

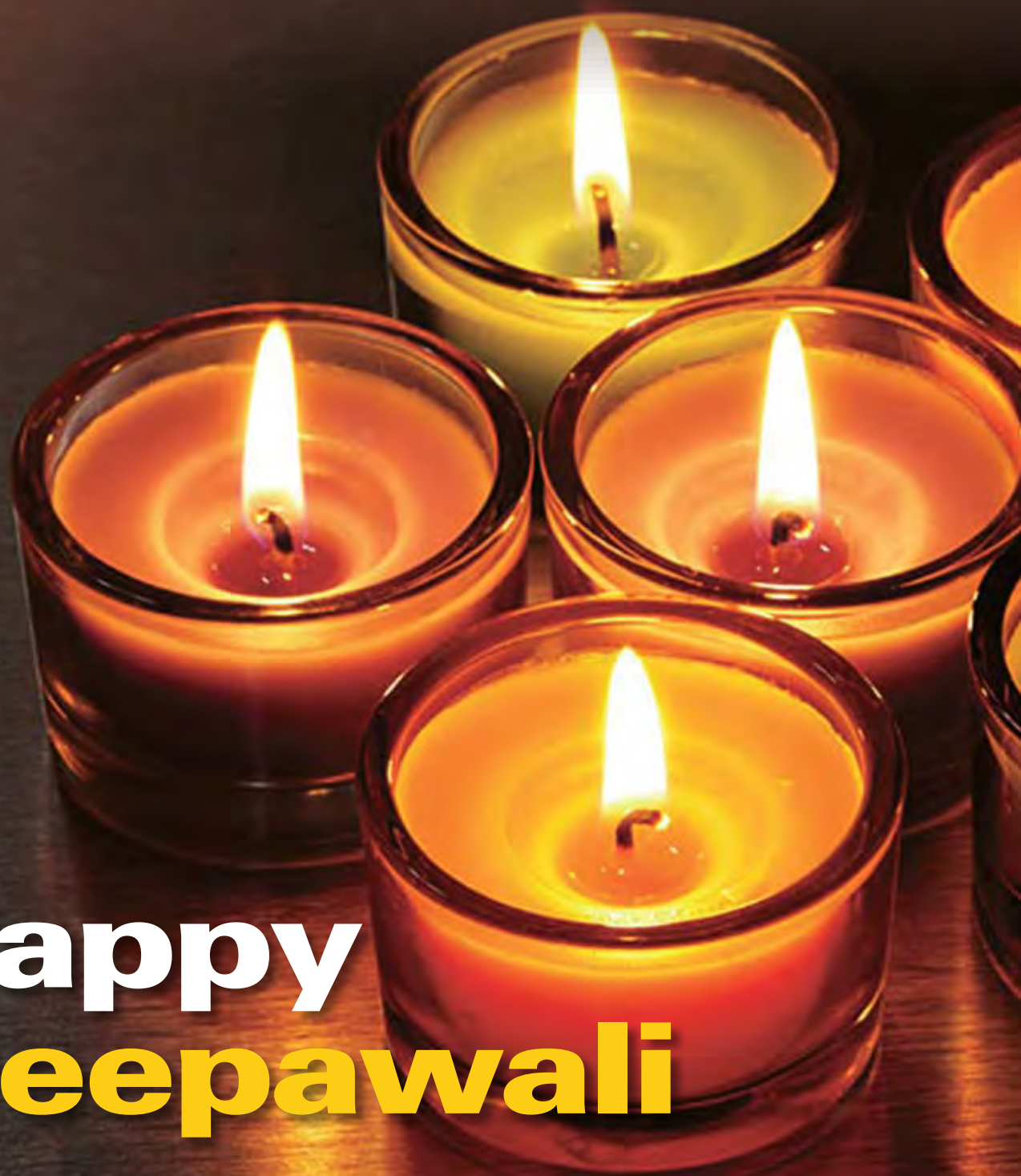


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SET UP BY AN ACT OF PARLIAMENT

THE CHARTERED ACCOUNTANT JOURNAL

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA



Happy Deepawali

VOLUME 59 | No. 5 | NOVEMBER 2010

THE CHARTERED ACCOUNTANT

₹ 100

CSR and Indian Accountancy Profession

Having transcended the national economic frontiers, the India growth story is now aggressively going global. The gigantic corporate growth has done India good. But there is even better side of this development. In the backdrop of tough competition and 'Liberalisation – Privatisation – Globalisation' (LPG) wave sweeping through countries and continents, more and more corporations are realising that a growth without a social face cannot be sustained for long. They are increasingly heeding the concepts like 'inclusive growth', 'Responsible Business Enterprise', 'Convergence of accounting standards' and to cap it all — Good Corporate Governance practices. They are successfully intertwining their Corporate Social Responsibility (CSR) with their business strategies to the benefit of all.

The CSR is no longer a cliché but a popular benevolent thinking in action. As such, corporate activities today extend to almost every sphere of life, from manufacturing to service, education, hospitality, environment and even spirituality.

But much more is still required to be done to make a real difference at the ground level at large, particularly in rural India. There is a need for an effective Government-NGO-Corporate partnership to do away the scepticism about CSR as just another tool of the ultimate business objective of maximising profits. It is time that Governments encourage corporations in their civic activities through supportive legislations. It is time that there is greater corporate accountability, and convergence of accounting standards to ensure transparency, efficacy and user-friendliness of corporate financial statements. SEBI has done its bit so far as statutory aspect of Corporate Governance and CSR is concerned. Revised Clause 49, Independent Directors, Whistle Blower Policy,

etc. have all been steps in the right direction.

The need of the hour is the business models where making profits and doing social environmental good go hand in hand. This background not only offers a plethora of professional opportunities for the Chartered Accountants but also puts important social responsibility on them. Given the set of skills they possess, CAs can play a crucial role with respect to both statutory and voluntary aspects of CSR. They are already proving to be an effective facilitator and implementer of the modern approaches like transparency in corporate financial disclosure, value addition and tax compliance. Further, they can help corporations devise such strategies, policies and projects that serve both their business as well as social goals. They can ensure that the corporate values and social values never come in conflict.

When associated with the Corporate-aided community projects, the CAs can ensure that the projects benefit the intended lot and their social objective is not lost in corporate exercise of profit maximisation or building brand equity. CAs have the potential to be the most effective tool of Good Corporate Governance. It is high time that professionals help create Responsible Business Enterprises.

With more and more companies embracing entire world as their workplace and market place, corporate governance has become the key to business success. Today, accounting is the language of global business. And compliance with accounting standards is the corner stone of corporate governance. This presents a great challenge and opportunity for the professionals who can be of great help in creating an enabling environment for better

corporate governance and practices. The rapid globalisation is continuously expanding the professional horizons. The flourishing and spreading economy, wave of mergers and acquisitions, integration of India with world economy, renewed stress on transparency and corporate governance and emergence of knowledge society have thrown up myriad of present and future opportunities for professionals be they in practice or industry. Starting with a small strength of just 1,685 as on 1st April, 1950, more than 1,60,000 CAs are today providing pivotal support, both behind and over the scenes, across different economic and business spheres right up to the level of CEOs and CFOs. Indeed, the Indian CA fraternity is already making a big difference and it has all the potential to make much more difference so far as ensuring good governance is concerned.

The country needs to improve implementation mechanisms for the efforts to yield results while the government expenditure needs to be efficiently directed and utilized. CAs can facilitate the same. They can put in place the much-needed fiscal discipline, accountability, transparency, fairness of transactions and good governance with regard to various Government schemes across the country. With the calls for private sector and governments to be more accountable and transparent getting shriller, today's accountants' role is in sharp focus. What is needed is a joint endeavour to fostering an environment of "cooperative federalism and collective pursuit of national goals". Indian economic tide must lift all boats in its wake. And Chartered Accountant can help bring about the same.

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
ICAI Bhawan, Post Box No.7100, Indraprastha Marg,
New Delhi-110002, Tel: +91 (11) 39893989.
E-mail: icaiho@icai.org, Website: www.icai.org

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Dear All,

"India stands at a crucial stage. All across the globe there is interest in India as an emerging global power... We have to be able to compete with the finest minds in the world. In this, education occupies a crucial position," so said Hon'ble President of India Smt. Pratibha Devisingh Patil recently. I am delighted to inform you that we had the honour to meet this visionary and inspiring first woman President of the country at the Rashtrapati Bhawan recently. During the meeting, the undersigned, along with Vice President CA. G Ramaswamy, Council Member CA. S.B. Zaware and a member from Pune CA. M.S. Jadhav updated her about our Institute and our contribution as an important partner in Nation Building. We also requested her to be the Chief Guest at the mega high-profile International Conference being organised by us on 4-6 January 2011, details of which have been published elsewhere in the journal. Her Excellency Smt. Patil showed keen interest in the activities and role of the Institute in the growth and development of national economy in particular and society in general. We fervently hope that she will kindly give her consent to grace our International Conference.

Meanwhile, as readers will recall, we basked in the glory of *Commonwealth Games* 2010 by winning a record number of medals. We got medals in events we were not hopeful at all. We did not mind being at second position, but we rejoiced performing better than England. Reasons for celebrations were many. There is a remarkable trend emerging slowly but distinctly, which is very keen on engulfing all spheres of human existence: our female sportspersons have performed unexpectedly better in many events of the *Commonwealth Games*. Ironically, Haryana having the lowest sex ratio probably has the largest share of medals earned by female sportspersons. We personally have observed that, of late, female students have been performing better in CA examinations too. In fact, they have been doing better in all other fields of education. Anyway heroes,



philosophers, or great men can exist, if we have intelligent and educated women in society.

It is time to learn a lesson, as it is never too late to do so: women deserve equal treatment and respect from our society. Initially, we may have to start with some adjustment in order to accommodate them with equality. Let us take a pledge to respect them in our family, *first*, as we know: *charity begins at home*. This will bring a sea change in not just the form and composition of our society but also in the quality of our own existence. To quote our adorable President of India Hon'ble Pratibha Devisingh Patil: "Empowerment of women is particularly important to me as I believe this leads to the empowerment of the nation". American lawyer and political activist Bella Abzug rightly observed: *Women are changing the stream, making it clean and green, and safe for all*. There is a definitive connection between women's rights and development, and socio-economic development and peace of a state.

Now let you be updated on some important developments over the last month.

MCA Delegation to Moscow

ICAI Vice-President CA. G. Ramaswamy with the Director, Board of Studies, Shri Vijay Kapur was in Moscow recently as part of the MCA delegation led by the MCA Secretary Shri R. Bandyopadhyay. Other members of the Indian delegation were ICWAI President Shri B. M.

Sharma and ICWAI Central Council member Shri A. N. Raman. Agenda of the delegation was to interact with the government functionaries and accounting professionals in Moscow. The Institute of Professional Accountants of Russia (IPAR) showed keen interest in our activities. On the initiatives of our Vice-President, the IPAR responded positively by coming forward with a proposal for mutual areas of cooperation regarding implementing IFRS, auditing and quality control standards, and internal audit standards, etc. We have invited the IPAR President Mr. Vyacheslav V. Skobara and Chair of the IPAR International Affairs Ms. Svetlana M. Bychkova to attend our International Conference to be held in January 2011. The delegation also met Mr. Sergey D. Shabalov, State Secretary, Deputy Finance Minister of Russian Federation.

Roundtable Conference on Commerce and Accountancy Education in India

We recently organised ICAI's first ever Roundtable Conference on Commerce and Accountancy Education System in India in New Delhi to exchange thoughts on various areas of academic and practical interest in the field of commerce and accountancy education in India. It was inaugurated by Shri Jitesh Khosla, Additional Secretary and Officer on Special Duty, Indian Institute of Corporate Affairs, who was keen on us leading in enhancing the financial literacy and the basic knowledge of

the accountancy amongst the people of India. Eight Vice-Chancellors, namely Prof. Manoj K. Mishra of University of Lucknow, Prof. K. K. Deka of Dibrugarh University, Prof. A. D. Sawant of University of Rajasthan, Prof. Binayak Rath of Utkal University, Prof. R. Venkata Rao of National Law School, Bangalore, Prof. I. V. Trivedi of Mohanlal Sukhadia University, and Prof. J. L. Gupta (former Vice-Chancellor) of Bilaspur University, attended the Conference. More than 55 Heads, Deans of Commerce and Management Department, and faculty members representing various management institutions and universities of India also participated. The undersigned also participated in the Conference with Central Council colleagues CA. Vinod Jain, Chairman, Board of Studies, CA. Jaydeep N. Shah, CA. Bhavna Doshi, CA. Rajkumar S. Adukia and CA. S. B. Zaware. Presentations were made by Prof. Ashish Bhattacharyya from IIM, Kolkata, Dr. Avinash Chander, Technical Director of ICAI and Shri Vijay Kapur, Director, Board of Studies of ICAI.

We wish to inform that the discussions held provided a good platform for exchange of views amongst the leading accounting educators of India. Quite rightfully, everybody requested us to bring out uniform reading material on Indian Accounting Standards converged with IFRS in a simplified and illustrative manner for university students. They also desired that the Institute could frame model course curriculum meant for the Indian universities. Representatives of some universities even offered us the space for building up reference libraries and classrooms for imparting education through e-learning mode. During the discussions, the participants also stressed the need to bring transparency and accountability in examination system. We are very confident that a synergy between the Institute and the universities can produce better results.

ICAI Offers Support to Shri Nandan Nilekani for UID Project

During the meeting recently held with Shri Nandan Nilekani, Chairman of the

Unique Identification Authority of India (UIDAI), the undersigned, on behalf of the Institute, extended a promise of complete support to the ambitious UID project of our country with all possible resources of the Institute. We suggested to him that ICAI can play important role in development and implementation of this project, while actively working with the Government. We showed our willingness to offer the manpower of vast base of ICAI members located across the country to be used in the implementation of the project, which will result in the issuance of Unique IDs to all citizens of India. We also informed Shri Nilekani that our members having experience in endeavours such as PAN card, e-governance and facilitation centres for sales tax and excise could be well-suited to be a part of this project. During the meeting, we also discussed the use of IT system in Goods and Service Tax among other issues of our mutual interest. Mr. Nilekani promised to utilise the services of Chartered Accountants in the GST project.

ICAI Briefs Media on IFRS Convergence

We would like to remind our members that we are committed to meet our deadline of the convergence of the Indian Accounting Standards with the International Financial Reporting Standards (IFRSs) effective April, 2011 in select entities as per the roadmap laid down by the Government. Let us also recall that, to spread awareness and popularise the convergence of our accounting standards with the IFRSs, we have launched a nationwide campaign. As part of this very initiative, we recently organised an interactive session with the representatives of Indian media, basically to brief them on the IFRSs-related developments and convergence, and to help them print objective and authentic information in this regard in the media. This whole exercise was aimed at encouraging and helping the media in supporting our efforts to spread mass awareness about IFRSs and to highlight the comprehensive benefits that convergence is going to provide

to society in general and our economy in particular.

Draft of ASLB on Presentation of Financial Statements Ready

In the direction of establishing a single set of high quality financial reporting standards for Local Bodies further, the Committee on Accounting Standards for Local Bodies (CASLB) has recently finalised the draft of ASLB on '*Presentation of Financial Statements*' to prescribe the manner in which general purpose financial statements should be presented. This would help the Local Bodies immensely in presenting their financial statements in a comparable and consistent manner. Also, drafts of Standards on '*Inventories*' and '*Segment Reporting*' will soon be finalised.

New Group to Respond to Parliamentary Standing Committee

A Special Group was constituted for formulating ICAI's views/response to the various recommendations made by the Parliamentary Standing Committee on Finance on Companies Bill 2009. The Group has met and deliberated on the Report in detail. The views/suggestions as formulated are getting finalised for sending our response.

ICAI Probe into Auditing/Accounting Violations in IPL

We are planning to send notices to six IPL franchisees seeking more information from the companies owning the teams. These franchisees are – Kings XI Punjab, Delhi Daredevils, Rajasthan Royals, Chennai Super Kings and Deccan Chargers. The investigations into alleged violations of auditing and accounting norms by the auditors are not yet complete due to the non-availability of the required information in these companies. This investigation is part of a multi-agency probe launched by the Government of India, e.g. I-T Department is probing tax evasion, ED money laundering, MCA sources of funding and shareholders' patterns, etc. Surprisingly, there is no published financial information with Kolkata Knight Riders and Royal Challengers.

Project Parivartan

Project *Parivartan*, a journey embarked on to bring about a paradigm shift in the working of our Institute and conceived with an idea of taking the Institute to a qualitatively new way of working, aims to create a single tightly-integrated system for catering to the entire community of chartered accountants and students, irrespective of their geographical locations, through the Internet. It also aims to create a truly next-generation Institute through IT-revolution. The journey so far in this direction has been quite successful and the Project is at the execution of next level of IT maturity. The ground covered so far includes the EoI for infrastructure and software applications, to onboard our IT partners. We have witnessed good traction and interest from major players in the market. The Project Management Office is working on closely with all other departments to complete our requirements for the tenders that we plan to float towards the end of this month. Despite the tedious process, we assure everybody that our institute is committed to transformation. We will keep you updated of the progress as we make from time to time.

CBDT Takes Positive Action Following ICAI Representaion

As you will be aware, an amendment to Rule 12 of the Income-tax Rules, 1962 vide notification no. 49 dated 9th July, 2010 made it mandatory for all Companies (including foreign companies) filing ITR-6 to digitally sign the Income-tax return for the AY 2010-11. Thereafter, certain procedural changes were effected. The Institute was given to understand that as per the changed requirements made applicable w.e.f. 1.08.2010, where the signatory to the return is not the same as the signatory in the immediately preceding year, the system required that the DSC also contains the PAN encryption therein. The said revised procedure was creating practical difficulties in case of Foreign Companies whose directors being non-residents were not required to

obtain a Permanent Account Number in India due to which a PAN encrypted DSC could not be immediately available. Hence, a representation posing the difficulty being faced by Foreign Companies was made by the Institute to the Central Board of Direct Taxes. In view of the same the Central Board of Direct Taxes has relaxed the requirement of using encrypted PAN on DSC for non-resident signatories of Foreign Companies. Accordingly, the signatory may register with a non-PAN DSC from CCA, India and use the same jurisdiction while uploading the return. This facility is available only for all foreign Companies under the jurisdiction of respective International Taxation wards or circles of Income Tax Department.

ICAI Wants Power to Act Against Erring Firms

It is quite affirmative now for the Institute to be ready for seeking power from the law to take action against erring CA firms. In this light, as per the Act, the Institute can take disciplinary action against its members but not against the firms. At the same time, it is becoming extremely important to curb the wrongful and illegal acts committed by the firms. So, for the first time, the ICAI has decided to recommend to the Government of India that power to act against an erring firms be given to the Institute after necessary amendments in the Act. Action against the firms are proposed to be initiated in rarest of rare circumstances and in the cases in which there are continuous and repetitive acts of negligence, jeopardising of public interest or proved collusion in perpetration of fraud. Generally the action is contemplated only against individual members. We definitely need more powers to ensure that big corporate scandals do not occur in future.

International Competition Law Conference

The Institute played a crucial role as Knowledge Partner for a high-profile International Competition Law Conference organised by Competition Law Bar Association in national capital recently. Corporate Affairs Minister

Mr. Salman Khurshid was the Chief Guest while Union Minister of Law and Justice Mr. M Veerappa Moily was the Guest of Honour at the well-attended conference. Other speakers included Chief Justice of India Mr. Justice S.H. Kapadia, Chairman Competition Appellate Tribunal Dr. Justice Arijit Pasayat and Competition Commission chairman Mr. Dhanendra Kumar. The undersigned also addressed the conference from professional perspective. The global competition law scenario vis-à-vis India, and various aspects of newly enforced Competition Law were discussed in the conference.

Asia-Oceania Standard Setters Group Meeting

We recently attended the second annual meeting of the Asia-Oceania Standard Setters Group (AOSSG), which was formed last year as a forum for the countries in the region to exchange their ideas and have a joint voice in matters relating to IFRSs. The undersigned, along with Council Member and the Chairman, Accounting Standards Board, CA. Manoj Fadnis and the Technical Director, Dr. Avinash Chander, put forth India's approach and perspective on various issues of mutual interest that were discussed and decided at the meeting in Tokyo. We are happy to inform you that at the meeting it was decided to establish a new working group for IAS 41, *Agriculture*, which will be led by the ICAI. The meeting was attended by 24 accounting standard setting bodies from countries and jurisdictions in the Asian-Oceania region, representatives from the International Accounting Standards Board (IASB) and a Trustee of the IFRS Foundation.

Initiatives for Members

Unique Code (UCD) for Members in Practice Soon:

We are planning to introduce a unique code numbers to check the increasing instances of fraudulent practices including forged attestations, as part of our ongoing Project *Parivartan* initiated to change our operational processes to meet global benchmarks. Modalities

are being worked out. We are being assisted by the software giant Infosys in this endeavour. Then, we would like our banks to insist upon this UCD, as people file different balance sheets for different purposes without the knowledge/approval of our members. Similarly, there are instances when financial statements filed in the tax department are different from the ones sent to banks or registrar of companies. Since the CA membership numbers are in public domain, introduction of UCD will certainly help in protection of our members.

Special Loan Scheme of Corporation Bank for CAs:

We take pleasure to inform our members that the Committee for Capacity Building of CA Firms and Small & Medium Practitioners has helped the Institute in going into an MoU with the Corporation Bank for providing financial assistance in form of liberalised loan scheme called *Corp CA* for our members and firms. Comptroller and Auditor General of India Shri Vinod Rai, Chairman & Managing Director of Corporation Bank Shri Ramnath Pradeep and Executive Director of Corporation Bank Shri Asit Pal were present on the occasion. This scheme will cater to various financial needs of members of the CA profession including cost of furniture/fixtures/office equipments contributing in the working capital for building their profession. We sincerely hope that a large number of members would be benefited by this landmark scheme. We must acknowledge the hard work of the Committee Chairman, CA. Sanjeev Maheshwari behind this accomplishment. The details of the scheme have been hosted on our website and also published elsewhere in the journal.

New Group to Consider Provisions for Physically Challenged CAs:

We are happy to inform you that a Group has been constituted to consider and prepare a draft paper on the various concessions that one can have for physically challenged Chartered Accountants *vis-à-vis* the options available in PSUs or in

the private sector. The Group shall comprise CA. Vinod Jain, Chairman, Board of Studies (Convenor) and CA. Pankaj I. Jain, Chairman, Professional Development Committee. The said Group will submit as early as possible the aforesaid draft paper to the Professional Development Committee and Board of Studies for consideration and making recommendations to the Council. The members of the Council may also be requested to give their suggestions/inputs for consideration by the Professional Development Committee/Board of Studies.

Tie-Up with United Stock Exchange for Currency Derivatives Awareness:

It is quite satisfying to inform you that we have operationalised the MoU signed last year with the United Stock Exchange (USE) of India Limited, newest stock exchange for currency derivatives, to impart comprehensive knowledge of financial markets to our members. Following this, the USE will sponsor our members by organising seminars, panel-discussions, workshops on financial markets and corporate governance. We would provide institutional support and facilitate interactions with our members. At least two such programmes are proposed to be organised with them before the end of this year. On this occasion, Managing Director and CEO of the USE Shri T. S. Narayanasami expressed his 'pleasure to be associated with ICAI' and desired 'to build knowledge about financial markets especially sophisticated instruments like currency derivatives in India.' We are sure that this would be enriching experience for both the organisations.

IICA-ICAI Joint Workshop on IFRS:

We recently organised a special workshop on 'IFRS—Issues in Transition' jointly with Indian Institute of Corporate Affairs (IICA). The workshop dwelt on managing transition to IFRS that poses a great challenge to the makers and users of financial statements and to the reporting authorities, i.e., the practical implication of IFRS. Prominent personalities who shared their views in

the workshop included Secretary, MCA Shri R. Bandyopadhyay, Shri Jitesh Khosla, Additional Secretary to the Government of India and Officer on Special Duty (OSD), IICA, Ms. Renuka Kumar, Joint Secretary MCA, Shri Pawan Kumar, Director (Tax Policy), Department of Revenue, Ministry of Finance, Ms. Gargi Ray of Infosys technologies, Past Presidents of ICAI CA. N. P. Sarda and CA. Ved Jain and Council members CA. Jayant P. Gokhale and CA. Bhawana Doshi. The undersigned highlighted the various steps taken by the ICAI in the process of convergence of Indian Accounting Standards with IFRS including the capacity building and other related initiatives. About 70 CEOs, Directors, CFOs, Auditors, representatives from regulatory bodies, fellow members of the ICAI and ICAI's CA employees attended the workshop.

Four-Day Training Workshops on Audit Excellence:

Auditing standards issued by our Institute are both best practices and performance benchmarks for our profession, and the quintessential features of our very existence and supremacy in the auditing profession. To give an impetus to our awareness creation initiatives, four-day Training Workshops on Audit Excellence will be launched soon by the Auditing and Assurance Standards Board (AASB) of ICAI for imparting training on implementation of the Standards on Auditing issued under the Clarity Project. The details are available elsewhere in the Journal.

Resources on Auditing Standards:

A *Guide* containing practical guidance and ready-to-use templates on application of auditing standards to audits of small entities will soon be published to help with the understanding of auditing standards and promoting implementation of Standards. As another measure to promote the understanding of auditing standards, the AASB is also developing a *Manual* of Presentations on Standards on Auditing & Other Engagement Standards that will act as a quick reference for an overview of the

requirements of auditing standards. This can be effectively used by the audit firms as well in training their audit staff on auditing standards.

Convocation Ceremony in Jaipur:

The convocation programme for the newly enrolled Associate Members of the Institute from Central Region (covering the states of Rajasthan and Madhya Pradesh) was successfully held at Jaipur on October 5, 2010. It was a time of celebration and of acknowledgement of our students' hard work. The undersigned inaugurated the function and conferred the certificates of merit to the deserving and newly-enrolled members in the presence of Past President CA. Sunil Goyal, Central Council colleague CA. Anuj Goyal, past Central Council colleague CA. P. P. Pareek and Jaipur Branch Chairman CA. C. L. Yadav among others. While stressing the need of having effective communication skills, the undersigned informed the members about the growing recognition of Indian CAs internationally, and noted with appreciation the rising ratio of female members.

Certified Filing Centre Registration till November 2010:

We want to inform all members of our community that the registration process under the Certified Filing Centre (CFC) scheme is valid till November 30, 2010. We have received 271 CFC applications (88 new application and 183 applications for renewal of existing CFCs) from the members till date.

Students' Initiatives

Residential Programme on Professional Skills & Development:

A six-week residential programme on Professional Skills and Development has been conceived by the Board of Studies for the benefit of our students and newly-qualified chartered accountants. All students who have passed PCC/IPCC/PE-II examinations and who are pursuing last year of the article training or those who are newly-qualified chartered accountants will be eligible for the programme and, therefore, are invited to join it. This will offer a unique opportunity to develop skills

in communication, leadership and personality in general including the technical skills for effective functioning in profession. The programme will start on December 1, 2010, at the Centre of Excellence of ICAI in Hyderabad. In fact, more than 50 students have already been enrolled for this programme. In the meantime, a three-month residential programme shall commence from December 6, 2010, at National Institute of Financial Management in Faridabad. We sincerely hope to witness a large number of participants and we are sure they will use this opportunity to become better professionals. Such an active participation will encourage us further to hold similar and better programmes for them in future.

Online Articles Placement Portal:

We are glad to inform that the Board of Studies has introduced an optional Campus Placement Scheme for selection of Articled Assistants by CA Firms. The Pilot Campus Placement Programme was held at Delhi in August 2010 for the CA firms having their HOs/Branch Offices in Delhi/New Delhi and for eligible students who would like to service their articles in the CA Firms in Delhi/New Delhi. Considering the good response, positive feedback and requests received from both CA Firms and Students, it has been decided to start an Online Articles Placement Portal - <http://bosapp.icaai.org> from 5th October, 2010 to facilitate placement of Articles in CA Firms on pan India basis. We request both eligible candidates and CA firms to avail of this facility and register themselves online through the portal. The candidates shortlisted by CA Firms would be informed by e-mail through the Portal, to appear for interviews/interactions at their respective Offices, at the designated date and time.

CPT Online Examination results:

The results of CPT online examinations held on 18th and 19th September this year were declared recently and we are happy to inform you that the results (28.40 per cent) have been satisfactory. What is more satisfying is that our online examinations are slowly-but-steadily gaining popularity among new-age students and this portends well for our

vision to make our examination system hi-tech and futuristic.

New Members Nominated on 21st Council of ICAI

We welcome Dr. T. V. Somanathan, Joint Secretary, Ministry of Corporate Affairs, New Delhi, and Ms. Usha Sankar, Director General (Commercial), Office of the Comptroller & Auditor General of India, New Delhi, as nominated members on the 21st Council of our Institute for the remaining term of the Council or till further orders. They have replaced Ms. Renuka Kumar and Shri K. P. Sasidharan respectively. We sincerely hope to get their complete help and support in all endeavours for progress of our Institute. We also place on record the valuable contributions made by Ms. Kumar and Mr. Sasidharan in the Council.

Meanwhile, we have submitted our comments/suggestions on Draft International Standard ISO 26000 (Guidance on Social Responsibility) and on Applicability of Foreign Direct Investments in LLP to the Ministry of Corporate Affairs (MCA).

Happy Deepawali

Deepawali, the pious festival of lights, is the celebration of the victory of good over evil. The underlining message of this festival is that the evil and falsehood may appear to be mightier and more resourceful but it is only the truth and good that prevails in the end. Let's imbibe the spirit of this festival and take a vow to lead the world from darkness to light, from falsehood to truth, and from wrong to right. Let us vow to live each day in the most pious, God-conscious way. This Deepawali let us give thanks for all we hold dear: Our health, our family, our friends and to the grace of God which never ends. May this Deepawali fill your life with prosperity and peace, and love and joy which doesn't cease. May the festival of lights be the harbinger of growth of our profession.

Wish you all a very happy Deepawali.

CA. AMARJIT CHOPRA



President, ICAI

October 25, 2010



Meeting with President of India

CA. Amarjit Chopra, President, ICAI, CA. G. Ramaswamy, Vice President, ICAI and CA. S. B. Zaware, Central Council Member with CA. M. S. Jadhav met Her Excellency Smt. Pratibha Devisingh Patil, President of India at Rashtrapati Bhavan, New Delhi. (October 18, 2010)



Round Table Conference

CA. Amarjit Chopra, President ICAI addressing the Round Table Conference on Commerce & Accountancy Education in India: Issues and Challenges held at India Habitat Centre, New Delhi. Other dignitaries on the dais are (from left) Shri Vijay Kapur, Director, BOS-ICAI, Shri Jitesh Khosla, Additional Secretary, Government of India, Shri T. Karthikeyan, Secretary, ICAI and CA. Vinod Jain, Chairman, BOS-ICAI. (September 26, 2010)



IFRS Workshop for Media Personnel

President, ICAI CA. Amarjit Chopra addresses the media personnel during the Workshop on Indian Accounting Standards Converged with IFRSs – “First time adoption of IFRS – Latest updates.” Central Council Member CA. Manoj Fadnis can be seen on the dais. (October 22, 2010)



Joint IICA-ICAI Workshop on IFRS

ICAI President CA. Amarjit Chopra presenting a memento to Shri R. Bandyopadhyay, Secretary, Ministry of Corporate Affairs in presence of Shri Jitesh Khosla, Additional Secretary, Government of India & OSD, IICA and Shri T. Karthikeyan, Secretary, ICAI during the Joint IICA-ICAI Workshop on IFRS. (September 27, 2010)



ICAI President with Chairman, UIDAI

President, ICAI during a meeting with Shri Nandan Nilekani, Chairman, Unique Identification Authority of India (UIDAI). Shri Shaleen Suneja, Sr. Assistant Secretary, ICAI was also present on the occasion. (October 20, 2010)



ICAI Vice President with President, IPAR

CA. G. Ramaswamy, Vice President, ICAI greets with Mr. V. V. Skobara, President, Institute of Professional Accountants and Auditors of Russia (IPAR) during a visit to Moscow.



Conference on International Taxation

CA. Amarjit Chopra, President, ICAI lighting the lamp at the Two Day Conference on International Taxation hosted by NIRC of ICAI at New Delhi in presence of CA. Atul Kumar Gupta, Chairman, NIRC, CA. Hans Raj Chug, Secretary, NIRC with two other dignitaries. (October 22, 2010)



Jaipur Convocation

CA. Amarjit Chopra, President, ICAI in presence of past President CA. Sunil Goyal lighting the lamp to inaugurate the Convocation 2010 held at Jaipur. Other dignitaries at the podium include CA. Anuj Goyal, Central Council Member, CA. Khemisha Soni, Chairman, CIRC of ICAI and CA. C. L. Yadav, Chairman, Jaipur Branch. (October 5, 2010)



CA. Amarjit Chopra, President, ICAI handing over the Certificate of Membership to a participant at the Convocation held at Jaipur in presence of CA. Anuj Goyal, Central Council Member, CA. Khemisha Soni, Chairman, CIRC and CA. C. L. Yadav, Chairman, Jaipur Branch. (October 5, 2010)

ANNOUNCEMENT

Plagiarism: A Matter of Growing Concern

[Our journal, The Chartered Accountant, is a means to enhance our members' knowledge and update them on contemporary developments in the area of accountancy and other allied professions and topics of professional interest. We cater this service to all our members, e.g. more than 1,60,000 in number. Our Journal is read by more than 2 lakh readers across India and abroad.]

