**Section 115BAA**
(1)	**Applicability**	Domestic manufacturing Co./ Electricity generation Co.	Any domestic Co.
(2)	**Rate of tax**	**15%**	**22%**
(3)	**Rate of surcharge**	**10%**	**10%**
(4)	**Effective rate of tax (including surcharge & HEC)**	**17.16%** [Tax@15% (+) Surcharge@10% (+) HEC@4%]	**25.168%** [Tax@22% (+) Surcharge@10% (+) HEC@4%]
(5)	**Applicability of MAT**	Not applicable	Not applicable
(6)	**Manner of computation of tax liability**		
	Income on which concessional rate of tax is applicable	The rate of tax **(i.e., 17.16%)** would be applicable in respect of income derived from or incidental to manufacturing or production of an article or thing or generation of electricity. **[Read with point no. 11 below, wherein the rate of 34.32% (i.e., Tax@30% + surcharge@10% + HEC@4%) would be applicable in specified circumstance]**	The rate of tax **(i.e., 25.168%)** is notwithstanding anything contained in the Income-tax Act, 1961, but subject to the provisions of Chapter XII, other than section 115BA and 115BAB.

(1)	(2)	(3)		(4)
S.No.	**Particulars**	**Section 115BAB**		**Section 115BAA**
	Rate of tax on income covered under Chapter XII [For example, LTCG chargeable to tax u/s 112 and 112A, STCG chargeable to tax u/s 111A]	Such income would be subject to tax at the **rates mentioned in the said sections in Chapter XII. Surcharge@10%** would be levied on tax computed on such income. **HEC@4%** would be levied on the income-tax plus surcharge.		Such income would be subject to tax at the **rates mentioned in the said sections in Chapter XII. Surcharge@10%** is leviable on tax computed on such income. **HEC@4%** would be levied on the income-tax *plus* surcharge.
	Rate of tax on other income in respect of which no specific rate of tax is provided in Chapter XII	The applicable tax rate is **25.168% (i.e., tax@22%, *plus surcharge* @10% *plus* HEC@4%)**, if such income has neither been derived from nor is incidental to manufacturing or production of an article or thing or **generating electricity** (For example, income from house property and income from other sources). In respect of such income, **no deduction or allowance in respect of any expenditure or allowance** shall be allowed in computing such income.		The applicable tax rate is **25.168% (i.e., tax@22% *plus surcharge*@10% *plus* HEC@4%)**. There is, however, **no restriction regarding claim of any deduction or allowance** permissible under the relevant provisions of the Act.
	Rate of tax on STCG derived from transfer of a capital asset on which no depreciation is allowable under the Act	The applicable rate of tax is **25.168% (i.e., tax@22%, *plus surcharge*@10% *plus* HEC@4%)**. There is, however, no restriction regarding claiming of dedn or allowance in this regard.		The applicable rate of tax is **25.168% i.e., tax @22%, *plus surcharge* @10% *plus* cess@4%**. There is no restriction regarding claiming of dedn or allowance in this regard.
(7)	**Conditions to be fulfilled for availing concessional rate of tax and exemption from MAT**			
	Conditions to be fulfilled for availing concessional rate of tax and exemption from MAT	(i)	The Co. should be **set-up and registered on or after 1.10.2019.**	No time limit specified. Both existing Cos and new Cos can avail benefit.
		(ii)	It should **commence manufacturing or production of an article or thing or business of generating electricity on or before 31.3.2024.**	Need not be a manufacturing or a production Co.
		(iii)	It should **not be formed by splitting up or the reconstruction of a business already in existence** (except in case of a Co., business of which is formed as a result of the re-establishment, reconstruction or revival by the person of the business of any undertaking referred to in section 33B in the circumstances and within the period specified therein).	No similar condition has been prescribed.
		(iv)	It does **not** use any P or M previously used for any purpose **[Refer Note at the end]**	No similar condition has been prescribed
		(v)	It does **not** use any building previously used as a hotel or a convention centre [meanings assigned in section 80-ID(6)] in respect of which dedn u/s 80-ID has been claimed and allowed.	No similar condition has been prescribed
		(vi)	It should **not** be engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it. ***Note** – Business of manufacture or production of any article or thing does **not** include business of* *(1) Development of computer software in any form or in any media* *(2) Mining* *(3) Conversion of marble blocks or similar items into slabs* *(4) Bottling of gas into cylinder* *(5) Printing of books or production of cinematograph films* *(6) Any other business as may be notified by the CG in this behalf.*	No similar condition has been prescribed
		***Note** - If difficulty arises regarding fulfilment of conditions listed in (iv) to (vi) above, the CBDT may, with the approval of the Central Govt, issue guidelines for the purpose of removing difficulty and to promote manufacturing or production of article or thing using new P & M.* *Every guideline issued by the CBDT has to be laid before each House of Parliament, and shall be binding on the person, and the income-tax authorities subordinate to it.*		

<table>
<tr><th>(1)</th><th>(2)</th><th>(3)</th><th>(4)</th></tr>
<tr><th>S.No.</th><th>Particulars</th><th>Section 115BAB</th><th>Section 115BAA</th></tr>
<tr><td>(8)</td><td>Common conditions for both sections for availing the concessional rate of tax and exemption from MAT</td><td colspan="2">In case of a Co. opting for either section 115BAA or 115BAB, the total income should be computed -
(i) without providing for deduction under any of the following sections:
<table>
<tr><th>Section</th><th>Provision</th></tr>
<tr><td>10AA</td><td>Exemption of profits and gains derived from export of articles or things or from services by an assessee, being an entrepreneur from his Unit in SEZ.</td></tr>
<tr><td>32(1)(iia)</td><td>Additional depreciation @20%, as the case may be, of actual cost of new P & M acquired and installed by manufacturing undertakings.</td></tr>
<tr><td>33AB</td><td>Dedn@40% of profits and gains of business of growing and manufacturing tea, coffee or rubber in India, to the extent deposited with NABARD in accordance with scheme approved by the Tea/Coffee/ Rubber Board.</td></tr>
<tr><td>33ABA</td><td>Dedn@20% of the profits of a business of prospecting for, or extraction or production of, petroleum or natural gas or both in India, to the extent deposited with SBI in an approved scheme or deposited in Site Restoration Account.</td></tr>
<tr><td>35(1)(ii)/(iia)/(iii)</td><td>Dedn for payment to any research association, co., university etc. for undertaking scientific research or social science or statistical research.</td></tr>
<tr><td>35(2AA)</td><td>Dedn of payment to a National Laboratory or University or IIT or approved specified person for scientific research</td></tr>
<tr><td>35(2AB)</td><td>Dedn of in-house scientific research expenditure incurred by a co. engaged in the business of bio-technology or in the business of manufacture or production of an article or thing.</td></tr>
<tr><td>35AD</td><td>Investment-linked tax deduction for specified businesses.</td></tr>
<tr><td>35CCC</td><td>Dedn of expenditure incurred on notified agricultural extension project</td></tr>
<tr><td>35CCD</td><td>Dedn of expenditure incurred by a co. on notified skill development project.</td></tr>
<tr><td>80C to 80U</td><td>Dedns from GTI under Chapter VI-A other than the provisions of section 80JJAA or section 80M.</td></tr>
</table>
(ii) without set-off of any loss or allowance for unabsorbed depreciation deemed so u/s 72A, where such loss or depreciation is attributable to any of the dedns listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further dedn for such loss shall be allowed for any subsequent year]
(iii) by claiming depreciation u/s 32 determined in the prescribed manner (i.e., in respect of depreciation of any block of assets entitled to more than 40% shall be restricted to 40% on the WDV of such block of assets). However, additional depreciation u/s 32(1)(iia) cannot be claimed.

Notes – Additional points relevant in the context of section 115BAA:
(1) In case of a Co. opting for section 115BAA, total income should be computed without set-off of any loss c/f or depreciation from any earlier A.Y., where such loss or depreciation is attributable to any of the dedns listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further dedn for such loss or depreciation shall be allowed for any subsequent year].
(2) In the case of a person having a Unit in the IFSC, referred to in section 80LA(1A), which has exercised option for section 115BAA, dedn u/s 80LA would be allowed subject to fulfilment of the conditions specified in that section.
(3) Since there is no time line within which option u/s 115BAA can be exercised, a domestic co. having b/f losses and depreciation on account of dedns listed in (i) above may, if it so desires, postpone exercise the option u/s 115BAA to a later A.Y., after set off of the losses and depreciation so accumulated.</td></tr>
<tr><td>(9)</td><td>Failure to satisfy conditions</td><td>On failure to satisfy the conditions mentioned in point no. (7) and (8) above in any P.Y., the option exercised would be invalid in respect of the A.Y. to that P.Y. and subsequent A.Ys.;
Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised for the A.Y. relevant to that P.Y. and subsequent A.Ys.

Note – Where option exercised u/s 115BAB is rendered invalid due to violation of conditions stipulated in point no.7 [(iv) to (vi)] above, such person may exercise option u/s 115BAA.</td><td>On failure to satisfy the conditions mentioned in point no. (8) above in any P.Y., the option exercised would be invalid in respect of the A.Y. relevant to that P.Y. and subsequent A.Ys.;
Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised for the A.Y. relevant to that P.Y. and subsequent A.Ys.</td></tr>
<tr><td>(10)</td><td>Availability of set-off of MAT credit b/f from earlier years</td><td>Since it is a new Co., there would be no b/f MAT credit</td><td>B/f MAT credit cannot be set-off against income u/s 115BAA.
Note - If a Co. has b/f MAT credit, it can first exhaust the MAT credit, and thereafter opt for section 115BAA in a subsequent P.Y.</td></tr>
</table>

(1)	(2)	(3)	(4)
S.No.	**Particulars**	**Section 115BAB**	**Section 115BAA**
(11)	**Adjustments for transactions with persons having close connection**	If the A.O. opines that the course of business b/w the Co. and any other person having close connection therewith is so arranged that the business transacted b/w them produces more than the ordinary profits to the Co., he is empowered to take into a/c the amt of profits as may be reasonably deemed to have been derived therefrom, while computing profits and gains of such company. In case the arrangement referred above involves a specified domestic transaction referred to in section 92BA, then, the amt of profits from such transaction would be determined by considering the arm's length price (ALP). **The amt, being profits in excess of the amt of the profits determined by the A.O., shall be deemed to be the income of the person.** **The income-tax on the income so deemed shall be subject to tax@34.32%(i.e., tax@30% + surcharge @10% +HEC@4%).** ***Note*** *– The scope of "specified domestic transaction" referred to in section 92BA has been expanded to include within its ambit, any business transacted between such persons with close connection, where one such person is a company claiming benefit under section 115BAB.*	No such requirement to make any adjustment
(12)	**Exercise of option by the company within the prescribed time**	The beneficial provisions of this section would apply only if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing **the first of the returns of income for any P.Y.** relevant to A.Y. or any subsequent A.Y. Such option, once exercised, would apply to subsequent A.Ys. Further, once the option has been exercised for any P.Y., it **cannot be subsequently withdrawn** for the same or any other P.Y. ***Notes*** – (1) The option has to be exercised at the time of furnishing the ***first of the returns of income*** for any P.Y. If a person fails to so exercise such option, it cannot be exercised thereafter for any subsequent P.Y. (2) In case of amalgamation, the option exercised u/s 115BAB shall remain valid in the case of the amalgamated company only and if the conditions mentioned in point no. (7) and (8) are continued to be satisfied by such co.	The beneficial provisions of this section would apply if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing the return of income for any P.Y. relevant to A.Y. or any subsequent A.Y. Such option, once exercised, would apply to subsequent A.Ys. Further, once the option has been exercised for any P.Y., it **cannot be subsequently withdrawn** for the same or any other P.Y. ***Note*** – The option can be exercised even in a later year, but once exercised, cannot be withdrawn subsequently. Further, where the person exercises option u/s 115BAA, the option u/s 115BA may be withdrawn.

Note *- For the purpose of point no.7(iv) in column (3) of the above table in relation to a co. exercising option u/s 115BAB, any P & M which was used outside India by any other person shall not be regarded as P & M previously used for any purpose, if all the following conditions are fulfilled, namely:—*

(a) such P & M was not, at any time previous to the date of the installation, used in India;

(b) such P & M is imported into India from any country outside India;

(c) no dedn on a/c of depreciation in respect of such P & M has been allowed or is allowable under the provisions of the Income-tax Act, 1961 in computing the total income of any person for any period prior to the date of installation of the machinery or plant by the person.

Further, where in the case of a person, any P & M or any part thereof previously used for any purpose is put to use by the Co. and the total value of the P & M or part so transferred does not exceed 20% of the total value of the P & M used by the Co., then, the condition specified that the Co. does not use any P & M previously used for any purpose would be deemed to have been complied with.

SCHEME FOR TAXATION OF BUSINESS TRUST

The scheme of taxability of income in the hands of the business trust, unit holders, sponsors etc. is briefed in the table given hereunder –

	Transaction	Section	Tax and TDS implications
(1)	**Trf of listed units of the business trust by the unit holders**	**Tax implications in the hands of unit holders:** STT leviable on trading of listed units on a RSE;	
		2(42A)	➢ The period of holding of units of business trust to qualify as "long-term capital assets" is "more than 36 months";
		112A	➢ LTCG upto ₹1 lakh would be exempt in the hands of the unit holders; LTCG exceeding ₹1 lakh would be taxable @10% plus surcharge, if applicable, and health and education cess @4%.
		111A	➢ STCG would be subject to concessional rate of tax@15% (plus surcharge, if applicable, and cess@4%).

	Transaction	Section	Tax and TDS implications
(2)	**Exchange of shares in SPV by sponsor for units of Business Trust**	**Tax implications in the hands of the sponsor:**	
		47(xvii)	➢ Such exchange is not treated as a trf. Hence, taxability of capital gains on such trf **deferred** to the time of disposal of units by the sponsor;
		112A & 111A	➢ The sponsor would get the same tax treatment on offloading of units under an Initial offer on listing of units as it would have been available had he offloaded the underlying shareholding through an IPO. STT shall be levied on sale of such units of business trust which are acquired in lieu of shares of SPV, under an initial offer at the time of listing of units of business trust in the like manner as in the case of sale of unlisted equity shares under an IPO. The benefit of concessional tax regime of tax @15% on STCG and @10% on LTCG exceeding ₹1 lakh u/s 112A shall be available to the sponsor on sale of units received in lieu of shares of SPV subject to levy of STT.
		49(2AC)	➢ For computing capital gains in the hands of the sponsor, cost of acquisition of units would be deemed to be the cost of acquisition of shares to the sponsor;
		2(42A)	➢ For computing capital gains in the hands of the sponsor, the period of holding of units to include the period of holding of shares for determining whether the capital gains are long-term or short-term.
(3)	**Interest income of business trust from SPV**	**Tax implications in the hands of the business trust & unit holders and TDS implications in the hands of the SPV & business trust:**	
		10(23FC)	Pass-through status for interest recd by business trust from SPV ➢ Interest income is not taxable in the hands of the business trust; and
		194A(3)(xi)	➢ SPV is not required to deduct tax at source on interest paid to business trust.
		115UA(3)	➢ Tax consequences on distribution of such income by the business trust to the unit holders: The distributed income or any part thereof, recd by a unit holder from the REIT, which is in the nature of interest recd or receivable from a SPV is deemed as income of unit holder.
		115A(1)(a)(iiac)	▪ Interest income taxable in the hands of the unit holders – ❍ @5%, in case of unit holders, being non-corporate non-resident (NCNR) or foreign companies; and ❍ at normal rates of tax, in case of resident unit holders.
		194LBA	▪ Business trust to deduct tax at source on interest component of income distributed to unit holders at the time of payment or credit of income to the account of the unit holder, whichever is earlier: ❍ @5%, in case of unit holders, being NCNR or foreign companies; and ❍ @10%, in case of resident unit holders.
(4)	**Interest payments to non-resident lenders on ECBs by the business trust**	**TDS implications in the hands of business trust:**	
		194LC	➢ A business trust paying interest income to a NCNR or to a foreign company is liable to deduct TDS@5% [Such interest would attract tax in the hands of the non-resident lenders @5% as per section 115A]. ▪ The above concessional rate of TDS@5% is applicable to interest in respect of money borrowed by the business trust in foreign currency from a source outside India – (i) Under a loan agreement b/w 1.7.2012 and 30.6.2023. (ii) By issuing long term infra bonds between 1.7.2012 to 1.10.2014. (iii) By issuing long term bond including long term infra bonds b/w 1.10.2014 and 30.6.2023. (iv) By way of issue of RDB on or before 30.6.2023. ▪ However, tax is required to be deducted @4% in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or RDB b/w 1.4.2020 and 30.6.2023, which is listed only on a RSE located in any IFSC [Such interest would attract tax in the hands of the non-resident lenders @4% as per section 115A].

	Transaction	Section	Tax and TDS implications
(5)	**Dividend received by the business trust from SPV**	**Tax implications in the hands of the SPV, business trust and unit holders and TDS implications in the hands of the SPV & business trust:**	
		10(23FC)(b)	➢ Pass-through status for dividend recd by business trust from SPV: - Dividend recd or receivable from a SPV, by the business trust would be exempt in its hands; - Consequently, SPV is not required to deduct tax at source on interest paid to business trust.
		115UA(3)	➢ Tax consequences on distribution of such income by the business trust to the unit holders: The distributed income or any part thereof, recd by a unit holder from the REIT, which is in the nature of dividend recd or receivable from a SPV, which has exercised option u/s 115BAA, is deemed as income of unit holder.
		10(23FD) 115A(1)(a)(iiac)	▪ Dividend income taxable in the hands of the unit holders – ❍ @10%, in case of unit holders, being NCNR or foreign companies; and ❍ at normal rates of tax, in case of resident unit holders. (However, in case where SPV has not exercised option u/s 115BAA, dividend income distributed by the business trust would be exempt in the hands of the unit holders)
		194LBA	▪ Business trust to deduct tax at source on dividend component of income distributed to unit holders at the time of payment or credit of income to the account of the unit holder, whichever is earlier, where SPV has exercised option u/s 115BAA: ❍ @ 10%, in case of unit holders, being NCNR or foreign companies; and ❍ @10%, in case of resident unit holders. (However, in a case where SPV has not exercised option u/s 115BAA, no tax is required to be deducted at source by the business trust on dividend income distributed by it to the unit holders)
(6)	**Capital gains on disposal of assets by the Business Trust**	**Tax implications in the hands of the Business Trust and Unit holders:**	
		115UA(2)	➢ Capital gains is chargeable at the applicable rates in the hands of the Business Trust: ▪ In case of LTCG, the provisions of section 112 would apply; ▪ In case of STCG on sale of listed shares, the provisions of section 111A would apply; ▪ Short-term capital gains, other than the gains subject to tax u/s 111A, would be subject to MMR.
		10(23FD)	➢ If such capital gains are further distributed to unit holders, the component attributable to capital gains would be exempt in the hands of the unit holders.
(7)	**Rental income arising to REIT from real estate property directly held by it**	10(23FCA)	➢ **Rental income of REIT from directly owned real estate asset** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the business trust.
		194-I	➢ **Rental income received or credited to a REIT** Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset, owned directly by such business trust, tax is not deductible at source
		115UA(3)	➢ **Distributed income received by unit holder** The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed as income of unit holder.
		194LBA	➢ **Distribution by REIT to unit holders of rental income from real estate assets directly owned by it** → TDS@10% in case of distribution to a resident unit holder → TDS at rates in force in case of distribution to a non-resident unit holder.

	Transaction	Section	Tax and TDS implications
(8)	**Income of business trust [Other than interest and dividend from SPV, rental income from real estate property]**	**Tax implication in the hands of the Business Trust and Unit holders:**	
		115UA(2)	➢ LTCG chargeable to tax u/s 112 – 20% ➢ STCG chargeable to tax u/s 111A – 15% ➢ Any other income of the trust is chargeable to tax at the MMR.
		10(23FD)	➢ The above income distributed to unit holders would be exempt in their hands

SCHEME FOR TAXATION OF INVESTMENT FUND

The scheme of taxability of income in the hands of the Investment Fund and its unit holders is briefed in the table given hereunder –

	Particulars	Investment Fund	Unit holder
(i)	**Income under the head "Profits and gains of business or profession"** of the Investment Fund	Taxable - @25%/30%, as the case may be, for a company and @30% for firm - At MMR in any other case.	Exempt u/s 10(23FBB)
(ii)	Income, **other than profits and gains of business or profession**	Exempt in the hands of investment fund u/s 10(23FBA). **Tax to be deducted u/s 194LBB on such income distributed to unit holders by investment fund** - @10%, in case of resident unit holder - at rates in force in case of NCNR or foreign company	Taxable u/s 115UB, as if he had directly made the investment.
Where total income of the investment fund is a loss under any head of income and such loss cannot be wholly set off against income under any other head of income, then			
(iii)	**out of such loss, there is a loss** under the head **"Profits and gains of business or profession"** incurred by the investment fund	To be carried forward for set-off as per Chapter VI at the Fund level	Not passed on to investors
(iv)	loss (other than loss referred to in (iii) above) where such loss has arisen in respect of unit which has not been held by the **unit holder for a period of at-least 12 months**	The Act is silent relating to the permissibility or otherwise of carry forward of these losses in the hands of investment funds.	Not allowed to be carried forward by the unit holder. He cannot set-off such losses against his income.
(v)	losses (other than losses referred to in (iii) and (iv) above)	Not allowed to be carried forward for set-off by the Investment Fund	Unit-holder can carry forward and set-off such losses against his income as per Chapter VI

Notes *- (1) Losses, other than business losses, accumulated at the level of the investment fund as on 31.3.2019 would be deemed to be the loss of the unit holder who held the unit as on 31.3.2019 in respect of the investments made by him in the investment fund, in the same manner as it were the loss incurred by him had he made such investments directly. Such loss can be c/f by the unit holder for the remaining period calculated from the year in which the loss had occurred for the first time taking that year as the first year. Accordingly, he can set-off such loss in accordance with the provisions of Chapter VI. The loss so deemed to be the loss of the unit holder shall not be available to the investment fund on or after 1.4.2019.*

(2) If income accruing or arising to, or received by, an investment fund, during a P.Y. is not paid or credited to the unit holders, deemed to have been credited to the account of the unit-holder on the last day of the P.Y. in the same proportion in which such person would have been entitled to receive the income had it been paid in the P.Y.

SCHEME FOR TAXATION OF SECURITISATION TRUST

The scheme of taxability of income in the hands of the securitisation trust and its investors is briefed in the table given hereunder –

Particulars	Securitisation Trust	Investors
Income from the activity of Securitisation	Exempt in the hands of securitisation trust u/s 10(23DA). **Tax to be deducted u/s 194LBC on such income distributed to investors by securitization trust** - @25%, in case of investor, being resident individuals and HUF - @30%, in case of investor, being resident other individual and HUF - at rates in force in case of NCNR or foreign company	Taxable u/s 115TCA, as if he had directly made the investment. If income accruing or arising to, or received by, a securitisation trust, during a P.Y. is not paid or credited to the investors, deemed to have been credited to the account of the investors on the last day of the P.Y. in the same proportion in which such person would have been entitled to receive the income had it been paid in the P.Y.

PART II: INTERNATIONAL TAXATION: A CAPSULE FOR QUICK RECAP

At the Final level, the core Paper 7 on Direct Tax Laws and International Taxation comprises of a separate part (i.e., Part II) on international taxation for 30 marks. This capsule covers select chapters in international taxation, namely, Chapters 1 to 3 of Part II: International Taxation of Final Paper 7. The provisions and concepts in these chapters have been presented in this Capsule using tables and diagrams for ease of revision. For comprehensive study, read the October 2021 edition of the Study Material along with the Supplementary Study Paper 2022, explaining the provisions which have been amended by the Finance Act, 2022 and notifications and circulars issued upto 31.10.2022.

CHAPTER 1: TRANSFER PRICING

Fig 1.1

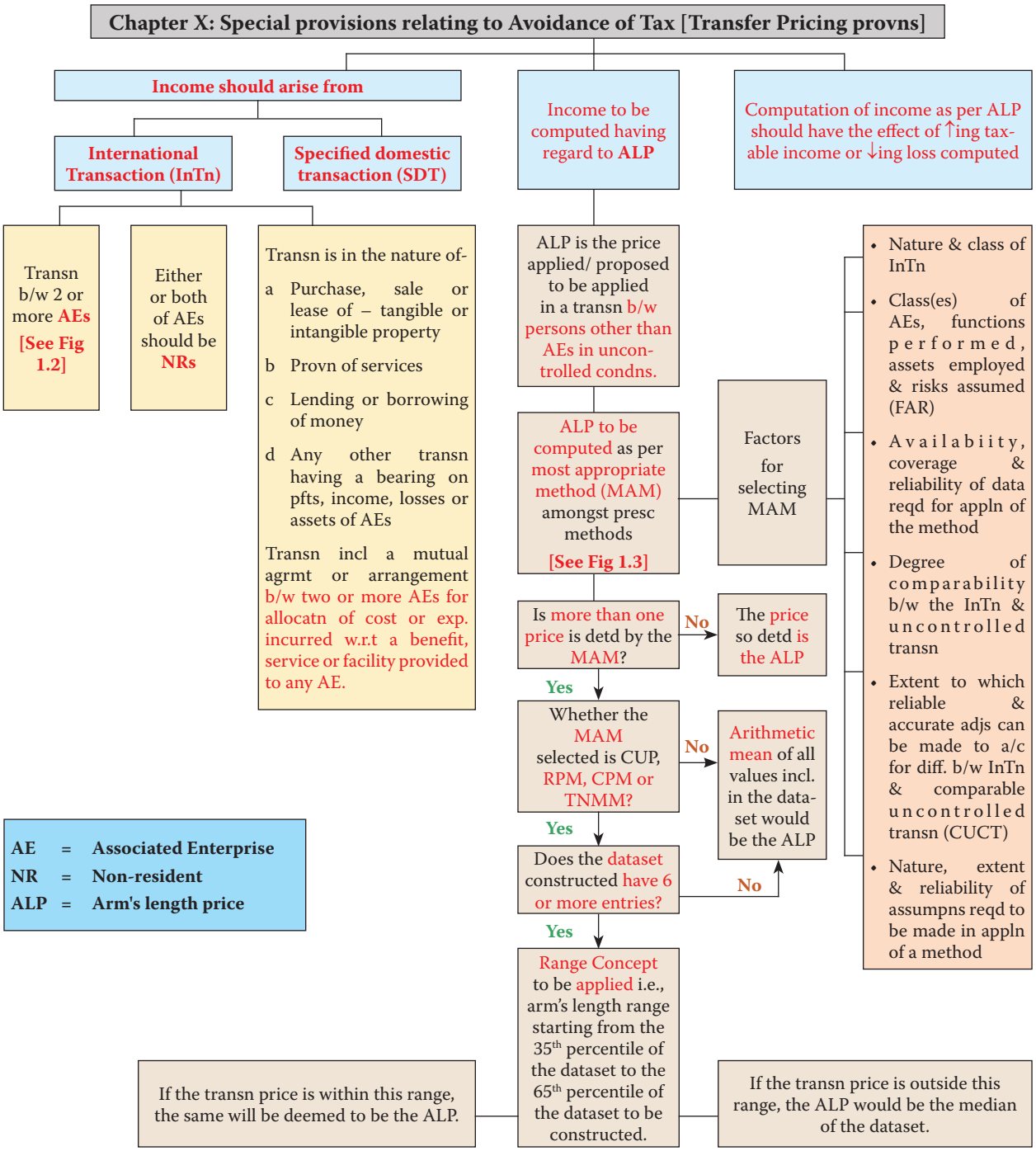


Fig 1.2

Associated Enterprises (AEs) [Section 92A]		
	Condition	**Example**
(1)	An enterprise (entr) which participates, directly (DP) or indirectly (IDP), or through one or more intermediaries, in: • Management (mgt) of the other entr (OE), or • control of OE, or • capital of OE	Where A Ltd. DP in mgt of B Ltd. and B Ltd. DP in mgt of C Ltd. In such situation, A Ltd. has DP in mgt of B Ltd. but has an IDP in mgt of C Ltd. A → B → C In such scenario, both B Ltd. and C Ltd. would be AEs of A Ltd.
(2)	If one or more persons participates, directly or indirectly, or through one or more intermediaries in: • mgt of the two different entrs • control of two different entrs • capital of two different entrs Then, those two entrs are AEs.	Mr. A directly has control in A Ltd. and B Ltd. In such a scenario, both A Ltd. & B Ltd. are AEs since they have a common person i.e. Mr. A, who controls both entities A Ltd. & B Ltd.

Deemed Associated Enterprises [Section 92A(2)]		
Condition	**Situation**	**Example**
Substantial Voting Power (VP)	**One entr holds 26% or more of the VP,** directly or indirectly, in the **other entr (OE).**	A Ltd. holds 33% of VP in B Ltd. and B Ltd. holds 80% VP in C Ltd. A —33%→ B —80%→ C In above situation, A Ltd. holds 26% or more VP in B Ltd. directly and in C Ltd. indirectly (i.e. through B Ltd.). Therefore, both B Ltd. & C Ltd. are deemed AEs of A Ltd.
Substantial VP in two entities by common person	Any person or entr **holds 26% or more of the VP**, directly or indirectly, in each of **two different entrs**.	Mr. A holds 40% of voting power in both X Ltd. and Y Ltd. where neither X Ltd. has any holding in Y Ltd. nor Y Ltd. has any holding in X Ltd. Mr. A 40% ↙ ↘ 40% X ↔ Y In this situation, since Mr. A directly holds 40% of voting power in both X Ltd. and Y Ltd., X Ltd. & Y Ltd. will be deemed AEs.
Advancing of substantial sum of money	One entr advances loan to the OE of an amt of **51% or more** of the book value (BV) of **the total assets of OE**	BV of total assets of Y Ltd. is ₹ 100 crores. X Ltd. advances loan of ₹ 60 crores to Y Ltd. Since, in this case, X Ltd. advances loan which is 60% of the BV of total assets of Y Ltd., X Ltd. & Y Ltd. are deemed AEs.
Guaranteeing borrowings	One entr guarantees **10% or more** of the **total borrowings of the OE.**	P Inc. has total loan of 1 million dollars from XYZ Bank of America. Out of that, A Ltd., an Indian company, guarantees 20% of total borrowings in case of any default made by P Inc. In such case, since A Ltd. guarantees 20% of total borrowings of P Inc., P Inc. and A Ltd. are deemed AEs.
Appointment of majority directors of OE	One Entr appoints **more than half of the BoD** or members of the governing board (GB), or one or more executive directors (EDs) or executive members (EMs) of the GB of **OE**.	X Ltd. has 15 directors on its Board. Out of that, Y Ltd. has appointed 8 directors. In such case, X Ltd. and Y Ltd. are deemed AEs.
Appointment of majority directors of two different entrs by same person(s)	**More than half of the directors** or members of the GB, or one or more of the EDs or members of the GB of each of the **two entrs** are appointed **by the same person(s).**	Mr. A appointed 9 directors out of 15 directors of X Ltd. and appointed 2 EDs on the board of Y Ltd. In such case, since a common person i.e. Mr. A appointed more than half of the directors in X Ltd. and appointed 2 EDs in Y Ltd., both X Ltd. and Y Ltd. are deemed AEs.
Dependence on intangibles w.r.t which OE has exclusive rights	The **manufacture (mfre) or processing of goods** or articles or business carried out by one entr is **wholly dependent (i.e. 100%) on the know-how**, patents, copyrights etc., or any data, documentation, drawing or specification relating to any patent, invention, model etc. of which the OE is the owner or in respect of which the OE has exclusive rights.	