We receive articles from our authors either on their own or in response to our invitation when we bring out special issues. In the recent past, we have come across the practice of *plagiarism* in some of the submissions by our authors. Contents of some articles have been found to be lifted from resources including books, websites, etc., and presented to us as authors' original work, which is nothing but plagiarism, an infringement of others' intellectual property rights and, therefore, a punishable offence.

It is an intellectual crime.

Authors who submit plagiarised work for publication will be strictly proceeded against as per policy and rules of Institute of Chartered Accountants of India and the law of the land. We will also represent such cases to authorities of the organisations where these authors work.

We appeal, therefore, to all our prospective authors not to send a plagiarised work to us for publication and not try to take credit for a work which is not theirs. Any reference of other sources/authors/content should be duly given within quotes with the name of the source in the body of the submitted articles' text itself. By following this practice, we will essentially show respect towards the creative community which all of us value immensely.

- Editor

LEGAL DECISIONS¹

DIRECT TAXES

Income-tax

Section 28(i) of the Income-tax Act, 1961 – Business & Professional Income – Chargeable as

Where a forward contract is entered into by assessee to sell foreign currency at an agreed price at a future date falling beyond last date of accounting period, loss if any would be incurred to assessee on account of evaluation of contract on last date of accounting period i.e. before date of maturity of forward contract [Assessment Year 1998-99 & 1999-2000]

Dy. CIT v. Bank of Bahrain & Kuwait, August 13, 2010 [MUM-ITAT (SB)]

The assessee is a non-resident company carrying on banking business in India. It entered into forward contracts with its clients to buy or sell foreign exchange at an agreed price on a future date. On the date of maturity, the contract was executed which might result in the profits or losses to the assessee. In some cases, the date of maturity of the contract falls beyond the end of the accounting period. In such cases, the assessee evaluated the unmatured forward contracts on the last day of the accounting period on the basis of rate of foreign exchange prevailing on that date and books the loss or profit, as per rates notified by Foreign Exchange Dealers Association of India (FEDAI). The revenue's stand was that, this method of accounting was not correct because the loss was incurred on the date of maturity of the contract and there could not be any loss prior to such date.

The Special Bench of the Tribunal held that forward foreign exchange contract means an agreement to exchange different currencies at a forward rate. Forward rate is a specified rate for exchange of currency at a specified date. The assessee entered into forward contract with clients to buy or sell foreign exchange at an agreed price at a future date in order to hedge against the possible future financial loss on account of wide fluctuation in the rate of foreign currency. Thus, firstly, forward foreign exchange contract created a continuing binding obligation on the date of contract against the assessee to fulfill the same on the date of maturity and secondly, it was in the nature of hedging contract because it was a contract entered into against possible financial losses.

The assessee's appeal was to be allowed for the following reasons:-

- i) A binding obligation accrued against the assessee the minute it entered into forward foreign exchange contracts.
- ii) A consistent method of accounting followed by assessee could not be disregarded only on the ground that a better method could be adopted.
- iii) The assessee had consistently followed the same method of accounting in regard to recognition of profit or loss both, in respect of forward foreign exchange contract as per the rate prevailing on March 31.
- iv) A liability was said to have crystallised when a pending

obligation on the balance sheet date is determinable with reasonable certainty. The considerations for accounting the income are entirely on different footing.

- v) As per AS-11, when the transaction is not settled in the same accounting period as that in which it occurred, the exchange difference arises over more than one accounting period.
- vi) The forward foreign exchange contracts have all the trappings of stock-in-trade.
- vii) In the ultimate analysis, there was no revenue effect and it was only the timing of taxation of loss/profit.

Accordingly, it was to be held that where a forward contract is entered into by the assessee to sell the foreign currency at an agreed price at a future date falling beyond the last date of accounting period, the loss, if any, would be incurred to the assessee on account of evaluation of the contract on the last date of the accounting period, i.e., before the date of maturity of the forward contract.

Section 28(i) of the Income-tax Act, 1961– Business & Professional Income – Chargeable as

If guarantee commission received by bank is refundable then it cannot be said that absolute right to commission has accrued in favour of bank at time of execution of contract for furnishing guarantee and on the other hand if guarantee commission is not depended upon period of guarantee and, thus, has accrued in favour of bank on date of execution of contract for furnishing guarantee then same has to be taxed in year in which guarantee is furnished irrespective of period to which guarantee remained alive [Assessment Year 1998-99 & 1999-2000]

Dy. CIT v. Bank of Bahrain & Kuwait, August 13, 2010 [MUM-ITAT (SB)]

The assessee-bank following mercantile system of accounting, accounted the guarantee commission related to the year only. The Assessing Officer was of the opinion that the transaction involving bank guarantee was only in the year the guarantee was given. The assessee got the right to receive the said commission in the said year. He observed that guarantee commission was not advance commission received and, therefore, there was no question of deferring the same to future year. He, accordingly, considered the entire income relating to guarantee commission in the year in which the guarantee was given. The basic question to be answered was as to at what stage the assessee acquired the absolute right to receive the income.

The Special Bench of the Mumbai Tribunal held that if the guarantee commission received by bank was refundable then it could not be said that absolute right to the commission had accrued in favour of the assessee at the time of execution of contract for furnishing guarantee by it, but if the guarantee commission was not depended upon the period of guarantee and, thus, had accrued in favour of the assessee on the date of execution of contract for furnishing guarantee then the same had to be taxed in the year in which the guarantee was furnished irrespective of the period to which guarantee remained alive. This was so

¹ Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.org. For the convenience of readers full text of these cases have been hosted on the website of the institute at the link: www.icai.org/post.html?post_id=967&c_id=59

because the guarantee commission cannot be apportioned with reference to the period over which the guarantee extended.

Section 28(i) of the Income-tax Act, 1961– Business & Professional Income – Chargeable as

Where assessee company was incorporated for purpose of effectuating transactions agreed in MOU with the very intention and purpose of establishing business in India by taking over compressor and related operations of another company in India, and non-compete agreement with said company was part and parcel of whole transaction, expenditure incurred by assessee in pursuance of non-compete agreement would be capital expenditure, deduction of which could not be granted to assessee as revenue expenditure [Assessment Year 1998-99]

Tecumseh India Private Limited v. Addl. CIT, July 30, 2010 [DEL-ITAT(SB)]

The parent company of the assessee company being leading manufacturer of compressors worldwide, had desired to enter the Indian market for that activity and, for the purpose of effectuating such desire that company entered into an agreement called MOU with the Whirlpool India Ltd. and its parent company in which it was clearly stated in clause 1.1 that Tecumseh and Whirlpool would enter into an asset purchase agreement whereby Tecumseh (through a to be established local Indian entity) shall purchase all compressor, machinery, equipment and tooling located at Whirlpool's Faridabad facility as well as related compressor component assets located at Whirlpool's Ballabgarh facility [including laminations, wire drawings, central tool room, overhead protectors and relays] and all such assets were to be fully identified in such asset purchase agreement or other appropriate local Indian documentation required to detail such sale and purchase. Similarly, in clause 12 and 12.1 the mention was made regarding non-compete agreement whereby Whirlpool India and Whirlpool USA (including its wholly owned subsidiaries) agreed not to manufacture or repair compressors during the term of global sourcing agreement with Tecumseh. However, Whirlpool had been given right to sell refrigerator compressors purchased from Tecumseh to service partners subject to provisions of clause 6.1 of the agreement.

For entire transaction which included non-compete agreement an aggregate sum of Rs.52.5 crore was agreed to be paid as per MOU. As per the MOU parties were to meet for determining the proper allocation of the purchase price for various assets. The allocation of price for various assets included a sum of Rs.2.65 crore being called as "non-compete fee".

The Special Bench of the Delhi Tribunal held that, if the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business, then it will be properly attributable to capital and, on the other hand, if it is made not for the purpose of bringing into existence any asset advantage, but for running the business or working it with a view to produce the profit, then, it will be in the nature of revenue.

The basic test to determine the nature of an expenditure

are the test of initial outlay of the business, the aim and object of the expenditure, enduring benefit test and the test of fixed and circulating capital.

The assessee had acquired a business concern in India with its outlay and the entire transaction was outlined in the MOU. The purchase price itself stated that the amount of Rs.52.5 crore was to be paid as a total purchase price for the Compressor Division assets and other land and building. The non-compete agreement was made an Appendix to the agreement and was, thus, part and parcel of the main agreement the signing and execution whereof was a condition precedent for the completion of the transaction.

The assessee company was incorporated for the purpose of effectuating the transactions agreed in the MOU. The purpose of the assessee company for which it was incorporated was that "Tecumseh USA" being a leading global compressor manufacturer was interested in purchasing compressor related operations of Whirlpool India for Indian compressor market. Thus, the very intention and purpose was to establish business in India by taking over the compressor and related operations of Whirlpool India in India. The non-compete agreement was part and parcel of the whole transaction and cannot be treated to be a separate transaction.

If the expenditure is made for the initial outlay or for the expansion of business or a substantial replacement of the equipment, then, it will fall under the capital expenditure. The expenditure in question was not incurred while the business was carrying on. The non-compete agreement was not executed subsequent to the date of main agreement, but in the main agreement itself the non-compete agreement was appended without which the transaction was not complete as by including the amount paid for non-compete agreement the purchase price as stated in MOU could be arrived at. Apart from this, the incurring of expenditure also brought an enduring benefit to the assessee.

In the case of the assessee there were several competitors and what the assessee had got only the non-compete agreement from one party, namely, "Whirlpool India" from which it had purchased the manufacturing related facilities. It was not necessary that the assessee should acquire monopoly rights while warding off the competition. Warding off competition in business even to a rival dealer constitutes capital expenditure and to hold them capital expenditure it is not necessary that non-compete fee is paid to create monopoly rights.

The expenditure as claimed by the assessee in pursuance of non-compete agreement were capital expenditure, the deduction of which could not be granted to the assessee as revenue expenditure.

Section 32 of the Income-tax Act, 1961 - Depreciation

Where in a case the unabsorbed depreciation allowance arose in assessment years 1997-98 to 1999-2000 which could not be adjusted against the income under the head 'Profits and gains of business or profession' up to assessment year 2002-2003, assessee could not claim set off of such unabsorbed depreciation allowance against income under any head other than "Profits and gains of

business or profession" in assessment years 2003-04 and 2004-05; assessee could not claim set off of such brought forward unabsorbed depreciation allowance against income under head 'Income from other sources' [Assessment Year 2003-04 & 2004-05]

Dy. CIT v. Times Guaranty Limited, June 30, 2010 [MUM-ITAT (SB)]

Where in a case the unabsorbed depreciation allowance arose in the second period i.e. assessment years 1997-98 to 1999-2000 which could not be adjusted against the income under the head 'Profits and gains of business or profession' up to assessment year 2002-2003, the assessee could not claim set off of such unabsorbed depreciation allowance against income under any head other than "Profits and gains of business or profession" in the assessment years 2003-04 and 2004-05. The assessee could also not seek to claim the set off of such brought forward unabsorbed depreciation allowance against income under the head 'Income from other sources'.

Thus, the unabsorbed depreciation relating to assessment years 1997-1998 to 1999-2000 was carried forward up to assessment years 2003-04 and 2004-05 was to be dealt with in accordance with the provisions of Section 32(2) as applicable for assessment years 1997-1998 to 1999-2000 and the same could not be dealt with in accordance with the said provisions as applicable to assessment years 2003-2004 and 2004-2005.

Section 40 (a) (ia) read with Section 139(1) of the Income-tax Act, 1961 – Expenses Disallowed – Interest, Commission or Brokerage, Fees for Professional or Technical Services

When assessee had deducted tax in last month of previous year i.e March 2005 and deposited same before due date of filing of return under Section 139(1), assessee's claim of deduction is to be allowed [Assessment Year 2005-06]

Bapushaeb Nanasaheb Dhumal v. Asstt. CIT, June 25, 2010 (ITAT-MUM)

As per the clause (ia) of sub-Section (a) of Section 40 when tax is deductible at source on the payment under Chapter –XVII and such tax has not been deducted or after deduction has not been paid then the said deduction is not allowable. As per the sub-clause "A" of Clause (ia) if the tax is deducted during the last month of previous year and paid on or before the due date of filing of return as per the provisions of Section 139(1) then such sum shall be allowed as deduction. In the cases where the tax is deducted during previous year other than the last month of previous year but is deposited before the last day of previous year then it will be allowed as deduction. Therefore, the conditions for allowability of the deduction is prescribed under Section 40(a)(ia) itself and provisions of Chapter –XVII and Section 194C under chapter XVIIIB at that relevant point of time are relevant only for the purposes of ascertaining the deductibility of the tax on the payment. Once, the nature of payment is falling under the provisions of Chapter –XVII/VIIB then the disallowance under Section 40(a)(ia) shall be as per the condition as provided under this Section itself. The proviso to Section 40(a)(ia) makes it further clear that even

in the case when the tax has been deductible as per the provisions of Chapter-XVII but deducted in the subsequent year or deducted during the last month of previous year but paid after the due date under Section 139(1) or deducted during the other month of the previous year except last month but paid after the end of the said previous year then the said sum shall not be allowed as deduction in computing the income of the previous year but allowed in the previous year in which the said tax has been paid. If the condition of deduction and payment prescribed under Section Chapter XVII/XVIIIB are applicable for disallowance of the deduction 40(a)(ia) then the provisions of Section 40(a)(ia) will be rendered as meaningless, absurdity and etios. As per the provisions of Section 40(a)(ia) the deduction is disallowed only in the case when either no tax was deducted or it was not paid after deduction. But when the tax is deducted may be belatedly and deposited belatedly then deduction is allowable in the previous year in which it was so deposited. Therefore, if the provisions of Section 194C with respect to the time of deduction and payments are applied for the disallowance under Section 40(a)(ia) then there will be no purpose or object for providing the certain conditions of actual deduction of tax and payment of tax under Section 40(a)(ia). The provisions of Chapter XVII are relevant only for ascertaining the deductibility of the tax at source and not for the actual deduction and payment for attracting the provisions of Section 40(a)(ia). Since in the case in hand when the assessee had deducted the tax in the last month of the previous year i.e March 2005 and deposited the same before the due date of filing of the return under Section 139(1) then it is covered under clause "A" of Section 40(a) (ia). Therefore, when the assessee's case covered under the main provisions of existing law then there is no need to go to the issue of prospective or retrospective effect of the amendment in the provisions by the Finance Act, 2010. Accordingly, the claims of the deduction of the assessee are to be allowed.

Section 115JB, read with Section 47 of Income-tax Act, 1961 – Special Provision for Payment of tax by certain Companies

Merely because long term capital gain is exempt under Section 47(iv) under normal provision of the Act, it is not correct to say that it is also to be reduced from net profit for purpose of computing book profit under Section 115JB when Explanation to Section 115JB does not provide for any deduction in terms of Section 47(iv) [Assessment Year 2004-05]

Rain Commodities Limited v. Dy. CIT, July 2, 2010 [HYD-ITAT (SB)]

Whenever the Legislature wanted income exempted under the normal provisions of the Act to be excluded from the computation of book profits, they have provided so. Under explanation (ii) and *Explanation (f)* to Section 115JB, the income and expenditure to which provisions of Sections 10, 11 and 12 apply are to be excluded from the computation of Book Profits. Similarly, if any deductions permitted under the normal provisions of the Act are intended to be deducted from the Book profits also the same is specifically

provided. Deductions under Sections 80HHC, 80HHD, 80HHE, 80HHF and deduction under Sections 80IA, 80IB were specifically excluded from the computation of Book profits at various times. The long term capital gain is to be included in the net profit prepared under the Companies Act and the same is not deductible from the net profit for the purpose of computing book profit under Section 115JB. Merely because the long term capital gain is exempt under Section 47(iv) under the normal provision of the Act, it is not correct to say that it is also to be reduced from the net profit for the purpose of computing book profit under Section 115JB when the Explanation to Section 115JB does not provide for any deduction in terms of Section 47(iv). In other words, Section 47(iv) has no application in the computation of book profit under Section 115JB. Thus from a reading of the Section 115JB as well as the analyses of various High Court and Supreme Court decisions, the inescapable conclusion is that the book profits have to be calculated on the net profits computed as per Parts II and III of Schedule VI to the Companies Act, 1956 and as adjusted by the amounts mentioned in the explanation. No further rebates or deductions after such adjustments, notwithstanding the fact whether any income is taxable or no under the normal provisions of the Income tax Act. Computation of income under the normal provisions and the Book profits are two parallel computations. While normally followed method of accounting in the books may also be taken for the purpose of computing income under the income tax Act, the actual computation of Book profits will not affect or be governed by the computation of income under the normal provisions of the Income tax Act. In fact only because the Government felt that companies availing of various deductions permitted under the Income tax Act showed a low income for the purpose of Income tax but was able to show healthy profits as per books on the basis of which dividends were distributed and to tax these types of companies that tax on book profits were introduced. By again importing deductions allowed under the normal provisions of income tax into computation of book profits, the very purpose for which these Sections were introduced would be negated. To sum up, it was to be held that in the absence of any provision for exclusion of capital gains exempted in the computation of book profit under the provisions contained in *Explanation* to Section 115JB, an assessee is not entitled to the exclusion thereof.

Section 147 of Income-tax Act, 1961 – Income escaping assessment

CIT v. Baer Shoes (India) Pvt. Ltd, August 3, 2010 (MAD)

[Assessment Year 1999-2000]

- Merely because a judgment has been rendered, even if by Apex Court, same cannot be a ground for reopening assessment under Section 147.
- Where for assessment year 1999-2000, first reassessment was done by Assessing Officer under Section 147 on 18-3-2003 and, thereafter, notice for reopening assessment for second time was issued to assessee on 4-8-2005, while four years period of limitation for invoking power under Section 147 expired

on 31-12-2004, since assessee had already disclosed all material facts and he had also filed return within time, proceedings initiated by Assessing Officer for second time under Section 147 would be barred by limitation.

- A perusal of the *Explanation* 1 to proviso to Section 147 would show that a mere production of accounts books and other evidence could have been discovered by the Assessing Officer would not amount to disclosure within the meaning of the provision. Therefore, the said *Explanation* 1 should be considered in the context of the provision, inasmuch as the same is applicable only for the production of the records and other evidence. Hence, the same will not be applicable to the case of filing of a return with adequate particulars fully disclosing all the materials for the purpose of assessment.

Section 148 read with Sections 80-IB and 147 of the Income-tax Act, 1961 - Income escaping assessment - Issue of notice

No notice would be issued under Section 148 after four years from end of assessment year on ground that assessee-Government contractor was not eligible for deduction in view of subsequent amendment in Act and thereby assessee became a deemed failure [Assessment Years 2003-04 & 2004-05]

Sadbhav Engineering Ltd. v. Dy. CIT, July 7, 2010 (GUJ)

The first proviso to Section 147 of the Act, lays down that where an assessment under sub-Section (3) of Section 143 or the said Section has been made for the relevant assessment year, no action shall be taken under the Section after expiry of four years from the end of the relevant assessment year, unless any income chargeable to tax has escaped assessment by reason of the failure on the part of the assessee to make a return under Section 139 or in response to a notice issued under sub-Section (1) of Section 142 or Section 148 or to disclose fully and truly all material facts necessary for his assessment. Thus, for the purpose of invoking Section 147 after the expiry of four years from the end of the relevant assessment year, the income chargeable to tax should have escaped assessment by reason of failure on the part of the assessee either (i) to make a return under Section 139 or in response to a notice issued under sub-Section (1) of Section 142 or Section 148, or (ii) to disclose fully and truly all material facts necessary for his assessment.

On a plain reading of the reasons recorded, it was apparent that the same were totally silent as regards any failure on the part of the petitioner to disclose fully and truly all material facts necessary for its assessment for the relevant assessment years. From the reasons recorded it was apparent that the assessments are sought to be reopened on the ground that as per the explanation given below Section 80-IA(13), which has been substituted by the Finance Act No.2 of 2009 with retrospective effect from 1.4.2000, deduction under Section 80-IA would not be admissible to an assessee who carries on business which was in the nature of works contract. That the petitioner-assessee being a civil contractor working for the Government was not eligible for deduction under

Section 80-IA as claimed by the assessee and, hence there was reason to believe that income chargeable to tax had escaped assessment for the assessment years under consideration. The record of the case did not in any manner indicate that proceedings under Section 147 were sought to be reopened by reason of failure on the part of the petitioner to disclose fully and truly all material facts necessary for its assessment for assessment years under consideration. The respondent in its affidavit in reply also had not disputed the fact that there was no failure on the part of the petitioner to disclose fully and truly all material facts. Only by way of submission advanced before the Court it was contended that in the light of the amendment of Section 80IB, it was deemed that the petitioner had failed to disclose the correct facts. As to whether or not there is any failure on the part of the assessee in disclosing fully and truly all material facts necessary for his assessment, is a matter of fact and there can be no deemed failure as is sought to be contended on behalf of the Revenue. In the circumstances, in absence of any failure on the part of the assessee to disclose fully and truly all material facts necessary for its assessment for the assessment years under consideration, the notices under Section 148 of the Act having been issued after the expiry of a period of four years from the end of the relevant assessment years, the very initiation of proceedings under Section 147 stood vitiated and as such could not be sustained.

Section 197 of the Income-tax Act, 1961 - Deduction of tax at source - Certificate for deduction at lower rate

If conditions for grant of a certificate under Section 197 were duly fulfilled, it would be impermissible for Assessing Officer to reject application for issuing a certificate; it cannot be contended that no prejudice would be caused to assessee since tax would be refunded later together with interest

Larsen & Toubro Ltd. v. Asstt. CIT, April 28, 2010 (BOM)

The Assessing Officer dismissed the application for the grant of certificate under Section 197 on the ground that (i) the calculation mechanism provided under Rule 28AA of the Income-tax Rules, 1962 fails as the financial statements of the assessee for the three previous years was unavailable; (ii) no e-TDS returns were filed by the assessee.

The Bombay High Court held that:

Sub-rule (1) of Rule 28AA would indicate that the Assessing Officer, on an application made in Form 13 under Section 197 may issue a certificate in accordance with the provisions of sub-Section (1) of Section 197 for deduction of tax at source at the rate or rates calculated in the manner specified thereafter.

Clause (1) of Rule 28AA provides a mode of computing the rate at which tax is to be deducted at source. This is not a condition of eligibility. It cannot be contended that the mechanism that is contemplated under Rule 28AA would break down in the case of the assessee on the ground that the financial statements of the assessee in the previous three years were not available. In this case, sub-clause (ii) would not apply and the rate would be computed under sub-clause (i).

The application cannot be rejected on the ground that the assessee has not filed e-TDS returns. The failure

of the assessee, if any to file e-TDS returns may result in independent consequences which are provided in law. That however, cannot justify the rejection of the application made by the assessee for the determination of withholding of tax at a lower rate on payments which are to be received by the assessee. The delay, if any, in paying tax may result in other consequences which are provided for by the Act, including penal consequences under Section 271(1). However, that cannot justify the rejection of an application under Section 197.

The Revenue could not take plea that in the event that the assessee paid excess tax, it would be entitled to a refund of the tax paid together with interest and hence, no prejudice would be caused to the assessee. The entire approach would be specious. The Assessing Officer was required, in the first instance, to apply his mind to the fact that the conditions for the grant of a certificate under Section 197 are duly fulfilled. If those conditions are duly fulfilled, it will be impermissible for the Assessing Officer to reject the application merely on a whim and on caprice. It is impermissible to hold that no prejudice would be caused to the assessee since tax would be refunded later together with interest.

Section 264 of the Income-tax Act, 1961 - Revision – Of other orders

Rejection of an application under Section 197 by Assessing Officer results in an order as required under Section 264 and, hence, revisional power which is vested in Commissioner under Section 264 would be attracted

Larsen & Toubro Ltd. v. Asstt. CIT, April 28, 2010 (BOM)

The Assessing Officer, when he decides an application under Section 197(1) must of necessity pass an order on the application. Where the application is allowed, that application culminates in the grant of a certificate in accordance with the provisions of sub-Section (1) of Section 197. But it would be far fetched to accept the view that the rejection of an application must lie in the absolute discretion of the Assessing Officer or that the Assessing Officer is not bound to indicate reasons or a basis for the rejection of the application. The fact that Parliament has empowered the Board to frame Rules under sub-Section 2A, having due regard to the convenience of assesseees and the interests of the Revenue specifying the cases and circumstances under which an application can be made and the conditions subject to which such a certificate may be granted is sufficient to indicate that the exercise of powers by the Assessing Officer is intended to be structured in accordance with the provisions of Section 197 and the Rules framed by the Board under sub-Section 2A. The Assessing Officer cannot be heard to urge that though an assessee fulfills all the requirements which are stipulated in Rule 28AA or, as the case may be, in Rule 29B, he possesses an unguided discretion to reject the application. Consequently, the Assessing Officer when he rejects an application is bound to furnish reasons which would demonstrate an application of mind by him to the circumstances which are mandated both by the Statute and by the Rules to be taken into consideration. Hence, the rejection of an application under Section 197 does not

result in an order. The expression “order” for the purposes of Section 264 has a wide connotation. Sub-Section (1) of Section 264 provides that in the case of any order other than an order to which Section 263 applies, passed by an authority subordinate to him, the Commissioner may either of his own motion or on application by the assessee for revision, call for the record of any proceeding under the Act in which any such order has been passed and after making an enquiry, pass such order thereon not being an order prejudicial to the assessee as he thinks fit. Parliament has used the expression “any order”. Hence, any order passed by an authority subordinate to the Commissioner, other than an order to which Section 263 applies, is subject to the revisional jurisdiction under Section 264. A determination on an application under Section 197 requires an order to be passed by the Assessing Officer after application of mind to the circumstances which are germane under Section 197 and the Rules framed under sub-Section 2A. There would be an order which would be subject to his revisional jurisdiction under Section 264.

INDIRECT TAXES

Excise

Rule 57Q of the Central Excise Rules, 1944 – Modvat Credit

CCE v. Rajasthan Spinning & Weaving Mills Ltd, July 9, 2010 (SC)

MODVAT credit is available in respect of steel plates and M.S. channels used in fabrication of chimney for diesel generating set, by treating these items as capital goods.



Sales Tax

Sales tax - Contempt of Court

Garware Polyester Ltd. v. State of Maharashtra, July 1, 2010 (BOM)

Where in assessment order, it was recorded that judgment of High Court in a particular case was not accepted by Revenue Department and legal proceeding is initiated against said judgment; but in fact said decision was not stayed, this amounted to contempt of High Court.

Service Tax

Section 65(105) of the Finance Act, 1994 – Information Technology Software Service

Software is goods and whether transaction would amount to sale or service would depend upon individual transaction; Parliament has legislative competence to charge tax on service in respect of software

Infotech Software Dealers Association v. Union of India, August 24, 2010 (MAD)

Software is goods

A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. The term ‘all materials, articles and commodities’ includes both tangible and intangible/incorporeal property which is capable of abstraction, consumption and use and which can be

transmitted, delivered, stored, possessed etc. A software is an intellectual property and it is an article of value. Indian law does not recognise or make a distinction between tangible property and intangible property. A 'goods' may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) utility (b) capable of being bought and sold (c) capable of transmitted, transferred, delivered, stored and possessed. If a software whether customised or non- customised satisfies these attributes, the same would be goods. In view of the settled law, it must be held that software is 'goods' as defined in Article 366(12) of the Constitution of India.

Legislative competence of Parliament to levy Sales and Service Tax

The software being an intangible property can be considered as goods for the purpose of levy of sales tax. However, in a transaction whereby the software is delivered to the customers, the question is as to whether it would amount to an exclusive sale. There may be cases of exclusive sale or exclusive service or where the element of sales and service is involved. In cases where an element of service is alone involved, the Parliament has the legislative competency to enact law for levying service tax under Entry 93-C. That Entry 93-C is not notified. Hence, in case if an element of service is available, the Parliament has got power to impose service tax under the residual Entry 97 of List I of VII Schedule.

After the Constitution (Forty-Sixth Amendment) Act, 1982 introducing clause (29A)(d) to Article 366 of the Constitution, tax on the sale or purchase of goods includes "a tax on the transfer of the right to use any goods for any purpose whether or not for a specified period" for cash, deferred payment or other valuable consideration. The Finance Act, 2008 has brought in some new services under the service tax net. One of them is "Information Technology Software Service". The relevant amendment became effective from 16.5.2008.

To decide the imposition of tax, the nature of transaction is relevant. When a statute, particularly a taxing statute is considered with reference to the legislative competency, the nature of transaction and the dominant intention on such transaction would be relevant. In the event the goods or commodity is sold as such, the transaction would fall under Entry 56 of List II of Schedule VII. However, without there being a sale of such goods, the right to use the information or the data stored in a commodity, namely, the software is transferred, whether it can be called as a sale of the commodity or the goods as such is the question to be considered.

Article 366(29A)(d) is a deeming provision as to tax on the right to transfer the use of any goods for any purpose be considered as a tax on sale or purchase of goods. Even before the Amendment came into force, the customs Notification No.21 of 2002 dated 1-3-2002 referring the goods in Sl.No.157 excluded the standard rate of customs for "Information Technology Software" and the document of title conveying the right to use the "Information Technology Software". Sl.No.311 of the Notification relates to Compact Disc Read Only Memory (CD-ROM) prescribing Nil standard rate. Even in the budget speech 2006-07, the Minister for Finance has stated that customised software and software downloaded from internet will be exempt from levy of 8% excise duty on packaged software sold over the counter. The exemption from excise duty for the packaged software would be available only when sales take place. Similarly, the excise Notification dated 1.3.2006 in Sl.No.27 has exempted tax for any customised software (that is to say any customised software developed for specific user or client) other than packaged software or canned software. The explanation provides that a packaged software or canned software means a software developed to meet the needs of variety of users and which is intended for sale and capable of being sold off the shelf. Similarly, in the budget speech 2008-09, the Minister for Finance in paragraph 151, while increasing the excise duty from 8% to 12% on packaged software to



bring it on par with the customised software which will attract a service tax of 12%. Only in the above background, the amendment was brought into the Finance Act, 1994 to include "Information Technology Software" service to be a taxable service.

To find out as to whether there is an element of sale involved when software is delivered to its customer, the terms and conditions of End User Licence Agreement (EULA) are material. Where the dominant intention of the parties would show that the developer or the creator of software keeps back the copyright of each software, be it canned, packaged or customised, and what is transferred to the network subscriber, namely, the dealers, is only the right to use with copyright protection. By that agreement, even the developer does not sell the software as such. By that Master End-User License Agreement, the dealers again enter into an End-User License Agreement for marketing the software as per the conditions stipulated therein. In common parlance, end user is a person who uses a product or utilises the service. An end user of a computer software is one who does not have any significant contact with the developer/creator/designer of the software. When a transaction took place between the dealers with its customers, it is not the sale of the software as such, but only the contents of the data stored in the software. This would amount to only service. To bring the deemed sale under Article 366(29A)(d) of the Constitution of India, there must be a transfer of right to use any goods and when the goods as such is not transferred, the question of deeming sale of goods does not arise and in that sense, the transaction would be only a service and not a sale.

The Parliament has the legislative competency to bring in enactments to include certain services provided or to be provided in terms of information technology software for use in the course or furtherance of business or commerce to mean a taxable service, in terms of the residuary Entry 97 of List I of Schedule VII, the challenge to the amended provision cannot be accepted so long as the residuary power is available. However, the question as to whether a transaction would amount to sale or service depends upon the individual transaction and on that ground, the vires of a provision cannot be questioned. The amended provision cannot be held to be unconstitutional on the ground that the Parliament lacks the legislative competency and the applicability of that provision would depend upon the individual transactions which could be established before the authorities as and when the demand is made.

In view of above findings, the challenge to provision of Section 65(105) (zzzzl) on the ground that it is contrary to the provisions of Articles 245, 265 and 268A must fail. For the same reasons, the other challenge with regard to Articles 14 and 19(1)(g) of the Constitution of India are also not proper.

Therefore, it is to be held that the software is goods and whether the transaction would amount to sale or service would depend upon the individual transaction and for the reason of that challenge, the amended provision of Section 65(105)(zzzze) cannot be held to be unconstitutional so long as the Parliament has the legislative competency to enact law in respect of tax on service in exercise of powers under Entry 97 of List I of Schedule VII.

OTHER ACTS

Companies Act

Section 630 of the Companies Act, 1956 read with Sections 34 & 406 of the Indian Penal Code – Penalty for wrongful withholding of Property

Automobile Products India Ltd. v. Das John Peter & others, July 20, 2010 (SC)

Where caretaker of property of company retired from service and promised to vacate the servant quarter by a particular date but committed default of his own promise, there was no other choice or option but to direct accused persons to vacate the premises and to hand over its peaceful vacant possession to the company.



**SEBI****Regulation 2(e) of the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 – Person acting in concert**

Unless it is shown that an agreement has been entered into for common objective or purpose of substantial acquisition of shares or voting rights or control over company, no person can be said to have come in relationship of “persons acting in concert”; deeming provision under sub-regulation (2) would give rise to presumption, only from date two or more persons come together in one of specified relationships and not from any earlier date

Daiichi Sankyo Company Ltd. v. Jayaram Chigurupati and Others, July 8, 2010 (SC)

The concept of “person acting in concert” under regulation 2(e)(1) is based on a target company on the one side, and on the other side two or more persons coming together with the shared common objective or purpose of substantial acquisition of shares etc. of the target company. Unless there is a target company, substantial acquisition of whose shares etc. is the common objective or purpose of two or more persons coming together there can be no “persons acting in concert”. For, de hors the target company the idea of “persons acting in concert” is as irrelevant as a cheat with no one as victim of his deception. Two or more persons may join hands together with the shared common objective or purpose of any kind but so long as the common object and purpose is not of substantial acquisition of shares of a target company they would not comprise “persons acting in concert”.

The other limb of the concept requires two or more persons joining together with the shared common objective and purpose of substantial acquisition of shares etc. of a certain target company. There can be no “persons acting in concert” unless there is a shared common objective or purpose between two or more persons of substantial acquisition of shares etc. of the target company. For, de hors the element of the shared common objective or purpose the idea of “person acting in concert” is as meaningless as criminal conspiracy without any agreement to commit a criminal offence. The idea of “persons acting in concert” is not about a fortuitous relationship coming into existence by accident or chance. The relationship can come into being only by design, by meeting of minds between two or more persons leading to the shared common objective or purpose of acquisition of substantial acquisition of shares etc. of

the target company. It is another matter that the common objective or purpose may be in pursuance of an agreement or an understanding, formal or informal; the acquisition of shares etc. may be direct or indirect or the persons acting in concert may cooperate in actual acquisition of shares etc. or they may agree to cooperate in such acquisition. Nonetheless, the element of the shared common objective or purpose is the *sin qua non* for the relationship of “persons acting in concert” to come into being.

The relationship of “persons acting in concert” is not a fortuitous relationship. It can come into being only by design. Hence, unless it is shown that an agreement has been entered into for the common objective or purpose of substantial acquisition of shares or voting rights or control over the company they can not be said to have come in the relationship of “persons acting in concert”.

Deeming provision as contained in sub-clause (2) of Regulation 2(e)

The deeming provision cannot do away either with the target company or the common objective or purpose of substantial acquisition of shares etc. of the target company shared by two or more persons because to do so would be destructive of the very idea of “persons acting in concert” as defined in sub-clause (1) of regulation 2(e). Sub-regulation (2) of regulation 2(e) containing the deeming clause should be seen as a ‘stand alone’ provision, independent of sub-regulation (1) of regulation 2(e).

The deeming provision simply says that in case of nine specified kinds of relationships, in each category, the person paired with the other would be deemed to be acting in concert with him/it. What it means is that if one partner in the pair makes or agrees to make substantial acquisition of shares etc. in a company it would be presumed that he/it was acting in pursuance of a common objective or purpose shared with the other partner of the pair. In order to hold that a person is acting in concert with the acquirer or with another person it must be established that the two share the common intention of acquisition of shares of some target company. The deeming fiction under sub-regulation (2) can only operate prospectively and not retrospectively. That is to say the deeming provision would give rise to the presumption, only from the date two or more persons come together in one of the specified relationships and not from any earlier date. ■

CIRCULARS/NOTIFICATIONS

DIRECT TAXES

I. Circulars

1. Circular No. 6/2010 dated 20-9-2010

Section 80P of the Income-tax Act, 1961

- Deduction in respect of income of co-operative societies - Clarification regarding eligibility of deduction under Section 80P to Regional Rural Banks

The Central Board of Direct Taxes has, through, this circular clarified that Regional Rural Banks are not eligible for deduction under Section 80P of the Income-tax Act, 1961 from the assessment year 2007-08 onwards. It has also been clarified that the Circular No. 319 dated 11-1-1982 deeming any Regional Rural Bank to be cooperative society stands withdrawn for application with effect from AY 2007-08.

This is in consequent to the amendment in section Finance Act, 2006, which laid down specifically that w.e.f. 1-4-2007 the provision of Section 80P will not apply to any cooperative bank other than a Primary Agricultural Credit Society or a Primary Cooperative Agricultural and Rural Development Bank. The same has been clarified by this circular.

II. Notifications

1. Notification No. 77, dated 11.10.2010, S.O. 2519(E)

Section 80CCF provides a deduction to an assessee, being an individual or a Hindu undivided family, of the amount paid as subscription to long-term infrastructure bonds as may, for the purposes of this section, be notified by the Central Government subject to a maximum of ₹20,000.

The Central Board of Direct Taxes, has, through this Notification notified the bonds, subscription to which would qualify for deduction under Section 80CCF subject to certain conditions specified therein. These bonds have been named as "Long term infrastructure bonds" of India Infrastructure Finance Company Limited (IIFCL) and shall be issued during the financial year 2010-11.

The complete text of the above notifications/ Circulars can be downloaded from the website of the Income-tax Department, www.incometaxindia.gov.in, and the complete link may be downloaded from the home page of the Direct Taxes Committee of the Institute at http://www.icai.org/post.html?post_id=965&c_id=57.

(Matter on Direct Taxes has been contributed by the Direct Taxes Committee of the ICAI)

INDIRECT TAXES

A. EXCISE DUTY

I Notification:

1. Notification No. 29/2010-CE (N.T.)

dated 24.09.2010 has amended Rule 2(a) of the CENVAT Credit Rules, 2004 so as to provide that components, spares and accessories of motor

vehicles, dumpers or tippers, as the case may be, used to provide the prescribed taxable services would be treated as capital goods.

Note: Dumpers or tippers used for providing site preparation and clearance, excavation, earth moving and demolition services and mining services were included in the list of capital goods eligible for CENVAT credit vide Notification No. 25/2010 CE(NT) dated 22.06.2010.

II.Circular:

1. Circular No. 935/25/2010-CX dated 21.09.2010

has been issued so as to streamline the procedures relating to processing of departmental litigation before the Supreme Court, High Courts and CESTAT. The Board has taken a serious note of the matter that more than 50 per cent of the proposals received by it suffer from infirmities including delays beyond limitation period. It has been decided to fasten accountability wherever SLP/Civil Appeal Proposal is received by the Board without observance of due procedure or with infirmities or later than the prescribed time frame. The field formations have been directed to scrupulously follow the instructions contained in this circular.

B. CUSTOMS DUTY

I. Circulars:

1. Circular No. 38/2010-Cus. dated 27.09.2010

has been issued to explain the salient features of the changes made by the Annual Supplement to the Foreign Trade Policy (FTP), 2009-2014 and the Handbook of Procedures (Vol.I) notified by the DGFT vide Notification No. 1(RE-2010)/2009-2014 dated 23rd August 2010 and Public Notice 1(RE-2010)/2009-14 dated 23rd August 2010 respectively. The Department of Revenue has since issued Notification Nos.88/2010-Cus, 89/2010-Cus and 90/2010-Cus all dated 01.09.2010, 91/2010-Cus dated 06.09.2010, 92/2010-Cus dated 10.09.2010, 93/2010-Cus dated 14.09.2010 and 97/2010-Cus dated 21.09.2010 to implement the Policy and the Handbook.

2. Circular No. 39/2010-Cus. dated 15.10.2010

has been issued to modify the procedure provided in Circular No.43/2007-Cus dated 05.12.2007 to the extent that the Commissioners of Central Excise or Customs and Central Excise, as the case may be, may issue authorisation to Dy./ Asstt. Commissioners of Central Excise posted in Divisions under them for the purpose of disbursing drawback to DTA units against disclaimers issued by SEZ units/developers. The cheque book issued by the Pay & Accounts Officer of the jurisdictional Central Excise or the Customs and Central Excise Commissionerate, as the case may be, to the Central Excise Division for making refunds may be used for disbursement of drawback and the accounting procedure as laid down in the Principal, CCA's office letter No. Coord/2(8)/98/434 dated 13.06.2005 may be followed in this regard.

C. SERVICE TAX

I. Notifications:

1. Notification No. 49/2010-ST dated 08.10.2010 has provided an optional mode of payment of service tax to a distributor or selling agent of lotteries by inserting sub-rule (7C) in rule 6 of the Service Tax Rules, 1994. The distributor or selling agents rendering the taxable service of promotion, marketing or organising/assisting in organising lottery can discharge their service tax liability in the following manner instead of paying service tax @10%:

Where the guaranteed lottery prize payout is > 80%	₹6000/- on every ₹10 Lakh (or part of ₹10 Lakh) of aggregate face value of lottery tickets printed by the organising State for a draw.
Where the guaranteed lottery prize payout is < 80%	₹9000/- on every ₹10 Lakh (or part of ₹10 Lakh) of aggregate face value of lottery tickets printed by the organising State for a draw.

In case of online lottery, the aggregate face value of lottery tickets will be the aggregate value of tickets sold. The distributor or selling agent will have to exercise such option within a period of one month of the beginning of each financial year. The option once exercised cannot be withdrawn during the remaining part of the financial year.

For the financial year 2010-11, the distributor or selling agent will have to exercise such option by 07.11.2010. The new service provider can exercise such option within one month of providing the service. Once exercised, the option cannot be withdrawn during the remaining part of that financial year.

The expressions "distributor or selling agent", "draw", "online lottery" and "organising state" will have the same meaning as is assigned to them under Lottery (Regulation) Rules, 2010.

2. Notification No. 50/2010-ST dated 08.10.2010 has exempted the persons marketing the lottery tickets, other than the authorised distributors or selling agents, from service tax if the distributor or selling agent avails of optional composition scheme notified vide *Notification No. 49/2010 ST dated 08.10.2010* in respect of such lottery during the financial year.

However, the exemption will not be available when such person markets lottery tickets to the distributors or selling agents who have not opted for the above-mentioned composition scheme.

Here, "distributor or selling agent" will have the meaning as is assigned to them under Lottery (Regulation) Rules, 2010.

II. Circulars:

1. Circular No. 129/11/2010-ST dated 21.09.2010 has been issued to clarify that new services notified through the Finance Act, 2010 fall under rule 3(1)(iii) and rule 3(iii) of the Export of Services Rules 2005 and the Taxation of Services (Provided from Outside India and Received in India) Rules,

2006 respectively. In other words, under both the Export and Import Rules, the new services will fall under the residual category.

2. Circular No. 130/12/2010-ST dated 20.09.2010 : The monetary limits for adjudication of penalty by Central Excise Officers have been revised by the Central Board of Excise and Customs vide *Notification No. 48/2010 ST dated 08.09.2010*. Under the revised limits, Superintendents have been empowered to adjudicate cases involving service tax upto ₹1 lakh in a show cause notice. Similar monetary limits for the purpose of adjudication under Section 73 have been prescribed vide this Circular.

Further, in respect of the above powers of adjudication conferred on the Superintendents, the following has been clarified vide the circular:

- The Superintendents would be competent to decide cases that involve service tax and/or CENVAT credit upto ₹one lakh in individual show cause notices.
- They would not be competent to decide cases that involve taxability of services, valuation of services, eligibility of exemption and cases involving suppression of facts, fraud, collusion, willful mis-statement, etc.
- They would be competent to decide cases involving wrong availment of CENVAT credit upto a monetary limit of ₹1 lakh.

The complete text of above notification and circulars are available at www.cbec.gov.in

(Matter on Indirect Taxes has been contributed by the Indirect Taxes Committee of the ICAI)

FEMA

1. RBI/2010-11/ 199 A.P. (DIR Series) Circular No. 13 dated September 14, 2010

Reporting under Foreign Direct Investment (FDI) Scheme

Ref: *Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended, A.P. (DIR Series) Circular No. 44 dated May 30, 2008*

In terms of para 9 of Schedule 1 to the Notification, Indian companies are required to report, the details of the amount of consideration received for issue of FDI instruments, viz. equity shares, fully and mandatorily convertible preference shares and debentures under the FDI scheme, in the Advance Reporting Format along with the KYC report on the non-resident investor, to the Regional Office of the Reserve Bank in whose jurisdiction the Registered Office of the company operates, within 30 days of receipt of the amount of consideration. Further, the Indian company is required to issue the FDI instruments to the non-resident investor within 180 days of the receipt of the inward remittance and report the same in Form FC-GPR, to the Regional Office concerned of the Reserve Bank, within 30 days from the date of issue of shares.



As FDI is an important component of the Balance of Payments (BoP) statistics, which is being compiled and published on a quarterly basis, any delay in submission of the FDI data results in under-reporting of FDI in the BoP statistics. Further, delay in reporting of the FDI transactions (receipt of advance consideration and issue of FDI compliant instruments) and issuance of shares/ refund of advance consideration beyond 180 days of receipt of the same without the Reserve Bank's approval are considered as violations under the provisions of the Foreign Exchange Management Act, 1999 (FEMA). Therefore, AD Category - I banks are advised to sensitize and impress upon their clients the importance of strict adherence to the FDI reporting requirements including the KYC report. In this regard, AD Category-I banks may make suitable internal arrangements to monitor / track the inward remittances reported through Advance Reporting Format and the subsequent issue of shares or refund of share application money by the companies.

The complete text of the above-mentioned circulars and notifications on FEMA can be downloaded from the link:
<http://www.rbi.org.in>

*(Matter on FEMA has been contributed by
CA. Manoj Shah and CA. Hinesh Doshi)*

CORPORATE LAWS

1. Permissible period for remittance of e-payments into Government account

www.rbi.gov.in



The RBI has issued Circular No. DGBA. GAD.No.H. 2444 /42.01.011/2010-11 dated 08.10.2010 that recalls a Committee which was constituted by the Controller General of Accounts, Ministry of Finance, Government of India, to review the permissible period for transfer of funds to the Government account in case of e-payment and other related issues and the Committee recommended that the remittance norm of T+1 working day (including put through date) for e-payment as applicable for private sector banks may also be made applicable for the public sector banks. Based on the recommendations of the Committee, it is decided that the remittance period in respect of all Government transactions made through e-payments in respect of public sector banks will be T+1 working day (including put through date) w.e.f. November 1, 2010. One may refer to the above website for further details.

2. Monthly reporting by Portfolio Managers

www.sebi.gov.in

The SEBI has issued Circular No. IMD/DF/14/2010 dated 08.10.2010 in relation to submission of monthly report by portfolio managers and advising that the format for the monthly report on portfolio management activity has been revised. All portfolio managers are advised to upload the report in the revised format on SEBI Portal by the 5th of the

following month with effect from the report for the month of October 2010 onwards. This amendment is made to protect the interests of investors in securities and to promote the development of and to regulate the securities market. One may refer to the above website for further details and revised format of the report.

3. Review of Securities Lending and Borrowing (SLB) Framework

www.sebi.gov.in

The SEBI has issued Circular No. CIR/MRD/DP/33/2010 dated 07.10.2010 in relation to SLB and has clarified that in relation to dividend, the amount for the same would be worked out and recovered from the borrower on the book closure / record date and passed on to the lender. One may refer to the above website for further details.

4. Portfolio managers - regulation of fees and charges

www.sebi.gov.in

The SEBI has issued Circular No. IMD/DF/13/2010 dated 05.10.2010 in relation to the above subject whereby SEBI has stated that it has been receiving complaints from clients relating to fees and charges being levied by portfolio managers and upon scrutiny of the complaints, it had come to the notice of SEBI that the clauses relating to fees and charges in the portfolio manager-client agreement do not always clearly reflect the fees and charges payable by the client and the manner of computation of the same. Hence, in order to bring about greater uniformity, clarity and transparency with regard to fees and charges, portfolio managers are advised to take the measures in respect of all client agreements in relation to fees and charges where it is clarified that profit / performance shall be computed on the basis of high water mark principle over the life of the investment, for charging of performance/profit sharing fee. All fees and charges shall be levied on the actual amount of clients' assets under management. The High Water Mark shall be applicable for discretionary and non-discretionary services and not for advisory services. In case of interim contributions / withdrawals by clients, performance fees may be charged after appropriately adjusting the high water mark on proportionate basis. To ensure transparency and adequate disclosure regarding fees and charges, the client agreement shall contain a separate Annexure which shall list all fees and charges payable to the portfolio manager. The above Circular also provides an Illustration giving sample computation for the fees and charges. One may refer to the above website for further details.

5. Declarations and undertaking from FIIs (Foreign Institutional Investors)

www.sebi.gov.in

The SEBI has issued Circular No. IMD/FII/12/2010 dated 29.09.2010 reminding that it had earlier mandated all registered FIIs to provide the requisite declarations

and undertaking about their structures and also it had communicated to the FIIs through their custodians that those entities that do not file the requisite information by the stipulated date shall not be able to take fresh positions in the cash as well as the derivatives market w.e.f. 1st October 2010 and that thereafter the non-compliant entities could either retain their current positions or sell-off/unwind. SEBI has clarified that w.e.f. 1st October 2010 the FIIs and sub-accounts that have not complied with these requirements of providing information on their structures will not be permitted to take fresh positions in cash and derivatives market while they can retain their current positions or sell-off/unwind. One may refer to the above website for further details.

6. Prudential norms on investment in zero coupon bonds

www.rbi.gov.in

The RBI has issued Circular No. DBOD No. BPBC. 44/21.04.141/2010-11 dated 29.09.2010 that it has come to its notice that banks are investing in long term zero coupon bonds (ZCBs) issued by corporates including those issued by Non-Banking Financial Companies (NBFCs). In the case of ZCBs, the issuers are not required to pay any interest or installments till the maturity of bonds. As a result, the credit risk in such investments would go unrecognised till the maturity of bonds and this risk could especially be significant in the case of long term ZCBs. Such issuances and investments if done on a large scale could pose systemic problems. Hence, the RBI has decided that banks should henceforth not invest in ZCBs unless the issuer builds up sinking fund for all accrued interest and keeps it invested in liquid investments/securities (Government bonds), and also that banks should put in place conservative limits for their investments in ZCBs. The banks are advised to take immediate action to adhere to the above instructions. One may refer to the above website for further details.

7. Bank loans for financing promoters contribution

www.rbi.gov.in

The RBI has issued Circular No. D BOD.No.BPBC.42 /21.04.141/2010-11 dated 27.09.2010 whereby it has stated that the current dispensation on 'bank finance against shares and debentures', promoters' contribution towards the equity capital of a company should come from their own resources and banks should not normally grant advances to take up shares of other companies (a few exceptions were made viz. that of allowing banks to extend financial assistance to Indian companies for acquisition of equity in overseas joint ventures/wholly owned subsidiaries or in other overseas companies, to successful bidders for acquisition of shares of the PSUs under the Government of India's disinvestment programme, etc.). The RBI has now advised that this restriction on grant of bank advances for financing promoters' contribution towards equity capital would also extend to bank finance to activities related to

such acquisitions like payment of non-compete fee, etc. It is further advised that these restrictions would also be applicable to bank finance to such activities by overseas branches/subsidiaries of Indian banks. One may refer to the above website for further details.

8. FII investment limits in Government securities and corporate bonds increased

www.pib.nic.in

The Ministry of Finance has issued PIB Press Release dated 23.09.2010 increasing the current limit of FII investment in Government Securities by US \$ 5 billion raising the cap to US \$ 10 billion and the incremental limit of US \$ 5 billion be invested in securities with residual maturity of over five years. The current limit of FII investment in corporate bonds has also been increased by US \$ 5 billion raising the cap to US \$ 20 billion and the incremental limit of US \$ 5 billion be invested in corporate bonds with residual maturity of over five years issued by companies in infrastructure sector. The enhancement of the FII investment cap is with the objective to provide avenues for increased FII investments in debt securities, help investment in infrastructure sector and the development of Government securities and corporate bond markets in the country. The policy has been reviewed in the context of India's evolving macroeconomic situation, its increasing attractiveness as an investment destination and need for additional financial resources for India's infrastructure sector while balancing its monetary policy. Currently, FIIs can invest up to USD 5 billion and USD 15 billion in Government securities and corporate bonds respectively. One may refer to the above website for further details.

9. Clarification on Introduction of Call Auction in pre-open session

www.sebi.gov.in

The SEBI has issued Circular No. CIR/MRD/DP/32/2010 dated 17.09.2010 regarding introduction of call auction in pre-open session clarifying (and superceding the previous circulars/clarifications in this regard) that in case the equilibrium price is not discovered in the pre-open session, wherein, there are only market orders, the market orders shall be matched at previous day's close price and all unmatched market orders shall be shifted to the order book of the normal market at previous day's close price following time priority. Previous day's close price shall be the opening price. In case the equilibrium price is not discovered in the pre-open session and there are no market orders to be matched, all unmatched market orders (at previous day's close price) and limit orders shall be shifted to the order book of the normal market following price time priority. One may refer to the above website for further details.

*(Matter on Corporate Laws has been contributed by
CA. Jayesh Thakur)*

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Report on Campus Placement Programme – August-September, 2010*

The Committee for Members in Industry organises Campus Placement Programmes for all level of Chartered Accountants at frequent intervals throughout the year. The Committee for Members in Industry is committed to provide world class placement services to the Members and best accounting and finance talents to the industry.

In its endeavor to provide quality Accounting, Finance, Tax, Audit and Management Consultancy personnel to recruiting entities, the Committee has successfully organized one more round of Campus Placement Programme for newly qualified Chartered Accountants at sixteen centres viz. Ahmedabad, Bangalore, Bhubaneswar, Chennai, Coimbatore, Ernakulam, Hyderabad, Indore, Jaipur, Kanpur, Kolkata, Ludhiana, Mumbai, Nagpur, New Delhi and Pune in Aug-Sept, 2010.

Brief summary of the placement programme of both the phases is as follows:

Number of Candidates Registered	3111
Number of Interview Teams	156
Number of Organisations	88
Number of Jobs Offered	1398
Percentage of jobs offered vis-a-vis registered candidates	44.94%

Executive Summary

- Highest salary offered for International posting in the Campus Placement Programme is ₹21 lacs per annum.
- Highest salary offered ever for Domestic posting in the Campus Placement Programme is ₹15 lacs per annum.
- The minimum salary paid is ₹3.25 lacs per annum.
- The average salary offered was ₹6.45 lacs per annum.
- Total 1406 candidates have participated in phase I interviews and 2920 candidates have participated in phase II interviews after merger of candidates from smaller centres. In all 3111 candidates registered for availing the services of Campus Placement Programme.
- Around 1398¹ jobs were offered to the candidates who participated in Campus Placement Programme.
- In all more than 44 per cent of registered candidates were offered jobs.
- 1144 candidates accepted the job offers.
- 88 entities including the corporate organizations and the Chartered Accountancy Firms have participated during the Campus Placement Programme.
- 156 Interview Panels have participated during this Campus Placement Programme.

Salient features

- Candidates have been given two choices to meet the recruiting organisations. First at smaller cities and second (if the candidates has not been selected at smaller cities) at bigger cities.
- The committee organised Orientation Programme for candidates to sharpen their soft skills and give updates on the Technical side.
- In this Campus Placement Programme all the candidates have been permitted to attend the Orientation Programme at any of the centres to avoid the requirement to travel to centres chosen for interviews for attending the Orientation Programme.

The following table shows the statistical information of campus interview at a glance:

A) Phase I

Centre	Candidates Registered	Number of Interview Teams	Total No of jobs Offered
Ahmedabad	314	6	153
Bhubaneswar	39	7	29
Coimbatore	30	4	5
Ernakulam	12	1	0
Indore	67	1	8
Jaipur	346	5	15
Kanpur	96	2	5
Ludhiana	68	1	0
Nagpur	30	3	10
Pune	404	5	54
Total	1406	35	279

A) Phase II

Centre	Candidates Registered*	Number of Interview Teams	Total No of jobs Offered
Bangalore	226	17	109
Hyderabad	107	11	53
Kolkata	313	20	122
Chennai	208	21	120
Mumbai	1115	25	441
New Delhi	951	23	274
Total	2920	117	1119

*The figures also include candidates merged from smaller centre to the bigger centres as per their choice.

*Comments/suggestions for improvement in placement programme, particularly to improve the penetration are welcome at placements@icai.org

¹This write up reflects the status as on 05/10/2010 11:00 AM. Results are awaited from some of the companies. For further details kindly visit <http://www.cmii.icai.org>

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ACCOUNTANT'S BROWSER

'PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE'

Index of some useful articles taken from Periodicals/Newspapers received during September-October 2010 for the reference of Faculty/Students & Members of the Institute.

1. ACCOUNTING

Accounting for Varieties of Capitalism: The Case Against a Single Set of Global Accounting Standards by Martin Walker. *The British Accounting Review*, Vol.42, 2010, pp. 137-152.

Blue-Ribbon Panel Narrows Field for Private Company Financial Reporting by Alexandra Defelice. *Journal of Accountancy*, September 2010, pp. 24-28.

Financial Regulatory Reform: What You Need to Know by Matthew G. Lamoreaux. *Journal of Accountancy*, September 2010, pp. 30-33.

IFRS 8 – Operating Segments by Nasir Hashmi. *Management Accountant*, May-June 2010, pp. 42-44.

IFRS 9: Financial Instruments – An Overview by Shantonu Moitra. *The Management Accountant*, September 2010, pp. 737-739.

The Influence of the Introduction of Accounting Disclosure Regulation on Mandatory Disclosure Compliance: Evidence from Jordan by Mahmoud al- Akra. *The British Accounting Review*, Vol.42, 2010, pp. 170-186.

2. AUDITING

Sustainability Reporting & XBRL – Part 2 by Brad Monterio. *Strategic Finance*, September 2010, pp. 56-57 & 61.

3. ECONOMICS

Accessing Institutional Finance : A Demand Side Story for Rural India. *Eco. & Pol. Weekly*, September 11, 2010, pp. 56-62.

Corporate Investment: Growth in 2009-10 & Prospects for 2010-11. *RBI Bulletin*, August 2010, pp. 1579-1590.

Finances of Public Limited Companies: 2008-09. *RBI Bulletin*, August 2010, pp. 1591-1640.

Financing of SME Firms in India Interview with Ranjana Kumar, Former CWD, Indian Bank: Vigilance Commissioner, Central Vigilance Commission by Ashok Thampy. *IIMB Management Review*, Vol.22, 2010, pp. 93-101.

Income Inequality in India: Pre & Post-Reform Periods by Sandip Sarkar & Balwant Singh Mehta. *Eco. & Pol. Weekly*, September 11, 2010, pp. 45-55.

Making the Global Economy More Sustainable by Peter Loscher. *Corporate Governance*, Vol.10/4, 2010, pp. 349-353.

Productivity & Capital Investments: An Empirical Study of Three Manufacturing Industries in India by Atanu Chaudhuri etc. *IIMB Management Review*, Vol.22, 2010, pp. 65-79.

Values & Virtues in the Era of Globalization. *University News*, September 27 – October 03, 2010, pp. 6-11.

4. EDUCATION

Changing Role of Teachers in Strengthening Value-based Higher Education by Raju Narayana Swamy. *University News*, September 27 – October 03, 2010, pp. 14-18.

Delcon Consortium: A New Addition in the Galaxy of Library e-Consortia in India by Anil Singh & Sanjiv Sain. *University News*, September 20-26, 2010, pp. 21-24.

Entry of Foreign Universities: How & How Much to Regulate by R. Govinda. *University News*, September 20-26, 2010, pp. 63-64.

Foreign Educational Institutions (Regulation of Entry & Operations) Bill, 2010: A Limited Enterprise by Kavita A. Sharma. *University News*, September 13-19, 2010, pp. 15-20.

Internationalization of Indian Higher Education by Pawan Agarwal. *University News*, September 13--19, 2010, pp. 46-53.

On Opening a World Class University by R.P. Singh. *University News*, September 13-19, 2010, pp. 65-66.

5. INVESTMENT

Allowability of Losses from Forex Derivatives by S. Dhananjayan. *BCAJ*, September 2010, pp. 9-14.

Commodity Derivatives Market of India – An Overview by Bidisha Sarkar Datta. *The Management Accountant*, September 2010, pp. 710-714.

6. MANAGEMENT

Corporate Governance & the Current Crisis by Philippe Haspeslagh. *Corporate Governance*, Vol. 10/4, pp. 375-377.

Follow the Leaders by Robert Angel. *CA Magazine*, October 2010, pp. 20-27.

Responding to the Crisis: Redefining Corporate Value by Bruno Berthon. *Corporate Governance*, Vol. 10/4, pp. 354-359.

Role of Forward Contracts in Corporate Risk Management by L.N. Koli & Brijesh Rawat. *The Management Accountant*, September 2010, pp. 707-709.

7. TAXATION & FINANCE

The Evolution of the Term "Beneficial Ownership" in Relation to International Taxation over the Past 45 Years by Charl du Toit. *Bulletin for International Taxation*, October 2010, pp. 500-510.

Is Fiscal Justice Progressing? by Frans Vanistendael. *Bulletin for International Taxation*, October 2010, pp. 526-540.

The Taxation of Mineral Resources – From the Resource Super Profits Tax to the Minerals Resource Rent Tax by Michael Butler. *Asia-Pacific Tax Bulletin*, July-August 2010, pp. 292-295.

Full Texts of the above articles are available with the Central Council Library, ICAI, which can be referred on all working days. For further inquiries please contact on 011-23370154 or by e-mail at library@icai.org

IFRS – Exceptions



Exposed Draft 1 proposed that a first time adopter should use either all the exemptions or none of them. However, the IASB reconsidered this approach in the light of comments received and grouped the exceptions to retrospective applications into two groups. Thus IFRS-1 establishes two categories of exceptions to the principle that an entity's opening IFRS statement of financial position shall comply with each IFRS. First category prohibits retrospective application of some aspects of other IFRSs. Second category grants exemptions from some requirements of other IFRSs. (Optional exceptional). This article provides an overview of the exemptions available in the IFRS. Read on to know more.



CA. Aditya Singhal

(The author is a member of the Institute.
He can be reached at eboard@icai.org)

Exposed Draft 1 proposed that a first time adopter should use either all the exemptions or none of them. However, the IASB reconsidered this approach in the light of comments received and grouped the exceptions to retrospective applications into two groups. Thus IFRS-1 establishes two categories of exceptions to the principle that an entity's opening IFRS statement of financial position shall comply with each IFRS:

a) First category prohibits retrospective application of some aspects of other IFRSs.

b) Second category grants exemptions from some requirements of other IFRSs. (Optional exceptional)

The first group consists of mandatory exceptions where full retrospective application is prohibited. These are in respect of some aspects of de-recognition, hedge accounting, estimates, assets classified as held for sale and discontinued operations.

The reason given by the IASB for these requirements is that there is a danger of abuse if retrospective application would require judgments by

managements about past conditions after the outcome of a particular transaction is already known.

And the Second group consists of optional exemptions which may be selected independently of each other. Entities adopting IFRSs will, therefore, need to decide in each case the advantages and disadvantages of using these exceptions. When more than one voluntary exemption affects an account balance, more than one exemption can be applied. The decision to apply individual voluntary exemptions is independent. There is no requirement to use a particular voluntary exemption as the result of choosing another voluntary exemption. Further please note that IFRS1 clearly states that an entity shall not apply these exemptions by analogy to other items

Prohibition of Retrospective Application of Some Aspects of Other IFRSs

Under this category, IFRS1 prohibits retrospective application of below four aspects of other IFRSs relating to:

A. Estimates

An entity's estimates in accordance with IFRSs at the date of transition to IFRSs shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

An entity may receive information after the date of transition to IFRSs about estimates that it had made under previous GAAP. In accordance with above paragraph, an entity shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with IAS 10 Events after the Reporting Period. For example, assume that an entity's date of transition to IFRSs is 1 January 20X4 and new information on 15 July 20X4 requires the revision

of an estimate made in accordance with previous GAAP at 31 December 20X3. The entity shall not reflect that new information in its opening IFRS statement of position (unless the estimates need adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the entity shall reflect that new information in profit or loss (or, if appropriate, other comprehensive income) for the year ended 31 December 20X4.

An entity may need to make estimates in accordance with IFRSs at the date of transition to IFRSs that were not required at that date under previous GAAP. To achieve consistency with IAS 10, those estimates in accordance with IFRSs shall reflect conditions that existed at the date of transition to IFRSs. In particular, estimates at the date of transition to IFRSs of market prices, interest rates or foreign exchange rates shall reflect market conditions at that date.

Above three paragraphs apply to the opening IFRS statement of financial position. They also apply to a comparative period presented in an

A first-time adopter shall apply the derecognition requirements in IAS 39 *Financial Instruments: Recognition and Measurement* prospectively for transactions occurring on or after 1 January 2004. In other words, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before 1 January 2004, it shall not recognise those assets and liabilities in accordance with IFRSs (unless they qualify for recognition as a result of a later transaction or event).

entity's first IFRS financial statements, in which case the references to the date of transition to IFRSs are replaced by references to the end of that comparative period.

B. Derecognition of financial assets and financial liabilities

Except as permitted by below paragraph, a first-time adopter shall apply the derecognition requirements in IAS 39 *Financial Instruments: Recognition and Measurement* prospectively for transactions occurring on or after 1 January 2004. In other words, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before 1st January, 2004, it shall not recognise those assets and liabilities in accordance with IFRSs (unless they qualify for recognition as a result of a later transaction or event).

Notwithstanding above paragraph, an entity may apply the derecognition requirements in IAS 39 retrospectively from a date of the entity's choosing, provided that the information needed to apply IAS 39 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.

C. Hedge accounting

As required by IAS 39, at the date of transition to IFRSs, an entity shall:

- Measure all derivatives at fair value; and
- Eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.

An entity shall not reflect in its opening IFRS statement of financial position a hedging relationship of a type that does not qualify for hedge accounting in accordance with IAS 39 (for example, many hedging relationships where the hedging instrument is a cash

instrument or written option; where the hedged item is a net position; or where the hedge covers interest risk in a held-to-maturity investment). However, if an entity designated a net position as a hedged item in accordance with previous GAAP, it may designate an individual item within that net position as a hedged item in accordance with IFRSs, provided that it does so no later than the date of transition to IFRSs.