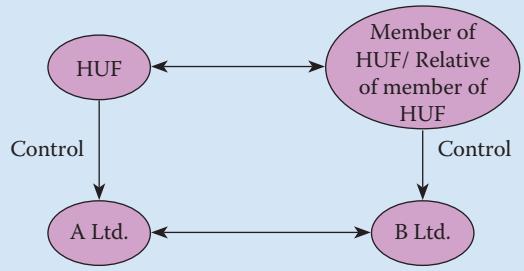
Dependence on raw material (RM) supplied by OE	**90% or more of RMs and consumables** required for the mfre or processing of goods or articles or business carried out by one entr, **are supplied by the OE**, or by persons specified by the OE, where the prices and other conditions relating to the supply are influenced by such OE.	
Dependence on sale	The **goods or articles mfrd** or processed by one entr, **are sold to the OE** or to persons specified by the OE, and the **prices and other conditions** relating thereto are **influenced by such OE.**	
Control by common individual (indvl)	Where **one entr is controlled by an indvl**, the **OE** is also **controlled by such indvl** or his relative or jointly by such indvl and his relatives.	Mr. A and Mr. B are relatives. Mr. A has control over X Ltd. and Mr. B has control over Y Ltd. Therefore, both X Ltd. and Y Ltd. would be deemed AEs.
Control by HUF or member thereof	Where one entr is **controlled by a HUF** and the **OE is controlled** by a **member** of such HUF or by **relative of a member** of such HUF or jointly by such member and his relative.	 A Ltd & B Ltd are deemed AEs
Interest in a firm, AOPs or BOIs	Where one entr is a firm, AOPs or BOIs, the **OE** holds **10% or more interest** in **firm/AOP/BOI.**	
Mutual interest relationship	There exists **b/w the two entrs**, any **relationship of mutual interest**, as may be prescribed.	

Fig 1.3

Methods for computing ALP [Section 92C]

CUP Method	Resale Price Method (RPM)	Cost Plus Method (CPM)	Profit Split Method (PSM)	Transactional Net Margin Method (TNMM)
This method is applied where there are similar transn(s) b/w unconnected parties	This method is applied where item obtained from AE is resold to unrelated party	This method is generally applied where semi-finished goods are sold to AEs	This method is applied where there is trf of unique intangibles or in multiple InTns	**Compute** NP margin of the entr from InTn with AE having regard to cost incurred/sales effected/assets employed
Identify price in a CUCT	**Identify** the RP at which the item is resold to unrelated party	**Identify** direct & indirect COP incurred for property trfd or services provided to AE	**Determine** combined NP of the AEs arising out of InTn	**Compute** the NP margin realised by the entr or unrelated entr in a CUCT by applying the same base
	Reduce the RP by the normal GP margin on CUCT & exp incurred (customs duty) w.r.t. purchase	**Determine** normal GP mark up to such costs by an unrelated entr in CUCT	**Evaluate** the relative contribution of each entr to the earning of combined NP on the basis of FAR	**Adjust** NP margin realised from CUCT to a/c for diffr affecting NP margin in the OM
Adjust the price for material diffr. in terms of contract, credit, transport etc.	**Adjust** the price for functional & other diffr. materially affecting GP margin in open market (OM)	**Adjust** the normal GP mark-up for functional and other diffr materially affecting GP mark-up in OM	**Split** the combined NP amongst the entrs in proportion to mkt returns; & residual pfts in prop. to their relative contribution	**Compare** NP margin relative to costs/sales/assets of the AE with NP margin of uncontrolled party in comparable transactions
Adjusted price is ALP	Adjusted price is ALP	Total Costs ↑d by adjusted mark up = ALP	ALP to be detd on the basis of profit apportioned	Adjusted NP margin taken into A/c to arrive at ALP

Fig 1.4

Penalty for failure to comply with TP provisions: A Summary

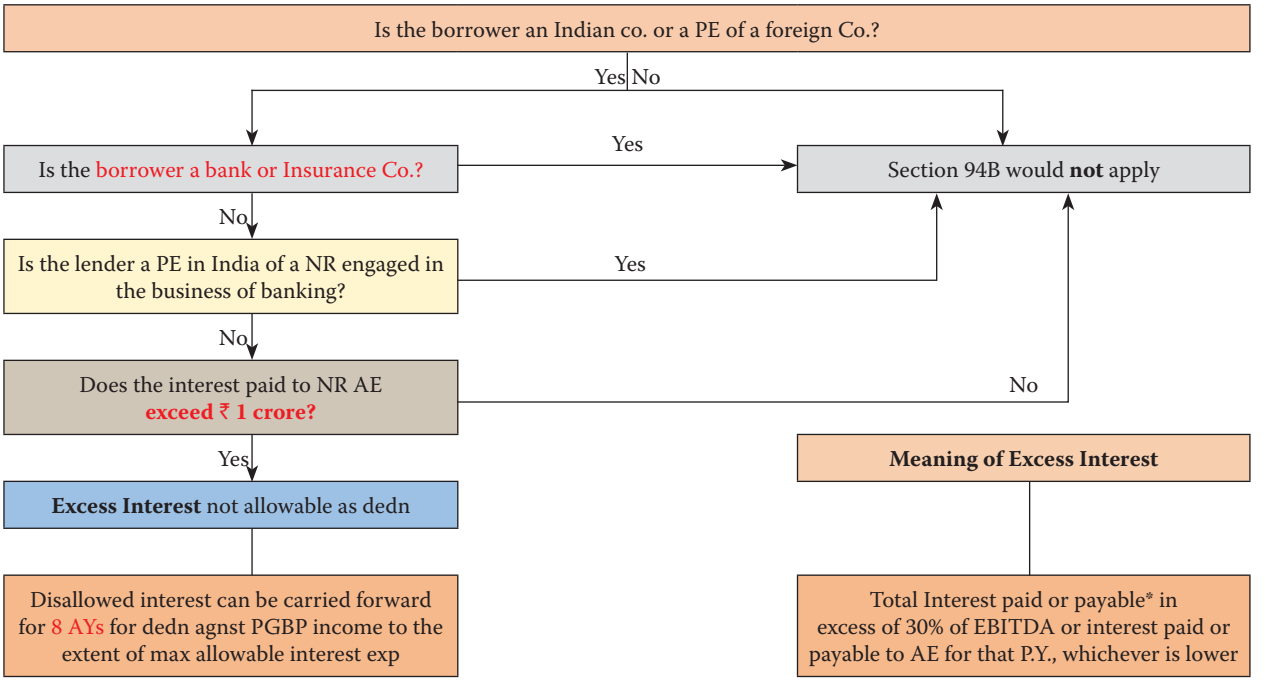
Section	Nature of default	Penalty
270A(9)	**Failure to report any InTn** or Deemed InTn to which the provns of Chap X applies would constitute 'misreporting of income'	200% of the tax payable on under-reported income
271BA	**Failure to furnish a report** from an accountant as required by sec 92E	₹ 1 lakh
271G	**Failure to furnish info or docs as required by AO or CIT(A)** u/s 92D(3) **within 30 days** from the date of receipt of notice or **extended period not exceeding 30 days**, as the case may be.	2% of the value of the InTn for each failure
271AA	(1) **Failure to keep and maintain any such doc and info** as required by sec 92D(1)/(2); (2) **Failure to report such InTn** which is required to be reported; or (3) **Maintaining or furnishing any incorrect info or doc.**	2% of the value of each such InTn

Notes:

- The **penalty u/s 271AA** is **in addition and not in substitution** of **penalty u/s 271BA.**
- If the assessee proves that there was **reasonable cause for the failure, no penalty** would be leviable u/s 271BA, 271G and 271AA.

Fig 1.5

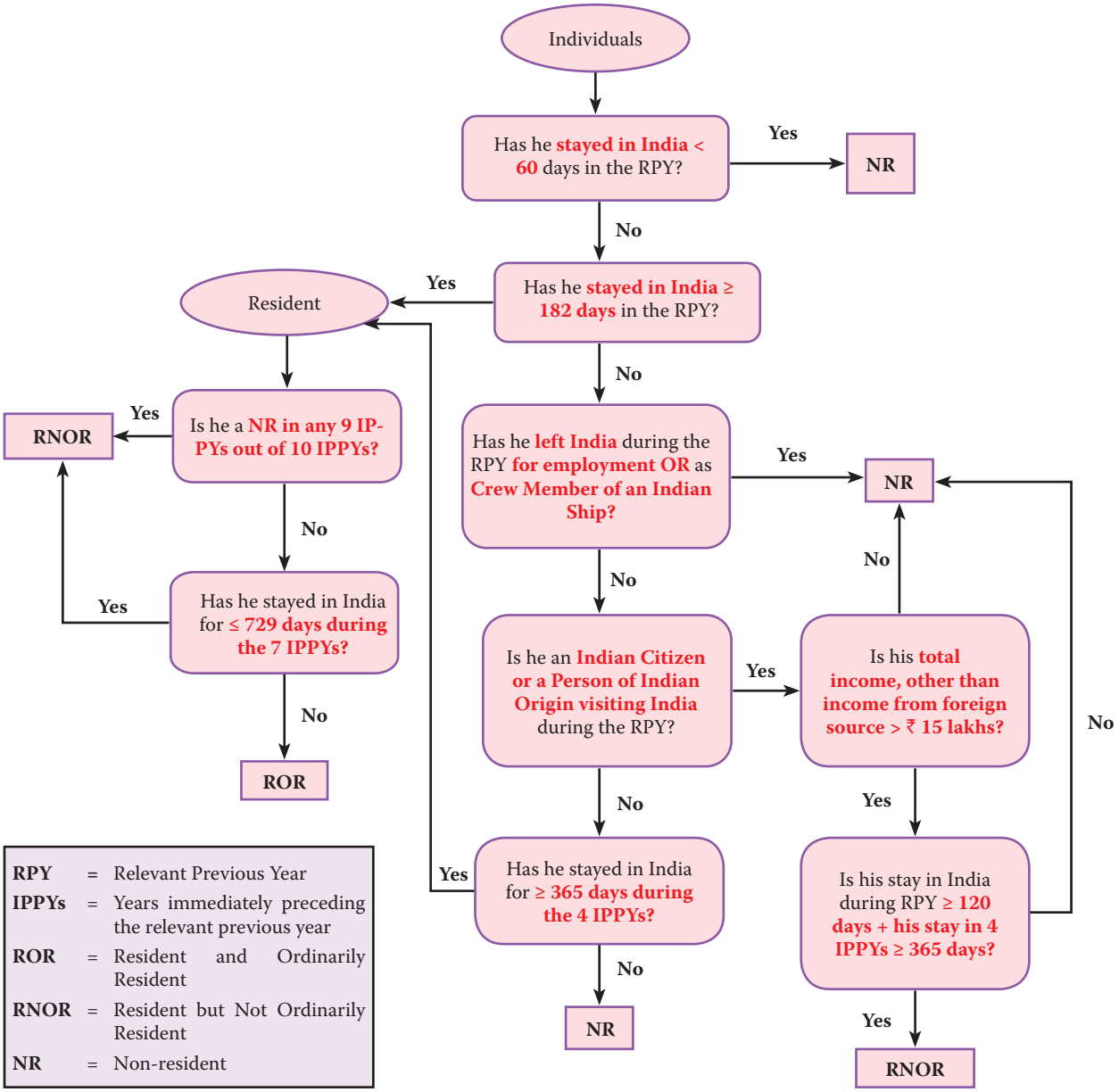
Limitation of interest deduction [Section 94B]



**Total interest paid or payable may be interpreted as interest paid or payable to NR AE as per the intent expressed in section 94B(1) and also the Explanatory Memorandum to the Finance Bill, 2017.*

Fig 2.1

Determination of Residential Status of Individuals [Section 6(1) & 6(6)(a)]



RPY	=	Relevant Previous Year
IPPYs	=	Years immediately preceding the relevant previous year
ROR	=	Resident and Ordinarily Resident
RNOR	=	Resident but Not Ordinarily Resident
NR	=	Non-resident

Deemed resident [Section 6(1A)]

An individual, **being an Indian citizen, having total income,** other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], **exceeding ₹ 15 lakhs** during the RPY would be **deemed to be resident in India** in that PY, **if he is not liable to pay tax in any other country** or territory by reason of his domicile or residence or any other criteria of similar nature.

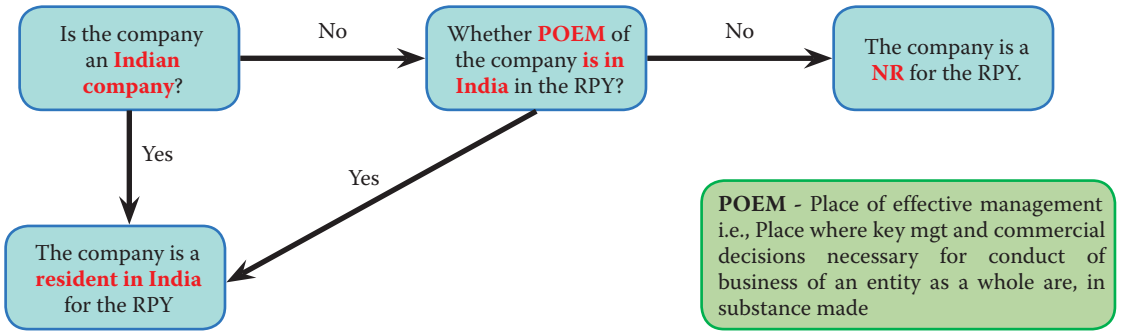
Notes –

(1) If an individual **is a resident in India** in the PY **as per section 6(1)**, then, **the provisions of deemed resident u/s 6(1A)** would **not apply to him.**

(2) A deemed resident u/s 6(1A) would **always be a RNOR.**

Fig 2.2

Determination of Residential Status of Companies [Section 6(3)]



Determination of POEM on the basis of ABOI Test

What is ABOI test? A company is said to be engaged in ABOI, if it fulfills the cumulative conditions:			
Its passive income* (whatever earned) is 50% or less of its total income	Less than 50% of its total assets are situated in India	Less than 50% of the total number of employees are situated in India or are residents in India	Payroll expenses incurred on such employees are less than 50% of its total payroll expenditure

**Passive income of a company shall be aggregate of:*

(i) Income from the transns where both the purchase and sale of goods is from/to its AEs; and

(ii) income by way of royalty, dividend, capital gains, interest (except for banking Cos and public financial institutions) or rental income whether or not involving AEs.

Active Business Outside India (Business Test)

Companies fulfilling the test of ABOI

- POEM **outside India, if majority BOD*** meetings are **held outside India**.
- If *de facto* **decision making authority is not BOD** but Indian parent or resident, POEM shall be in India.

Companies other than those fulfilling the test of ABOI

Stage 1: **Identification of persons** who actually **make the key mgt and commercial decisions** for conduct of the company's business as a whole.