If, before the date of transition to IFRSs, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in IAS 39 the entity shall apply paragraphs 91 and 101 of IAS 39 to discontinue hedge accounting. Transactions entered into before the date of transition to IFRSs shall not be retrospectively designated as hedges.

D. Non-controlling interests

A first-time adopter shall apply the following requirements of IAS 27 (as amended in 2008) prospectively from the date of transition to IFRSs:

- a) The requirement in paragraph 28 that total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;
- b) The requirements in paragraphs 30 and 31 for accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and
- c) The requirements in paragraphs 34–37 for accounting for a loss of control over a subsidiary, and the related requirements of paragraph 8A of IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

However, if a first-time adopter elects to apply IFRS 3 (as revised in 2008) retrospectively to past business combinations, it shall also apply IAS 27 (as amended in 2008) in accordance with IFRS1.



Exemptions From Some Requirements of Other IFRSs

Under this category, a first time adopter may elect to use one or more of the following exemptions:

A. Business Combinations

A first-time adopter may elect not to apply IFRS 3 (as revised in 2008) retrospectively to past business combinations (business combinations that occurred before the date of transition to IFRSs). However, if a first-time adopter restates any business combination to comply with IFRS 3 (as revised in 2008), it shall restate all later business combinations and shall also apply IAS 27 (as amended in 2008) from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 20X6, it shall restate all business combinations that occurred between 30 June 20X6 and the date of transition to IFRSs, and it shall also apply IAS 27 (amended 2008) from 30 June 20X6.

If a first-time adopter does not apply IFRS 3 retrospectively to a past business combination, this has the following consequences for that business combination:

- a) The first-time adopter shall keep the same classification (as an acquisition by the legal acquirer, a reverse acquisition by the legal acquiree, or a uniting of interests) as in its previous GAAP financial statements.

- b) The first-time adopter shall recognise all its assets and liabilities at the date of transition to IFRSs that were acquired or assumed in a past business combination, other than:

- i. Some financial assets and financial liabilities derecognised in accordance with previous GAAP (see paragraph B2); and
- ii. Assets, including goodwill, and liabilities that were not recognised in the acquirer's consolidated statement of financial position in accordance with previous GAAP and also would not qualify for recognition in accordance with IFRSs in the separate statement of financial position of the acquiree (see (f)–(i) below).

The first-time adopter shall recognise any resulting change by adjusting retained earnings (or, if appropriate, another category of equity), unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill (see (g)(i) below).

- c) The first-time adopter shall exclude from its opening IFRS statement of financial position any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under IFRSs. The first-time adopter shall account for the resulting change as follows:

- i. The first-time adopter may have classified a past business combination as an acquisition and recognised as an intangible asset an item that does not qualify for recognition as an asset in accordance with IAS 38 Intangible Assets. It shall reclassify that item (and, if any, the related deferred tax and non-controlling interests) as part of goodwill (unless it deducted goodwill directly from equity in accordance with previous GAAP, see (g)(i) and (i) below).

- ii. The first-time adopter shall recognise all other resulting changes in retained earnings.*

**Such changes include reclassifications from or to intangible assets if goodwill was not recognised in accordance with previous GAAP as an asset. This arises if, in accordance with previous GAAP, the entity (a) deducted goodwill directly from equity or (b) did*

not treat the business combination as an acquisition.

- d) IFRSs require subsequent measurement of some assets and liabilities on a basis that is not based on original cost, such as fair value. The first-time adopter shall measure these assets and liabilities on that basis in its opening IFRS statement of financial position, even if they were acquired or assumed in a past business combination. It shall recognise any resulting change in the carrying amount by adjusting retained earnings (or, if appropriate, another category of equity), rather than goodwill.

- e) Immediately after the business combination, the carrying amount in accordance with previous GAAP of assets acquired and liabilities assumed in that business combination shall be their deemed cost in accordance with IFRSs at that date. If IFRSs require a cost-based measurement of those assets and liabilities at a later date, that deemed cost shall be the basis for cost-based depreciation or amortisation from the date of the business combination.

- f) If an asset acquired, or liability assumed, in a past business combination was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening IFRS statement of financial position. Instead, the acquirer shall recognise and measure it in its consolidated statement of financial position on the basis that IFRSs would require in the statement of financial position of the acquiree. To illustrate: if the acquirer had not, in accordance with its previous GAAP, capitalised finance leases acquired in a past business combination, it shall capitalise those leases in its consolidated financial statements, as IAS 17 Leases would require

the acquiree to do in its IFRS statement of financial position. Similarly, if the acquirer had not, in accordance with its previous GAAP, recognised a contingent liability that still exists at the date of transition to IFRSs, the acquirer shall recognise that contingent liability at that date unless IAS 37 Provisions, Contingent Liabilities and Contingent Assets would prohibit its recognition in the financial statements of the acquiree. Conversely, if an asset or liability was subsumed in goodwill in accordance with previous GAAP but would have been recognised separately under IFRS 3, that asset or liability remains in goodwill unless IFRSs would require its recognition in the financial statements of the acquiree.

- g) The carrying amount of goodwill in the opening IFRS statement of financial position shall be its carrying amount in accordance with previous GAAP at the date of transition to IFRSs, after the following two adjustments:

- i. If required by (c)(i) above, the first-time adopter shall increase the carrying amount of goodwill when it reclassifies an item that it recognised as an intangible asset in accordance with previous GAAP. Similarly, if (f) above requires the first-time adopter to recognise an intangible asset that was subsumed in recognised goodwill in accordance with previous GAAP, the first-time adopter shall decrease the carrying amount of goodwill accordingly (and, if applicable, adjust deferred tax and non-controlling interests).
- ii. Regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply

A first-time adopter may elect not to apply IFRS 3 (as revised in 2008) retrospectively to past business combinations (business combinations that occurred before the date of transition to IFRSs). However, if a first-time adopter restates any business combination to comply with IFRS 3 (as revised in 2008), it shall restate all later business combinations and shall also apply IAS 27 (as amended in 2008) from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 20X6, it shall restate all business combinations that occurred between 30 June 20X6 and the date of transition to IFRSs, and it shall also apply IAS 27 (amended 2008) from 30 June 20X6.

IAS 36 in testing the goodwill for impairment at the date of transition to IFRSs and in recognising any resulting impairment loss in retained earnings (or, if so required by IAS 36, in revaluation surplus). The impairment test shall be based on conditions at the date of transition to IFRSs.

h) No other adjustments shall be made to the carrying amount of goodwill at the date of transition to IFRSs. For example, the first-time adopter shall not restate the carrying amount of goodwill:

- i. To exclude in process research and development acquired in that business combination (unless the related intangible asset would qualify for recognition in accordance with IAS 38 in the statement of financial position of the acquiree);
- ii. To adjust previous amortisation of goodwill;
- iii. To reverse adjustments to goodwill that IFRS 3 would not permit, but were made in accordance with previous GAAP because of adjustments to assets and liabilities between the date of the business combination and the date of transition to IFRSs.

i) If the first-time adopter recognised goodwill in accordance with previous GAAP as a deduction from equity:

i. It shall not recognise that goodwill in its opening IFRS statement of financial position. Furthermore, it shall not reclassify that goodwill to profit or loss if it disposes of the subsidiary or if the investment in the subsidiary becomes impaired.

ii. Adjustments resulting from the subsequent resolution of a contingency affecting the purchase consideration shall be recognised in retained earnings.

j) In accordance with its previous GAAP, the first-time adopter may not have consolidated a subsidiary acquired in a past business combination (for example, because the parent did not regard it as a subsidiary in accordance with previous GAAP or did not prepare consolidated financial statements). The first-time adopter shall adjust the carrying amounts of the subsidiary's assets and liabilities to the amounts that IFRSs would require in the subsidiary's statement of financial position. The deemed cost of goodwill equals the difference at the date of

transition to IFRSs between:

- i. The parent's interest in those adjusted carrying amounts; and
 - ii. The cost in the parent's separate financial statements of its investment in the subsidiary.
- k) The measurement of non-controlling interests and deferred tax follows from the measurement of other assets and liabilities. Therefore, the above adjustments to recognised assets and liabilities affect non-controlling interests and deferred tax.

The exemption for past business combinations also applies to past acquisitions of investments in associates and of interests in joint ventures. Furthermore, the date selected for paragraph 1 applies equally for all such acquisitions.

B. The Effects of Changes in Foreign Exchange Rates

An entity need not apply IAS 21 *The Effects of Changes in Foreign Exchange Rates* retrospectively to fair value adjustments and goodwill arising in business combinations that occurred before the date of transition to IFRSs. If the entity does not apply IAS 21 retrospectively to those fair value adjustments and goodwill, it shall treat them as assets and liabilities of the entity rather than as assets and liabilities of the acquiree. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied in accordance with previous GAAP.

An entity may apply IAS 21 retrospectively to fair value adjustments and goodwill arising in either:

- a) All business combinations that occurred before the date of transition to IFRSs; or
- b) All business combinations that the entity elects to restate to comply



with IFRS 3, as permitted by paragraph C(i) above.

C. Share-based payment transactions

A first-time adopter is encouraged, but not required, to apply IFRS 2 Share-based Payment to equity instruments that were granted on or before 7 November 2002. A first-time adopter is also encouraged, but not required, to apply IFRS 2 to equity instruments that were granted after 7 November 2002 and vested before the later of (a) the date of transition to IFRSs and (b) 1 January 2005. However, if a first-time adopter elects to apply IFRS 2 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in IFRS 2. For all grants of equity instruments to which IFRS 2 has not been applied (eg equity instruments granted on or before 7 November 2002), a first-time adopter shall nevertheless disclose the information required by paragraphs 44 and 45 of IFRS 2. If a first-time adopter modifies the terms or conditions of a grant of equity instruments to which IFRS 2 has not been applied, the entity is not required to apply paragraphs 26–29 of IFRS 2 if the modification occurred before the date of transition to IFRSs.

A first-time adopter is encouraged, but not required, to apply IFRS 2 to liabilities arising from share-based payment transactions that were settled before the date of transition to IFRSs. A first-time adopter is also encouraged, but not required, to apply IFRS 2 to liabilities that were settled before 1 January 2005. For liabilities to which IFRS 2 is applied, a first-time adopter is not required to restate comparative information to the extent that the information relates to a period or date that is earlier than 7 November 2002.

D. Insurance contracts

A first-time adopter may apply the transitional provisions in IFRS 4

An entity need not apply IAS 21 The Effects of Changes in Foreign Exchange Rates retrospectively to fair value adjustments and goodwill arising in business combinations that occurred before the date of transition to IFRSs. If the entity does not apply IAS 21 retrospectively to those fair value adjustments and goodwill, it shall treat them as assets and liabilities of the entity rather than as assets and liabilities of the acquiree. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied in accordance with previous GAAP.

Insurance Contracts. IFRS 4 restricts changes in accounting policies for insurance contracts, including changes made by a first-time adopter.

E. Fair value or revaluation as deemed cost

An entity may elect to measure an item of property, plant and equipment at the date of transition to IFRSs at its fair value and use that fair value as its deemed cost at that date.

A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to IFRSs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

- Fair value; or
- Cost or depreciated cost in accordance with IFRSs, adjusted to reflect, for example, changes in a general or specific price index.

The elections are also available for:

- Investment property, if an entity

elects to use the cost model in IAS 40 Investment Property and

- Intangible assets that meet:
 - The recognition criteria in IAS 38 (including reliable measurement of original cost); and
 - The criteria in IAS 38 for revaluation (including the existence of an active market).

An entity shall not use these elections for other assets or for liabilities.

A first-time adopter may have established a deemed cost in accordance with previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatization or initial public offering. It may use such event-driven fair value.

F. Leases

A first-time adopter may apply the transitional provisions in IFRIC 4 Determining whether an Arrangement contains a Lease. Therefore, a first-time adopter may determine whether an arrangement existing at the date of transition to IFRSs contains a lease on the basis of facts and circumstances existing at that date.

G. Employee benefits

In accordance with IAS 19 Employee Benefits, an entity may elect to use a 'corridor' approach that leaves some actuarial gains and losses unrecognised.

Retrospective application of this approach requires an entity to split the cumulative actuarial gains and losses from the inception of the plan until the date of transition to IFRSs into a recognised portion and an unrecognised portion. However, a first-time adopter may elect to recognise all cumulative actuarial gains and losses at the date of transition to IFRSs, even if it uses the corridor approach for later actuarial gains and losses. If a first-time adopter uses this election, it shall apply it to all plans.

An entity may disclose the amounts required by paragraph 120A(p) of IAS 19 as the amounts are determined for each accounting period prospectively from the date of transition to IFRSs.

H. Cumulative translation differences

IAS 21 requires an entity:

- a) To recognise some translation differences in other comprehensive income and accumulate these in a separate component of equity; and
- b) On disposal of a foreign operation, to reclassify the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) from equity to profit or loss as part of the gain or loss on disposal.

However, a first-time adopter need not comply with these requirements for cumulative translation differences that existed at the date of transition to IFRSs. If a first-time adopter uses this exemption:

- a) The cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to IFRSs; and
- b) The gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to IFRSs and shall include later translation differences.

I. Investments in subsidiaries, jointly controlled entities and associates

When an entity prepares separate financial statements, IAS 27 (as amended in 2008) requires it to account for its investments in subsidiaries, jointly controlled entities and associates either:

- a) At cost or
- b) In accordance with IAS 39.

If a first-time adopter measures such an investment at cost in accordance with paragraph 18, it shall measure

that investment at one of the following amounts in its separate opening IFRS statement of financial position:

- a) Cost determined in accordance with IAS 27 or
- b) Deemed cost. The deemed cost of such an investment shall be its:
 - i. Fair value (determined in accordance with IAS 39) at the entity's date
 - ii. of transition to IFRSs in its separate financial statements; or
 - iii. Previous GAAP carrying amount at that date.

A first-time adopter may choose either (i) or (ii) above to measure its investment in each subsidiary, jointly controlled entity or associate that it elects to measure using a deemed cost.

J. Assets and liabilities of subsidiaries, associates and joint ventures

If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its assets and liabilities at either:

“A first-time adopter is encouraged, but not required, to apply IFRS 2 Share-based Payment to equity instruments that were granted on or before 7 November 2002. A first-time adopter is also encouraged, but not required, to apply IFRS 2 to equity instruments that were granted after 7 November 2002 and vested before the later of (a) the date of transition to IFRSs and (b) 1 January 2005. However, if a first-time adopter elects to apply IFRS 2 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in IFRS 2.”

- a) the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary; or
- b) The carrying amounts required by the rest of this IFRS, based on the subsidiary's date of transition to IFRSs. These carrying amounts could differ from those described in (a) above:
 - i. When the exemptions in this IFRS result in measurements that depend on the date of transition to IFRSs.
 - ii. When the accounting policies used in the subsidiary's financial statements differ from those in the consolidated financial statements. For example, the subsidiary may use as its accounting policy the cost model in IAS 16 Property, Plant and Equipment, whereas the group may
 - iii. Use the revaluation model.

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it.

However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Similarly, if a parent becomes a first-time adopter

for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

K. Compound financial instruments

IAS 32 *Financial Instruments: Presentation* requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of IAS 32 involves separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, in accordance with this IFRS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to IFRSs.

L. Designation of previously recognised financial instruments

IAS 39 permits a financial asset to be designated on initial recognition as available for sale or a financial instrument (provided it meets certain criteria) to be designated as a financial asset or financial liability at fair value through profit or loss. Despite this requirement exceptions apply in the following circumstances:

- An entity is permitted to make an available-for-sale designation at the date of transition to IFRSs.
- An entity is permitted to designate, at the date of transition to IFRSs, any financial asset or financial liability as at fair value through profit or loss provided the asset or liability meets the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A of IAS 39 at that date.

M. Fair value measurement of financial assets or financial liabilities at initial recognition

Notwithstanding the requirements of paragraphs 7 and 9, an entity may apply the requirements in the last sentence of IAS 39 paragraph AG76 and in paragraph AG76A, in either of the following ways:

- Prospectively to transactions entered into after 25 October 2002; or
- Prospectively to transactions entered into after 1 January 2004.

N. Decommissioning liabilities included in the cost of property, plant and equipment

IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition to IFRSs. If a first-time adopter uses this exemption, it shall:

- Measure the liability as at the date of transition to IFRSs in accordance with IAS 37;
- To the extent that the liability is within the scope of IFRIC 1, estimate the amount that would have been included in the cost of the related asset when the liability first arose,

IAS 32 *Financial Instruments: Presentation* requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of IAS 32 involves separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, in accordance with this IFRS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to IFRSs.

by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period; and

- Calculate the accumulated depreciation on that amount, as at the date of transition to IFRSs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity in accordance with IFRSs.

O. Financial assets or intangible assets accounted for in accordance with IFRIC 12

A first-time adopter may apply the transitional provisions in IFRIC 12.

P. Borrowing costs

A first-time adopter may apply the transitional provisions set out in paragraphs 27 and 28 of IAS 23, as revised in 2007. In those paragraphs references to the effective date shall be interpreted as 1 July 2009 or the date of transition to IFRSs, whichever is later. ■



Accounting for Customer Loyalty Programmes Under IFRS



Customer loyalty programmes have become an integral part of a wide range of businesses and are used by companies to retain customers and increase sales volumes. These programmes represent a structured marketing effort intended to reward customers for the past purchases. The article intends to explain what these programmes are and what led to the development of a specific accounting pronouncement. It further explains what is covered and what is not under IFRIC-13 and explains the accounting treatment.



CA. Anjani Kumar Khetan
(The author is a member of the Institute.
He can be reached at eboard@icai.org)

What it is?

Customer loyalty programmes are now an integral element of a wide range of businesses and are used by companies to retain customers and increase sales volumes. These programmes represent a *structured marketing effort intended to reward customers for the past purchases*. Normally members under the programme are granted 'award credits' that can be redeemed – *with or without conditions* - to obtain *free or discounted* goods and services. Further, those free goods or services can *either* be provided by

the entity itself or by an external third party. A typical example in India is a departmental store (say, Pantaloon Retail) that awards reward points to its member-cardholders, which can be redeemed by them in future.

Accounting Pronouncement Under IFRS

In June 2007, the IFRIC issued IFRIC-13: *Customer Loyalty Programmes*, which addresses accounting for the award credits granted by an entity to their customers. Until that time, IFRSs did not have any detailed

guidance in this area and accordingly corporate practices to account for such obligations were varying. IFRIC-13 is applicable for annual periods beginning on or after 1st July 2008 with earlier application permitted.

Scope of IFRIC-13

IFRIC-13 covers all types of customer loyalty programmes, in which the award credits are granted to customers as *part of the sale transaction* (including awards that can be redeemed for goods or services not supplied by the entity). However, if an entity distributes 'money-off vouchers' or, any other sort of promotion that *do not require an initial purchase*, IFRIC-13 does not apply. Put differently, IFRIC-13 applies only when the right to obtain free or discounted goods or services is granted to customers as part of the *initial sale transaction*. In particular, the IFRIC explains *how* such entities should account for their obligations to provide for free or discounted goods or services (awards) to customers, who redeem their award credits.

Accounting For Award Credits Granted Under Customer Loyalty Programme

According to the consensus in IFRIC-13:

- An entity shall apply paragraph 13 of IAS-18 and account for award credits as a *separately identifiable component* of the sales transaction(s) in which they are granted (the 'initial sale');
- The fair value of the consideration received or receivable in respect of the initial sale *shall be allocated* between the award credits and the other components of the sale; and
- The consideration allocated to the award credits shall be measured by reference to their *fair value*, (i.e., the amount for which the award credits could be sold separately).

In June 2007, the IFRIC issued IFRIC-13: Customer Loyalty Programmes, which addresses accounting for the award credits granted by an entity to their customers. Until that time, IFRSs did not have any detailed guidance in this area and accordingly corporate practices to account for such obligations were varying. IFRIC-13 is applicable for annual periods beginning on or after 1st July 2008 with earlier application permitted.

Put differently, the IFRIC requires that the *fair value of the consideration received or receivable in respect of the initial sale* shall be allocated between the (i) award credits and (ii) the other component of the sale. However, it does not prescribe an allocation method for multiple component sales. Once the allocation is determined, the amount applicable to the first component is *deferred as a liability* until the entity fulfils its obligation in respect of the award credits. The balance of the amount is recognised as revenue at the time of first sale. Here, it is important to reiterate that the IFRIC requires an entity to measure the liability with respect to the award credits on the basis of *fair value of the award credits to the customer* (and not on the basis of their 'cost to the entity').

Further, for the purposes of classifying the accounting treatment under IFRIC-13, the following scenarios are relevant:

- Scenario 1:** The entity itself supplies free goods or services of the same type
- Scenario 2:** The entity itself supplies free goods or services of different types
- Scenario 3:** The entity gives differential award credits
- Scenario 4:** Award credits are redeemed by third parties

Estimating Fair Value of 'Award Credits'

For the purposes of accounting for the 'award credits', fair value of the award credits need to be ascertained, since IFRIC-13 requires that the award credits should be measured by reference to their fair value (i.e., the amount for which the award credits can be sold separately).

However, the fair value estimation is the most challenging issue. The following factors are generally considered in fair value estimation:

- changes in popularity of the loyalty programme over the years
- changing redemption pattern (which may be a result of customers' age group / geographical location / buying pattern)
- minimum award credits required before a customer can redeem them and the ability of the customers' to achieve that level
- absence of historical experience because of changing circumstances

Illustration:

The following paragraphs illustrate a very simplified accounting for award credits given under a customer loyalty programme.

Assume that a departmental store gives 10 award points for every purchase worth ₹500 which can be redeemed by the customer for further shopping with the store. Unutilised points will lapse on the expiry of 2 years from the date of grant. The fair value of each point is assumed to be ₹0.50. Assume further that during the accounting year ended 2008, the departmental store awarded 100 lac points to various customers (for a total yearly sale of ₹5000 lacs), of which 18 lac points remained to be redeemed at 2008 year-end. The management of the departmental store expects that only 80% of these points will be redeemed in future. During 2009, 10.80 lac award

points were redeemed and during the year 2010 and the management is now of the view that the balance 3.60 lac award points will be redeemed in 2010. However, only 180,000 award points were actually redeemed in 2010 – with the balance 1.80 lacs award points getting lapsed.

Given the above, the award points will be accounted for (during the year 2008 to 2010, when any unutilized award credits eventually lapse) as follows:

Year 2008:

- (a) Accounting for 100 lacs points awarded:

Dr. Bank account 5000 lacs
 Cr. Sales account 4950 lacs
 Cr. Deferred Revenue 50 lacs
(Being sale recognised excluding 'fair value of 100 lacs award credits')

It can be seen from the above that ₹50 lacs (being the fair value of the 100 lacs award points credited during 2008) has been credited to the liability account and the balance ₹4950 lacs has been recognised as revenue.

- (b) Accounting for 82 lacs points redeemed:

When 82 lac award points are redeemed, the liability of ₹41 lacs (equivalent to the fair value of 82 lacs award points) will be reversed and the corresponding revenue recognised, for which the following entry will be passed:

Dr. Deferred Revenue 41 lacs
 Cr. Sales account 41 lacs
(Being revenue recognised on redemption of 82 lacs award credits)

- (c) The next question at 2008 year-end is: how much of the balance deferred revenue liability ₹9 lacs (being 50 lacs less 41 lacs) should be carried forward to the next

year(s) since only 80 per cent of the outstanding award points are expected to be redeemed in future?

Here, the departmental store can apply paragraph 36 of IAS-37 for estimating the future obligations at the end of 2008. It may be recalled that Para 36 of IAS-37 stipulates that "the amount recognised as provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period". Further, IAS-37 allows application of probability factor for measurement of provisions. Accordingly, only 80 per cent of the total liability of ₹9 lacs should be deferred and the balance ₹1.80 lacs (being ₹9 lacs less ₹7.20 lacs) will be recognised as revenue at the end of Dec-2008, for which the entry is:

Dr. Deferred Revenue 1.80 lacs
 Cr. Sales account 1.80 lacs
(Being writing back of deferred revenue based on management estimate)

With the above entry being passed, there will be a balance of ₹7.20 lacs in deferred revenue (representing

Put differently, the IFRIC requires that the fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the (i) award credits and (ii) the other component of the sale. However, it does not prescribe an allocation method for multiple component sales. Once the allocation is determined, the amount applicable to the first component is deferred as a liability until the entity fulfils its obligation in respect of the award credits. The balance of the amount is recognised as revenue at the time of first sale.



fair value of '80 per cent of 18 lacs award points' expected to be redeemed in future)

Year 2009:

- (d) During 2009, 10.80 lacs award points are redeemed. On redemption of these points the following entry need to be passed:

Dr. Deferred Revenue 5.40 lacs
 Cr. Sales account 5.40 lacs
(Being revenue recognised on redemption of 10.80 lacs award credits)

With the above entry being passed, there will be a balance of ₹1.80 lacs in deferred revenue (representing fair value of balance 3.60 lacs award points expected to be redeemed in 2010)

Year 2010:

- (e) During 2010, 1.80 lacs award points are redeemed. On redemption of these points the following entry need to be passed:

Dr. Deferred Revenue 0.90 lacs
 Cr. Sales account 0.90 lacs
(Being revenue recognised on redemption of 1.80 lacs award credits)

- (f) Since the award points are no longer redeemable after 2010, the liability with respect to the balance of 1.80 lacs award points is no longer required and need to be written back, for which the following entry is passed:

Dr. Deferred Revenue 0.90 lacs
 Cr. Sales account 0.90 lacs
(Being writing back of deferred revenue for 1.80 lac award points). ■

Concern for “Going Concern”



Going Concern is one of the Fundamental Accounting Assumptions as laid down by the Accounting Standard -1 issued by the Institute of Chartered Accountants of India (Institute). As per this assumption, the enterprise is normally viewed as a going concern, i.e., as continuing in operation for the foreseeable future. The purpose of this article is to discuss the role of an auditor in the audit of financial statements as far as the concept of “Going Concern” is concerned.

It's high time to come terms with “Going Concern.” Going Concern is one of the Fundamental Accounting Assumptions as laid down by the Accounting Standard - 1 issued by the Institute of Chartered Accountants of India. As per this assumption, the enterprise is normally viewed as a going concern, i.e., as continuing in operation for the **foreseeable future**. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of operations. On the basis of this assumption, the assets are not stated at their realisable value in the Balance Sheet but on cost or cost less depreciation.

The purpose of this article is to discuss the role of the auditor in the audit of financial statements as far as the concept of “Going Concern” is concerned. The Institute had issued a Statement on Standard Auditing Practices (SAP/AAS-16 / SA 570) on Going Concern with the main objective of describing auditor's responsibilities in the audit of financial statements regarding the appropriateness of the going concern assumption as a basis for the preparation of the financial statements. It is of utmost importance for the auditors to consider the appropriateness of the going concern assumption in the audit of the financial statements.

Meaning of Going Concern

a	Oxford Dictionary	"A principle of accounting practice that assumes businesses to be going concerns, unless circumstances indicate otherwise." This principle implies that "assets are shown at cost, or at cost less depreciation, and not at their break up values," and "liabilities applicable only on liquidation are not shown."
b	Activity Based Risk Evaluation Model of Auditing.	An entity is considered as 'going concern' if it is able to pay its debts as and when they fall due.



CA. Rahul Kumar Bajaj

(The author is member of the Institute. He can be reached at rahul.kumar.bajaj@icai.org)

Indicators/Signs of “Going Concern” in Danger

It is very important to know as to what are the cases or situations wherein the “Going Concern” is at risk. As an auditor, such cases are of vital

“It is very important to know as to what are the cases or situations wherein the “Going Concern” is at risk. As an auditor, such cases are of vital significance particularly because the auditors need to express their opinion on the true and fairness of the financial information on which a lot of users are dependent.”

significance particularly because the auditors need to express their opinion on the true and fairness of the financial information on which a lot of users are dependent. The report of the auditor helps establish the credibility of the financial statements. AAS 16/SA 570 on Going Concern lays down certain indicators where Going Concern is to be questioned: -

the issue of Going Concern, then AAS-16 / SA 570, Going Concern, requires him to update his audit procedures accordingly to collect sufficient appropriate audit evidences to resolve the issue of Going Concern and satisfy himself that the enterprise will continue in operation for a foreseeable future. In such circumstances where Going Concern is questionable, following

S. No.	Financial	Operating	Others
1	Negative Net Worth/ Working capital	Loss of key management without replacement	Non-compliance with capital or other statutory requirements
2	Reliance on short-term borrowings to finance long-term assets or lack of funds to discharge the Long term Liabilities.	Loss of a major market, franchise, license, or principal supplier	Pending legal proceedings against the entity that may, if successful, result in judgments that could not be met.
3	Adverse key financial ratios	Labour difficulties or shortages of important supplies	Changes in legislation or government policy
4	Substantial operating losses		Sickness of the entity under any statutory definition
5	Negative cash flows from operations		
6	Arrears of dividends		
7	Entering into a scheme of arrangement with creditors for reduction of liability		
8	Inability to obtain financing for essential new product development or other essential investments		
9	Difficulty in complying with the terms of loan agreements		

Face Off with “Going Concern”

AAS-5 / SA 500 (“Audit Evidence”) requires the auditor to obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures so as to enable him to draw reasonable conclusions therefrom on which base his opinion on the financial information which is the objective of his audit (“AAS-2 / SA 200A => Objectives and Scope of an Audit of Financial Statements”). If at any time during the course of an audit, an auditor finds himself in suspicion on

points, *in view of the author, might be of significance for an auditor (the list is not intended to be exhaustive): -*

- Consider the number of suppliers available with the enterprise so as to mitigate the *logistical risk*.
- Ensure whether the assets appearing in the Balance Sheet are covered under insurance.
- Ensure that there is a sufficient market in place for the products of the enterprise and have related discussions with the management.
- Review the existing conditions so

as to determine that whether the assets appearing in the financial statements are free of any charge, if any.

- Consider the availability of sufficient funds with the enterprise so as to discharge its liabilities in the normal course of the business.
- Review the loan agreements and the conditions attached thereto, if any, and consider their suitability with the existing circumstances as to whether the enterprise is in a condition to fulfill those conditions.
- Consider the cases and litigations and discuss them with the management as well as with the experts, if any and take their opinion and status on such cases and litigations with regards to the claims etc.
- Discuss heavy provisions appearing in the Profit & Loss Account of the Entity.



Reporting Requirements as per AAS 16/SA 570

The Auditor's report is an essential component of usage for the users of the financial information, especially the shareholders in case of listed companies. For instance, if a public company reports that its auditors have doubts about its ability to continue as a going concern, investors are likely to take that as a sign of increased risk and would want to take back their funds as soon as possible.

If an auditor, after analysing the collected sufficient appropriate audit evidences, feels that the "Going Concern" is at risk then he needs to ensure as to whether there is adequate disclosure in the financial statements that the enterprise will not be able to realise its assets and discharge off its liabilities in the normal course of business. An auditor needs to consider whether the financial statements describe the principal conditions which raise the doubt about the enterprise's ability to continue in the foreseeable future. If there is proper disclosure of the above mentioned facts in the financial information, then an auditor need not qualify his report but mention such fact in his report by referring the corresponding note in the financial information.

For instance, if an auditor concludes that the company is incurring heavy losses from the past few years and

doubts that the company will be able to continue for a foreseeable future then he shall include the following paragraph in his audit report: -

"We draw attention to Note___ in the financial information. The company is incurring heavy cash losses from the past 5 years which has adversely affected the profitability of the company. These factors along with other factors as laid out in Note___ raise doubt on the ability of the company to continue its operations for a foreseeable future."

However, if the auditor discovers that there is no adequate disclosure of the facts mentioned in para 5.2, then he needs to qualify his report in the following form (considering same example):

"The company is incurring heavy cash losses from the past 5 years which has adversely affected the profitability of the company. There is no mention of these facts in the financial information."

In our opinion, subject to the omission of the information dealt with in the preceding paragraph, the financial statements give a true and fair view of the financial position of the Company at March 31, 19X1 and the results of its operations for the year then ended."

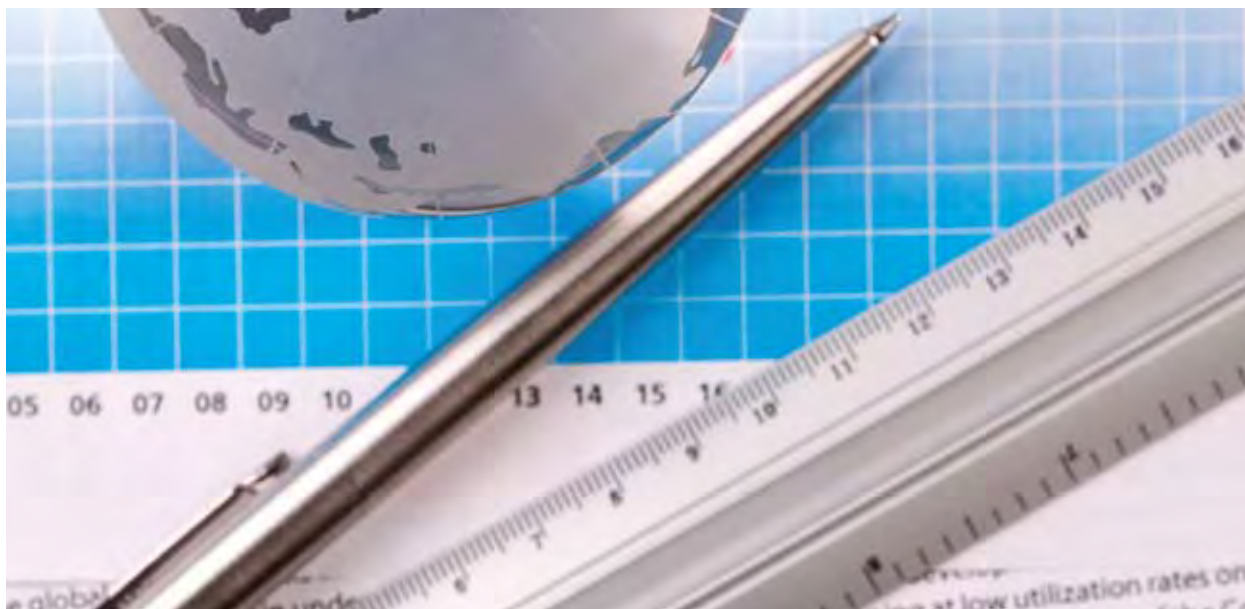
Examples of Reporting by Some Enterprises

Following is a compilation of the examples of some of the reporting in cases where the concept of Going Concern was questionable:

S. No.	Name of Company	Auditor's Comments
1	Alcobex Metals Ltd	"The accumulated losses of the company have exceeded the net worth of the company and the company has been incurring cash losses for the past few years. However, the accounts of the company have been prepared on the basis of going concern assumption."
2	Alembic Glass Industries Ltd.	"No provision has been made by the company in respect of difference, if any, in the price of gas supplied by ONGC during the period January 30, 1987 to May 31, 1991 and interest for delayed payment thereon, the matter being sub-judice." And, "despite impending liability of ONGC on the company... accounts are continued to be prepared on a going concern basis."
3	Fairfield Atlas Ltd	"`the appropriateness of the going concern basis used for the preparation of the accounts in view of substantial erosion of net worth of the company arising from operating losses.'" The company, however, justifies that `no adjustment has been made to write down the assets to net realisable value' because `the principal shareholder, Fairfield Manufacturing Company Inc, US, has informed the company of its intention of providing financial support to the company to meet its obligations, as they fall due.' Perhaps, the obligations are yet to fall due."
4	Ispat Profiles India Ltd	"The company has further received notice from some of its secured lenders under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, which the company has challenged." As a result, The going concern concept will hold good depending upon the receipt of support from its bankers, financial institutions and promoters, etc, note the auditors. Necessary adjustment may have to be made to the value of assets and liabilities in case the going concern concept is vitiated."
5	Scindia Steam Navigation Company Ltd.	"The shipping operations of the company stand suspended. Further, the company has continuously incurred losses (other than profit on sale of properties) during the quarter and thereby the net worth of the company has been totally eroded and a substantial loss is carried forward as at September 30, 2006." Despite this, the company's accounts have been prepared on a going concern basis, `in the absence of adequate data and information for its compilation on an alternative basis'."

Source: - "Business Line", Friday, January 5, 2007

If at any time during the course of an audit, an auditor finds himself in suspicion on the issue of Going Concern, then AAS-16/SA 570 - Going Concern, requires him to update his audit procedures accordingly to collect sufficient appropriate audit evidences to resolve the issue of Going Concern and satisfy himself that the enterprise will continue in operation for a foreseeable future.



“The Auditor’s report is an essential component of usage for the users of the financial information, especially the shareholders in case of listed companies.”

Examples of Going Concern

In the case of projects, the Going Concern issue arises during the last year when the project is about to be completed. Such cases are no different from others. Here, the assets and the liabilities in the last year, when Going Concern is at risk, the assets and the liabilities are to be stated at their realisable values. The facts about the enterprise’s inability to continue in foreseeable future need to properly disclose in the financial statements and accordingly proper disclosure need to be made in the Auditor’s report.

There are some cases where the Going Concern is at risk due to some legislative Provisions. For instance, the Government might come out with a law stating that all the companies with an annual turnover of ₹50 crore or more need to provide employment to “x” new persons every year else they would be treated as defunct. Now while auditing,

an auditor finds non-compliance with the aforesaid law, then AAS 16/SA 570 plays a vital role in how the auditor shall face this situation.

Another might be the case where the enterprise has a pending litigation as at the end of the year which involves a heavy claim and if decided against the enterprise would question the concept Going Concern. In such circumstances, the auditor needs to have discussions with the management as well as with the experts, if any (lawyers etc) so as to get a clear picture of the litigation/case as at the balance sheet date. If the auditor feels that the enterprise is on an adverse side with regards to such litigation/case, then he needs

“If an auditor, after analysing the collected sufficient appropriate audit evidences, feels that the “Going Concern” is at risk then he needs to ensure as to whether there is adequate disclosure in the financial statements that the enterprise will not be able to realise its assets and discharge off its liabilities in the normal course of business.”

“The concept of Going Concern is of vital importance for an auditor if he needs to properly express his opinion on the true and fair position of the financial position and the operating results as at the Balance Sheet Date.”

to ensure a proper disclosure in the financial information as well a proper reporting in his Report.

Conclusion

Going Concern, being a fundamental accounting assumption holds significant importance for an auditor. The financial statements need to disclose the policies which have been followed in the preparation of financial statements. But with regards to 3 fundamental accounting assumptions including “Going Concern”, one need not disclose their compliance but non-compliance. Eventually, the concept of Going Concern is of vital importance for an auditor if he needs to properly express his opinion on the true and fair position of the financial position and the operating results as at the Balance Sheet Date. ■

A New Approach to the Audit of ULBs in the New Environment of Reforms



More than five years have elapsed since the publication of the National Municipal Accounts Manual (NMAM). Implementation of accrual-based double entry accounting in the Urban Local Bodies (ULBs) of many states of India is in progress on the lines of the NMAM, either on the basis of its guidelines as such, or getting the same customised in the perspective of the ideals and the objectives of the related states. Though milestones achieved in this area are far less than the satisfactory level, the need for a National Audit Manual for ULBs is already felt. Read on to have an overview of the concept.

More than five years have elapsed since the publication of the National Municipal Accounts Manual (NMAM). Implementation of accrual-based double entry accounting in the Urban Local Bodies (ULBs) of many states of India is in progress on the lines of the NMAM, either on the basis of its guidelines as such, or getting the same customised in the perspective of the ideals and the objectives of the related states. Though milestones achieved in this area are far less than the satisfactory level, the need for a National Audit Manual for ULBs is already felt. This is especially in view of the status of the ULBs of some states which are in quite advanced stage in following the codified structure and Chart of Accounts as per the NMAM, and in maintaining day-to-day accounts electronically.

Before highlighting the scope of a prospective National Audit Manual for ULBs, proper analysis is required on the background which inspired the reforms activities in the ULBs, ever since the local bodies have been recognised as the third tier of government. With local

bodies as the third-tier of government becoming gradually more and more engaged in citizen-centric public sphere of activities, scope of their audit will ramify and will be particularly significant in the examination of the propriety of their transactions.

Basis of Extended Audit Functions

With the enactment of the Constitution (Seventy-fourth Amendment) Act, 1992, States were asked to endow the ULBs with such powers and authority as may be necessary to enable them to function as institutions of self-government. Article 243W empowers the Legislature of a State to devolve upon the ULBs powers and responsibilities subject to specified conditions, with respect to – (i) the preparation for plans for economic development and social justice; (ii) the performance of functions and the implementation of schemes as may be entrusted to them including those in relation to the matters listed in the Twelfth Schedule. In the Twelfth Schedule as many as 18 broad outlines have been



**CA. Atanusasan
Mukhopadhyay**

*(The author is a member of the Institute.
He can be reached at eboard@icai.org)*

prescribed to suggest the areas of functions of the ULBs. A careful study of the 18-point charter of functions will help one assess the vast and wide range of activities that may bind the ULBs obviously to the enormous accountability towards citizens. Auditors share great responsibility in this connection as the vast areas of functions of the ULBs will naturally involve huge financial transactions, and common citizens' intent must be to get assured of the healthy financial discipline.

The 11th Finance Commission recommended greater control and supervision over proper maintenance of accounts by all ULBs, and their audit. The commission held that in regard to utilisation of grants by local bodies, more stringent compliance was required, formats for preparation of Budget and Accounts by ULBs needed to be reviewed and suitably prescribed, formats should be evolved to determine the cost of important utilities and services, and the like. The position of accounting was really very alarming in an average ULB, and the general impression about the ULBs was very much in the negative, viz., the correct

position of Funds of an ULB could not be known, it was difficult to have an idea about the own corpus of the ULB, position of Secured and Unsecured Loan could not be determined, status of Assets/Liabilities was not fully known, status of on-going works/liabilities could not be gauged, huge receivables of the ULBs from tax and non-tax revenue was not ascertainable, measuring service costs was almost impossible, and so on. There was, therefore, a common cry of demands for new initiatives by all the stakeholders. The directions of the combined demands were towards ensuring good urban governance, self-reliance and sustenance, combating increasing pressure on infrastructure, improved capacity building, strengthening institutional arrangement, installing standard operating procedure, effective citizens relationship management, strengthening decentralised planning in a participative manner, ensuring enhanced service delivery system, meeting service demands and expectations of citizens, effective grievance-redressal management, overall improvement of financial management, et al. This implies that the scope of auditors' examination of the state of affairs of the ULBs will have two aspects – first, examination of transactions having direct bearing on finance and accounts, and second, the persistent irregularities and weaknesses in different areas of functions causing avoidable spending and loss of revenue. Therefore, developing national level broad audit guidelines for ULBs will call for clear understanding of all the components involved in each of the aforesaid activities.

Outcome Budget Exercise

Outcome Budget is another area which will change the planning process vis-à-vis budgetary control exercise to an enormous extent. Following the implementation of City Development

Plan (CDP)/Draft Development Plan (DDP) for a specified block of years with participative citizen interface, and the break up of the CDP/DDP into Annual Development Plan (ADP) for each year of the related block, the process of Budget in the ULBs will be in the threshold of significant changes. ADP is the quantitative and qualitative description of plans and programmes containing prioritised proposals for each year. The same is taken out of the Development Plan for the related block of years, and is matched with resources/funds available for the related year. Once the ADP is linked to the Financial Budget, Budget would become much more than a traditional financial statement in the municipal parlance. In the changed scenario of reforms of the ULBs especially through implementation of Development Plan, Budget will be oriented towards projection and achievement of physical target/volume and the consequential allocation of financial outlay against such physical goals both in qualitative and quantitative terms. ULBs across the country will be, within near future, in the vicinity of the synchronisation of the chain actions of City/Draft Development Plan – Annual Development Plan – Financial Budget, and will thereby come within the terrain of Outcome Budget.

The conventional revision of financial budget after six months of operation, would in the changed circumstances focus one's attention not only on the receipts/incomes or payments/expenditure, but the physical operational targets would as well require study/revision both from qualitative and quantitative aspects. The mid-term review of the Development Plan, as will be required to reorient it with real-life situation, might lead to the re-prioritisation of project proposals resulting appropriate reflection in the ADP for the subsequent years. The ADP thus

“In the Twelfth Schedule as many as 18 broad outlines have been prescribed to suggest the areas of functions of the ULBs. A careful study of the 18-point charter of functions will help one assess the vast and wide range of activities that may bind the ULBs obviously to the enormous accountability towards citizens. Auditors share great responsibility in this connection as the vast areas of functions of the ULBs will naturally involve huge financial transactions, and common citizens' intent must be to get assured of the healthy financial discipline.”

Audit gains tremendous importance in the said area of synchronization of the chain actions of City/Draft Development Plan – Annual Development Plan – Financial Budget. The planning process, the linking of financial outlay to the planned projects and activities to draw up budget estimate, mid-term review of development plan, revised budget, variance analysis of financial figures and physical data – all these will come under the scanner of auditors.

modified would serve as input to the Revised Budget Estimate. The process of budget will, therefore, involve ascertainment of financial figures with reference to projects and physical operational targets. Any review of the financial figures will naturally stem from study of the circumstances involving projects and physical operational targets. Budgetary Control exercise would, therefore become more broad-based. Favourable and adverse variance analysis would apply both to financial figures as well as quantitative and qualitative physical targets and outcomes. Audit gains tremendous importance in the said area of synchronization of the chain actions of City/Draft Development Plan – Annual Development Plan – Financial Budget. The planning process, the linking of financial outlay to the planned projects and activities to draw up budget estimate, mid-term review of development plan, revised budget, variance analysis of financial figures and physical data – all these will come under the scanner of auditors.

Audit will also assess perfection in ULBs' Budget through queries, e.g.,

- How minimum are the variations

between original estimates, revised estimates and the actual figures?

- How minimum is the supplementary demand?
- Are the projections unreal and unachievable?
- How user-friendly and readable are the budget documents?
- Can the Budget be accepted as a reliable MIS tool?

Audit will check the Budget Variance Report (BVR) and examine:

- whether the BVR is analysed at the overall organisation level of the ULBs?
- whether the BVR is analysed at each Budgeting Centre?
- whether the BVR is analysed on quarterly basis?
- whether the variance report is analysed to ascertain *Reasons for Variance* and to regularly take up *Corrective Measures*.

Audit in Financial Sector

In the financial sector of the ULBs, reforms for mobilising internal and external financial resources, transparency and disclosures, an overall internal control system as tools for better monitoring get utmost importance in the changed scenario of greater expectations of citizens from ULBs. The NMAM acts as a precursor to these activities since installing accrual-based double entry accounting will greatly help in collection and collation of relevant data. For the first-time audit in Finance and Accounts sector in the accrual accounting environment, auditor will need to cover two aspects – (a) examination of opening balance sheet which will be the first step of migration from traditional single entry to accrual-based double entry accounting, and (b) examination of annual accounts *vis-à-vis* compilation at the year end. From the second year onwards, only the second part

will apply. In the present write-up, the major part of the discussion on examination of opening balance sheet will be skipped.¹

System Study in Computerised Environment

In relation to the examination of annual accounts *vis-à-vis* compilation at the year end, auditors' first task is to study the system of computerised environment. The computerised environment may mean application of one or more modules in the individual ULBs on stand-alone basis, or an e-Governance system installed in all the ULBs of a state either through individual and independent servers or through the Central Data Monitoring Centre (CDMC). Prospective auditors of the ULBs have to keep in mind that to follow the codified Chart of Accounts as prescribed in the NMAM is almost impossible without using software that is capable of exhibiting accounting results fully or partially under Function, Functionary, Field and Fund codes separately.

Ministry of Urban Development, GOI has made a compulsive obligation on the ULBs availing themselves of the financial assistance under Jawaharlal Nehru National Urban Renewal Mission (JNNURM) to install e-Governance system. The Ministry has already specified the areas of functions to be brought under e-Governance system in "Hand Book on Service Level Bench Marks for e-Governance in Municipalities".² In Section II of the Hand Book (Pages 39 – 147) the following Service Level Bench Marks have been indicated under an integrated e-Governance system:

Birth/Death Registration
Calculation and Payment of Property Tax
Payment and Management of Utility Bills

¹ Interested readers may kindly refer to the present author's article entitled "Conversion of ULB Accounting System by Proper Mix of Internal Workforce and External Agency" published in the Chartered Accountant – Volume 56, No. 09, March 2008 where an indicative checklist was presented. The checklist will inter alia help in covering the major areas for verification of the correctness of the opening balance sheet.

² Visit website "http://jnnurm.nic.in" to see the above Hand Book.

Grievances Handling
 Building Plan Approval
 e-Procurement and Project/Ward Works
 Solid Waste Management System
 Licenses
 Accounting System
 Personnel Management System

In the circumstances, system study comes as the first major obligation of auditors of the ULBs, including the study of system integration, system security and sustenance of the system. While conducting usual audit checks in respect of different modules of e-Governance system, auditor has to understand the operational flowchart, linear relationship between all the modules, integration of finance and accounts and other modules, and accordingly formulate the audit programme. While different codes used in different modules have to be studied and understood with reference to the subjective application of codes in absence of the standard codes for different modules, in the case of finance and accounting module the standard codification structure as prescribed in the NMAM will be hopefully followed across the country. Audit checks on day-to-day accounting will first ensure that the 7-digit Primary Accounting Code has been correctly applied with Major head – 3 digits, Minor head – 2 digits, and Detailed head – 2 digits (with Secondary Accounting code of 3-digits) as prescribed in the NMAM. Any deviation made from the prescribed 7-digit Primary Accounting Code by the ULBs of any state will cause difficulties for them in future in that for any national-level compilation of codification-wise results for the ULBs, such states will face problems of conversion from codes used to codes prescribed in the NMAM. Apart from the 7-digit Primary Accounting Code, the other important aspect to be considered is the booking of all accounting entries under the given

codes of (a) *Function*, (b) *Functionary*, (c) *Field*, and (d) *Funds*. All accounting entries should be booked Function-wise, Functionary-wise and Field-wise. For the present, Municipal Fund is the common fund with Major and Minor Funds categorised within it. Accounting should be done strictly in accordance with these codes without which Budget Estimate and Revised Budget Estimate would not be generated from the system as prescribed in the NMAM.

Grants and Other Funds, Cost of Utilities and Services, Optimal Use of Assets

In course of routine checking of transactions, special emphasis should – in view of the recommendations of the 11th Finance Commission, be given on utilisation of grants and other funds, determination of cost of important utilities and services and recovery of such costs, proper accounting and optimal uses of assets, and the like. In relation to grants, auditor needs to check if grants are being utilised for the purpose for which they are received – whether there is any diversion of grant funds and if so, whether the diversion has been properly reflected in accounts – and whether the utilisation certificates for grants are in agreement with the actual utilisation of funds. In respect of loans, the checking should include whether secured and unsecured loans are taken for valid reasons and at minimum cost – whether there was any alternative source of financing – whether principal and interest amounts of loans are being repaid as per schedule. Similarly, audit checks in respect of funds received under Deposit Works should ascertain whether funds received against Deposit Works from Zilla Parishads/ MPLAD/MLA fund (BEUP) or from any other source for specific works, are utilized for the purpose for which the same were received.

In regard to recovery of operation and maintenance cost (such as – in connection with water supply, sanitation, garbage removal, etc.), auditor needs to enquire as to whether the attempt to recover cost includes recovery of capital as well as operation and maintenance cost – whether the recovery is made through consolidated service charge or by the application of service-wise separate charges – whether the process of recovery is consistent with the decision of full cost or partial cost recovery – whether there exists a well defined policy of pricing, viz., cost-based pricing, or target pricing including a rate of return, or pricing on a sliding scale based on marginal costing. Auditor may come across situations when pricing will be dependent on competitive environment emerging out of extraneous political factors. Such situations will call for fair and professional reporting.

Audit-checks to test the position of assets management will involve examining whether assets used for

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Accounting of major items of assets and liabilities has been fairly dealt with in the NMAM from which the auditor's lines of action can be conceptualized and drawn. However, certain items not discussed in the NMAM, nevertheless quite significant both in terms of value and accounting treatment, will deserve auditor's attention for proper accounting thereof. One such special item is Capital Expenditure without right to assets.

discharging primary functions such as water supply, cleaning operations, sewerage treatment, water treatment etc. are in optimum use – whether there is any loss of revenue or additional expenditure for the inefficiencies of such assets – how best they can be efficiently run – whether other assets of the municipalities like parks and playgrounds, tourist spots, heritage buildings, etc. are in proper shape to act as good sources of revenue and square up the current loss of revenue or opportunity loss – whether there are some idle assets such as parking space, open lands, etc., which are suitable for best use and purposes in the interest of citizens, simultaneously making it possible for the civic body to generate some income out of them. A candid professional reporting is required also in this case.

Treatment of Items for Which Specific Prescription is Not Available

Accounting of major items of assets and liabilities has been fairly dealt with in the NMAM from which the auditor's lines of action can be conceptualised and drawn. However, certain items not discussed in the NMAM, nevertheless quite significant both in terms of value and accounting treatment, will deserve

auditor's attention for proper accounting thereof. One such special item is Capital Expenditure without right to assets. ULBs often pay hefty sums of money to the Electricity Authority for arranging street lighting within their respective municipal jurisdiction. Such amounts are generally paid as cost for light posts, cables and other accessories, apart from the usual service charges of the Electricity Authority. The ownership to the light posts, cables and the related accessories in such cases is not transferred in favour of the ULBs. Similarly, ULBs often pay to Public Health Department or other State Government/autonomous bodies substantial amounts as contribution to the construction of public utility infrastructure, maybe, covering more than one ULB in a cluster, e.g. installing trans-municipal water supply system and laying pipe lines, long roads, etc. In such cases the constructing agency generally operates and maintains the same even after the construction is completed and put to use. The subject-assets are not handed over to any ULB. The situations are somewhat similar to the one mentioned in para 10 of the ICAI's Guidance Note on Treatment of Capital expenditure not represented by assets during Construction period, and the Guidance Note in this case recommends to disclose the expenditure in the balance sheet under the general heading of "Capital Expenditure" subject to two conditions – first, the description of this specific item on the balance sheet should be such as to indicate quite clearly that the capital expenditure is not represented by any assets, and the second, the capital expenditure should be written off over the approximate period of its utility or over a relatively brief period not exceeding five years, whichever is less. The format of Balance Sheet prescribed in the NMAM will require addition of a new major head to provide scope to accommodate such

"Capital Expenditure" in the financial statement. Alternatively, Government of India may authorise state governments to create a detailed head code describing "Capital expenditure without right to assets", under minor head code 80 describing "Other Fixed Assets" under major head code 4-10 describing "Fixed Assets". Creation of the said primary accounting code will also call for the creation of a detailed head like "Write-off one-fifth of capital expenditure without right to assets" with an appropriate detailed head code under minor head code 80 of the major head code 2-72. Auditor's professional comments would be important for the appropriate treatment of these items on the part of Government of India and the state governments.

Audit Approach at Formative Stage

Besides, auditor should make certain important disclosures in the notes on financial statements, viz., amount of contracts entered into in respect of capital works but no work started, claims against ULB awaiting judicial decision, escalation claims made

Auditor should make certain important disclosures in the notes on financial statements, viz., amount of contracts entered into in respect of capital works but no work started, claims against ULB awaiting judicial decision, escalation claims made by contractors, any other claims not acknowledged as debts, assets remaining with ULB without title deed, assets in permissive possession without any economic benefit being enjoyed, litigated receivables from taxes and other revenues not collected, guarantee given by ULB for elected representatives/ staff, and the like.

by contractors, any other claims not acknowledged as debts, assets remaining with ULB without title deed, assets in permissive possession without any economic benefit being enjoyed, litigated receivables from taxes and other revenues not collected, guarantee given by ULB for elected representatives/staff, and the like. It is noteworthy that this changed environment of newly introduced accrual accounting, planning and development procedure, e-Governance and the overall professional management for the ULBs as conceived, in consonance with the overhauling and restructuring of the total management of the ULBs under the JNNURM, are at present at the budding stage. All these processes will surely pass through various phases of trial and error and check-points to finally reach the optimum levels of efficiency. Audit is perhaps the most significant check-point which can direct the derailed lines of action to the right track by its objective critique. The current period of time can be called construction period for the ULBs' journey towards professionalism. Hence, at this formative stage, audit's approach should be more oriented to offering suggestions for improvement of the weak areas of activities so that the competent authorities can comfortably sail through a learning process, and comprehend exactly what deliverables are expected of them from the citizens. Also, audit can really focus on subjects of relevance which may not have hitherto given birth to discourses at adequate scale, even though absolutely desirable.

Chartered Accountants' Concern

In relation to Arrangements in Local Bodies Audit & Accounts, office of the C&AG has come out with a Report ³ which *inter alia* includes recommendation of the Second

“The financial statements and balance sheet of the ULBs should be audited by an Auditor in the manner prescribed for audit of Government Companies under the Companies Act, 1956 with the difference that in the case of audit of these local bodies, the C&AG should prescribe guidelines for empanelment of the Chartered Accountants and the selection can be made by the State Governments within these guidelines. The audit to be done by the Local Fund Audit or the C&AG in discharge of their responsibilities would be in addition to such an audit.”

Administrative Reforms Commission on Local Bodies. The report states that a number of recommendations of the Sixth Report of the Second Administrative Reforms Commission titled “Local Governance – An Inspiring Journey into the Future” has been accepted by Government of India. Among the recommendations accepted by Government of India, the following may be found relevant and interesting for chartered accountants:

- The accounting system for the ULBs as provided in the National Municipal Accounts Manual (NMAM) should be adopted by the State Governments.
- The financial statements and balance sheet of the ULBs should be audited by an Auditor in the manner prescribed for audit of Government Companies under the Companies Act, 1956 with the difference that in the case of audit of these local bodies, the C&AG should prescribe guidelines for empanelment of the Chartered Accountants and the selection can be made by the State Governments within these guidelines. The audit to be done by the Local Fund

Audit or the C&AG in discharge of their responsibilities would be in addition to such an audit.

- The existing arrangement between the C&AG of India and the State Governments with regard to providing Technical Guidance and Supervision (TGS) over maintenance of accounts and audit of PRIs and ULBs should be institutionalised by making provisions in the State Laws governing local bodies.
- Audit reports on local bodies should be placed before the State Legislature and these reports should be discussed by a separate committee of the State Legislature on the same lines as the Public Accounts Committee (PAC).
- Each State may ensure that the local bodies have adequate capacity to match with the standards of accounting and auditing.
- The system of outcome auditing should be gradually introduced. For this purpose the key indicators of performance in respect of a government scheme will need to be decided and announced in advance.
- To complement institutional audit arrangements, adoption and monitoring of prudent financial management practices in the local bodies should be institutionalised by the State Governments by legislating an appropriate law on Fiscal Responsibility for Local Bodies.

The above report suggests that Chartered Accountants are most likely to be awarded with audit assignments of ULBs across the country. It is therefore imperative that Chartered Accountants will take the onus of contemplating the pros and cons of ULB audit beforehand. This article aims at providing some inputs to the designing of the audit programme in this connection.■

³ Visit website “www.cag.gov.in/html/localbodies.htm”.

Royalty & Fees for Technical Service– Analysis of Recent Judgments of Authority of Advance Rulings



The globalisation of Indian economy and the progressive development that has taken place in recent years have allured the multi-national corporations to enter into all types of business and trade formats in India be it as own or engaging through domestic partners and channels. One of the significant matters arising out of such international trade is the taxability of complex and widely debated issues like Permanent Establishments, taxation of Royalty and Fees for Technical Services (“FTS”), Dividends, Cross Border Capital Gains, etc. Whether the country in which the recipient of income is resident has a right to tax the income generated from an international transaction or the country from which the Source of income is derived has the right to tax the income. To resolve these issues and to avoid taxation of the same income in more than two countries, most of the countries enter into bilateral agreements known as Double Taxation Avoidance Agreements (‘DTAA or tax treaty’), wherein the rights of the country to tax a particular source of income are clearly determined. This article focuses on recent judicial precedents delivered by Authority of Advance Rulings (‘AARs) in India in respect of taxability of Royalty and FTS to the service/technology provider.

Background

Kautilya’s Arthashastra deals with the system of taxation in a real elaborate and planned manner. Kautilya described in detail, the trade and commerce carried on with foreign countries and the active interest of Mauryan Empire to promote such trade. Goods were imported from

China, Ceylon and other countries and levy known as a “Vartanam” was collected on all foreign commodities imported in the country. There was another levy called “Dvarodaya” which was paid by the concerned businessman for the import of foreign goods. With the change in times

(Contributed by the Committee of International Taxation of the ICAI. Comments can be sent to citax@icai.org)

nomenclature changed and Vartanam or Dvarodya became custom duties or import duties but basic concept of levy of taxes on import of goods and services continued.

The globalisation of Indian economy and the progressive development that has taken place in recent years have allured the multi-national corporations to enter into all types of business and trade formats in India be it as own or engaging through domestic partners and channels. One of the significant matters arising out of such international trade is the taxability of complex and widely debated issues like Permanent Establishments, taxation of Royalty and Fees for Technical Services ("FTS"), Dividends, Cross Border Capital Gains, etc. Whether the country in which the recipient of income is resident has a right to tax the income generated from an international transaction or the country from which the Source of income is derived has the right to tax the income. To resolve these issues and to avoid taxation of the same income in more than two countries, most of the countries enter into bilateral agreements known as Double Taxation Avoidance Agreements ('DTAA or tax treaty'), wherein the rights of the country to tax a particular source of income are clearly determined.

Meaning of the Terms – 'Royalty and FTS'

Royalty and FTS arise from commercialisation of intellectual property rights. Royalty is defined under the Income-tax Act, 1961 ('Act') to mean sum payable for the use or right to use intellectual property like patent, invention, model, design, secret formula or process or trade mark or similar property and any industrial, commercial or scientific equipment. Any payment made in relation to imparting information or any other services rendered in connection with the said properties is also termed as

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The term FTS is defined under the Act to include any payment made for rendering technical, consultancy and managerial services. The definition in the treaty is more or less the same, but most of the treaties do not include managerial services within the ambit of FTS. Further, treaties with certain countries such as US, UK, Singapore, Portugal, etc have an additional criteria of "make available technical knowledge, skill etc" for a payment to qualify as FTS. Some of the treaties term the FTS as "Fees for Included Services" ("FIS"). Simply put, FTS/FIS means rendering of technical, consultancy and managerial services and make available the technical skill, knowledge, experience, know-how, or processes to the recipient. The concept of make available is interpreted and explained in detail with examples in the 'Memorandum of Understanding concerning fees for included services in Article 12' forming a part of India-US DTAA. Generally, as per the provisions of treaties, Royalty and FTS can be

taxed in the state in which income arises on gross basis. Most of treaties provides rate of taxation of 10 per cent or 20 per cent for such payment.

Concept of "make available" is of a huge litigation in India and there are numerous judicial precedents in this respect. As held consistently by judiciary in India and overseas countries as well as by OECD and other commentaries technology will be considered as "made available" when the person acquiring the service is enabled to apply the technology on his own without the aid of service provider. Unless the Litmus test of "make available" is not satisfied, the payment cannot be characterised as FTS/FIS (wherever provided in DTAA) and taxability is curtailed. Thus the scope of FTS gets considerably restricted in case where the treaties contain an FIS clause.

Current Trends

While the Revenue authorities are striving towards bringing maximum possible incomes within the ambit of Royalty or FTS, on the other hand the assesses are attempting to avoid such classification since income which is not classified as Royalty or FTS is business income and in absence of PE in the source state the same is taxable only in the state where the recipient of income is resident. This divergence of interests is the cause of much litigation.

In order to avoid perpetual litigation tax payers are increasingly resorting to the Authority of Advance Rulings ('AAR'). A ruling by the AAR is binding only on the Applicant, in respect of the transaction in relation to which the ruling has been sought and on the Tax Authority, in respect of the Applicant and the said transaction, unless, there is a change, either in law or in facts, on the basis of which the advance ruling was pronounced. However, the advance rulings do have a persuasive value and the Courts in India and the



appellate authorities do recognise the principles and ratio laid down by the AAR, while deciding similar cases.

In the ensuing article we have discussed some interesting issues in light of some recent rulings of AAR dealing with Royalty or FTS.

ISSUE I

Payment for architectural services, designs and drawings – Whether Fees For Technical Services or Sale of designs and plans?

With the modernisation in the Construction industry arena, Indian companies are increasingly hiring the foreign companies to harness the benefits of their world class architectural expertise and experience for developing super structures in India as well. In such a scenario, typically the work is broadly divided into three parts though covered in one single agreement:

Stage I: Development of programme, master plan and concept designs

Stage II: Preparation of design development drawings and related documents;

Stage III: Implementation of designs and supervision of actual construction

Additionally, the foreign companies

may also provide services like identifying cost saving schemes, assisting in the bidding process, selection of contractor etc. depending upon the terms of contract. Sometimes, the foreign companies work jointly with an Indian sub-contractor/associate architect. A part of project, like development of design, drawings and related dossiers and other consultancy services are rendered by the foreign counterpart from overseas and the actual implementation and construction supervision is the responsibility of the Indian team.

The consideration is divided

“An agreement in case of architectural services has to be read having regard to the scope and objective. A holistic view needs to be considered in viewing the agreement without being carried away by the apparent tenor of some of the clauses of the agreement. If the essence of any agreement is to obtain consultancy and technical services, the same cannot be read otherwise and the payments made should be categorised as FTS only and not outright sale of designs and drawings.”

between the foreign architect and Indian associate as per the agreement terms. Payments to Indian sub-contractors/associates are usually made by Indian companies directly. In such cases, assesses have been arguing that the agreement should be considered as an integrated one and should be considered as sale of designs and plans and not rendering of any technical services. It was further argued that as the documents/plans are sent from overseas countries to the Indian companies, the sale has been concluded outside India and in view of absence of PE of the foreign companies in India, payments made to overseas countries are not taxable in India.

AAR has recently examined the issue in case of GMP International GmbH (AAR No 827 of 2009 reported at 321 ITR 411)) and HMS Real Estate Pvt. Ltd. (A.A.R. No. 832 of 2009) wherein arguments of the assesseees are negated and following principles have been laid down for adjudging the taxability of such transactions.

- Basic designs services including preparation of master plan, concept design, schematic design, design development and construction documents, assistance in bidding and contractors' selection process

“Judiciary has consistently held that technical skill, knowledge, etc. can be said to be made available only when the recipient of the service is enabled to apply the technology or know-how. A related ruling of the AAR has confirmed the said principle and clarified that support services, sharing of information, giving guidelines / plans to achieve uniformity, brand building and cost efficiency do not amounts to “make available” any technical knowledge or experience and hence not subject to tax in India.”

and consultancy during the construction phase are all part of broad nature of architectural services and the agreement cannot be read in isolation and the components of the contract cannot be placed in water-tight components. The agreement shall be read as a whole and not in parts.