Stage 2: Determination of **place where these decisions are, in fact, made**

* BOD – Board of Directors

Fig 2.3

Scope of Total Income [Section 5]

Scope of Total Income: Whether the following incomes are to be included in Total Income?			
Particulars	**ROR**	**RNOR**	**NR**
Income received or deemed to be received in India during the RPY	Yes	Yes	Yes
Income accruing or arising or deeming to accrue or arise in India during the RPY	Yes	Yes	Yes
Income accruing or arising outside India during the RPY	Yes, **even if** such income is **not received or brought into India** during the P.Y.	Yes, but **only if** such **income** is derived from a **business controlled from or profession set up in India;** Otherwise, No.	**No**

Fig 2.4

Income exempted specifically in the hands of Non-residents (NRs) [Section 10]

Section	Income	Available to
10(4)(ii)	Int. on moneys standing to the credit in a NRE A/c of an indvl in any bank in India as per the FEMA Act, 1999	Indvl resident outside India (under FEMA Act) or an indvl who has been permitted to maintain said A/c by RBI
10(4C)	Int. payable by an Indian co. or Business Trust (BT) in respect of moneys borrowed from a source outside India by way of issue of rupee denominated bond (RDB) during the period from 17.9.2018 to 31.3.2019	A non-corporate NR or foreign co.
10(4D)	Income accrued or arising to or recd by specified fund - from trf of a capital asset, being a bond of an Indian co. or a public sector company [sold by the Govt. and purchased by the specified fund in foreign currency (FC)], GDR or RDB of an Indian co. or derivative or any other notified security, on a RSE located in any IFSC and where the consideration for such trf is paid or payable in convertible foreign exchange; or - from trf of securities (other than shares in a co. resident in India); or - from securities issued by a NR (not being a PE of a NR in India) and where such income otherwise does not accrue or arise in India; or - from a securitisation trust which is chargeable under the head "PGBP" to the extent such income accrued or arisen to, or is received, is attributable to units held by a NR (not being the PE of a NR in India) or is attributable to the investment division of offshore banking unit, computed in the prescribed manner	A specified fund
10(4E)	Any income accrued or arisen to, or recd by, a NR as a result of trf of - non-deliverable forward contracts or - offshore derivative instruments or - over-the-counter derivatives, entered into with an offshore banking unit of an IFSC ref to in section 80LA(1A), which fulfills prescribed conditions	NR
10(4F)	Any income of a NR by way of royalty or interest, on a/c of lease of an aircraft or a ship in a PY, paid by a unit of an IFSC ref to in section 80LA(1A), if the unit has commenced its operation on or before 31.3.2024. "Aircraft" means an aircraft or a helicopter, or an engine of an aircraft or a helicopter, or any part thereof. "Ship" means a ship or an ocean vessel, engine of a ship or ocean vessel, or any part thereof.	NR
10(4G)	Any income recd by a NR from portfolio of securities or financial products or funds, managed or administered by any portfolio manager on behalf of such NR, in an a/c maintained with an Offshore Banking Unit in any IFSC ref to in section 80LA(1A), to the extent such income accrues or arises outside India and is not deemed to accrue or arise in India	NR
10(6)(ii)	Remuneration (remn) recd by Foreign Diplomats/ Consulate and their staff **Conditions:** **1.** The remn recd by our corresponding Govt. officials/member of staff resident in such foreign countries should be exempt. **2.** The member of staff should be the subjects of the respective countries and should not be engaged in any other business or profn or employment in India.	Indvl (not being a citizen of India)
10(6)(vi)	Remn recd as an employee of a foreign enterprise (FE) for services rendered by him during his stay in India, if: a) FE is not engaged in any trade or business in India; b) His stay in India does not exceed 90 days in aggregate in such P.Y.; and c) Such remn is not liable to be deducted from the income of employer chargeable under IT Act	Indvl - Salaried Employee (not being a citizen of India) of a FE
10(6)(viii)	Salary recd by or due for services rendered in connection with his employment on a foreign ship if his total stay in India does not exceed 90 days in the P.Y.	Indvl - Salaried Employee (NR who is not a citizen of India) of a foreign ship

10(6)(xi)	Remn recd as an employee of the Govt. of a foreign State during his stay in India in connection with his training in any Govt. Office/ State Undertaking/ corporation/ registered society etc.	Indvl - Salaried Employee (not being a citizen of India) of Govt. of foreign State
10(6BB)	Tax paid by Indian Co., engaged in the business of operation of aircraft, which has acquired an aircraft or an aircraft engine on lease, under an approved (by CG) agrmt, on lease rental/income derived (other than payt for providing spares or services in connection with operation of leased aircraft) by the Govt. of a foreign State or FE.	Govt. of foreign State or FE (i.e., a person who is a NR)
10(6C)	Royalty income or FTS under an agrmt with the CG for providing services in or outside India in projects connected with security of India	Foreign Co. (notified by the CG)
10(6D)	Royalty income from or FTS rendered in or outside India to, the National Technical Research Organisation (NTRO)	Non-corporate NR and foreign co.
10(15)(iiia)	Int. on deposits made by a foreign bank with any scheduled bank with approval of RBI.	Bank incorporated outside India and authorised to perform Central Banking functions in that Country.
10(15)(iv)(fa)	Int. payable by scheduled bank on deposits in FC where the acceptance of such deposits is duly approved by RBI. [Scheduled bank does not include co-operative bank]	a) NR or b) Indvl or HUF, being a resident but not ordinarily resident
10(15)(viii)	Int. on deposit made on or after 01.04.2005 in an Offshore Banking Unit	
10(15)(ix)	Int. payable by a unit located in IFSC in respect of monies borrowed by it on or after 1.9.2019	NR
10(23FBC)	Any income accruing or arising to or recd by a unit holder from a specified fund or on trf of units in a specified fund	Unit holder of specified Fund
10(23FE)	Dividend, Int. or LTCG arising to specified person from an invst made by it in India, whether in the form of debt or share capital or unit, if such invst (i) is made b/w 1.4.2020 and 31.3.2024; (ii) is held for at least 3 years (iii) is in a BT, a co./enterprise/entity in developing/ operating/maintaining an infrastructure facility or (iv) a SEBI Category I or II AIF having not less than 50% invst in one or more of the co. or enterprise or entity ref to in (iii) or in (v) or in (vi) or in an Infrastructure Investment Trust or (v) a domestic co., set up and registered on or after 1.4.2021, having minimum 75% invsts in one or more of the companies or enterprises or entities ref to in (iii) or (vi) a NBFC registered as an Infrastructure Finance Co. or in an Infrastructure Debt Fund, having minimum 90% lending to one or more of the companies or enterprises or entities ref to in (iii).	Specified person, being (i) a wholly owned subsidiary of the Abu Dhabi Investment Authority (ii) a sovereign wealth fund (iii) pension fund satisfying the prescribed conditions.
10(23FF)	Income of the nature of capital gains on a/c of trf of share of a co. resident in India, by the resultant fund or a specified fund to the extent attributable to units held by NR (not being a PE of a NR in India) in such manner as may be prescribed, and such shares were trfd from the original fund, or from its wholly owned special purpose vehicle, to the resultant fund in relocation, and where capital gains on such shares were not chargeable to tax if that relocation had not taken place.	NR or specified fund
10(48)	Income recd in India in Indian currency on a/c of sale of crude oil or any other goods or rendering of services, as may be notified by the CG in this behalf., to any person in India. Foreign Co. and agrmt should be notified by the CG in national interest.	Foreign co. on a/c of sale of crude oil, any other goods or rendering of services. It should not be engaged in any other activity in India.
10(48A)	Income accruing or arising on a/c of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India. Foreign Co. and agrmt should be notified by the CG in national interest.	Foreign co. on a/c of storage of crude oil in a facility in India and sale of crude oil therefrom.
10(48B)	Income from sale of leftover stock of crude oil from facility in India after the expiry of agrmt or arrangement ref u/s 10(48A) or on termination of the said agrmt or arrangement, in accordance with the terms mentioned therein, subject to such conditions notified by the CG.	Foreign co. from sale of leftover stock of crude oil from the facility in India.

Fig 2.5

SUMMARY OF PRESUMPTIVE PROVISIONS APPLICABLE TO NON RESIDENTS				
Particulars	**44B**	**44BBA**	**44BB**	**44BBB**
Nature of business	**Shipping business**	**Operation of aircraft**	Business of providing services or facilities in connection with, or **supplying P & M on hire used**, or to be used, in the prospecting for, or **extraction or production of, mineral oils**	Business of **civil construction or the business of erection of P & M or testing or commissioning** thereof, in connection with **turnkey power projects** approved by the CG.
Eligible assessee	NR	NR	NR	**Only Foreign co.**
Presumptive income	**7.5%** of specified sum	**5%** of specified sum	**10%** of specified sum	**10%** of specified sum
Specified sum	(i) **Amt. paid** or payable on a/c of **carriage of passengers, livestock, mail or goods** shipped **at/ from any port/ place in India**; and (ii) Amt. **recd or deemed to be recd** in India on a/c of the carriage of passengers, livestock mail or goods shipped **at/ from any port/place outside India**		(i) Amt. **paid or payable on a/c of the provn of such services** or facilities for the aforesaid purposes in India; and (ii) Amt. **recd or deemed to be recd in India** on a/c of the provn of services or facilities for the aforesaid purpose outside India.	Amt. **paid or payable on a/c of such civil construction, erection, testing or commissioning**
Option to declare lower profits	**Not available**		**Lower profits may be claimed** u/s 44BB and u/s 44BBB provided the assessee **maintains BOA** u/s 44AA and **gets them audited** u/s 44AB.	

Fig 2.6

Dedn of HO expd in case of NRs while computing PGBP [Section 44C]

Lower of

5% of adjusted TI

Meaning of Adj. TI

TI, without giving effect to:

(i) HO expd

(ii) Unabsorbed depr

(iii) Capital expd on family planning

(iv) Losses c/f :

- Business loss u/s 72(1)
- Spec. business Loss u/s 73(2)
- LTCL/STCL u/s 74(1)
- Loss from owning and maintaining race horses u/s 74A(3)

(v) Dedns under Chap VI-A from GTI

Amt. of HO expd incurred by the NR attributable to the business or profn in India

Meaning of HO expd

Executive and general admin expd incurred by the NR outside India, incl:

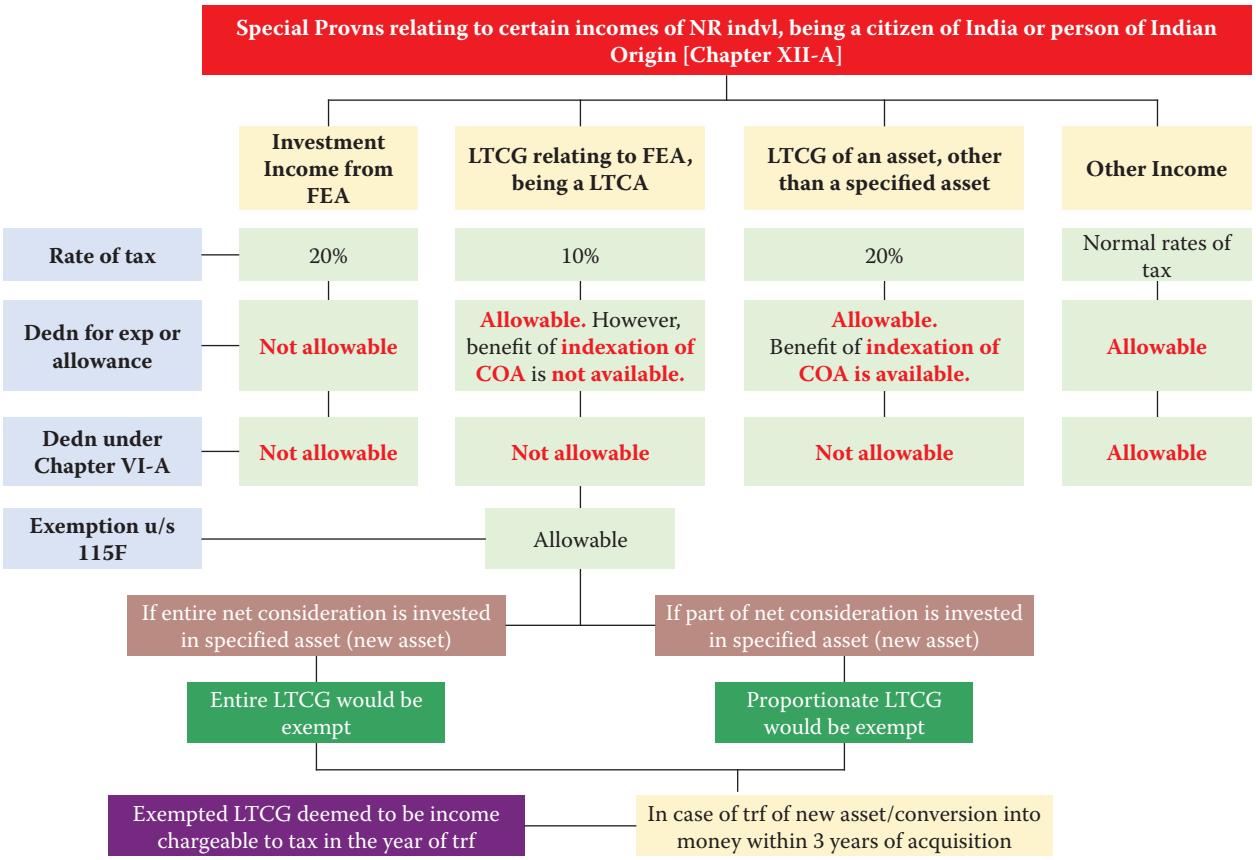
(a) Rent, rates, taxes, repairs or ins of any premises outside India used for business or profn

(b) Salary, wages, perqs etc. to any employee or other person managing the affairs of any office outside India

(c) Travelling exp by any employee or other person managing the affairs of any office outside India

(d) Such other executive and general admin expd prescribed

Fig 2.7



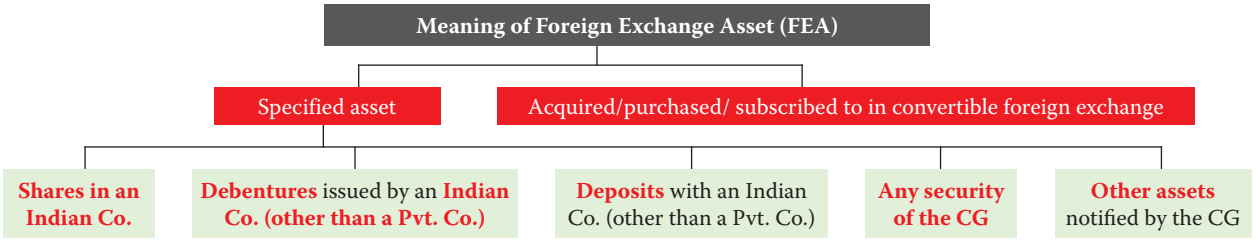


Fig 2.8

Special provisions for computing tax on income by way of dividend and interest [Section 115A]