- The services are in the nature of FTS as it transfers technical plans and designs to the Indian companies. AAR further, observed that the architectural services can also be brought within the fold of the first part of clause (b) starting with the expression “make available”. However, AAR has categorically observed that it is unnecessary to express a final view in the matter.
- The approach should be to ascertain what is the true scope and dominant object of the contract. The essence of the transaction in reality is to obtain



“design and consultancy services” and not merely sale of designs and drawings. Further, in case of HMS Real Estate, AAR also highlighted the inference to the definition of FTS in the India- US tax treaty¹

- AAR has also observed that they would not like to express an opinion on the question whether the consideration attributable to the transfer of designs and plans can be brought within the scope of the clause – “payment received for information concerning industrial, commercial or scientific experience” occurring in the definition of “royalty” vide Article 12.3(a).
- Remittances made to the overseas architectural firm for the purpose of payments to consultants in overseas country would not be subject to tax in India as the services are rendered outside India. *(needs to be examined in view of retrospective amendment to Section 9)*
- Payments made towards other reimbursable expenses cannot be considered income as chargeable to tax in the hands of architectural firm.

Conclusion

An agreement in case of architectural services has to be read having regard to the scope and objective. A holistic

view needs to be considered in viewing the agreement without being carried away by the apparent tenor of some of the clauses of the agreement. If the essence of any agreement is to obtain consultancy and technical services the same cannot be read otherwise and the payments made should be categorised as FTS only and not outright sale of designs and drawings.

Additional point

Further, the AAR has held that concessional rate of 10 per cent in accordance with provisions of Section 115A would be applicable at the time of tax withholding. As per the provisions of Section 115A of the Act concessional rate is applicable, provided the agreement is approved by the Central Government; or where it relates to the matter included in the Industrial Policy. Divergent views are in existence on these. However, it appears that the AAR has not examined the controversy in detail while deciding the issue of applicable rate of tax.

ISSUE 2

Payment for Support Services from Group Companies – “Make available” or not?

Today, Multinational Companies (MNCs) operate across the globe providing same services or manufacturing same goods in various parts of the world. Generally,

¹ Article 12 (4) of India – US DTAA

“For purposes of this Article, “fees for included services” means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received ; or

(b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.”



MNCs would like to follow similar strategies, policies, plans, methods, procedures etc at all the locations. This standardisation results in brand-building and uniformity on one hand and reduces the duplication of efforts on other.

Today the Indian subsidiaries/ associates receive continuous assistance from parent/group companies such as business support, marketing support, information technology support, strategy support, policy formation assistance ranging from personnel to managing public relations, communications and risk etc. Regarding compensation, the group companies are compensated on cost plus mark-up basis or the Indian entity is allocated a portion of cost on some rationale basis depending on the terms of agreement.

It is well accepted that these services partake the color of technical or at times consultancy services. As per the provisions of the Act, any payment made for technical, managerial or consultancy services is considered as FTS and hence is liable to tax. Majority of the Double Taxation Avoidance Agreement that India has entered into with other nations have definition of FTS similar to the one provided in the Act. Hence, payments to those countries may be liable to tax as FTS.

The dispute arises in case of those countries which have 'make available' clause in the definition of FTS in the tax treaty. As discussed above generally speaking technology would be considered to have been made available only when the purchaser of the services is enabled to apply the technology on his own without the aid of service provider. The issue is whether the support services discussed here make available any technical knowledge, skill, know-how etc to the Indian counterparts so as to constitute FTS/FIS as per the provisions of the tax treaty.

The above issue has been discussed by AAR in the case of Bharati AXA General Insurance Co.Ltd. (AAR No 845 of 2009 reported at 2010-TIL-30-ARA-INTL)

The said judgment has been analysed with reference to DTAA between India and Singapore. The definition of FTS given in the tax treaty is similar to the India - US tax treaty. The AAR has proceeded to analyze the interpretation of term 'make available' as per the meaning given in Memorandum of Understanding ("MOU") given in the India- US DTAA. The same is on the legal position that merely because treaties are with different countries does not mean different meanings have to be assigned to same words especially when both have been entered into by the same country on the other side, namely India².

In light of the same AAR has held that some of the services undoubtedly have the flavor of management, consultancy or technical services. But the more important question to be answered is whether the group companies make available to the Indian counterparts any technical knowledge, experience, skills or know-how by providing the 'support services' or not. What all was provided by the overseas group companies was information on various business and commercial

matters, guidelines, templates, best practices and strategies that could be adopted in various spheres of their business. Dissemination of information, furnishing guidelines and suggesting plans of action aimed at uniformity and seamless quality in business dealings of participating group entities do not per se amount to making available to them technical knowledge and experience possessed by overseas group companies. AAR specifically observed that – *"Even if we proceed on the basis that some of the services have the flavour of imparting technical knowledge and experience to the recipient of service, the further question is whether such provision of services enables the person acquiring the services to apply the technology contained therein. This test specifically laid down in clause (b), in our view, is not satisfied and the legal position clarified by this Authority while interpreting more or less similar Treaty provisions applies with greater force to the present case in view of the narrow language employed in the India-Singapore Tax Treaty."*

AAR further observed in the case of cost allocation in respect of Information Technology services that – *"It will be too much to say that by providing such*

“Services rendered by accreditation institution for granting accreditation certificate cannot be said to have made available any technical knowledge, skills etc and hence the same cannot be classified as FTS/FIS. The AAR ruling is consistent with the judicial trend in respect of interpretation of “make available”. The AAR has rightly held that organisation are appraised by the accreditation institute for any shortcomings or need of improvement does not amounts to technical service within the meaning of FTS.”

² *Raymond Limited vs. DCIT [2003] 86 ITD 791*

services (assuming they are technical or consultancy services), the applicant receiving the services is enabled to apply the technology contained therein i.e. the technology, knowledge, skills, etc. possessed by the service provider or technical plan developed by the service provider. We do not find anything in the IT support services that answer the description of technical services as defined in the Treaty."

Conclusion

Judiciary has consistently held that technical skill, knowledge, etc can be said to be made available only when the recipient of the service is enabled to apply the technology or know-how. The above referred ruling has confirmed the said principle and clarified that support services, sharing of information, giving guidelines/plans to achieve uniformity, brand building and cost efficiency do not amounts to "make available" any technical knowledge or experience and hence not subject to tax in India.

ISSUE 3

Payment for Accreditation service – whether FTS or not?

The Accreditation agencies accredit various organisations which provide third party certification and / or inspection services. Such accreditations provide users the

confidence/comfort that goods and services meet established standards. During the process of their assessment accreditation agencies evaluates the capabilities, competence, potential and infrastructure possessed by such organisations in light of certain set standards and parameters. Subsequently, they apprise organisations of its shortcomings and deficiencies, if any, or given an opportunity to rectify. Once the assessment meets their standards these agencies accredit the organisations.

The question under consideration is whether the accreditation services provided to the Indian companies are in the nature of FTS/FIS and subject to tax in India or not.

The similar issue has been dealt with by AAR in Joint Accreditation System of Australia and New Zealand (AAR No 838 of 2009 reported at 2010-TII-28-ARA-INTL)

The AAR has observed that though Accreditation agency evaluates the capabilities, competence, potential and infrastructure possessed by such organisations they do not transfer of any skills or technical knowledge or experience or process or know-how to the Indian organisations. The fact that such organisations are apprised of its shortcomings and deficiencies, if any, or given an opportunity to rectify, does not reasonably lead to the inference of "making available" the skills, technical knowledge etc., possessed by the applicant. The fact that the organisations are benefited from the accreditation has no bearing on the issue. AAR categorically observed that- "CAB, will of course, be benefited by the accreditation certificate issued by the applicant but that fact has hardly any bearing on the point whether "make available" criterion has been satisfied or not. Viewed from any angle, it cannot be said that the applicant is imparting any knowledge or skills to

Characterisation of income for supply / use of software is an issue of debate in India since long. A ruling by the AAR further reiterates that payments for computer software should be determined, having regard to the nature and extent of rights granted to the purchaser and the provisions of copyright law would be relevant for this purpose. The AAR has also referred and relied on the OECD commentary while arriving at the conclusion and hence confirms the relevance of OECD commentary even on the aspect on which India has expressed certain reservations.

the CABs which are utilized by CAB in conducting its business. The nature of activity undertaken by the applicant clearly rules out any such inference."

Conclusion

Services rendered by accreditation institution for granting accreditation certificate cannot be said to have made available any technical knowledge, skills etc and hence the same cannot be classified as FTS / FIS. Ruling is consistent with the judicial trend in respect of interpretation of "make available". The AAR has rightly held that organisation are apprised by the accreditation institute for any shortcomings or need of improvement does not amounts to technical service within the meaning of FTS.

ISSUE 4

Supply of Software which is neither off the shelf nor customised to reseller – Whether Royalty?

This is the most litigious issue as regards sale of software/ right to use the software is concerned. The Revenue authorities have always been taking a position that payments made by an Indian assessee in respect of software would classify as Royalty and



assesses have maintained a stand that these payments are not in the nature of Royalty.

This issue has been dealt with by AAR in M/s. Dassault Systems K.K., (AAR No 821 of 2009 reported at 2010-TIOL-02-ARA-IT)

In the given case, the applicant, a Japanese company is selling standardised but special purpose software to its Indian reseller for onward sale to the end user in India. The invoices were raised by the Japanese company on the Indian reseller. The applicant contended that the transaction with the end user is transfer of a copyrighted software product and not the copyright in such software. The copyright continues to be vested with the Japanese company. Neither the end user nor the reseller has any rights which would enable

commercial exploitation of the software. Therefore, the applicant contended that the payment was not in the nature of Royalty under Article 12 of the Indo-Japan treaty. Further, it was contended that the income should be treated as business income taxable under Article 7 of the treaty and in absence of a PE of the applicant in India; the income cannot be taxed in India.

The Revenue authorities contended that the license fees paid by the end user in India is for transfer of copyrights in computer software and therefore the payment should be treated as Royalty for use of process. Further, the Revenue authorities also contended that the reseller is a dependant agent of the applicant in India, since the reseller is performing functions on behalf of the applicant and has the authority to conclude contracts in India.

The AAR noted that Copyright, which is a species of Intellectual Property Rights, belongs to the owner. Ownership includes a bundle of rights mentioned in the Indian Copyright Act, 1957, directed towards commercial exploitation of the copyright. If any of these rights are parted in favour of another so that the other person can enjoy that right in the same manner in which the owner can, it can then be said that these specific rights, concerning use of copyright, have been conferred upon him. The AAR observed that- *"The copyright which is a species of intellectual property rights belongs to the owner or its assignee if any. The ownership thereof carried with it a bundle of rights which are by and large directed towards commercial exploitation of this intangible property right. Those rights attached to copyright are enumerated in Section 14 of the Copyright Act, 1957. If any of these rights are parted with in favour of another so that the other person can enjoy that right in the same manner in which the owner can, it can then be said that those specific rights concerning the*



use of copyright have been conferred on him."

The AAR observed that in the given case, the core of the transaction is to authorize the end user to have access and make use of the licensed software products over which the Applicant has exclusive copyright, without giving any scope for the end user or the reseller to deal with them any further. The AAR categorically held that – *"In the instant case, the end-user is not given the authority to do any of the acts contemplated in sub-clauses (i) to (vii) of clause (a) of Section 14, not to speak of the exclusive right to do the said acts. In fact, the restrictions placed on the end-user and the VAR which have been referred to earlier couples with a declaration that the intellectual property rights in the licensed programmes will remain exclusively with the applicant (or its licensors) and the non-exclusive and non-transferable character of license are all meant to ensure that none of the rights vesting in the applicant as copyright-holder can be claimed or enjoyed by the licensee and that they will remain intact and are preserved."* It was further observed that – *"Where the purpose of the licence or the transaction is only to establish access to the copyrighted product for internal business purpose, it would not be legally correct to state that the copyright itself has been transferred to any extent. It does not make any difference even if the computer programme based on to the user is a highly specialized one. The parting of intellectual property rights inherent in an attached to the software product in favour of the licensee /*

“With the recent development in the Income-tax arena i.e. introduction of Direct tax Code (DTC), taxability of Royalty and FTS has got a new dimension. DTC has touched two major components deciding taxability of payments as Royalty or FTS – rates (i.e. 20 per cent from 10 per cent) and definition, e.g. the definition of Royalty has been enlarged to cover payment for use/right to use of transmission by satellite, cable, optic fibre or similar technology, transfer of all or any rights in respect of cinematograph films & live coverage of events. Similarly, definition of FTS would also include payment for development and transfer of a design, drawing, plan or software, or any other service of a similar nature. These changes in the DTC would have far reaching consequences on the taxability of Royalty and FTS.”

customer is what is contemplated by the definition clause in the Act as well as the Treaty.” The AAR thus held that merely authorizing and enabling an end user to have the benefit of data or instructions contained therein, without any further right to deal with them independently, does not amount to transfer of rights in relation to copyright or conferment of rights to use the copyright. Thus it was held that the payment is not royalty either under the Act or under the treaty.

The AAR further held that by making use of or having access to the computer programmes or following a set of instructions so as to be able to effectively use the computer programmes would not amount to use of process. Accordingly, such payments would not fall within the ambit of ‘use of process’ part of the definition of royalty. The AAR observed that- *“By making use of or having access to the computer programs embedded in the software, it cannot be said that the customer is using the process that has gone into the end product or that he acquired any rights in relation to the process as such. Nor can it be said that following the series of instructions so as to be able to effectively make use of the programs contained in the software amounts to the use of process or acquisition of any rights in relation thereto.”*



In case of GeoQuest Systems B.V., the question raised before the AAR was whether the income arising to the Applicant (Netherlands Company) from offshore supply of software would be said to accrue or arise or deemed to be accrued or arisen in India?

The AAR categorically observed that the crucial clauses in the Agreement concerning Dassault Systems are substantially similar to the clauses in the Agreement relevant to the present case. Thus relying upon the arguments discussed in the Dassault Systems Ruling, the AAR held that the income from offshore supply of software cannot be treated as royalty within the meaning of Article 12 of the India-Netherlands treaty.

Conclusion

Characterisation of income for supply / use of software is an issue of debate in India since long. This ruling by the AAR further reiterates that payments for computer software should be determined, having regard to the nature and extent of rights granted to the purchaser and the provisions of copyright law would be relevant for this purpose. The AAR has also referred and relied on the OECD commentary while arriving at the conclusion and hence confirms the relevance of OECD commentary even on the aspect on which India has expressed certain reservations.

Additional Point

In the given fact pattern where:

- Business of distributor is not controlled by the principal
- Distributor is not negotiating or concluding the contracts on behalf of principal
- Order procured by distributor is subject to confirmation by principal
- Distributor is free to decide its price

There is not principal and agent relationship and the same does not constitute Agency PE.

ISSUE 5

Payments made for supply of system comprising of Hardware + Software + Services – Royalty or FTS/FIS?

Another interesting situation could be a case where a system is supplied under a contract which comprises of hardware, software and involves rendering of services as well. Whether payment for such a system would be considered as Royalty or FTS/FIS?

Well, such a question can only be answered in the light of the actual facts of the case of and substance of the contract.

Similar issue has been analyzed and explained by AAR in Airport Authority of India, (AAR No 810 of 2009 reported at 36 DTR (AAR) 323

In this case, Airport Authority of India (‘AAI’) had entered into a contract for Automation Upgrade for third runway at IGI Airport with a US company. The contract involves Raytheon supplying hardware, software and providing services in connection with installation. The cost of software is the major component of the contract.

US Company granted the licence on non-transferable, non-exclusive, royalty-free basis to use the executable software code and technical documentation for use in the automation system to AAI. It was responsible for delivering, installing, testing and inspecting of the system and providing the necessary information to operate, maintain and repair the system. The software of the automation system was the mechanism through which the information and inputs concerning various technical aspects were provided to the AAI personnel.

Based on these facts, AAR held that software provided by US company equipped AAI with the necessary technical skills and operational efficiency to run the system. The AAR observed that – *“The software of the automation system is the mechanism through which the informations and inputs*

concerning various technical aspects based on the expertise and experience of Raytheon are made available to the AAI personnel which in turn equips them with the necessary technical skills and operational efficiency. By means of various technical services provided by Raytheon's personnel and the sharing of their technical knowledge and experiences with AAI personnel at the time of integration with the existing system and the site acceptance test and the technical manuals and data furnished for putting the system to effective use, Raytheon is making available to AAI its technical knowledge and skills. In ultimate analysis, the recipient of service is enabled to apply the technology. Viewed from another angle, the transfer of a technical plan is also involved in devising and activating the upgraded automation system.

Thus, the AAR has given a strange finding that once the technology has been embedded in the equipment and if the purchaser of the equipment is enabled to use the same it tantamount to making available technical skills, know-how etc. Further, AAR has distinguished ruling of Dassault Systems by stating that the same was in respect of standardised software. Interestingly, the AAR has concluded that payment made towards supply of software is in the nature of FTS with these findings – *"The fact that the applicant – AAI itself has not been provided with the technology for developing the software as such does not really make a difference. The expression used is: "make available technical knowledge, experience or skills". The substance of the transaction, in our view, is rendering of technical and consulting services which make available to AAI the technical knowledge, experience and skills possessed by Raytheon in the field and the provision of software system is only part of that exercise. The delivery of software and the specification of the cost of*

software cannot be viewed in isolation. Software is a part of the package of setting up upgraded automation system and as stated earlier, it has no value unless the supplier shares the technical knowledge, information and experience with the user and suitably equip the personnel of AAI to handle the system by themselves. It needs training and imparting of valuable informations and instructions. Viewed in this background, we are of the view that the payment made towards software can be legitimately brought within the fold of Art 12(4) (b) of the Tax Treaty, if not Art 12(3)."

Conclusion

The decision of the AAR in Airports Authority of India has surprisingly turned back the wheels of time. It has surprisingly ignored the jurisprudence developed over a series of cases beginning with the decision of the Special Bench of the Delhi Tribunal in the case of *Motorola Inc. v. DCIT* wherein Courts have differentiated a sale of a copyrighted article from a transfer of the underlying copyright. Judiciary has consistently held that receipts from an ordinary sale of software not involving a transfer of copyrights would be classified as business profits and not as FTS or Royalty. The AAR has failed to appreciate that the standard industry practice of transferring software is by way of a licence which specifies the terms of usage but does not transfer any right in the copyrights that subsist in the software.

Wrapping Up

It appears that objective of avoiding double taxation to a certain extent is solved but the problem of under taxation or erosion of tax base still exists and revenue authorities of different countries are still interpreting the treating in their own way. Further, the development of e-commerce and free technology transfers raises new questions as regards concepts of



permanent establishment and taxation of Royalty and FTS / FIS. We hope that the above discussions and analysis throw some light and clarifies certain aspects of the most talked about issues in International taxation arena - Royalty and FTS/FIS.

Moreover, with the recent development in the Income-tax arena i.e. introduction of Direct tax Code ('DTC'), taxability of Royalty and FTS has got a new dimension. DTC has touched two major components deciding taxability of payments as Royalty or FTS – rates (i.e. 20 per cent from 10 per cent) and definition, e.g. the definition of Royalty has been enlarged to cover payment for use/right to use of transmission by satellite, cable, optic fibre or similar technology, transfer of all or any rights in respect of cinematograph films and live coverage of events. Similarly, definition of FTS would also include payment for development and transfer of a design, drawing, plan or software, or any other service of a similar nature. These changes in the DTC would have far reaching consequences on the taxability of Royalty and FTS. However, only the time would decide whether these changes would reduce the existing litigation or add to it. Let's wait and watch ourselves! ■

Interest, Royalty & Fees for Technical Services to Non-Residents



The issues of International taxation are becoming more and more important for the day. The proposed Direct Code Tax (DTC) is also containing changes in the direct tax system to check the tax evasions. The taxation of Interest, Royalty and Fees for technical services (FTS) depends on the provisions of the Income-tax Act, 1961 and the relevant Double Taxation Avoidance Agreement (DTAA). With the support of Section 90(2), the assessee has an option to opt for the taxation either under the act or under the DTAA, whichever is more beneficial to him. [*Union of India v/s Azadi Bachao Andalon (2003)(SC)*]. Read on to know more.



CA. Anshuman Chaturvedi
(The author is a member of the Institute.
He can be reached at eboard@icai.org)

Introduction

The issues of International taxation are becoming more and more important for the day. The proposed Direct Code Tax (DTC) is also containing changes in the direct tax system to check the tax evasions.

The taxation of Interest, Royalty and Fees for technical services (FTS) depends on the provisions of the Income-tax Act, 1961 and the relevant

Double Taxation Avoidance Agreement (DTAA). With the support of Section 90(2), the assessee has an option to opt for the taxation either under the act or under the DTAA, whichever is more beneficial to him. [*Union of India V/s. Azadi Bachao Andalon (2003)(SC)*]

Hon'ble High Court of Madras in the case of *CIT V/s. Copes Vulcan Inc. (1987)* has held that in case FTS does not fall within the ambit of Section 9(1)

(vii), recourse cannot be had to the general provisions of the “business connection” under Section 9(1) to tax the income.

Presumptive Taxation

The Income-tax Act provides that a non-resident having sources of income situated in India is taxed on presumptive basis on most of the incomes arising in India. The deeming provisions are Section 44D and Section 115A of the Income-tax Act, 1961. These provisions read together provide for a special method for computing income by way of royalty or fees for technical services in the case of foreign companies. The rate of tax is fixed at a flat 10 per cent of the gross receipts for royalty or technical services, in total disregard of any expenditure incurred by the non-resident referred to in Section 28 to 44C of the Income-tax Act. Thus, 10 per cent of the gross receipts to the foreign entity are to be withheld with disregard to the actual income accruing to the non-resident. This policy of presumptive taxation is grounded on reasons of practical convenience like absence of books of account, supporting evidences etc. provided they maintain a permanent establishment in India and comply with the requirements of Section 44A and 288 of the IT Act.

Composite Payments and TDS

Very often one comes across agreements in connection with royalties and fees for technical services wherein a resident agrees to pay contractual consideration to a non-resident. The consideration consists of two parts, one part is for royalties or technical services on which the resident is obliged to withhold tax, and the other part is claimed to be non-taxable in the hands of the non-resident recipient on grounds of being mere reimbursement of expenditure incurred by the non-resident, hence not liable to taxation.

The pertinent questions that arise in such a factual matrix are whether such integrated payments can be subjected to different tax treatment, and whether withholding is to be on the net profit comprised in gross sums or on the gross sums themselves.

In the leading case of *Sultan Brothers v. CIT*, Hon'ble Supreme Court has held that the Assessing Officer can enquire whether the contract could still have stood if hypothetically the contract were to be split, and the reimbursement ignored — if it can, then the sums can be subject to different tax treatment, otherwise not.

In addition to above there are various judicial pronouncements relating to Section 195 the deduction of tax at sources and on the re-imbursement of expenses. As per the critical analysis of these cases, if the re-imbursement amount is very clearly indicated and supported by the invoices, then no tax needs to be deducted. However, where the re-imbursement amount is related to the fee and the same is mentioned in the agreement, then tax needs to be deducted.

“The Income-tax Act provides that a non-resident having sources of income situated in India is taxed on presumptive basis on most of the incomes arising in India. The deeming provisions are Section 44D and Section 115A of the Income-tax Act, 1961. These provisions read together provide for a special method for computing income by way of royalty or fees for technical services in the case of foreign companies. The rate of tax is fixed at a flat 10 per cent of the gross receipts for royalty or technical services, in total disregard of any expenditure incurred by the non-resident referred to in Section 28 to 44C of the Income-tax Act.”

Deduction of Tax on Royalty and Fees for Technical Services

As regards transfer of payment to a non-resident in consideration of royalty or technical services received, Section 195 of the IT Act provides that any person responsible for paying to a non-resident any sum chargeable under the Act shall at the time of credit of such income deduct income-tax thereon at the rates in force. Income by way of royalty or technical services is chargeable under the IT Act. Thus, the primary obligation of paying the tax on royalties or technical services is not on the non-resident himself but on the person who is making such payments to him. Failure to comply with this provision may result in disallowance of the expenditure, interest on the taxes and penal action.

Clauses (v), (vi) and (vii) of Section 9(1) of the IT Act provide that income shall be deemed to arise in India by way of royalties and fees for technical services respectively if the payment is payable by the Government or a resident, except in cases where such payment is payable for the purposes of a business or profession or making an earning from a source outside India. Moreover, payment by a non-resident is also included in this category if such payment is for the purposes of business or profession carried on by such person in India or for the purposes of earning any income from any source in India. To illustrate, X & Co, an Indian resident, enters into a contract with D Inc, a resident of the US, that on payment of certain sums, D Inc would courier to X & Co certain drawings and diagrams related to construction of iron ore melting plants. Though, in this case service has not been performed in India, still withholding tax would become due. However, if an Indian business chain were to set up a business in UK, and technical services were availed in UK for the purpose of setting up of the

“There are two different schools of thoughts viz., a school of thought does exist to the effect that the concept of territorial nexus, for the purpose of determining the tax liability, is relevant only for a territorial tax system in which taxability in a tax jurisdiction is confined to the income earned within its borders. Under this system, any foreign income that is earned outside of its borders is not taxed by the tax jurisdiction, but then apart from tax heavens, the only prominent countries that are considered territorial tax systems are France, Belgium, Hong Kong and the Netherlands, and in those countries also this system comes with certain anti-abuse riders. In other major tax systems, the source and residence rules are concurrently followed”

business, which would be a source of income to the Indian business chain there, such payments would not be subject to Indian withholding tax. This receipt basis of taxation is the object of much criticism and against the spirit of various tax treaties entered into by India with foreign countries.

The Hon'ble Supreme Court in

a landmark judgment *Ishikawajima-Harima Heavy Industries Ltd. v. DIT* had given an opposite position from the above, where it was held that a service can be taxed in India only when it is rendered and utilised in India.

To overcome the rule made under the *Ishikawajima*, the Finance Act, 2007 was amended by the revenue. However such amendment did not changed the position of the law.

Further, the Finance Act 2010 has made amendment in the Income Tax Act by inserting the following clause in Section 9:

“It is proposed to provide that the income of non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-Section (1) and shall be included in the total income of the non-resident, whether or not-

(i) The non-resident has a residence or place of business or business connection in India; or (ii) The non-resident has rendered services in India.

The amendment will take effect, retrospectively, from 1st June 1976 and will, accordingly, apply in relation to the assessment year 1977-1978 and subsequent years.

The aforementioned amendment has made the intention of the government very clear to tax all those payments in the nature of interest,

royalty and fees for technical services, whose source is in India.

The government has taken the support of the Source Rule, which is recognised in India's DTAA's and it is very much valid. Accordingly, India may tax any such income or payment which is being paid to a non-resident by its resident irrespective of the situs of the service. Hence, the situs of the payer and the situs of the utilisation of services will determine the tax jurisdiction.

In almost all the DTAA's signed by India, the provision relating to taxation of Interest, Royalty and FTS is that these arising in a contracting state and paid to a resident of the other contracting state may be taxed in that other state. However, such amounts may also be taxed in the contracting state in which they arise, and according to the law of that state.

Regarding the provision for the small services, such providers i.e. Individuals providing the professional services or independent services shall be taxable only in the state unless he has fixed place of business available to him in the other contracting state based on the DTAA.

In a recent judgement pronounced by ITAT Mumbai in the case of *Ashapura Minichem Limited Vs. ADIT [2010]*, where it was held that the FTS



paid by an Indian Company to Chinese Company are liable to tax in India even if the services are rendered outside India.

There are two different schools of thoughts viz., a school of thought does exist to the effect that the concept of territorial nexus, for the purpose of determining the tax liability, is relevant only for a territorial tax system in which taxability in a tax jurisdiction is confined to the income earned within its borders. Under this system, any foreign income that is earned outside of its borders is not taxed by the tax jurisdiction, but then apart from tax heavens, the only prominent countries that are considered territorial tax systems are France, Belgium, Hong Kong and the Netherlands, and in those countries also this system comes with certain anti-abuse riders. In other major tax systems, the source and residence rules are concurrently followed. On a conceptual note, source rule of taxation requires an income sourced from a tax jurisdiction to be taxed in this jurisdiction, and residence rule of taxation requires income, earned from wherever, to be taxed in the tax jurisdiction in which earner is resident.

New Section 206AA : The new requirement to furnish the PAN has been inserted through the Finance No. (2) Act, 2009 vide Section 206AA w.e.f. 1st April 2010 after Section 206A of the Income-tax Act, 1961. This new section overrides the entire act and non-furnishing of the PAN may lead to a higher tax expenses to non-residents. The wordings of this section are "Notwithstanding anything contained in any other provisions of this Act, any person entitled to receive any sum or income or amount, on which tax is deductible under Chapter XVIIIB".

This is the anti-avoidance provision. Therefore, this section will override the Section 90(2) of the IT Act also; it may override the entire treaty. The intention

behind the additional requirement of this section is to put a check on the tax evasion and in case of non-resident it becomes more important because of the practical difficulties faced by the department for having no jurisdiction on the non-residents.

Chapter XVIIIB deals with the deduction at source by the payer, whereas Chapter XVII deals with collection and recovery of tax and Section 195 falls in Section XVII. On analysis of Section 206AA with Section 195, the tax is liable to be deducted at source when the sum is chargeable to tax under the provisions of IT Act. In case, the sum is not taxable, there is no need to deduct tax at source as well as the Section 206AA will not apply.

In a very recent judgment by Hon'ble Supreme Court in the case of *GE India Technology Centre Private Ltd. vs. CIT (2010)*, it has been held that 'the obligation to deduct tax at source arises only when there is a sum chargeable under the act'. Therefore, where the sum paid/payable is not an income in the hands of recipient and not chargeable to tax, there is no need to deduct tax at source and the provisions of Section 206AA would not be applicable. For instance, where the payment is made for import of certain commodity, there is no need to deduct tax at source.

Meaning of the term Royalty & FTS as per various courts: Fee for use of satellite is "royalty" under Act & DTAA [*New Skies Satellites vs. ADIT (ITAT Delhi Special Bench)*]

Royalty paid by non-resident does not "arise" in India if there is no "economic link" between the PE and the royalty [*DDIT vs. SET Satellite (Singapore) (ITAT Mumbai)*]

Software embedded on a CD is a "good" and hence, any consideration received for the same would be towards sale of "good" [*Tata Consultancy Services (271 ITR 401)(SC)*]

Payment made for access of a portal

located outside India was payment for use of equipment and hence royalty [*Cargo Community Network Pte Ltd (289 ITR 355)(AAR)*]

Outright sale of engineering calculations, designs and drawings, etc. by a non-resident entity to a resident entity cannot be regarded as royalty [*Davy Ashmore India Ltd (190 ITR 626)(Cal. HC)*]

Definition of Interest

Both the OECD and UN Model use similar words to define the term interest:

Article 11(3) defines the term "interest" to mean income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. The definition provides that penalty charges for late payment shall not be regarded as interest for the purpose of this article.

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Definition of Royalty

Generally, royalty is the sum payable for the right to use someone else's property for the purpose of gain. Royalty is a sum which is taxable under section 9 of the IT Act, which section further provides that consideration flowing in from the following items shall be deemed to be royalty:

- i. the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- ii. the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- iii. the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
- iv. the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- v. the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in Section 44BB;
- vi. the transfer of all or any rights (including the granting of a licence) in respect of any copyright,

literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or

The terms "secret" appearing in the phrase "secret formula or process" in Explanation 2 to Section 9(1)(vi) and in the relevant Article of DTAA will not qualify the word "process." Therefore, to fall within the meaning of royalty as envisaged in these provisions, it is not necessary that the services rendered must be through "secret process" only. Even services rendered through simple process will also be covered within the meaning of royalty.

The payments received by assessee from their customers is on account of use on account of use of their satellites for telecommunication and broadcasting, amounts to royalty within the meaning of Section 9(1)(vi) of IT Act, 1961. It also amounts to royalty within the meaning of respective Articles of DTAA

What is not Royalty?: Clause (v) to Explanation 2 of Section 9(1)(vi) of the IT Act makes an exception for consideration for the sale, distribution or exhibition or cinematographic film, which all shall not be deemed as

Definition of Technical Services Technical service has been defined as any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but not including consideration for any construction, assembly, and mining or like project. Thus, under the head technical service, managerial and consultancy services too have been included. ”

royalties. Also, the capital gains earned from the sale or transfer of IPR are not deemed to be royalties.

Fees for Technical Services

Definition of Technical Services Technical service has been defined as any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but not including consideration for any construction, assembly, and mining or like project. Thus, under the head technical service, managerial and consultancy services too have been included. ■

Applicability of Concessional Tax Rate to Non-Residents on Long-Term Capital Gains Arising from Transfer of Securities

At this stage of globalization when prominent offshore companies have queued for investment in India, the mode of investment in our companies is channelized either through private investment in form of FDI or investment in capital markets. Acquisition of shares by non-residents in Indian company is permitted subject to foreign exchange regulations. Conversely, exit of such investment from securities of Indian companies besides compliance of foreign exchange regulations would result in tax implications on gains or losses arising from sale of such securities. From the viewpoint of taxability for nonresidents, foreign entities are undertaking enormous investments in securities of Indian entities to promote their business in India. This article discusses applicability of concessional rate of tax on gains arising from sale of securities by non-residents in India.



CA. Shailendra Sharma

(The Author is a member of the Institute. He can be contacted at eboard @icai.org.)