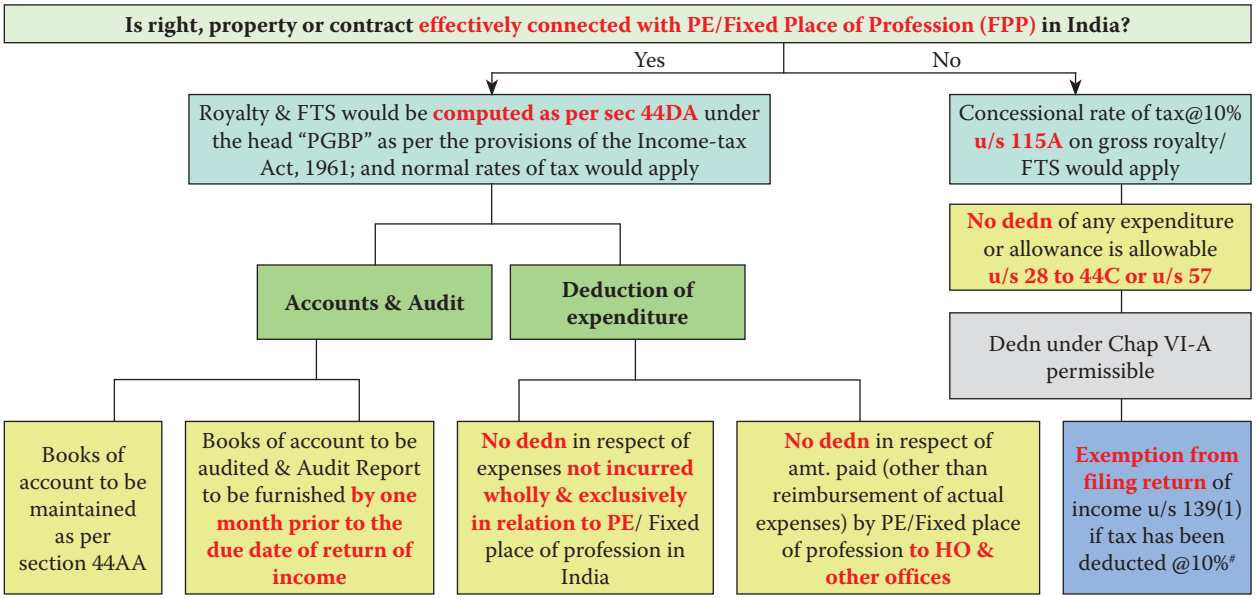
Where the total income of a foreign co. or a non-corporate NR includes any income by way of	Rate of Tax
(1) Dividends	20%
(2) Int. recd from the Govt. or an Indian concern on moneys borrowed or debt incurred by the Govt. /Indian concern in FC, other than (3), (4), (5) and (6) mentioned below	20%
(3) Int. recd from an infrastructure debt fund ref to in section 10(47)	5%
(4) Int. ref to in section 194LC recd from an Indian co. or BT – - in respect of monies borrowed by an Indian co. or BT in FC from sources outside India • Under a **loan agreement between 1.7.2012 and 30.6.2023** or • by way of issue of **long-term infrastructure bonds [LTIB] b/w 1.7.2012 and 30.9.2014** or • by way of issue of **long-term bonds including LTIB b/w 1.10.2014 and 30.6.2023** as approved by the CG - in respect of monies borrowed from sources outside India by way of **RDB on or before 30.6.2023** - in respect of monies borrowed by it from a source outside India by way of issue of any **long-term bond or RDB b/w 1.4.2020 and 30.6.2023,** which is listed only on a RSE located in any IFSC	5% 4%
(5) Int. to a FII or QFI [ref to in section 194LD] **[Refer Fig 2.12]**	5%

Where the total income of a foreign co. or a non-corporate NR includes any income by way of	Rate of Tax
(6) Distributed income ref to in section 194LBA(2), - **Int.** income of a **BT from a SPV,** distributed by BT to its NR unit holders - **dividend income of a BT recd or receivable from a SPV** exercising the option to pay tax at **concessional rate u/s 115BAA,** distributed by BT to its NR unit holders However, if the SPV has not exercised the option to pay tax at concessional rate u/s 115BAA, dividend income would be exempt in the hands of unit holders	 5% 10%
(7) Income recd in respect of **units purchased in FC of a mutual fund (MF) specified u/s 10(23D) or of the UTI**	20%

Notes:
1. **Special rate of tax** is applicable on the **abovementioned incomes**. The **remaining income** of the assessee will be chargeable to tax at **normal rates applicable to assessee.**
2. **No dedn** in respect of any expd or allowance shall be allowed **u/s 28 to 44C and section 57** in computing the above income.
3. **Dedn under Chapter VI-A is not available** in respect of abovementioned incomes. However, a unit of an IFSC can claim dedn u/s 80LA against abovementioned incomes.
4. **Exemption from filing return** of income u/s 139(1) would be available if his total income during the PY consisted only income taxable u/s 115A and **tax has been deducted from such incomes** and the **rate** of such **tax deduction** is **not less** than the **rate specified u/s 115A.**

Fig 2.9

Tax treatment of Royalty & Fees for technical services recd from Govt. / Indian concern in pursuance of approved agreement



*#If tax has been **deducted at a rate lower than 10%** by availing the beneficial provisions of DTAA, then, **no exemption** would be available from filing return of income.*

Fig 2.10

Special provisions for computing tax on income of Specified Fund or Foreign Institutional Investors from securities or capital gains arising from their transfer [Section 115AD]

(1)	(2)	(3)
S. No.	**Income**	**Rate of Tax**
(a)	Income recd in respect of securities **other than** • income on units ref to in section 115AB i.e., units of MF specified u/s 10(23D) or UTI • Int. ref u/s 194LD	20% in case of FII, 10% in case of specified fund
(b)	Int. ref u/s 194LD	5%
(c)	Income by way of **Short term capital gains** arising from the trf of securities (**other than** Short term capital gains **u/s 111A**)	30%
(d)	Income by way of **Short term capital gains u/s 111A**	15%
(e)	Income by way of **Long term capital gains** arising from the trf of securities (**other than** Long term capital gains **u/s 112A**)	10%
(f)	Income by way of **Long term capital gains u/s 112A exceeding ₹ 1 lakh**	10%
(g)	Other income of **Specified Fund or FII**	At normal rates of tax

Notes:

(1) In case of specified fund, the provn of this section **would apply only to the extent of income** that is attributable to units held by NR (not being a PE of a NR in India) calculated in the prescribed manner.

(2) Where the specified fund is **investment division of an offshore banking unit**, the provns of this section would apply to the **extent of income that is attributable to the investment division of such banking units**, calculated in prescribed manner.

(3) **No dedn** in respect of any expd or allowance shall be allowed **u/s 28 to 44C and section 57** from income from securities (ref to in (a) and (b) above).

(4) **Dedn under Chapter VI-A is not available** in case of income from securities, STCG or LTCG arising from trf of securities.

(5) **Conversion to FC and indexation benefit would not be available** while computing capital gains on trf of securities.

Fig 2.11

Special provision for computing tax on non-resident sportsmen or sports associations [Section 115BBA]

	Assessee	Income
(1)	(2)	(3)
(a)	A sportsman (including an athlete), who is not a citizen of India and is a NR	Any income recd or receivable by way of— (i) participation in India in any game (other than a game the winnings wherefrom are taxable u/s 115BB, being winning from crossword puzzles, races including horse races, card games and other games of any sort of gambling or betting) or sport; or (ii) advertisement; or (iii) contribution of articles relating to any game or sport in India in newspapers, magazines or journals;
(b)	A NR sports association or institution	Any amt guaranteed to be paid or payable to such association or institution in relation to any game (other than a game the winnings wherefrom are taxable u/s 115BB) or sport played in India
(c)	An entertainer who is not a citizen of India and is a NR	Any income recd or receivable from his performance in India

Notes:

1. The **abovementioned incomes would be chargeable to tax @20%.** The **remaining income** of the assessee will be chargeable to tax at **normal rates applicable to assessee**.
2. **No dedn** in respect of any expd or allowance shall be allowed under any provisions of the Act in computing the above mentioned income.
3. **Exemption from filing return** of income u/s 139(1) would be available if his total income during the P.Y. consisted only of the abovementioned income and **tax has been deducted from such incomes**.

Fig 2.12

WITHHOLDING TAX PROVISIONS RELATING TO NRs: A SUMMARY

Section	Nature of payment	Rate of TDS
192	Salary	Normal Slab rates
192A	**Premature withdrawals from EPF**, aggregating **to ₹ 50,000 or more**	10%
194B	Income by way of **winnings from lotteries, crossword puzzles, card games and other games of any sort**, where payt to a person **> ₹ 10,000**	30%
194BB	Income by way of **winnings from horse races,** where payt to a person **> ₹ 10,000**	30%
194E	Specified payts **ref u/s 115BBA** to NR sportsmen/sports association or an entertainer **[Refer Fig 2.11]**	20%
194G	**Commission** etc. on the **sale of lottery tickets**, where amt. payable to a person **> ₹ 15,000**	5%
194LB	**Int.** payable **by infrastructure debt fund** to non-corporate NR or foreign co.	5%
194LBA(2)	**Distribution** of any **int. income**, recd or receivable **by a BT from a SPV**, to its unit holders	5%
	Distribution of any dividend income, recd or receivable **by a BT from a SPV exercising option** to pay tax at concessional rate u/s 115BAA, to its unit holders. However, if the **SPV is not exercising the option to pay tax at concessional rate** u/s 115BAA, dividend income would be exempt in the hands of unit holders and tax would not be deductible at source	10%

Section	Nature of payment	Rate of TDS
194LBA(3)	Distribution of any **income recd from renting or leasing or letting out any real estate asset directly owned** by the BT, to its unit holders	At the rates in force
194LBB	**Investment fund** paying income to a unit holder [other than income chargeable under the head "PGBP" which is **exempted u/s 10(23FBB)**].	
194LBC(2)	**Income in respect of invst made** in a securitisation trust (specified in Explanation to section 115TCA)	
194LC	**Int. payable by an Indian Co. or a BT** to a non-corporate NR or foreign co.– - in respect of monies borrowed in FC from sources outside India • Under a **loan agrmt b/w 1.7.2012 and 30.6.2023** or • by way of **issue of long-term infrastructure bonds** during the period **b/w 1.7.2012 and 30.9.2014** or • by way of **issue of long-term bonds** including long term infrastructure bonds **b/w 1.10.2014 and 30.6.2023** as approved by the CG or - in respect of **monies borrowed from sources outside India** by way of **RDB on or before 30.6.2023**	5%
	Int. payable by an Indian co. or a BT to non-corporate NR or foreign co., in respect of monies borrowed by it from a source outside India by way of **issue of any long term bond or RDB b/w 1.4.2020 and 30.6.2023**, which is listed only on a RSE located in any IFSC	4%
	Int. payable by an Indian co. or a BT to a NR, including a foreign co., in respect of **RDB issued outside India during the period from 17.9.2018 to 31.3.2019**	Nil [Since such int. is exempt u/s 10(4C), no tax is deductible u/s 194LC]
194LD	On **int. payable** - **b/w 1.6.2013 and 30.6.2023** on • **RDB** of an Indian Co. or • **Govt. securities** or - **b/w 1.4.2020 and 30.6.2023 on municipal debt securities** to a FII or QFI on investment made in	5%
194N	On **withdrawal of cash in excess of ₹ 1 crore**	2% on amt exceeding ₹ 1 crore
	In case the recipient has **not filed ROI for all the 3 immediately preceding PYs**, for which time **limit u/s 139(1) has expired**, the sum shall be the amt or agg. of amts, **in cash > ₹ 20 lakhs during the P.Y.**	- @2% of the sum, where cash withdrawal > ₹ 20 lakhs ≤ ₹ 1 crore - @5% of the sum, where cash withdrawal > ₹ 1 crore
195	Any other sum payable to NR	At the rates in force
196A	**Income on units of a MF** specified u/s 10(23D) or **from the specified co.** ref to in section 10(35) payable to non-corporate NR or foreign co.	20%
196B	**Income from units of a MF or UTI** purchased in FC (including LTCG on trf of such units) **payable to an Offshore Fund**	10%
196C	**Income by way of int. or dividend on bonds** of an Indian Co. or public sector co. sold by the Govt. and purchased by a NR in FC or GDRs ref to u/s 115AC (including LTCG on trf of such bonds or GDRs) payable to a NR	10%
196D	**Income of FII from securities** (not being income by way of int. ref u/s 194LD or capital gain arising from such securities)	20%
	Income of specified fund from securities [not being income by way of int. ref u/s 194LD or capital gain arising from such securities or income exempt u/s 10(4D)]	10%

Note - In all the above cases, the rate of tax would be increased by surcharge, wherever applicable, and HEC @4%.

CHAPTER 3: DOUBLE TAXATION RELIEF

Fig 3.1

Double taxation means taxing the same income twice in the hands of an assessee

This arise from the two basic rules that enables the country of residence as well as the country where the source of income exists to impose tax namely,

In order to avoid such double taxation, Double Tax Avoidnace Agreements come into play.

Source Rule

Income taxed in the Country in which it originates irrespective of whether the income accrues to a resident or NR

Residence Rule

Income taxed in the Country in which the taxpayer is resident

Fig 3.2

DT Relief under the IT Act, 1961

Bilateral Relief [Section 90/90A]

Agrmt with foreign countries or specified territories

Objective

The CG may enter into an agrmt with the Govt of any country outside India or specified territory or specified assn outside India,—

- for the granting of relief in respect of doubly taxed income
- for the avoidance of DT of income without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance
- for exchange of infn for the prevention of evasion or avoidance of income-tax
- for recovery of income-tax

Taxability

- Taxability of income would be detd based on DTAA or the IT Act, 1961, whichever is more beneficial.

Charge of tax on foreign Co.

- The charge of tax in respect of a foreign co. at a rate higher than the rate at which a domestic co. is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign co.

Tax Residency Certificate (TRC)

- In order to claim DT relief, the NR to whom such DTAA applies, has to obtain a TRC from the Govt of that country or specified territory.
- The NR to also provide such other docs and info, as may be prescribed, for claiming treaty benefits.

Unilateral Relief [Section 91]

Countries with which no agrmt exists

Applicability

- Assessee, who is a resident in India during the P.Y.

Conditions

- The income accrues or arises to him outside India.
- The income is not deemed to accrue or arise in India during the P.Y.
- The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.
- The assessee has paid tax on the income in the foreign country.
- There is no agrmt for relief from DT b/w India and the other country where the income has accrued or arisen.

Computation of Relief

- Doubly taxed income **X** Indian rate of tax or Rate of tax in the said country, whichever is lower

CA FINAL - PAPER 8: INDIRECT TAX LAWS

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students of Chartered Accountancy Course. Keeping with this objective, BoS has come up with a crisp and concise capsule on Part II: Customs & FTP of Paper 8: Indirect Tax Laws of Final Course, to facilitate students in quick revision before examination. The Capsule makes use of diagrams, tables, flow charts etc. to facilitate recap of select topics of Customs law namely, levy of and exemptions from customs duty; types of duty & classification of imported and export goods.
The capsule is based on the Customs law as amended by the Finance Act, 2021 and significant notifications/circulars issued till 31st October 2021 and is thus, relevant for students appearing in May, 2022 examination. Students may note that this capsule is a tool for quick revision and thus, should not be taken as a substitute for the detailed study of the subject. Students are advised to refer to the October 2021 Edition of Final Course Study Material along with Statutory Update for May 2022 examination which has been hosted on the ICAI website, for comprehensive study and revision.