Introduction

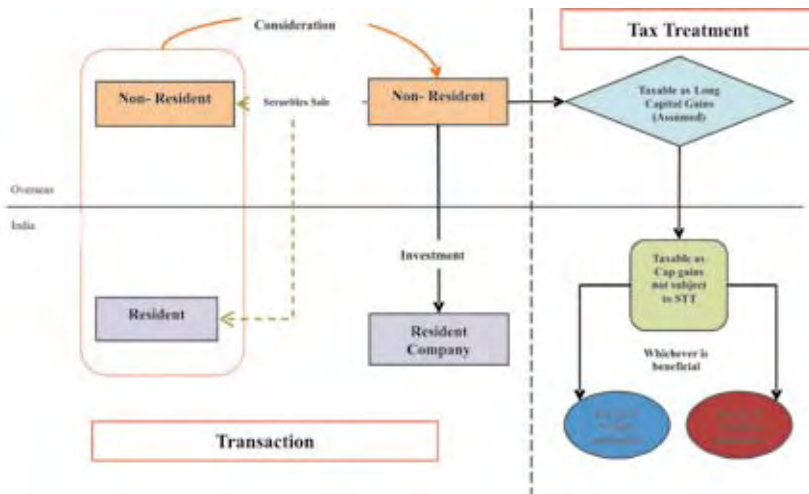
India has reached the forefront of globalisation which is evidenced through prominent offshore companies lined up for investment opportunities. The mode of investment in Indian companies is channelised either through private investment in the form of Foreign Direct Investment or investment in capital markets. Acquisition of shares by non-residents in Indian company is permitted subject to foreign exchange regulations. Conversely, exit of such investment from securities of Indian companies besides compliance of foreign exchange regulations would result in tax implications on gains or losses arising from sale of such securities.

This article discusses the applicability of concessional rate of tax on gains arising from sale of securities by non-residents in India. Viewed from the standpoint of taxability for

non-residents, foreign entities are undertaking enormous investments in securities of Indian entities to promote their business activities in India. Such Indian firms attracting foreign investment may or may not be listed on Indian stock exchanges. Many of such corporations are subsidiaries of other foreign companies.

Of late, non-residents have been facing litigation towards tax treatment of gains arising on sale of listed or non-listed securities of Indian companies. The debate is primarily on account of tax rate applicable and implication of income tax on non-residents on capital gains arising from sale of securities. In many cases, the transaction is between two or more non-residents situated outside India. In such a case also, question arises whether capital gain, if any, will be liable to tax in India at special long term rate of 20 per cent or at a concessional rate of 10 per cent.

A diagrammatic representation of the transaction along with the tax implication on capital gains arising on sales of securities is given below:



Capital Gains Tax Regime in India

Under the Indian tax laws, Section 45 to 55A of the Income-tax Act, 1961 ('the Act') deals with treatment of capital gains/losses arising on transfer of capital asset. Section 45 of the Act, provides that any profits or gains arising from transfer of capital asset effected in the previous year (commencing from April 1 up to March 31) shall, subject to available exemptions pursuant to Sections 54, 54B, 54D, 54EA, 54EB, 54F, 54G and 54H [with effect from 1-4-1991] shall be chargeable to income tax under the head 'Capital Gains'.

The basic question arises as to whether 'Capital Gains' being capital receipt can be brought to tax as income. It is pertinent to note that ordinary accounting principles distinction between capital receipt and revenue receipt are not always followed under the Act. Section 2(24) of the Act explicitly provides that "income" includes any capital gains chargeable under Section 45 of the Act.

The requisites of charging capital gains to income tax, under Section 45 are:

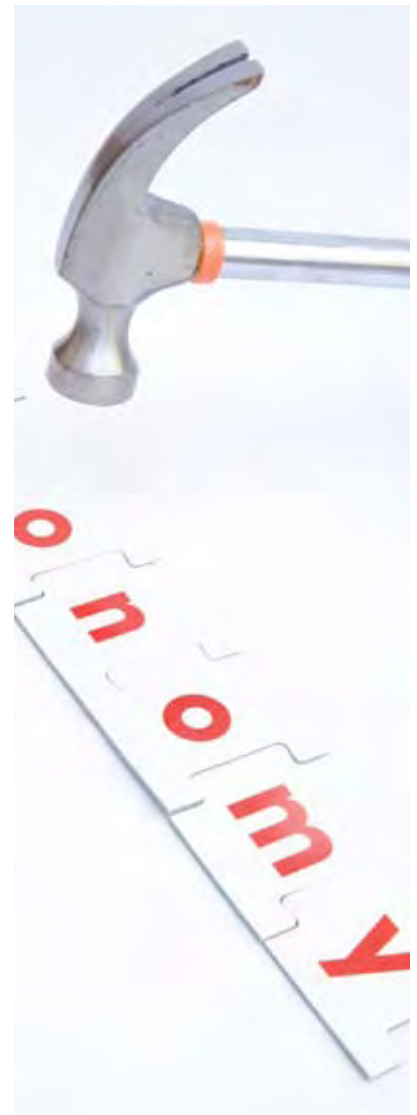
- There must be a capital asset;
- The capital asset must have been transferred;

- The transfer should be for a consideration;
- The transfer must have been effected in the previous year; and
- Gain/losses arising on such transfer of a capital asset should be computable.

Under the Indian tax laws, gains arising on transfer of capital assets held for more than 36 months (12 months for securities listed on a recognized stock exchange or mutual fund units) are treated as long-term capital gains and are taxed at special rates as compared to short-term capital gains. While computing long-term capital gains, the cost of acquisition and improvement is considered at a prescribed cost inflation index for the year. As a result, the step-up cost as indexed cost of acquisition will be reduced from sale consideration received, to arrive at the capital gain.

Presently, long-term capital gains are taxed at the rate of 20 per cent for individuals and foreign companies, and 30 per cent in case of short-term capital gains. However, long-term capital gains on the transfer of shares/bonds issued in foreign currency under a scheme notified by the Indian Government are taxed at 10 per cent. A synopsis of tax payable on gains arising from sale of securities has been tabulated:

“The debate is primarily on account of tax rate applicable and implication of income tax on non-residents on capital gains arising from sale of securities. In many cases, the transaction is between two or more non-residents situated outside India. In such a case also, question arises whether capital gain, if any, will be liable to tax in India at special long-term rate of 20 per cent or at a concessional rate of 10 per cent.”



Period of holding	Characterisation	Tax rate (inclusive of surcharge and education cess)		
		Domestic Company	Foreign Company	Individuals
12 months or less	Short term	33.99* percent, in case of shares not listed on any recognised stock exchange	42.23 percent, in case of shares not listed on any recognised stock exchange	30.90 percent, in case of shares not listed on any recognised stock exchange
		16.99* percent, in case of shares listed on a recognised stock exchange and the sale / transfer is subject to Securities Transaction Tax ('STT')	15.84 percent, in case of shares listed on a recognised stock exchange and the sale / transfer is subject to STT	15.45 percent, in case of shares listed on a recognised stock exchange and the sale / transfer is subject to STT
More than 12 months	Long term	22.66* percent, in case of shares not listed on any recognised stock exchange	21.12* percent, in case of shares not listed on any recognised stock exchange	20.60* percent, in case of shares not listed on any recognised stock exchange
		Nil, in case of shares listed on a recognised stock exchange and the sale / transfer is subject to STT	Nil, in case of shares listed on a recognised stock exchange and the sale / transfer is subject to STT	Nil, in case of shares listed on a recognised stock exchange and the sale / transfer is subject to STT

* assuming taxable income exceeds ₹10 million

Capital Gains Tax Implication for Non-Residents

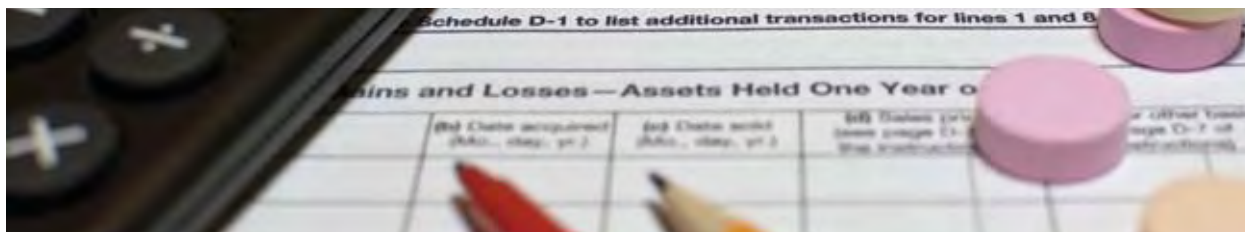
Section 112 of the Act provides for tax on long-term capital gains at the rate of 20 per cent in case of various categories of assessee including non-residents. Clause (c) of Section 112, applies to all non-residents including foreign company. Section 112 as originally enacted, effective from the assessment year 1993-94, did not apply to non-residents. However, Section 115AB, provides for a rate of tax at 10 per cent on long-term capital gains in respect of units purchased in foreign currency by an overseas financial organisation, effective from

the assessment year 1992-93.

Subsequently, effective from assessment year 1993-94, Section 115AD provides for 10 per cent rate of tax on long-term capital gains in respect of securities other than units (as referred in 115AB) purchased by foreign institutional investors. Other non-residents were taxable at a higher rate vis-à-vis long-term capital gains. Effective from the assessment year 1995-96, Clause (c) was inserted under Section 112(1) by the Finance Act, 1994 in order to provide a uniform rate of tax on long-term capital gains accruing to other non-residents. Accordingly, Section 112(1)(c) will apply to non-residents other than the non-residents

specified under Sections 115AB and 115AD with an effective rate of tax on long-term capital gains accruing to such non-residents at 20 per cent.

Interestingly, proviso to Section 112(1) was inserted by the Finance Act, 1999, effective from assessment year 2000-01. As a result from assessment years 1995-96 to 1999-2000, rate of tax on long-term capital gains accruing to non-residents (except non-residents falling under Sections 115AB and 115AD) is 20 per cent, irrespective of whether the case of the assessee falls within the scope of the first or second proviso to Section 48 of the Act. On perusing the provisos to Section 48 of the Act, it is amply clear that computation of



“Section 45 of the Act, provides that any profits or gains arising from transfer of capital asset effected in the previous year (commencing from April 1 up to March 31) shall, subject to available exemptions pursuant to Sections 54, 54B, 54D, 54EA, 54EB, 54F, 54G and 54H [with effect from 1-4-1991] shall be chargeable to income tax under the head ‘Capital Gains’.”

capital gain is bifurcated into two parts. The first proviso covers those cases where capital assets being shares or debentures of an Indian company are acquired by a non-resident in foreign currency.

In such a scenario, cost of acquisition and expenditure incurred wholly and exclusively in connection with transfer of such shares as well as the sale consideration is required to be converted in the same foreign currency, which were utilised for acquiring such shares/debentures so as to compute the capital gains in foreign currency. The capital gains so computed are then reconverted into Indian currency for the purpose of computing tax thereon. This method is applicable to short-term as well as long-term capital assets, being shares or debentures of an Indian company. Any other assets are not covered under this proviso.

The second proviso to Section 48 provides method of computing long-term capital gains in respect of any long-term capital assets acquired by an assessee irrespective of the status except long-term capital gains arising to a non-resident from transfer of long-term capital assets specified in the first proviso to Section 48. According to this method ‘cost of acquisition’ and ‘cost of improvement’ referred in Section 48(ii) should be substituted by ‘indexed cost of acquisition’ and ‘indexed cost of improvement’ which would be deducted from the sale consideration

while computing long-term capital gain. Application of this method is restricted to cases falling within the scope of the second proviso to Section 48.

The legislature has used the word ‘shall’ in the first and second provisos to Section 48 vis-à-vis computation of capital gains. Both the provisos are mutually exclusive and no option lies either with the assessee or with the assessing officer in this regard. The expression in proviso to Section 112(1) ‘before giving effect to the provisions of the second proviso to Section 48’ presupposes existence of a case where computation of long-term capital gain is to be made in accordance with the formula contained in respect of second proviso to Section 48. This means that the legislature never intended to give benefit of the proviso to Section 112(1) to those cases where long-term capital gain is required to be computed under the first proviso to Section 48. The language of the proviso is very clear.

In other words, Section 112(1) of the Act provides for 20 per cent tax rate applicable on long-term capital gains to residents and non-residents depending on the nature of securities, provided such securities are held for a period exceeding 12 months (as determined under the Securities Contract (Regulations) Act). However, a 10 per cent concessional tax rate is available for gains arising on the sale of listed shares so long as the assessee has not computed gains using cost indexation facility under the second proviso to Section 48 of the Act. Wherever second proviso to Section 48 is applicable, it only means that calculation under the second proviso shall not enter into the computation of capital gain, the same cannot be construed as a condition precedent for invoking the proviso to Section 112(1). Consequently, the benefit of indexation on the cost of acquisition under second proviso to Section 48 of the Act for long-term capital assets, other than shares

and debentures, would be available to non-residents, irrespective of whether these assets had been purchased in foreign exchange or not.

Conversely, Section 115AB provides tax rate of 10 per cent on long-term capital gain arising or accruing to overseas financial organizations vis-à-vis units purchased in foreign currency. However, Section 115AB(2) specifically provides that second proviso to Section 48 would not apply for computing such capital gain. The first proviso to Section 48 is not applicable to units purchased in foreign currency and, therefore, the legislature has not mentioned the first proviso to Section 48 in Section 115AB(2).

Hence, the legislature has provided marginal relief under Section 112(1) proviso in those cases where rate of 20 per cent on net long-term capital gains is more than 10 per cent rate of tax on gross amount of capital gains. There is a deliberate attempt by the legislature to restrict the benefit of Section 112(1) proviso to those cases where the long-term capital gains are to be computed under the second proviso to Section 48 of the Act.

Accordingly, the legislature has provided concessional rate of tax at 10 per cent on the gross amount of long-term capital gains, i.e. computation without claiming any deduction or benefit under the first and second provisos to Section 48 of the Act. It is in this context the legislature believes that

“Presently, long-term capital gains are taxed at the rate of 20 per cent for individuals and foreign companies, and 30 per cent in case of short-term capital gains. However, long-term capital gains on the transfer of shares/bonds issued in foreign currency under a scheme notified by the Indian Government are taxed at 10 per cent.”

the tax payers falling under the second proviso to Section 48 should not be put to a disadvantage as compared to tax payers falling under Sections 115AB and 115AD.

Resolving the Dispute – Issues and Precedence

Recently, there have been a difference of opinion between the Income-tax Appellate Tribunal and Authority for Advance Rulings (AAR) on the issue whether the concessional rate of tax at 10 per cent is available to a non-resident company or not. In fact, the rate of 10 per cent as contained in proviso to Section 112(1) applies on the amount of capital gain calculated before giving effect to the provisions of the second proviso to Section 48, i.e. indexation of cost of acquisition. According to the Tribunal, the concessional rate provided in the proviso to Section 112(1) will be available only in those cases where the benefit of indexation is applicable. Where the provisions of indexation as contained in second proviso to Section 48 are not applicable, the concessional rate of 10 per cent will not be available. Reference in this connection is made to *BASF Aktiengesellschaft vs. DCIT* [2007] 293 ITR 1 (Bombay).

If view of the Tribunal is to be accepted, long-term capital gain is taxable at 20 per cent - both for Indian and foreign companies. However, the tax rate of 20 per cent will be reduced to 10 per cent in case of Indian companies, where the indexation benefit is not availed. Since, indexation provisions are not applicable to foreign companies such companies will be liable to pay tax at 20 per cent. In the event, if the above interpretation is accepted, foreign companies stand at a disadvantageous position as compared to Indian companies. This will create discrimination against foreign companies and also against the principles envisaged in the tax treaties India has signed with other countries.

The tax treaties invariably contain provisions of non-discrimination against foreign enterprises which in effect provide that a foreign enterprise in India will not be subjected to any taxation which is more burdensome than the taxation to which Indian enterprises are subjected to under similar conditions. If foreign enterprises are discriminated by imposing higher rate of tax without providing similar benefits as that to the Indian enterprise, it is certainly a concern on India's commitment to honour tax treaties entered with other sovereign States.

Alternatively, the AAR has ruled 'contrarian opinion' according to the benefit of lower rate of tax conferred by the proviso to Section 112(1) which can be invoked by non-residents. The language used in proviso to Section 112(1) does not deny the concessional rate of tax to any category of assessee who are not eligible to claim the benefit of indexed cost of acquisition as provided in Section 48. In other words, the eligibility to avail benefit of indexed cost is not a *sine qua non* for applying the reduced rate of 10 per cent

“As a result from assessment years 1995-96 to 1999-2000, rate of tax on long-term capital gains accruing to non-residents (except non-residents falling under Sections 115AB and 115AD) is 20 per cent, irrespective of whether the case of the assessee falls within the scope of the first or second proviso to Section 48 of the Act. On perusing the provisos to Section 48 of the Act, it is amply clear that computation of capital gain is bifurcated into two parts. The first proviso covers those cases where capital assets being shares or debentures of an Indian company are acquired by a non-resident in foreign currency.”

prescribed in Section 112(1). Reference in this connection may be made to a recent case of *Fujitsu Services Limited* [2009] 182 Taxmann 263 (AAR).

The AAR followed the case of *Timken France SAS* [2007] 294 ITR 513 (AAR), where the Tribunal held that in respect of the long term capital gains arising from the sale of shares, Timken France SAS (a non-resident) was entitled to the benefits of the first proviso to Section 112 (1) based on the discussions above and therefore the quantum of tax payable shall not exceed 10 per cent of the amount of capital gain.

Similarly, following the analogy laid down in the above AAR rulings it appears that, the benefit of indexed cost of acquisition of long-term capital assets should be available to non-residents irrespective of whether these assets had been purchased in foreign exchange. Also, the mere fact that protection from exchange rate fluctuation is available to non-residents, does not conclude that the non-residents should not be entitled for the benefit of reduced rate of tax which the residents are eligible as reiterated in the case of *McLeod Russel India Limited* [2008] 299 ITR 79 (AAR), *Burmah Castrol Plc* [2008] 307 ITR 324 (AAR), *Alcan Inc. vs. DDIT* [2007] 112 TTJ 328 (Mumbai) and followed by *Compagnie Financiere Hamon*, [2009] 310 ITR 001 (AAR).

Key Takeaways

The issue for the time being has been settled by AAR and other judicial authorities by following the accepted principle of lower rate of permissible to non-residents until the same is not been over-ruled or challenged before the higher judicial authorities. The issue remains to face the litmus test before the lower tax authorities who would challenge during assessment proceedings going forward and its acceptability before enforced as law or clarification from the regulators. ■

Corporate Governance and Company Attributes: Case of Selected Private Sector Companies in India



Adam Smith introduced the importance of governance when he talked about the responsibility of the directors of a company and compared them with partners in a *private coparcenary*, who frequently keep an eye over their own. He, however, did not use the phrase Corporate Governance. The word *governance* was used for the first time by Geoffrey Chaucer (also known as father of English literature). Concern for governance grew tremendously during 1980's as a result of a number of international business frauds and failures. New rules and regulations governing the conduct of Board were written with the objective to achieve a balance between the essential powers of board and their proper accountability. This article describes the case of selected Indian private sector companies in that context.

The seeds of corporate governance were sowed long back when Adam Smith recognized the importance of governance and said: *The directors of the company being managers of other people's money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private coparcenary frequently watch over their own.* Adam Smith, however, did not use the phrase 'Corporate Governance'. The word *governance* occurred for the first time in the writings of Geoffrey Chaucer. The concern for governance started gaining grounds during 1980's as an aftermath of series of frauds and business failures in the US and the UK. As a result, a plethora of rules and regulations governing the conduct of Board were formed. The main objective in all these codes of best practices was

a need to achieve a balance between the essential powers of board and their proper accountability.

Oxford Dictionary defines corporate governance as a 'system by which business corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the Board of Directors, manager, shareholders and other stakeholders, and spell out the rules and procedures for making decisions on corporate affairs. By doing this, it provides the structure through which the company objectives are set along with the means of attaining these objectives as well as for monitoring performance'.

Thus, corporate governance is not just corporate management, but is referred to as the inbuilt and



Dr. Punam Agarwal

Dr. Manoj Sharma

(The authors are Associate Professors in the Govt. PG College for Girls and in the Panjab University, Chandigarh respectively. They can be contacted at punamagarwal@yahoo.com.)



dynamic mechanism adopted by the corporate bodies in its widest connotations to include a fair, efficient and transparent administration to meet certain well defined objectives and also for meeting the unmet in terms of achieving corporate excellence. It is a system of structuring, operating and controlling a business with a view to achieve long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers and complying with the legal and regulatory framework, apart from meeting environmental and local community needs. When it is practiced under a well laid out system, it leads to the building of a legal, commercial and institutional framework and demarcates the boundaries within which these functions are performed.

J. Wolfensohn, the president of World Bank, defines the purpose of corporate governance as to promote corporate fairness, transparency and accountability. A wide range of activities like transparency in management, optimum and judicious utilisation of scarce resources of the society, tax compliance, better employee management, protection of investors' interest, better disclosure for the stakeholders, protection from environmental pollution and degradation and the like fall within the ambit of corporate governance.

The regulatory framework of corporate governance in India consists of the companies legislation; SEBI Act 1992; the Securities Contract Act, 1956, the Listing Agreement, etc. Clause-49 incorporating the recommendations of Kumar Mangalam Birla Committee ordains the listed companies to comply with various corporate governance norms. For the purpose of compliance, every listed company must include a separate section captioned as "Report on Corporate Governance" in its annual Report. The report shall provide details of compliance with every mandatory

“The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board of directors, manager, shareholders and other stakeholders, and spell out the rules and procedures for making decisions on corporate affairs.”

item of corporate governance guidelines. The non-compliance of any mandatory requirement with reasons thereof must be stated in the Annual Report. Similarly, the extent to which the non-mandatory requirements have been adopted should also be specifically highlighted. The revised Clause-49 shall be implemented as:

- i) By all companies seeking listing for the first time at the time of listing
- ii) By all companies having a paid up capital of Rs. 3 crore and above or net worth of Rs. 25 crore or more at any time in the history of the entity, the revised clause will have to be applied by December 31, 2005.

In this regard, the stock exchanges shall set up monitoring cell to monitor compliance with the revised clause and submitted a consolidated compliance report to SEBI within 60 days from the end of each quarter.

The broad outline of mandatory and non-mandatory requirements is:

Mandatory

1. Board of Directors (includes Composition of the Board; Non-executive Director Compensation and disclosures; Provisions as to Board and its committees; and Code of conduct for the Board and Management.
2. Qualified and independent Audit Committee (Committee's Meetings, Powers, Role and Mandatory Review of information)
3. Subsidiary companies (unlisted

subsidiary company information)

4. Disclosure with respect to: Basics of related party transactions; Disclosure of Accounting treatment; Board disclosures – risk management; Disclosure of use of funds from public issues, rights issues preferential issues, etc.; Remuneration of Directors; Management Discussions and Analysis; Disclosure to shareholders.
5. CEO/CFO certification
6. Report on corporate governance
7. Compliance Certificate

Non-Mandatory

1. Chairman of the Board
2. Remunerations Committee.
3. Shareholders Rights
4. Audit Qualifications
5. Training of Board members
6. Mechanism for evaluating non-executive Board Members.
7. Whistle Blower Policy.

The scope of corporate governance is broad with a wide spectrum of interrelated and interconnected activities in a harmonized and transparent way towards the effective achievement of organizational goals in a profound manner by laying greater emphasis to the corporate and social accountability of the business enterprises to the stakeholders in particular and society as a whole.

Research Methodology

The private-sector companies, as ranked on average market capitalization in a business magazine (2005-06) constituted the subject of the study. Banking and insurance companies were excluded from the sample because of their different disclosure requirements. First 100 companies, out of 500 listed in the magazine, constituted the sample and the time period covered was 2005-06 and 2006-07.

The data was collected from the

annual reports of the companies, their websites, proweb database of CMIE, stock exchange directories, etc., to measure the extent and quality of corporate governance, an unweighted corporate governance index was developed. This corporate governance index included both mandatory and non-mandatory disclosures as given out in the Clause 49 of Listing Agreement. The mandatory disclosures included information on composition of board, their remuneration, audit committee, disclosures on various issues, CEO/CFO certification, corporate governance report and compliance report. The non-mandatory disclosures included a policy on code of conduct for the directors and management, declaration of half-yearly performance, remuneration committee, training of the director's evaluation system for non-executive directors and whistle blower policy.

After developing the indexes, annual reports were thoroughly analyzed to see the disclosure extent. A score of 1 was assigned on inclusion in the annual report and 0 for non-inclusion. Then, total score obtained by a company was calculated. These scores were converted into 100 using the following formula:

$$\text{Governance Index in \%} = \left[\frac{\text{Scores obtained by the company}}{\text{Maximum score of the relevant index}} \right] \times 100.$$

The score obtained by the companies for governance (see Appendix 1) were then subjected to various statistical analysis tools, i.e. correlation analysis, simple regression analysis and T-test (independent and paired samples). The study goes further to analyse the influence of certain corporate attributes like size, profitability, type of the audit firm, character of the company and extent of disclosure, on the corporate governance score of the selected companies using above stated statistical tools. The size of the company was measured

using turnover or sales (Rs. in crore) and total assets (Rs. in crore). The profitability was measured using net profit to sales ratio and net profit to total assets ratio.

For type of audit firms, seven large and reputed audit firms were put in one group and the rest in the second group. Then, companies were divided into two groups depending upon whether they got their accounts audited from any of the specified audit firms or by an audit firm belonging to second group. T-tests, then, were applied to see if there existed significant difference between the mean corporate disclosure or governance score of the two groups. Similarly, for the character of the companies, the selected companies were divided into two groups, i.e. MNC and domestic, and, then, T-tests were applied.

For the calculation of corporate disclosure score, an index similar to Corporate Disclosure Index was used. The index used in this study consists of an extensive list 147 information items – both mandatory and voluntary items. The items so included in the index are applicable to a wide range of users and are not directed to a specific user group. The items included were divided into three broad groups, viz. futuristic, contemporary and historical information. The futuristic information included general business outlook. Future plans, projected cash-flow

statements and projected operating and financial performance of the company.

The contemporary information related to general company information, products and markets, plants and warehouses, directors, manager auditors, shares related information, employee related information accounting issues, etc. The historical information consisted of quantitative details like ratios, EPS, DPS, expansions and improvement efforts assets and liabilities details, stock market data, segment reporting, corporate social responsibility reporting, value-added statement, corporate governance reports, etc.

Following points summarise the conclusion of the study:

1. 100 per cent of the companies under study prepared a report on corporate governance to be included in the annual reports of the respective companies.
2. All companies showed an improvement in their corporate governance score in the year 2006-07 as compared to 2005-06. However, the increase was not significant at 95 per cent level of confidence.
3. The maximum score of 72 was attained by Gillette India followed by Asian Paints, ICI India, Matrix Labs, Tata Motors (71 in their case) in the year 2005-06.
4. In the year 2006-07, the maximum score of 76 that was attained by Seas Goa followed by Gillette India (75), M & M & Reliance Capital (73), ICI India, Matrix Labs and Tata Motors (72).
5. The mean value of corporate governance score increased from 62.436 to 65.464 in a period of one year, i.e. from 2005-06 to 2006-07.
6. The number of companies in each quartile virtually remained same in both the years.

With regard to detailed governance

“For the purpose of compliance, every listed company must include a separate section captioned as “Report on Corporate Governance” in its annual Report. The report shall provide details of compliance with every mandatory item of corporate governance guidelines. The non-compliance of any mandatory requirement with reasons thereof must be stated in the Annual Report.”

report under each head and sub-head, following conclusions were made:

1. 100 per cent of the companies gave a statement of company's philosophy on code of corporate governance.
2. 100 per cent companies disclosed the composition of its BOD's segregating in each case between independent, executive and non-executive directors.
3. 4 per cent of the companies did not disclose whether its chairman executive or non-executive director.
4. 100 per cent companies disclosed information with regard to non-executive director's compensation, their attendance, number of board meetings held in a year.
5. Information about companies where board members hold positions was not disclosed at all.
6. 100 per cent of the companies disclosed information about audit committee-- its composition, meetings, participation of head of finance in audit committee meetings. However, information regarding seeking permission to take outsiders expert advice was disclosed only by 11 per cent company. This may be because

companies are not taking any expert opinion form outside and hence no permission is required and thus no disclosure.

7. Only 19 per cent of the companies disclosed information about its unlisted subsidiary companies remaining 81 per cent simply remained silent on the issue probably because they do not have any unlisted subsidiary company.
8. Shareholdings of non-executive directors were disclosed only in 37 per cent of the companies while remaining 63 per cent kept silence. This information is vital in assessing the independence of non-executive directors.
9. Good Internal control system paves way for efficient governance. Still only 40 per cent of the companies disclosed the working of internal control system prevailing in their organization while the rest 60 per cent did not disclose.

In the non-mandatory information category, following is the summary of conclusions:

1. 63 out of 71 (89 per cent) companies disclosed that they have a policy on code of conduct applicable to its management. While remaining 8 (11.2 per cent) companies did not have a policy on code of conduct applicable to management.
2. 34 per cent of the companies (24 out of 71) had a policy prohibiting insider trading while 47 companies did not frame such a policy.
3. 41 out of 71 (58 per cent) companies disclosed information about their whistle blower policy to provide safeguards against the intimidation of employees who avail of the mechanism.
4. 17 out of 71 companies did not formulate the remuneration committee. The remaining 54 companies disclosed the composition of the remuneration committee also.

5. Regarding communication of half yearly results to shareholder household, it was found that 28 out of 71 companies (29 per cent) actually sent the information. One company disclosed that it sends information on shareholders request. 42 companies did not disclose the information.
6. 47 out of 71 companies had maintained a separation between the roles played by CEO and chairman of the company.
7. Only 1 out of 71 companies, i.e. Infosys, disclosed that annual meetings for non-executive or independent directors were regularly held in the company.
8. As many as 24 companies had a system of evaluating board members performance. While 47 companies did not have such a system.
9. 33.8 per cent of the companies had a system for the training of the board members while 47.2 per cent did not have such a system.
10. 11 out of 71 companies disclosed the tenure of directors while a majority did not do so. Only one company disclosed the age limit of the directors while remaining 70 kept silent.

The most interesting aspect of the study was that not even a single company out of the 71 revealed the succession plan of the director of the board which otherwise is desirable under the annals of the corporate governance. The study goes further to analyze the correlation between corporate governance and other company attributes like disclosure, size, profitability, type of audit firm and the character of the company

- A) The correlation coefficient between corporation disclosure and corporate governance score for the year 2005-06 was 0.385, which was found to be significant at 0.01 levels. The R-value for the

“The mandatory disclosures included information on composition of board, their remuneration, audit committee, disclosures on various issues, CEO/CFO certification, corporate governance report and compliance report. The non-mandatory disclosures included a policy on code of conduct for the directors and management, declaration of half-yearly performance, remuneration committee, training of the director's evaluation system for non-executive directors and whistle blower policy.”

year 2006-07 was 0.250 which was significant at 0.05 levels. Better disclosure score is indicative of better governance, hence the positive correlation. The F-values under regression analysis too were significant at 0.01 levels for both the years. Thus, corporate disclosure enhances governance.

Good governance facilitates better corporate disclosure and vice versa is also true. As companies are becoming more aware and convinced about better governance, more and more stakeholders' related information is being made public by them. Since the board works for the best interest of all stakeholders, they are not hesitant to disclose. This statement was adequately supported by the values of Pearson correlation coefficient R in both the periods under study.

Tables 1.1 and 1.2 reveal the correlation coefficient between corporate disclosure score and corporate governance score for the year 2005-06 and 2006-07. The value of R for 2005-06 was 0.385 while the same in the year 2006-07 was 0.250. These values were found to be positive and highly significant at 99 per cent and 95 per cent level of confidence respectively. As companies are becoming more aware and convinced about better governance, more and more stakeholders' related information is being made public by them.

Table 1.1

Correlations between Corporate Disclosure and Corporate Governance 2005-06			
		Corporate Disclosure 2005-2006	Corporate Governance 2005-2006
Corporate Disclosure 2005-2006	Pearson Correlation	1	.385**
Corporate Governance 2005-2006	Pearson Correlation	.385**	1

** Correlation is significant at the 0.01 level (2-tailed).

Table 1.2

Correlations between Corporate Disclosure and Corporate Governance 2006-07			
		Corporate Governance 2006-2007	Corporate Disclosure 2006-2007
Corporate Governance 2006-2007	Pearson Correlation	1	.250*
Corporate Disclosure 2006-2007	Pearson Correlation	.250*	1

* Correlation is significant at the 0.05 level (2-tailed).

Transparency in corporate disclosures has become the important phenomenon of good corporate governance to disseminate in a prudent and crystal-clear manner all the necessary information to the users of financial statements to help them take rational decision making in order to protect their diversified interests. A transparent disclosure approach indicates a company's commitment to good corporate governance and helps to build trust with stakeholders. The study further analyses causative relation between the two using simple regression analysis. The results were as follows:-

Table 1.3

Year	Dependent Variable	Regression Coefficient		R ²	R-2	F - Value
		Constant	Independent Variable			
2005-06	Corporate Governance	43.556	0.171	0.148	0.136	0.001*
2006-07	Corporate Governance	52.031	0.117	0.063	0.049	0.035*

Simple Regression Results: Corporate Disclosure

The Table 1.3 shows the predictive power of corporate disclosure score to assess the corresponding corporate governance score. F-value of 0.001 in the year 2005-2006 and F-value of 0.035 in the year 2006-2007 were found to be highly significant at 0.01 level. 14.8 per cent and 6.3 per cent variability in the corporate governance score for the year 2005-2006 and 2006-2007 was on

account of corporate disclosure score. The results obtained above were found to be consistent with the results of the study by Kant (2004).