CUSTOMS

LEVY OF AND EXEMPTIONS FROM CUSTOMS DUTY

Charging Section [Section 12]

Charging section 12 → Customs Duties are levied on **goods imported into and exported from India** → At rates specified in Customs Tariff Act, 1975 [CTA, 1975] → Provisions to apply to Govt. goods also

Taxable event

- **Taxable event**
  - Imports
    - goods cleared for home consumption — when goods reach customs barriers + B/E for home consumption filed
    - goods warehoused — custom barriers would be crossed when goods sought to be taken out of customs & brought to mass of goods in country
  - Exports
    - when the goods cross the territorial waters of India — when the goods cross the territorial waters of India

Important terms

- **Indian Customs waters** – means waters extending into the sea up to the limit of EEZ & **includes** any bay, gulf, harbour, creek or tidal river. Powers of customs officers extend up to Indian Customs Waters.
- **Territorial Waters of India (TWI)**- extends up to 12 nautical miles (nm) into sea from baseline.
- **Exclusive Economic Zone (EEZ)** - area beyond TWI. The limit of EEZ is 200 nm from the nearest point of the baseline. Area beyond that is 'high seas'

Schedules of the Customs Tariff Act, 1975

- **The Customs Tariff Act, 1975**
  - **First Schedule** — enlists the goods liable to import duty
  - **Second Schedule** — enlists the goods liable to export duty

Date for determining the rate of duty and tariff valuation of imported goods [Section 15]

- **Goods entered for home consumption** — Date of presentation of bill of entry **OR** Date of entry inwards of the vessel/arrival of the aircraft or vehicle **whichever is later**
- **Goods cleared for home consumption from the warehouse** — Date on which a bill of entry for home consumption in respect of such goods is presented
- **Any other goods** — Date of payment of duty

Duty liability in special circumstances

(A) Re-importation of goods

(i) Re-importation of goods exported under duty drawback, exported for repairs, etc. - Concessional duty payable

S. No.	Description of goods exported	Amount of import duty payable if re-imported
1.	Goods exported- (i) under claim for duty drawback; (ii) under claim for refund of integrated tax paid on export goods; (iii) under bond without payment of integrated tax (iv) under duty exemption scheme (Advance Authorisation/ DFIA) or EPCG)	Amount of incentive availed of at the time of export In case of point (iv) amount of IGST and compensation cess leviable at the time and place of importation of goods subject to specified conditions.
2.	Goods other than those falling under S. No. 1 exported for repairs abroad	Duty of customs (BCD, IGST and GST compensation cess) on value = Fair cost of repairs including cost of materials (actually incurred or not), used in repairs + insurance and freight charges, both ways.
3.	Goods other than falling under S. No. 1 & 2 above	NIL

Conditions to be satisfied for claiming the above two concession exemptions:-

Time-limit for re-importation

- 3 years further extendable for a period up to 2 years.
- In case of goods exported under AA / DFIA / EPCG / DEPB etc - 1 year further extendable for a period upto 1 year

Same goods

No change in ownership

(ii) Exemption to re-import of goods and parts thereof for repairs/ reconditioning/reprocessing/remaking or similar other process

S. No.	Particulars	Time-limit for re-importation from the date of exportation	Other conditions to be satisfied
1.	Goods manufactured in India and re-imported for repairs/ reconditioning other than specified goods	3 years Export to Nepal- 10 years.	(a) Re-exported within 6 months (extendable till 1 year) of the date of re-importation. (b) The AC/DC of Customs is satisfied as regards identity of the goods. (c) Execution of bond
2.	Goods manufactured in India and re-imported for Reprocessing/ Refining/Re-making/any other similar process	1 year	

(B) Goods derelict, wreck etc. [Section 21]

All goods, derelict, jetsam, flotsam and wreck brought or coming into India → Treated like imported goods

No duty on pilfered goods [Section 13]

If imported goods are pilfered → After unloading → Before order for clearance for home consumption /deposit in a warehouse → No duty payable

If goods restored to the importer after pilferage → importer becomes liable to duty

Remission of duty on goods lost, destroyed or abandoned [Section 23]

If importer proves upto the satisfaction of AC/DC → imported goods are lost/destroyed → At any time before clearance for home consumption → Duty is remitted

Right to relinquish the title to the goods-abandonment of goods

Owner of any imported goods may relinquish his title to the goods → Any time before an order for clearance of goods for home consumption OR order for permitting the deposit of goods in a warehouse → Not be liable to pay the duty → No relinquishment of title - Goods regarding which an offence appears to have been committed

Abatement of duty on damaged or deteriorated goods [Section 22]

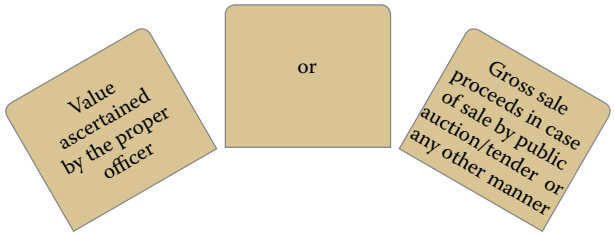
(a) Cases where the abatement is available

Goods	Damaged / Deteriorated up to the satisfaction of AC/DC	
Any imported goods	before or during unloading	
Any imported goods, other than warehoused goods	by accident after unloading but before examination for assessment by the customs authorities	Provided such accident is not due to any wilful act, negligence or default of the importer, his employee or agent
Any warehoused goods	by accident in warehouse before their actual clearance from such warehouse	

Amount of duty chargeable after abatement

$$= \text{Duty on goods before damage/deterioration} \times \frac{\text{Value of damaged/deteriorated goods*}}{\text{Value of goods before damage/deterioration}}$$

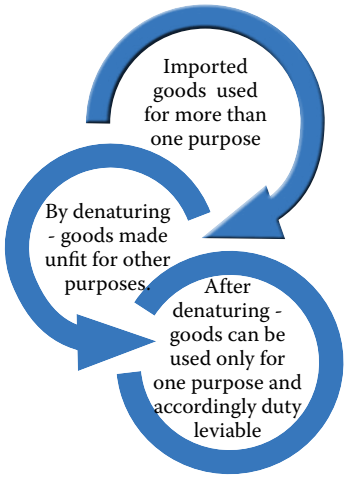
*Valuation of the damaged or deteriorated goods



Difference between section 13, 22 and 23 of the Customs Act, 1962

Section 13	Section 22	Section 23
NO DUTY on PILFERED goods.	REDUCED duty on DAMAGED goods.	REMISSION of duty on DESTROYED goods.

Denaturing or mutilation of goods [Section 24]



Exemption from customs duty [Section 25]

General Exemption	Special Exemption
☐ Central Government in public interest	☐ Central Government in public interest
☐ by notification in the Official Gazette	☐ by special order in each case
☐ exempt generally either absolutely or conditional exemption	☐ exempt from payment of duty only under circumstances - exceptional nature
☐ conditional exemption-valid upto 31st day of March falling immediately after 2 years from the date of such grant/ variation unless otherwise specified	☐ No duty - if the amount of duty leviable is equal to or less than Rs. 100.

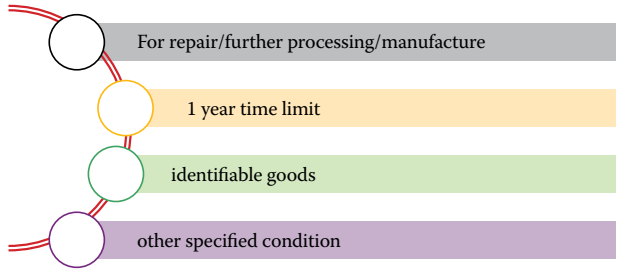
Effective date of notification

Effective date not mentioned
- Date of its issue by the Central Government for publication in the Official Gazette.

Exemption through a special order
- Date of its issue

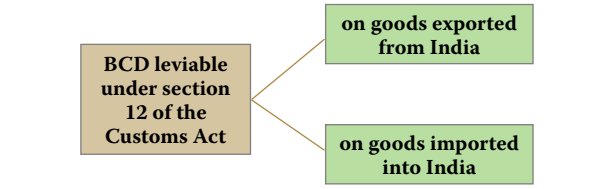
Clarifications
- Issued within 1 year from the issue of the notification
- retrospective effect

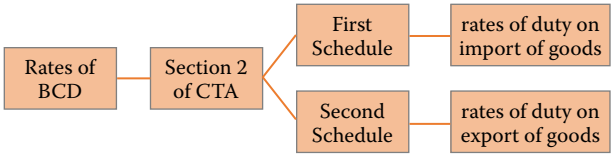
Exemption from customs duty on imported goods used for inward processing of goods [Section 25A] / re-imported goods used for outward processing [Section 25B]



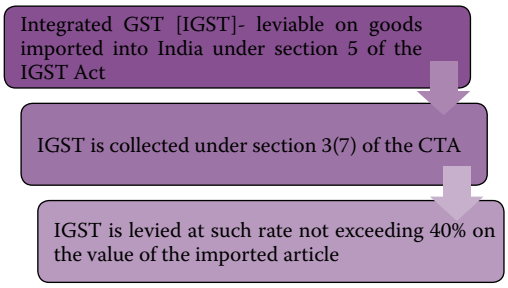
TYPES OF DUTY

Basic customs duty (BCD) [Section 12 of the Customs Act & Section 2 of the Customs Tariff Act (CTA)]

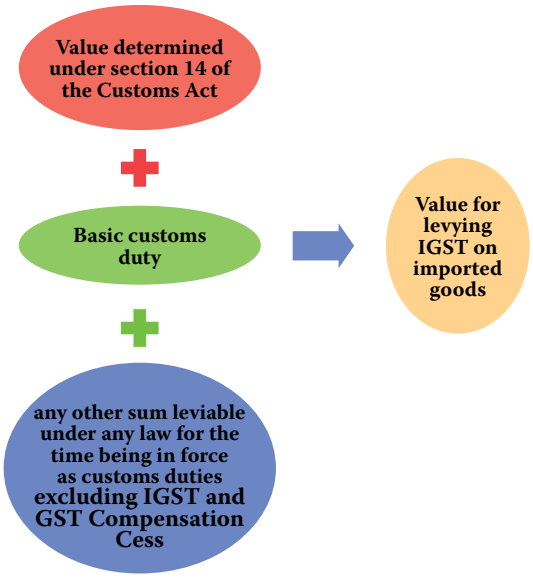




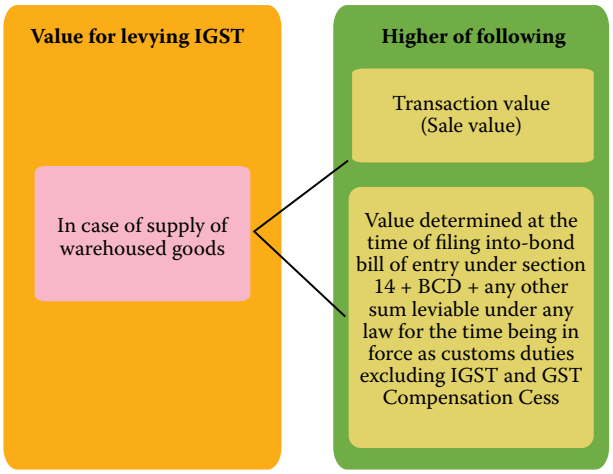
Integrated tax [Section 3(7) of the Customs Tariff Act]



Manner of computing assessable value for levying integrated tax



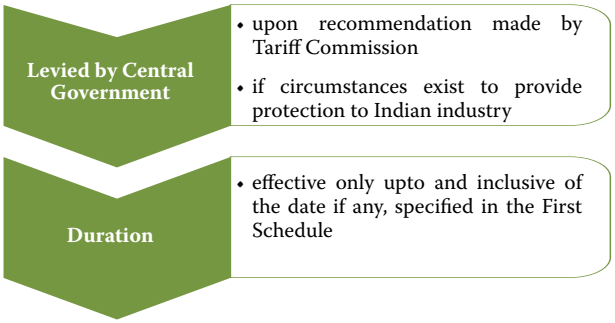
Manner of computing value in case of warehoused goods



Social Welfare Surcharge (SWS) on imported goods

Rate	Duties Excluded	Exempted
• 10% of BCD • levied & collected on goods imported into India	• Safeguard measures • Countervailing duty • Anti-dumping duty • SWS	• Integrated tax • GST compensation cess

Protective duties [Section 6 & 7 of the Customs Tariff Act]



Emergency power to impose or enhance export duties [Section 8 of Customs Tariff Act]

Central Government empowered by amendment to the second schedule by notification

Conditions

- Goods may/may not be specified in second schedule
- Necessary circumstances exist

Emergency power to impose or enhance import duties [Section 8A of Customs Tariff Act]

Central Government empowered by amendment to the first schedule by notification

Conditions

- Goods should be specified in first schedule
- Necessary circumstances exist

Power of Central Government (CG) to apply safeguard measures [Section 8B of the Customs Tariff Act]

Any article imported into India in increased quantities

+

It is causing / threatening to cause serious injury to domestic industry

→ CG after enquiry can impose safeguard measures by issuing a notification in the Official Gazette

Modes of safeguard measures	Duration	Exemption from safeguard measures
• imposition of safeguard duty or • application of tariff-rate quota or • other measures as the CG deems appropriate.	• 4 years • May be extended by CG- total period of levy of safeguard measures-10 years • Provisional safeguard measures- maximum period of 200 days	• **Articles from developing country**-share of imports < 3% of total imports • **Articles originating from more than one developing country-** aggregate of imports from developing countries each with less than 3 % import share taken together does not exceed 9% of total imports. • **Imports by 100% EOU or units in a SEZ except in specified cases**

Anti-dumping duty [Section 9A of the Customs Tariff Act]

Dumping is

Normal value in the exporting market > Export price

Computation of anti-dumping duty

Anti-dumping duty — Lower of the following
- Injury margin
- Margin of dumping

Margin of dumping

Margin of dumping = Normal Value − Export Price

Normal Value

Comparable price at which the goods under complaint are sold in the domestic market of the exporting country or territory in the ordinary course of trade.

If the normal value cannot be determined as per the sales in the domestic market of exporting country, normal value shall be

- Comparable representative export price to an appropriate third country, or
- Cost of production in the country of origin + Administrative, selling and general costs, profits.

Export Price

Price of an article exported from the exporting country or territory.

Computation of injury margin

Injury Margin — Difference between the following
- Landed value of the dumped articles
- Fair Selling Price [Non-Injurious Price] due to the domestic industry

Landed value

AV under Customs Act & applicable BCD except special duties

Countervailing duty on subsidised articles [Section 9 of the Customs Tariff Act]

Any country pays subsidy upon manufacture/production/ exportation of article

+

such article imported into India

+

whether or not directly from the country of manufacture

+

whether or not in the same condition as when exported from country of manufacture

→ Countervailing duty on subsidized articles is imposed

Amount of countervailing duty **shall not exceed** **amount of subsidy paid**

Common provisions for countervailing duty on subsidised articles & anti dumping duty

Duration	5 years
Extension of period	up to 5 years

Common provisions for countervailing duty on subsidised articles & anti dumping duty

Circumvention of duty	Absorption of duty	Non-applicability of duty
• by altering the description/ name/ composition of the article • by import of such article in an unassembled/ disassembled form • by changing the country of its origin/ export or • in any other manner, whereby the duty so imposed is rendered ineffective.	• if there is a decrease in the export price of an article without any commensurate change in the cost of production/export price/ resale price in India of such article as the case may be • other specified circumstances	• Duty shall not apply to article imported by a 100% EOU or a unit in SEZ , unless,- (i) it is specifically made applicable in such notification/ to such undertaking/unit; or (ii) such article is either cleared as such into the DTA/ or used in the manufacture of any goods that are cleared into the DTA on the portion of the article so cleared or used.

In case of circumvention or absorption of duty → Duty may be extended or modified respectively from such date, not earlier than the date of initiation of the inquiry, as the CG may specify by notification in the Official Gazette.

No levy under Section 9 or Section 9A in certain cases [Section 9B of the Customs Tariff Act]

- Both countervailing and anti-dumping duties not leviable for same situation
- Both duties not leviable if articles are exempt [sole reason]
- Both duties not leviable on imports from member country of WTO/ country with whom GOI has a most favored nation agreement
- Provisional countervailing and anti-dumping duties not to be levied on article imported from specified countries

Appeal [Section 9C of the Customs Tariff Act]

Authority	Time limit
CESTAT	within 90 days of the date of order under appeal

Computation of customs duty and integrated tax payable thereon

Particular	Amount (₹)
Assessable value (AV)	xxx
Add: Basic custom duty @ X% (AV x X%) [A]	xxx
Add: Social welfare surcharge @ 10% x BCD [B]	xxx
Value for computing integrated tax- (1)	xxx
Add: Integrated tax (1 × Y%) [C]	xxx
Total customs duty payable [(A) + (B) +(C)]	xxx

Goods and Services Tax compensation cess [Section 3(9) of Customs Tariff Act]

- GST compensation cess levied on inter/intra State supply of goods and/or services - to provide compensation to States for loss of revenue due to GST implementation
- applicable only on goods and/or services notified by Central Government
- currently levied on luxury and sin goods like pan masala, tobacco etc

Agriculture infrastructure and development cess (AIDC) on import of certain items

- Levied on import of specified goods at notified rate
- Example-apples, kabuli chana, urea etc

CLASSIFICATION OF IMPORTED AND EXPORT GOODS

Rules of interpretation and explanatory notes

- Rules of interpretation → Six
- General Explanatory Notes → Three

General explanatory notes

Relevance of one dash ["-"], two dash ["--"] and three dash ["---"]

- "-" denotes that the said article/group of articles is sub-classification of the article/ group of article covered by the said heading.
- "--" denotes that that the said article/ group of articles is sub-classification of the immediately preceding article/group of articles which has "-".
- "---" or "----" denotes that the said article/ group of articles is a sub-classification of the immediately preceding description of the article / group of articles which has "-" or "--"

"%" in relation to the rate of duty

- It means that the duty to be computed at the percentage specified on the value of the goods

Standard rate of duty applicable if no preferential rate specified

- If no preferential rate of duty notified - standard rate of duty is applicable.

Rules of interpretation of the First Schedule to the Customs Tariff Act

1	• General Rule of Classification
2(a)	• Classification of Incomplete/Unfinished Articles
2(b)	• Classification of Mixtures/Combinations of a Material/ Substance with Other Materials/Substances
3	• Classification in case goods are classifiable under two or more headings
4	• Akin Rule
5	• Classification of cases/containers used for packaging of goods and packing materials/packing containers
6	• Only Sub-Headings at the same level are comparable

Rules of Interpretation

Rule 1 General Rule

- Titles of sections/chapters/sub-chapters - ease of reference only
- Terms of headings read with relative section/chapter notes - legally relevant

Rule 2(a) Classification of Incomplete/ Unfinished Articles

- If any particular heading refers to a finished/ complete article - incomplete/unfinished/ unassembled/dis-assembled form of that article also classified under same heading
- If it has essential characteristics of finished goods

Rule 2(b) Classification of Mixtures/ Combinations of a Material/ Substance with Other Materials/Substances

- Reference to a material/ substance would refer to mixture / combination of that material / substance
- Reference to a material/ substance would include reference to goods consisting wholly / partly of such material / substance

Rule 3 - Classification in case goods are classifiable under two or more headings

Rule 3(a)-Specific over general	Rule 3(b) – Essential character principle	Rule 3(c) – Latter the better
• Heading providing a more specific description should be preferred over heading providing a general description	• If goods cannot be classified under rule 3(a) • Composite goods should be classified on the basis of that material / substance that gives it its essential character	• If goods cannot be classified by reference to rule 3(a) / rule 3(b), • To be classified under heading which occurs last in numerical order

Rule 4 Akin Rule

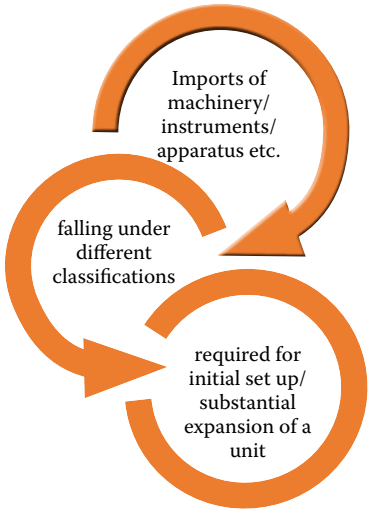
- If goods cannot be classified in accordance with the earlier rules
- to be classified under the heading in which the most akin goods are classified.

Rule 5(a)-Classification of cases/containers used for packaging of goods	Rule 5(b) – Classification of packing materials & packing containers
• Camera cases, musical instrument cases etc and similar containers - to be classified with a specific article/set of articles when of a kind normally sold therewith. • Exception-When packing material itself gives the essential character as a whole	• Packing materials & packing containers presented with the goods therein to be classified with the goods, if they are of a kind normally used for packing such goods. • Exception-Durable containers capable of repetitive use - to be classified separately.

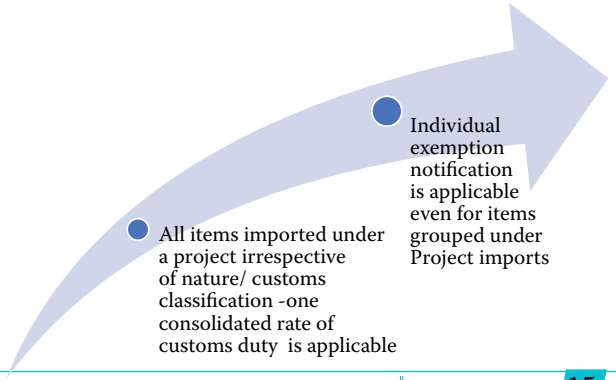
Rule 6 Only Sub-Headings at the Same Level are Comparable

- A sub-heading can be compared only with another sub-heading within the same heading.

Project imports



Classification of project imports



CA FINAL - PAPER 8 - INDIRECT TAX LAWS

It has always been the endeavour of Board of Studies to provide quality academic inputs to the students of Chartered Accountancy Course. Keeping in mind this objective, BoS has come up with a crisp and concise capsule on Part II: Customs & FTP of Paper 8: Indirect Tax Laws of Final Course to facilitate students in quick revision before examination. The Capsule makes use of diagrams, tables, flow charts, etc., to facilitate recap of select Chapters of Customs law namely- Chapter 4: Valuation under the Customs Act, 1962 and a part of Chapter 5: Importation, Exportation and Transportation of goods.
The capsule is based on the Customs law as amended by the Finance Act, 2021 and significant notifications/circulars issued till 30th April, 2022 and is thus, relevant for students appearing in November, 2022 examination. Students may note that this capsule is a tool for quick revision and thus, should not be taken as a substitute for the detailed study of the subject. Students are advised to refer to the October 2021 Edition of Final Course Study Material along with statutory updates for November, 2022, which has been hosted on the ICAI website for comprehensive study and revision.

PART II – CUSTOMS & FTP
VALUATION UNDER THE CUSTOMS ACT, 1962

VALUE OF GOODS [SECTION 2(41) OF THE CUSTOMS ACT]

Value of goods
- Value determined as per Section 14(1) -Transaction value (TV)
- Value determined as per Section 14(2)-Tariff value

TECHNICAL TERMS RELATING TO VALUE IN THE COURSE OF IMPORT OR EXPORT – INTERNATIONAL COMMERCIAL (INCO) TERMS

Ex-Factory Price	Price of the goods at the factory gate
F.O.B.	Cost at which the goods are placed on board the conveyance carrying the vessel
C.I.F	Cost at which the goods are delivered at the Indian port

TWO APPROACHES FOR COMPUTING THE ASSESSABLE VALUE

Two approaches for cases of rejection of declared value
- To take the actual wholesale market price of the goods in question and give necessary abatements to adjust the post–importation costs
- To take value given in the invoice as base & make necessary adjustments for factors influencing the price in individual transactions

Default mode of valuation = Declared transaction value + Elements that are to be added under law

VALUATION OF GOODS BASED ON SECTION 14

Modes of identifying the value of imported or export goods for the purpose of payment of customs duty

Transaction Value [sec. 14(1)]
- Price actually paid/payable for goods when sold for export to/from India
- for delivery at time & place of importation/ exportation
- buyer & seller are not related
- price is the sole consideration for sale
- subject to conditions prescribed by rules

Tariff Value [sec. 14(2)]
- CBIC may notify Tariff values for any class of imported/ export goods
- Where tariff values are fixed, then duty to be chargeable w.r.t. such tariff value.
- Section 14(2) has an overriding effect on section 14(1)

CONVERSION DATES

Rate of exchange
- Imported goods – Date of filing bill of entry [B/E]
- Export goods – Date of filing shipping bill (vessel or aircraft) /bill of export (vehicle)

CURRENCY CONVERSION RATE

Currency conversion rate for the purpose of valuation under Customs laws → Rate notified by CBIC (Board) shall be taken into account

CUSTOMS VALUATION (DETERMINATION OF VALUE OF IMPORTED GOODS) RULES, 2007

Value of imported goods

- TV of imported goods [Rule 3]
- TV of identical goods [Rule 4]
- TV of similar goods [Rule 5]
- Deductive Value based on identical/similar imported goods [Rule 7]
- Computed Value [Rule 8]
- Residual method [Rule 9]

RULE 2 – DEFINITIONS

Place of Importation [Rule 2(1)(da)] — The customs station, where the goods are brought for being
- cleared for home consumption
- removed for deposit in a warehouse

Related Persons [Rule 2(2)] [same as in GST]

Persons including Legal Persons —DEEMED AS→ RELATED PERSONS —IF→

- Such persons are officers/ directors of one another's business
- Such persons are legally recognised partners in business
- Such persons are employer & employee
- A third person controls (directly/indirectly) or own / holds ≥ 5% voting stock/ shares of both of them
- One of them controls (directly/indirectly) the other
- A third person controls (directly/indirectly) both of them
- Such persons together control (directly/ indirectly) a third person
- Such persons are members of the same family
- One of them is the sole agent/ sole distributor/ sole concessionaire of the other

Identical goods [Rule 2(1)(d)]

(i) means imported goods which are same in all respects except for minor differences in appearance that do not affect the value of the goods

Similar goods [Rule 2(1)(f)]

(i) means imported goods although not alike in all respects, have like characteristics & like component materials which enable them to perform the same functions & to be commercially interchangeable with the imported goods w.r.t. the quality, reputation & the existence of trade mark

(ii) produced in country in which imported goods were produced;
(iii) produced by the same person who produced the imported goods/where no such goods are available, goods produced by a different person,
but shall not include imported goods where engineering, development work, etc., undertaken in India were completed directly/ indirectly by the buyer on these imported goods free of charge or at a reduced cost for use in connection with the production & sale for export of these imported goods.

RULE 3 – DETERMINATION OF THE METHOD OF VALUATION

Value of imported goods under rule 3(1) = TV adjusted as per rule 10, subject to rule 12 (i.e. right of rejection by Proper Officer)

Such TV shall be accepted provided that -
- No restriction on buyer for disposal of goods
- Sale/Price is not subject to conditions/ consideration for which value cannot be determined
- No further consideration will accrue to seller which is not adjustable as per rule 10
- Buyer & seller are unrelated

If buyer & seller are related, then also TV is accepted
- When relationship didn't influence price &
- Importer proves that price is close to TV of identical/ similar goods, in sales to unrelated buyers; deductive/ computed value of identical/similar goods

RULE 4 – TRANSACTION VALUE OF IDENTICAL GOODS

Transaction value of identical goods sold for export to India

Imported at or about the same time as the goods being valued

Identical goods should be sold at the same commercial level & substantially the same quantity.
If sold at different commercial level/quantity, then adjustment to be made for the difference

Adjustment to be made on account of difference in distance and means of transport used for import of identical goods as per rule 10(2)

In case more than one transaction value of identical goods is available, lowest value to be considered

RULE 5 – TRANSACTION VALUE OF SIMILAR GOODS

The principles of valuation of identical goods also apply to valuation of similar goods

RULE 6 – DETERMINATION OF VALUE WHERE VALUE CAN NOT BE DETERMINED UNDER RULES 3, 4 AND 5

Value to be determined under rule 7

Rule 8-when the value cannot be determined under rule 7

At the request of importer, and with the approval of proper officer, order of application of rules 7 and 8 shall be reversed.

RULE 7 – DEDUCTIVE VALUE

+

Unit price at which imported/identical/similar imported goods are sold in greatest aggregate quantity to unrelated persons in India.

−

Commission, profit & general expenses relating to sales in India

Transport, insurance costs & associated costs within India

Customs duties & other taxes payable in India

RULE 8 – COMPUTED VALUE

Cost/Value of materials & fabrication/other processing employed in producing the imported goods

+

Profit and general expenses = usually reflected in sales of goods of the same class/kind of goods made in country of exportation for export to India

→ Computed Value

+

Expenses referred under rule (u/r) 10 (2)

RULE 9 – RESIDUAL METHOD

Value determined using reasonable means consistent with principles & general provisions of these rules and on the basis of data available in India

Value so determined ≤ Normal price of such goods

Residuary method shall not be used for valuation on the basis of—

(i) Selling price in India of the goods produced in India;
(ii) a system which provides for the acceptance for customs purposes of the highest of the 2 alternative values;
(iii) the price of the goods on the domestic market of the country of exportation;
(iv) the cost of production other than computed values which have been determined for identical/similar goods as per rule 8;
(v) the price of the goods for the export to a country other than India;
(vi) minimum customs values; or
(vii) arbitrary or fictitious values.

METHOD OF APPLICATION OF VALUATION RULES

Valuation Rules to be applied sequentially → However, importer may request Proper Officer to apply computed value method before deductive value → The residuary method can be considered if valuation is not possible by any other method

Transaction value rejected under Rule 12 by Proper Officer or Transaction value not available

- Determine value as per Rule 4 to 9 sequentially
- Apply Rule 3
  - Transaction value adjusted in accordance with Rule 10

RULE 10 – COST AND SERVICES

Rule 10(1) - Costs to be added if not included:

i) commissions etc. **except buying commissions**, cost of containers/ packing
ii) engineering, design work, etc., **undertaken elsewhere in India**, materials, tools, dies, consumables, etc., used in production of imported goods - supplied free of charge/ at reduced cost
iii) royalties & license fees as condition of sale
iv) Proceeds of any subsequent sale accruing to seller
v) all other payments as condition of sale

RULE 10(2)

Rule 10(2) - Transaction value shall include

- Transport Cost (TC), loading, unloading & handling charges upto place of importation
- Insurance cost (IC)

TRANSPORT COST (TC)

If TC etc. not ascertainable,	• Transport cost etc. = 20% of Customs FOB
If Customs FOB not ascertainable, but Customs FOB + Insurance cost ascertainable	• Transport cost, loading, unloading and handling charges = 20% of (Customs FOB + Insurance cost)

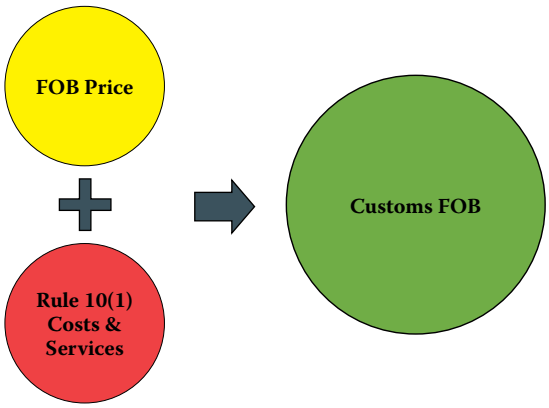
INSURANCE COST

If insurance cost not ascertainable	• Insurance cost = 1.125% of Customs FOB
If Customs FOB not ascertainable, but Customs FOB + TC etc. ascertainable	• Insurance cost = 1.125% of (Customs FOB + transportation cost etc.)

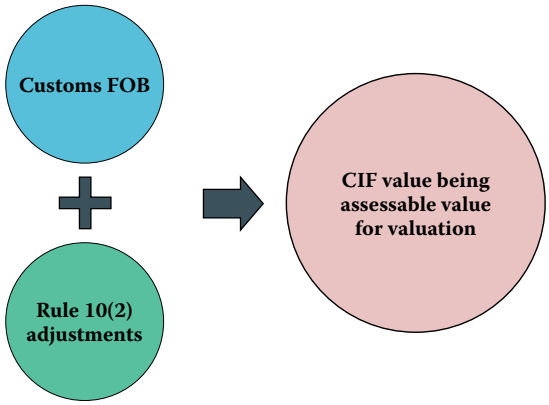
KEY POINTS REGARDING TRANSPORTATION COST

In case of goods imported by air, where transport, loading, unloading and handling charges is ascertainable	• such cost shall not exceed 20% of FOB value
In case of goods imported by sea or air and transshipped to another customs station in India	• the cost of insurance, transport, loading, unloading, handling charges associated with such transshipment shall be **excluded**.
cost of transport of the imported goods	• includes the ship demurrage charges on charted vessels, lighterage/barge charges.

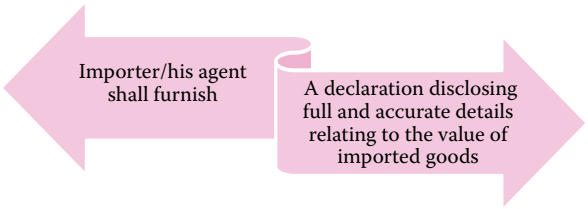
CUSTOMS FOB



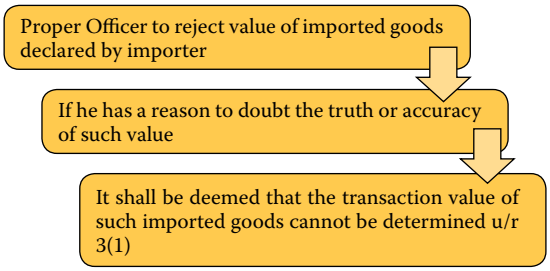
ASSESSABLE VALUE



RULE 11 – DECLARATION BY THE IMPORTER



RULE 12 – REJECTION OF DECLARED VALUE

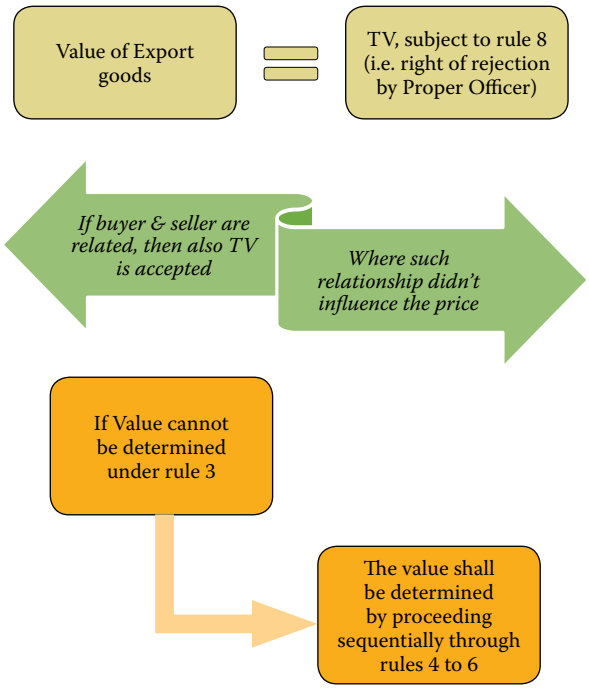


CUSTOMS VALUATION (DETERMINATION OF VALUE OF EXPORT GOODS) RULES, 2007

RULE 2 – DEFINITIONS

Goods of like kind and quality [Rule 2(1)(a)]	Export goods which are identical/similar in physical characteristics, quality & reputation as the goods being valued and;
	Perform the same functions/are commercially interchangeable with the goods being valued, produced by the same person/a different person

RULE 3 - DETERMINATION OF THE METHOD OF VALUATION

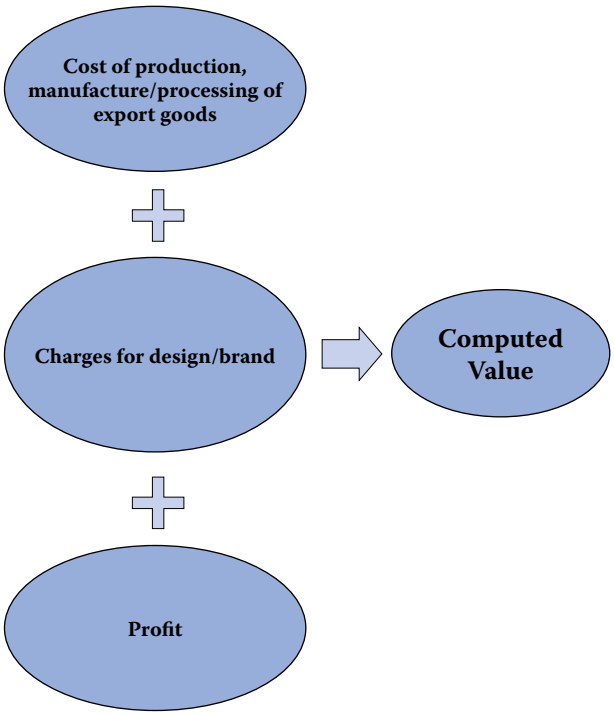


RULE 4 - DETERMINATION OF EXPORT VALUE BY COMPARISON

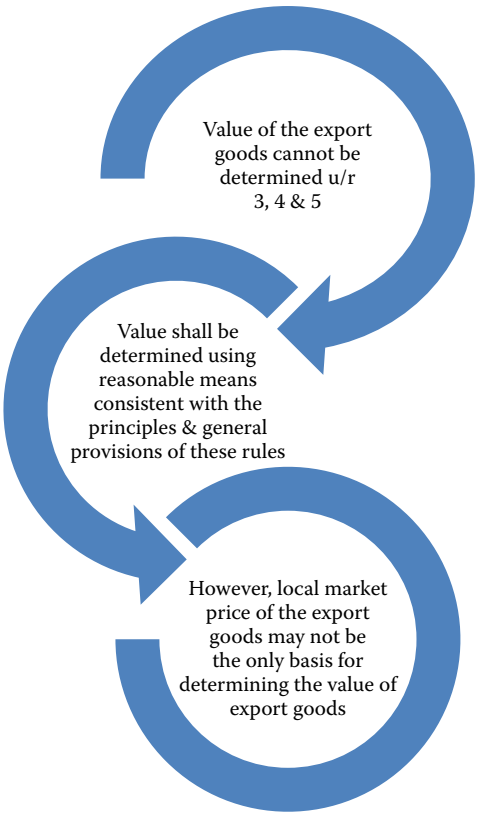
Value = Transaction value of "goods of like kind and quality" exported at/about the same time to other buyers in the same destination country of importation/in its absence another destination country of importation adjusted by proper officer considering relevant factors, incuding -

(i) difference in the dates of exportation
(ii) difference in commercial levels & quantity levels
(iii) difference in composition, quality & design
(iv) difference in domestic freight & insurance charges

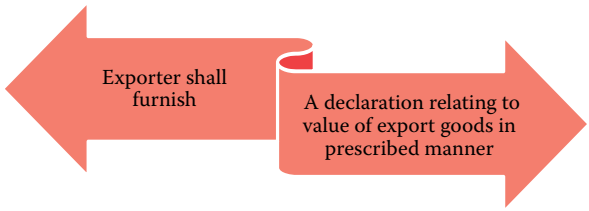
RULE 5 - COMPUTED VALUE METHOD



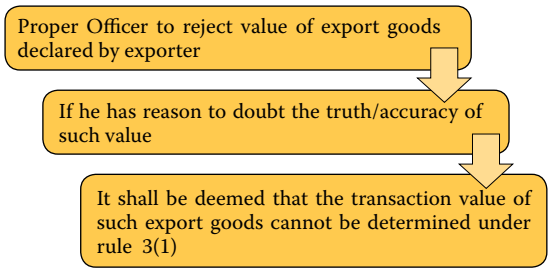
RULE 6 - RESIDUAL METHOD



RULE 7 - DECLARATION BY THE EXPORTER



RULE 8 - REJECTION OF DECLARED VALUE



DATE FOR DETERMINATION OF RATE OF DUTY & TARIFF VALUATION OF IMPORTED GOODS [SECTION 15]

Imported goods	Date for determination of rate of duty/ tariff value
Entered for home consumption	Later of (i) Date of filing B/E u/s 46 or (ii) Date of entry inwards of vessel/date of arrival of vehicle/aircraft
Cleared from Warehouse	Date on which B/E for home consumption is presented
Any other goods	Date of payment of duty

DATE FOR DETERMINATION OF RATE OF DUTY & TARIFF VALUATION OF EXPORT GOODS [SECTION 16]

Export goods	Date for determination of rate of duty/ tariff value
Entered for Export	Date of the 'let export' order
Any other goods	Date of payment of duty

DETERMINATION OF DUTY WHERE GOODS CONSIST OF ARTICLES LIABLE TO DIFFERENT RATES OF DUTY [SECTION 19]

- Articles liable to duty with reference to quantity → Chargeable to that duty
- Articles liable to duty with reference to value
  - Liable to duty at the same rate → Chargeable to duty at that rate
  - Liable to duty at different rates → Chargeable to duty at the highest of such rates
- Articles not liable to duty → Chargeable to duty at the rate at which articles liable to duty with reference to value
- Accessories, parts and implements imported along with article → Chargeable at the same rate of duty as that article → If they are compulsorily supplied along with that article & no separate charge is made for such supply & their price being included in the price of the relevant article

IMPORTATION, EXPORTATION AND TRANSPORTATION OF GOODS

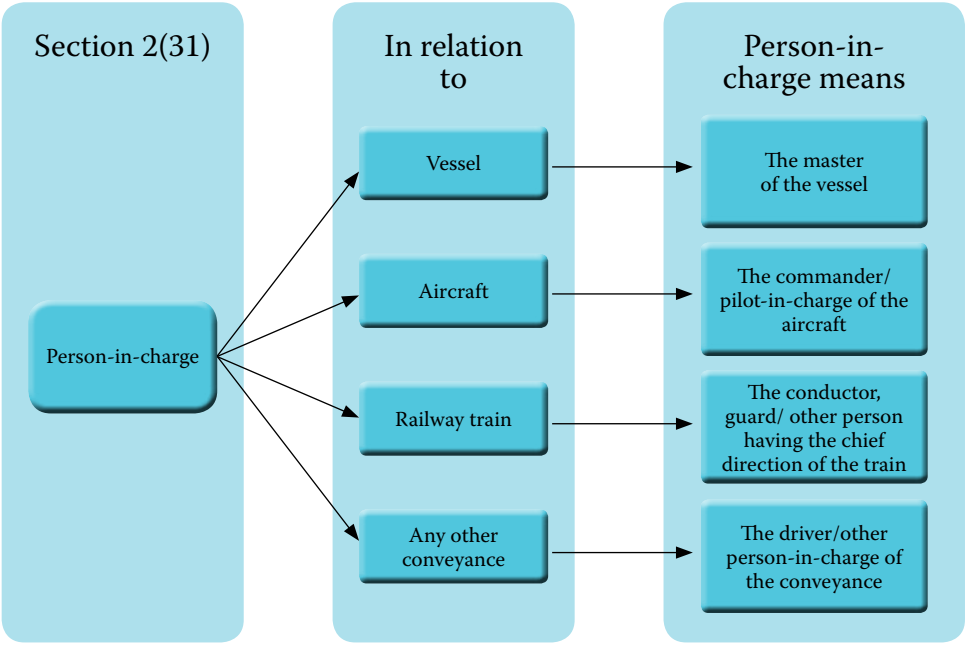
IMPORTANT DEFINITIONS

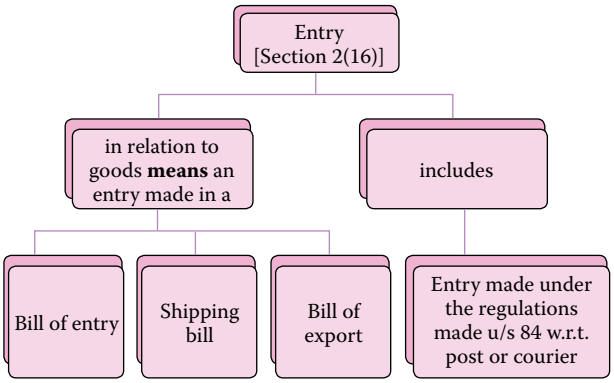
Conveyance includes [Section 2(9)]
- vessel
- aircraft
- vehicle

Exporter [Section 2(20)]
- In relation to any goods at any time between their entry for export and the time when they are exported, includes
  - Any owner
  - Beneficial owner
  - Any person holding himself out to be the exporter

Importer [Section 2(26)]
- In relation to any goods at any time between their importation and the time when they are cleared for home consumption, includes
  - Any owner
  - Beneficial owner
  - Any person holding himself out to be the importer

Foreign going vessel or aircraft [Section 2(21)]
- means
  - Any vessel/ aircraft for the time being engaged in the carriage of goods/ passengers between any port/ airport in and outside India, irrespective of touching any intermediate port/airport in India
- includes
  - any naval vessel of a foreign Government taking part in any naval exercises
  - any vessel engaged in fishing/ any other operations outside the territorial waters of India
  - any vessel/ aircraft proceeding to a place outside India for any purpose whatsoever





ARRIVAL OF VESSELS AND AIRCRAFTS IN INDIA [SECTION 29]

Person-in-charge of vessel/ aircraft entering India not to permit the vessel/ aircraft to call/ land at any place other than customs port/ customs airport

for the first time after arrival in India or

at any time while carrying passengers/ cargo unless permitted by the Board

Allowed to call/ land at other place if compelled by accident, stress of weather/ other unavoidable cause

Obligations of person-in-charge of such vessel/ aircraft:-

(i) To report arrival of vessel/landing of aircraft to the nearest customs officer/officer in charge of police station & produce log book if demanded

(ii) W/o consent of such officer - not permit unloading of goods & any passengers/crew to leave the vicinity of vessel/aircraft

(iii) Comply with all the directions given by such officer

Exception:- Goods can be unloaded or passengers/crews can leave w/o consent due to health, safety/preservation of life or property

DELIVERY OF ARRIVAL MANIFEST/ IMPORT MANIFEST/ IMPORT REPORT [SECTION 30]

Imported goods brought in	Import Document to be presented by person-in-charge	Time limit for presentation of IM/IR	Mode of presentation
Vessel/ Aircraft	Arrival manifest (AM)/ import manifest (IM)	Any time prior to its arrival	Electronic filing
Vehicle	Import Report (IR)	Within 12 hourrs after its arrival	Prescribed manner

Principal Commissioner/ Commissioner of Customs may allow AM/IM to be delivered in any other manner, if not feasible to present electronically.

Penalty for delay w/o sufficient cause → Not exceeding ₹50,000

Proper officer satisfied that AM/IM/IR is in any way incorrect/incomplete & no fraudulent intention → May permit it to be amended or supplemented.

PASSENGER AND CREW ARRIVAL MANIFEST AND PASSENGER NAME RECORD INFORMATION [SECTION 30A]

Person-in-charge/any other specified person has to deliver to proper officer

- The passenger and crew arrival manifest
  - **Before** arrival in the case of an aircraft/vessel
  - **Upon** arrival in the case of a vehicle
- The passenger name record information

Means records prepared by operator/ his authorised agent of any aircraft/vessel/ vehicle for each journey booked by/ on behalf of any passenger.

Penalty for delay w/o sufficient cause → **Not exceeding ₹50,000**

IMPORTED GOODS NOT TO BE UNLOADED FROM VESSEL UNTIL ENTRY INWARDS GRANTED [SECTION 31]

- Master of vessel not permitted unloading of any imported goods until order granting entry inwards given by proper officer
- Order to be given only if arrival manifest/ import manifest delivered or proper officer satisfied that there was valid reason for its non-delivery.
- Exception:- Unloading of baggage accompanying passenger/member of the crew, mail bags, animals, perishable goods & hazardous goods

IMPORTED GOODS NOT TO BE UNLOADED UNLESS MENTIONED IN ARRIVAL MANIFEST OR IMPORT MANIFEST OR IMPORT REPORT [SECTION 32]

W/o permission of proper officer

- Imported goods not to be unloaded
- Unless mentioned in arrival manifest, import manifest/ import report for being unloaded in that customs station

LOADING AND UNLOADING OF GOODS AT APPROVED PLACES ONLY [SECTION 33]

Loading & Unloading of goods to be undertaken → Only at approved places

GOODS NOT TO BE LOADED OR UNLOADED EXCEPT UNDER THE SUPERVISION OF CUSTOMS OFFICER [SECTION 34]

Loading & unloading of goods to/from conveyance to be done under supervision of proper officer

Exception

- Board may give **general permission** by notification in Official Gazette
- Proper officer (P.O.) may give **special permission** in any particular case

RESTRICTIONS ON GOODS BEING WATER-BORNE [SECTION 35]

Boat note required for

- Imported goods to be waterborne for being landed from any vessel
- Export goods to be water-borne for being shipped if not accompanied by a shipping bill
- Exception: Goods/class of goods to be waterborne w/o boat note for which:-
  - Board may give general permission by notification in Official Gazette
  - Proper officer may give special permission in any particular case