B) The size of a company as measured by sales and total assets was not found to be influencing the corporate governance score for both the years.

C) Extent of corporate governance and profitability of a company too were found to be independent variables as the R values were found to be insignificant at 0.05 levels.

D) Market capitalizations, EPS and DPS do not influence the corporate governance score of a

company as reflected by the results of the correlation analysis.

E) The study shows that actual governance score was not significantly associated with nature of the audit firm and character of the company either.

Recommendations:

Dr. Madam Bhasin, from Sung Kyun Kwan University, South Korea, advocates the following for improving corporate governance:

The index used in this study consists of an extensive list 147 information items – both mandatory and voluntary items. The items so included in the index are applicable to a wide range of users and are not directed to a specific user group. The items included were divided into three broad groups, viz. futuristic, contemporary and historical information.

“The items so included in the index are applicable to a wide range of users and are not directed to a specific user group. The items included were divided into three broad groups, viz. futuristic, contemporary and historical information. The futuristic information included general business outlook. Future plans, projected cash-flow statements and projected operating and financial performance of the company.”

1. Reforms of the Boards of Directors that include:

- The requirement of independent directors in the board should further be enhanced to the level of the NYSE and NASDAQ system listing rules requiring majority of the board of directors to be independent.
- The number of directorship an individual may hold should be 'restricted' so that their performance is not hampered.

- The training of the directors should be made mandatory to ensure that directors remain knowledgeable of current trends.
- The liability of the directors should be increased to better protect Investors and make them more responsible in their actions.

2. Enforcement Issues: The law enforcement should be transparent, swift and uniform to ensure credibility and utility of a framework. In India, there are three regulatory bodies namely DCA, SEBI and Stock exchanges which possess the power to prescribe and enforce the rules. This dispersion of power weakens the enforcement. So, clear-cut mandate for each regulatory body should be established.

3. Redefining India's corporate Laws- While India's corporate laws are sophisticated; they are inadequate on a number of counts. Corporate laws in India need modification in order to facilitate sound corporate



governance practices:

- Liberalizing India's capital markets to protect the interest of minority shareholders.
 - Implementing more robust bankruptcy laws
 - Expanding the legal rights of whistle blowers.
 - Increasing shareholders activism would help to prevent abuses by majority shareholders that are a cause for concern in Indian businesses. Shareholders activism will fill the void in managerial monitoring.
4. Embracing corporate governance has a philosophy – it requires evolution of a culture of social conscience. The board of directors must play a very crucial part in cultivating a positive corporate culture.■

Appendix I

CORPORATE GOVERNANCE SCORES OF THE INDIAN COMPANIES

Sl. no.	Name of the company	Corporate Governance (CG)		CG in %		Increase or decrease in CG	% Change in CG
		2005-06	2006-07	2005-06	2006-07		
1	ABB	61.00	62.00	74.39	75.61	1.00	1.64
2	Amtek autos	63.00	69.00	76.83	84.15	6.00	9.52
3	Ashok leyland	67.00	68.00	81.71	82.93	1.00	1.49
4	Asian paint	71.00	73.00	86.59	89.02	2.00	2.82
5	Aventis pharma	53.00	56.00	64.63	68.29	3.00	5.66
6	Bharat forge	64.00	66.00	78.05	80.49	2.00	3.13
7	Bharati Tele Tech	51.00	53.00	62.20	64.63	2.00	3.92
8	Biocon	61.00	63.00	74.39	76.83	2.00	3.28
9	Britannia	67.00	68.00	81.71	82.93	1.00	1.49
10	Ballarpur Industries	63.00	65.00	76.83	79.27	2.00	3.17
11	Cipla	60.00	61.00	73.17	74.39	1.00	1.67
12	Crompton Greaves	51.00	70.00	62.20	85.37	19.00	37.25
13	Cummins India	59.00	67.00	71.95	81.71	8.00	13.56
14	Castrol India	67.00	69.00	81.71	84.15	2.00	2.99
15	Dabur India	69.00	70.00	84.15	85.37	1.00	1.45
16	Essar oil	61.00	65.00	74.39	79.27	4.00	6.56
17	ElI	57.00	60.00	69.51	73.17	3.00	5.26
18	Financial technologies	63.00	65.00	76.83	79.27	2.00	3.17

19	Gammon India	58.00	62.00	70.73	75.61	4.00	6.90
20	Gillette India	72.00	75.00	87.80	91.46	3.00	4.17
21	Glaxosmithkline	63.00	70.00	76.83	85.37	7.00	11.11
22	Godrej consumer product	69.00	71.00	84.15	86.59	2.00	2.90
23	Grasim Industries	64.00	65.00	78.05	79.27	1.00	1.56
24	Gujrat Ambuja	56.00	57.00	68.29	69.51	1.00	1.79
25	HCL Infosystem	59.00	61.00	71.95	74.39	2.00	3.39
26	Hero Honda	66.00	69.00	80.49	84.15	3.00	4.55
27	HDFC	59.00	61.00	71.95	74.39	2.00	3.39
28	Hindalco Industries	69.00	70.00	84.15	85.37	1.00	1.45
29	Hindustan lever ltd.	63.00	65.00	76.83	79.27	2.00	3.17
30	Hindustan zinc ltd	48.00	55.00	58.54	67.07	7.00	14.58
31	HT media	60.00	61.00	73.17	74.39	1.00	1.67
32	ICI India	71.00	72.00	86.59	87.80	1.00	1.41
33	Infosys Technologies	69.00	70.00	84.15	85.37	1.00	1.45
34	I- Flex solutions	49.00	51.00	59.76	62.20	2.00	4.08
35	Indian hotels - Taj	67.00	68.00	81.71	82.93	1.00	1.49
36	Indian Petrochemical corp.	63.00	65.00	76.83	79.27	2.00	3.17
37	ITC ltd.	70.00	72.00	85.37	87.80	2.00	2.86
38	Jet airways	66.00	67.00	80.49	81.71	1.00	1.52
39	Jindal steel & power	63.00	68.00	76.83	82.93	5.00	7.94
40	JSW steel	67.00	71.00	81.71	86.59	4.00	5.97
41	L & T	60.00	61.00	73.17	74.39	1.00	1.67
42	Lupins limited	56.00	57.00	68.29	69.51	1.00	1.79
43	Maruti Udyog	60.00	64.00	73.17	78.05	4.00	6.67
44	Matrix labs	71.00	72.00	86.59	87.80	1.00	1.41
45	McLeod Russell	60.00	63.00	73.17	76.83	3.00	5.00
46	M & M	67.00	73.00	81.71	89.02	6.00	8.96
47	Nicholas primal India	64.00	66.00	78.05	80.49	2.00	3.13
48	Nirma	52.00	55.00	63.41	67.07	3.00	5.77
49	Nestle india	59.00	60.00	71.95	73.17	1.00	1.69
50	Pidilite Industries	64.00	70.00	78.05	85.37	6.00	9.38
51	Pantaloon retail [India]	59.00	60.00	71.95	73.17	1.00	1.69
52	Patni computer system	57.00	59.00	69.51	71.95	2.00	3.51
53	Pfizer	58.00	63.00	70.73	76.83	5.00	8.62
54	P & G Hygiene & Health Care	55.00	61.00	67.07	74.39	6.00	10.91
55	Ranbaxy	63.00	65.00	76.83	79.27	2.00	3.17
56	Raymond	68.00	69.00	82.93	84.15	1.00	1.47
57	Reliance Capital	61.00	73.00	74.39	89.02	12.00	19.67
58	Reliance Industries	67.00	71.00	81.71	86.59	4.00	5.97
59	Satyam Computer services	61.00	63.00	74.39	76.83	2.00	3.28
60	Sesa Goa	70.00	76.00	85.37	92.68	6.00	8.57
61	Siemens	67.00	69.00	81.71	84.15	2.00	2.99
62	Sun pharmaceutical	59.00	61.00	71.95	74.39	2.00	3.39
63	Tata Motors	71.00	72.00	86.59	87.80	1.00	1.41
64	Tata Power	64.00	66.00	78.05	80.49	2.00	3.13
65	Tata Steel	58.00	61.00	70.73	74.39	3.00	5.17
66	Tata Tea	68.00	71.00	82.93	86.59	3.00	4.41
67	TCS	61.00	62.00	74.39	75.61	1.00	1.64
68	Ultratech cement	65.00	68.00	79.27	82.93	3.00	4.62
69	UP Hotels Ltd.	63.00	65.00	76.83	79.27	2.00	3.17
70	WIPRO	68.00	71.00	82.93	86.59	3.00	4.41
71	Wockhardt	58.00	65.00	70.73	79.27	7.00	12.07

A to Z of Limited Liability Partnership



Limited Liability Partnership (LLP) is a body corporate formed and incorporated under the LLP Act, which is a distinct legal entity separate from that of its partners. Introducing LLPs as a new business structure would fill the gap between business firms such as sole proprietorship and partnership, which are generally unregulated and Limited Liability Companies, which are governed by the Companies Act, 1956. It will also help in the growth of services sector in India. This article provides an overview of the procedural aspects of LLP right from the incorporation to winding up.

Introduction

The concept of Limited Liability Partnership (LLP) in India is viewed as an alternative corporate business vehicle that provides the benefits of limited liability and also allows its members the flexibility of organising their internal structure as a partnership based on a mutually arrived agreement. The revised Bill received the assent of the President of India on January 7, 2009.

LLP is a body corporate formed and incorporated under the LLP Act, which is a distinct legal entity separate from that of its partners. Introducing LLPs as a new business structure would fill the gap between business firms such

as sole proprietorship and partnership, which are generally unregulated and Limited Liability Companies, which are governed by the Companies Act, 1956. It will also help in the growth of services sector in India. Further, the provisions of the Indian Partnership Act, 1932 shall not apply to a limited liability partnership.

Salient Features

The salient features of the act are as follows:

1. LLP can be formed by any two or more person, associated for carrying on a lawful business, by subscribing their names to incorporation document.



CA. Rajat Mohan

(The author is a member of the Institute. He can be reached at rajat.mohan@icai.org)

2. The rights and duties of LLP and its partners shall be governed by an agreement between partners or between LLP and the partners.
3. The LLP will be a separate legal entity, liable of its assets, with liability of the partners being limited to their agreed contribution in the LLP.
4. Every LLP shall have at least two partners and shall also have at least two individuals as Designated Partners, of whom at least one shall be resident in India.
5. The LLP shall be under an obligation to maintain annual accounts reflecting true and fair view of its state of affairs.
6. A firm, private company or an unlisted company is allowed to convert itself into LLP.
7. The act provides for the winding up of LLP which may be either voluntary or by the tribunal.
8. The provisions of the Indian Partnership Act, 1932 are not applicable to LLP.

“A partner is not personally liable; directly or indirectly for an obligation, solely by reason of being a partner of the limited liability partnership. However, the personal liability of a partner shall not be affected for his own wrongful act or omission, but a partner shall not be personally liable for the wrongful act or omission of any other partner of the LLP. If in case any act being carried out be LLP or any partner with intention to defraud creditors or any other person or for any fraudulent purpose, the liability in such cases shall be unlimited for all or any other debts or other liabilities of the LLP.”

Incorporation of LLP

The procedure for incorporation of LLP is same as that of Incorporation of a Company, which is given below:

(i). Registration of User

In order to access the relevant official website (www.11p.gov.in) every user needs to be registered with the site by filling an online form

1. Register yourself on the website of LLP, i.e. www.11p.gov.in by clicking on “Register” tab on top right hand corner of the page.
2. Also upload your digital signature certificate.

(ii). Obtaining Designated Partner Identification Number

Every Designated partner of the proposed LLP shall obtain “Designated Partner Identification Number (DPIN), by filing Form 7 online.

1. Individual Designated Partner shall Log into their account by entering user name and password. After this, open Form 7 Form E-forms and fill the required information.
2. Submit the application form online after Paying filing fee of ₹100 online. Note the provisional DPIN generated by the system.
3. Take the print-out of the application form, affix a latest passport size photograph and get it attested/certified for submission physically, along with documentary evidences (proof of identify and proof of residence).
4. Deliver the printed and signed application form, along with the prescribed documents by hand/ courier/registered post to the Office of Registrar, Ministry of Corporate Affairs, 3rd Floor, “Paryavaran Bhawan”, CGO Complex, Lodhi Road, New Delhi – 110003.

(iii). Reserve name of proposed LLP

Name of Proposed LLP may be

reserved by any Partner/Designated Partner by filing Form 1.

- Individual Designated Partner of Partner shall log into their account by entering user name and password. After this, open Form 1 from E-forms and fill in the details. Details of minimum two designated partners of the proposed LLP, one of them must be a resident of India, is required to be filled in the application for reservation of name. Only individuals or nominees on behalf of the bodies corporate as partners can act as designated partners.
- Select name of the proposed LLP (max. 6 choices can be indicated).
- Attach Digital signatures, pay the necessary fee online and submit the e-form on LLP Portal.

(iv). Incorporation of LLP

This is the last step of incorporating a LLP, where Form-2 is required to be filed with registrar along with necessary documents.

1. After the name is reserved by the Registrar, log on to the portal and fill up Form 2 “Incorporation Document and Statement”.
2. Pay the prescribed fee for registration as specified under ‘Annexure A’ of the LLP Rules, 2009.
3. Statement in the e-form is to be digitally signed by a person named in the incorporation document as a designated partner having permanent DPIN and also to be digitally signed by an advocate/ company secretary/chartered accountant/cost accountant in practice and engaged in the formation of LLP.
4. Following documents are required to be filed along with Form 2:
 - Copy of authorisation where the partner is a limited liability partnership, or company, or a limited liability partnership

incorporated outside India or a company incorporated outside India.

- Proof of address of registered office of limited liability partnership.
 - Details in respect of names of partners/witnesses and their signatures.
 - Any other document as specified in the form.
5. Registrar will register the LLP, within 14 days of filing of Form 2 and a certificate of incorporation will be issued to LLP in Form 16.

(v). Filing of other information

Following documents are required to be filed within 30 Days of incorporation of LLP or these may also be filed simultaneously at the time of filing Form 2.

- Form 3 – Details of LLP agreement
- Form 4 – Notice of Appointment of Partner/Designate Partner.

Eligibility to be a Partner

Any person may become a partner by and in accordance with the limited liability partnership agreement and he may also cease to be a partner in accordance with limited liability partnership agreement.

Extent and Limitation of Liability of Partners

A partner is not personally liable; directly or indirectly for an obligation, solely by reason of being a partner of the limited liability partnership. However, the personal liability of a partner shall not be affected for his own wrongful act or omission, but a partner shall not be personally liable for the wrongful act or omission of any other partner of the LLP.

If in case any act being carried out be LLP or any partner with intention to defraud creditors or any other person or for any fraudulent purpose, the liability

in such cases shall be unlimited for all or any other debts or other liabilities of the LLP. In case any such act is carried out by a partner, then his liability shall be unlimited and also liability of LLP be unlimited unless it is established by the limited liability partnership that such act was without the knowledge or the authority of the limited liability partnership. However, a partner shall not be personally liable for the wrongful act or omission of any other partner of the LLP.

Every person who is knowingly a party to any such act shall be punishable with an imprisonment for a term which may extend to two years and with fine which shall not be less than fifty thousand rupees but which may extend to ₹5 lakh.

Designated Partners

Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India. In case all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.

Every designated partner of a limited liability partnership shall obtain

a Designated Partner Identification Number (DPIN).

A designated partner shall be liable to all penalties imposed on the limited liability partnership for any contravention of the provisions of the act.

Books of Accounts

Every limited liability partnership shall keep books of accounts which shall contain:

1. particulars of all sums of money received and expended by the limited liability partnership and the matters in respect of which the receipt and expenditure takes place;
2. a record of the assets and liabilities of the limited liability partnership;
3. statements of cost of goods purchased, inventories, work-in-progress, finished goods and cost of goods sold; and

Such books of accounts shall be preserved for eight years.

Every LLP shall file the Statement of Accounts and Solvency in Form-8 with the Registrar, within a period of thirty days from the end of six months of the financial year.

Audit

Every limited liability partnership shall be required to get its accounts audited. However a limited liability partnership whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed ₹25 lakh shall not be required to get its accounts audited. Audit can be assigned only to a Chartered Accountant in practice.

Annual Return

Every limited liability partnership shall file and annual return with the Registrar in Form 11 within 60 days of closure of its financial year. The annual return of an LLP having turnover upto ₹5 crore during the corresponding financial year or contribution upto ₹50 lakh

“ Every limited liability partnership shall be required to get its accounts audited. However a limited liability partnership whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty-five lakh rupees shall not be required to get its accounts audited. Audit can be assigned only to a Chartered Accountant in practice. ”

shall be accompanied with a certificate from a designated partner (other than the signatory to the annual return), to the effect the annual return contains true and correct information. In all other cases, the annual return shall be accompanied with a certificate from a Company Secretary in practice to the effect that he has verified the particulars from the books and records of the limited liability partnership and found them to be true and correct.

Conversion From Firm into LLP

A firm can be converted into LLP. Upon such conversion, the partnership firm shall be deemed to dissolved and all the assets and liabilities of the firm shall be transferred to, and vest with LLP.

Conversion can be carried out by the following procedure:

1. Obtain DPIN
2. Reserve name of proposed LLP
3. Apply to Registrar in Form 17 online duly signed by proposed Designated Partner. This application should also be verified by a Practicing Company Secretary. Following documents shall be attached with this Form:
 - a. Consent of each of the partner of the firm.
 - b. Duly filled in Form 2, 3 and 4.
 - c. No Objection Certificate from Tax authorities.
 - d. In case of Professional Firms, approval from governing Council of relevant body.
 - e. Consent of Creditors.

The ROC may register the firm as an LLP and issue Certification of registration in Form 19, provided all the partners of the firm become partners of LLP. The new LLP so formed is required to inform within 15 days of the date of registration, to the concerned Registrar of Firms with which it was registered under the provisions of the Indian Partnership Act, 1932 about the conversion and particulars of the

A Private Company/ Unlisted Public Company ("Co.") can be converted into LLP. Upon such conversion the company shall be deemed to be dissolved and all the assets and liabilities of the company shall be transferred to, and vest with LLP. Conversion can be carried out in three steps: (a) Obtain DPIN (b) Reserve name of proposed LLP, and (c) Apply to Registrar in Form 18 online duly signed by proposed Designated Partner. This application should also be verified by a Practicing Company Secretary.

limited liability partnership shall also be required to be submitted in Form-14.

The LLP shall ensure that within a period of twelve months commencing not later than 14 days after the date of registration, every official correspondence of the LLP bears a statement that it has, as from the date of registration, been converted from a firm into a LLP and the name of registration number, of the firm from which it was converted.

Conversion from Private Company/Unlisted Public Company into LLP

A Private Company/Unlisted Public Company ("Co.") can be converted into LLP. Upon such conversion the company shall be deemed to be dissolved and all the assets and liabilities of the company shall be transferred to, and vest with LLP. Conversion can be carried out by the following procedure:

1. Obtain DPIN
2. Reserve name of proposed LLP
3. Apply to Registrar in Form 18

online duly signed by proposed Designated Partner. This application should also be verified by a Practicing Company Secretary.

Following documents shall be attached with this Form:

- a) Consent of each shareholder of the Co.
- b) Duly filled in Form 2, 3 and 4.
- c) No. Objection Certificate from Tax authorities.
- d) In case of Professional Firms, approval from governing Council of relevant body.
- e) Consent of Creditors.

The ROC may register the company as an LLP and issue Certificate of registration in Form 19, provided all the members of the company become partners of LLP. The new LLP so formed is required to inform within 15 days of the date of registration, to the concerned Registrar of Companies with which it was registered under the provisions of the Companies Act, 1956 about the conversion and particulars of the limited liability partnership shall also be required to be submitted in Form 14.

The LLP shall ensure that within a period of twelve months commencing not later than 14 days after the date of registration, every official correspondence of the LLP bears a statement that it, as from the date of registration, has been converted from a company into a LLP and the name and registration number, of the company from which it was converted.

Winding up and Dissolution of LLP

The Act provides for voluntary winding up of LLP or circumstances under which the winding up proceedings can be initiated by the tribunal. The Central Government is also empowered under the act to make rules for the provisions in relation to winding up and dissolution of LLP. ■

New Competition Regime in India and the WTO— Opportunities for Chartered Accountants



The importance of professional services in a globally competitive milieu and the impact of competition regime on professional services cannot be over emphasised. During the interaction between the High Level Committee on Competition Policy and Law¹ and the Professional Institutes, Chambers of Commerce and the Bar Associations, the need for an appropriate strategy for enhancing the competitiveness of the professional services in the global context was stressed almost unanimously. The sole attributable factor for this stress is the coming into being of the World Trade Organisation (WTO) Agreement known as General Agreement on Trade in Services (GATS). This article addresses the opportunities for Chartered Accountants in the New Competition Regime in India and in the context of India having become a Member of the WTO.



Dr. S. Chakravarthy

(The author is IAS (rtd) and a former member of Monopolies and Restrictive Trade Practices Commission. He can be reached at chakravarthy38@gmail.com)

General Agreement on Trade in Services (GATS) is the first ever set of multilateral, legally-enforceable rules covering International Trade in Services. It was negotiated in the Uruguay Round discussions, when the WTO came into being. The Agreement incorporates the principles of "Most Favoured Nation" status and "National Treatment" and deals with market reforms, with a view to removing all barriers to trade in services. It further deals with specific subjects like Financial Services, Transport, Telecommunications and Natural Persons.

In terms of GATS, four different modes of supply govern a

comprehensive definition of trade in services. The four modes are:

Mode 1: Cross-border supply of services - under this mode, the service crosses the sovereign national barriers much like the international trade in goods (eg. international telephone calls)

Mode 2: Consumption abroad - this involves the supply of a service in the territory of one member country to the service consumer of another member country (eg. tourism or a student joining an educational institute abroad)

Mode 3: Commercial presence - under this mode, the supply of a service is rendered through the commercial

¹ High Level Committee (2000): Report of 'The High Level Committee on Competition Policy and Law' – Dept. of Company Affairs, Govt. of India, New Delhi, 2000.

“The demand for professional services is a derived demand.

Accounting services and in particular, Chartered Accountancy services, for instance, originate in the requirement of a client to meet either statutory requirements or Management needs. The current trend shows that the dominant mode of supply for such services is through commercial presence (mode 3).”

presence of a foreign supplier in the territory of a Member country (eg. establishing branch offices to deliver services such as banking, legal advice or communications)

Mode 4: Movement of natural persons - temporary movement of natural persons falls under this mode. In this category, the provider of the service crosses the border (eg. consultants)

Eleven basic service sectors plus a twelfth category for miscellaneous services constitute the classification of services in GATS. This is based on the United Nations Central Product Classification system. One of the twelve services recognised is designated as business services which include professional and computer services. India has great interest in professional and computer services, as it has a large reservoir of highly skilled and experienced professionals like Lawyers, Chartered Accountants, Cost Accountants, Company Secretaries and Computer and Electronics based Scientists/Technicians, Information Technology/Communications Scientists/Technicians, Engineers, Doctors, etc, (there are other categories of professionals and non-mention of

them does not mean any reflection on their importance for the country or global competition).

India's Competitiveness

The demand for professional services is a derived demand. Accounting services and in particular, Chartered Accountancy services, for instance, originate in the requirement of a client to meet either statutory requirements or Management needs. The current trend shows that dominant mode of supply for such services is through commercial presence (mode 3). and engagement through international networks.

The next and most important mode is movement of natural persons (mode 4). Inconclusive negotiations in the Uruguay Round in 1994 primarily focused on securing commitments to allow a larger movement of individual qualified professionals. This category is regarded by many countries, particularly, the developing countries to include many categories of professionally qualified persons and of skilled persons like construction workers, etc.

India's competitiveness lies more in services rather than in the manufacturing sector. It has a distinct

advantage in terms of the second largest English speaking skilled (technically) population after the US. India has a large reservoir of technically skilled population for all levels and sectors. Needless to add, that this advantage needs to be and is sought to be exploited via GATS negotiations on professional services in present and in future. India's competition policy and competition law need to be in the perspective that sub-serves the above mentioned advantage the country is enjoying, in terms of its professionals and skilled persons.

LPG and Professions

With Liberalisation, Privatisation and Globalisation (LPG) emerging gradually in all economic activities, the professions have become more than ever before, important, if not critical for their survival and growth. Financial lending decisions, mergers and acquisitions, privatisation of state-owned enterprises, valuation of public assets, stock market developments, issues relating to Foreign Direct Investment and the like require professionals in the areas of Accountancy, Law, and Finance. Those operating in multi-national environment desire integrated solutions to support decision-making. Electronic commerce



is opening up entirely new areas, which requires a high degree of interaction between Accountants and software professionals.

Barriers to Movement of Persons under Mode 4

Developing countries and in particular, India, are generally interested in mode 4 supply under GATS. Mode 4 is of particular interest to India, which has impelled its negotiators at the WTO discussions to make a demand of the developed countries for higher commitments of movement of natural persons, particularly professionals. Developing countries have been experiencing barriers to the movement of natural persons, created by developed countries through one or more of the following:

- Additional tariff/tax on the nationals of foreign countries that do not apply to one's own nationals.
- Other regulatory restrictions on the nationals of foreign countries.
- Quantitative limits of temporary movement of natural persons (eg. H 1B visas).
- Fees/charges applicable for providing social security net to temporary movement of natural persons.
- Non-tariff barriers on the movement of natural persons.

The competition policy and/or competition law should be appropriately formulated/drafted to deal with such anti-competitive practices constituted by the aforesaid barriers to movement of natural persons.

Professions in India

This article applies to all professions. Nonetheless, in order to provide an analysis of the impact of competition on professional services, the professions of Accountancy and Law have been chosen. *Mutatis mutandis*, the analysis and suggestions can apply to almost every other profession.

Accountancy is a profession, which has a direct bearing and interaction for most economic activities. With the WTO regime in place, there is an imperative need for an appropriate strategy for enhancing the competitiveness of the Indian professional Accountancy services in the global context. While a need for such a strategy cannot be over-emphasised, the presence and implications of GATS impel a sense of urgency for the strategy.

The Accountancy sector is regulated in India through a combination of both law and professional self-regulation. The Chartered Accountants Act, 1949 governs the profession of Chartered Accountancy in the country. Likewise, the Cost and Works Accountants Act, 1959 governs the profession of Cost Accountancy. The Advocates Act, 1961 governs the profession of lawyers. The Chartered Accountants Act, 1949 and the regulations thereunder impose certain restrictions in forming partnership firms. There are restrictions on the trade name having a nexus with individual or group of individuals (abstract names are not allowed), on the number of partners (restricted to twenty) and on the number of statutory audits of companies (not more than twenty per partner). (As per the extant

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Partnership Act) this reciprocity factor is grounded on National honour, professional self-respect and the desire of the Institute to use it as a bargaining chip.

The regulations under the Chartered Accountants Act, 1949 allow an accountant to advertise in a manner as per (ICAI guidelines); there are restrictions on soliciting custom, paying commission, brokerage or share of profits to anybody other than another accountant actively engaged in bilateral and multilateral dialogue for recognition of its qualifications and currently has bilateral arrangement with leading accounting bodies i.e. UK, Australia, Ireland and it is gathered that active engagement with many others is on.

The legislative restrictions abroad have the combined effect of denying opportunities and growth to professional firms, restricting their desire and ability to compete globally, preventing the country from obtaining the advantage of India's considerable human expertise and precluding consumers from the opportunity of free and informed choice. Multilaterally there should be move to ease out a local regulatory architecture. Domestically, many structural changes are in the offing like LLP, which once fully operational would pave way for a broader role by the accounting firms.

It is in this context, when existing barriers based on citizenship or nationality are increasingly becoming irrelevant, that it is necessary to promote competitive quality in Accountancy services and full accountability therefore on the part of the Accountants. It is desirable to promote large partnerships of Accountants to enable them to be globally competitive in efficiency and quality of services rendered. Very few firms in India provide what is called the “single window services” which means providing not only Accountancy but also legal, financial and other advice to

their clients. Rules as in Limited Liability Partnership should provide for multi-disciplinary partnerships (Lawyers, Accountants and other professionals), which would permit delivery of composite services, as desired by the clients.

If the Accountancy profession desires to grow and serve in foreign soil, freedom of movement must be built into the competition policy. Unnecessary barriers will have to be removed to facilitate professional development and improvement in the quality of services besides building an environment for easy movement of accountant professionals outside the country. It also remains a fact that Preamble to GATS recognizes the right of members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives.

The profession of lawyers is governed by the Advocates Act, 1961. Like the Accountancy profession, the Lawyer profession is governed by the said statute and self-regulation stipulations. If the Indian legal system has to integrate internationally, an appropriate regulatory system must be in place, which ensures that,

- a) there is a general reciprocity of rights and non-discrimination,
- b) foreign lawyers/firms are subject to the same disciplinary jurisdiction as Indian lawyers,
- c) there are greater opportunities for the future development of the legal profession in India, and
- d) Indian law professionals can move abroad for rendering legal services.

Having listed the restrictions on professionals, which limit competition and their growth, it has to be mentioned that this should not be construed that all regulations must be removed. Regulations are necessary with regard

“ In the new competition regime, consequent on the enactment and enforcement of the Competition Act, 2002, the Chartered Accountants have a great opportunity before the Competition Commission of India to represent the parties to the cases coming up before it. In other words, Chartered Accountants can appear before the Competition Commission of India on behalf of complainants, defendants or the Director General. ”

to professional qualifications on the basis of which such services can be rendered. The professional bodies need to regulate the qualifications and need to discipline the conduct of the members who are rendering professional services. Equally legitimate is the regulation, which precludes attempts at blatant advertising. Likewise, setting accounting standards and performance practices is a legitimate regulation. But those regulations which disallow normal promotional activity, which deny the consumers the benefit of full unrestricted and informed profile about professional firms and deny the consumers of the choice of firms should have no place.

Competition Law and Chartered Accountants

The new Indian Competition Law, namely, Competition Act, 2002 (amended in 2007) has rightly provided an excellent window for the profession of Chartered Accountants. It declares in Section 35 thereof that,

“A complainant or defendant or the Director General may either appear in person or authorise one or more chartered accountants or company

secretaries or cost accountants or legal practitioners or any of his or its officers to present his or its case before the Commission.

Explanation.—For the purposes of this section,—

- (a) “chartered accountant” means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (b) “company secretary” means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 (56 of 1980) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (c) “cost accountant” means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (d) “legal practitioner” means an advocate, vakil or an attorney of any High Court, and includes a pleader in practice”.

In the new competition regime, consequent on the enactment and enforcement of the Competition Act, 2002, the Chartered Accountants have a great opportunity before the Competition Commission of India to represent the parties to the cases coming up before it. In other words, Chartered Accountants can appear before the Competition Commission of India on behalf of complainants, defendants or the Director General. In order to so represent, the Chartered Accountants need to brace themselves

on the features and provisions of Competition Act, 2002 with particular reference to anti-competitive practices, abuse of dominance, mergers, amalgamation, acquisitions and acquisitions of control. To put it in another way, Chartered Accountants will have to practice 'out of the box' of Chartered Accountants and equip themselves with knowledge and information about the competition law, its rules and regulations. This implies that Chartered Accountants anchoring their profession in Chartered Accountancy will have to go for a reinforcing anchor in competition law. This is likely to propel Chartered Accountant professionals to diversification and greater heights.

Desirability or Otherwise of Allowing Foreign Accountants

A question that troubles the policy makers and thinkers in the Government and also the Institute of Chartered Accountants of India (ICAI) is whether Foreign Accountants and Foreign Accountant firms should be allowed free play in our country in terms of GATS and the competent reciprocal

“A question that troubles the policy makers and thinkers in the Government and also the Institute of Chartered Accountants of India (ICAI) is whether Foreign Accountants and Foreign Accountant firms should be allowed free play in our country in terms of GATS and the competent reciprocal facility of Indian Accountants and Indian Accountant firms entering the global field without hindrance. A Paper published in 2003 calls for a strategy for the Indian Chartered Accountants community.”

facility of Indian Accountants and Indian Accountant firms entering the global field without hindrance. A Paper published in 2003 calls for a strategy for the Indian Chartered Accountants community. The roadmap for the strategy as suggested in the White Paper includes:

- Organising and sensitising themselves that their collective interest has been impaired with the entry and occupation of the Indian consultancy market by the Multinational Accounting Firms (MAFs) and their infiltration into the audit and attestation segment in the Indian accounting sector because of the policies followed hitherto and also because of GATS,
- Articulating boldly that market reforms framed by the interest groups in the West should not be implemented as such, unless a level playing field is created for developing countries vis-a-vis the developed countries,
- Reorienting the thinking that the Indian Chartered Accountants are not merely employees & SMPs but entrepreneurs and employers as quality of professional work has no relation to size of firm
- Enlisting the support of different stake holders in the Indian economy to expose the practice of funding agencies and institutions like the World Bank and IMF of imposing auditing firms nominated by them on Indian corporates, and
- Networking with other professional firms like lawyers, consultancy firms, etc., to offer one stop service which aspect the LLP provisions are perceptibly going to address.

The Paper has commended a goal called “India First”. This mantra should not be construed to mean Indian Chartered Accountants to the exclusion of the Foreign Accountants. On the other hand, the mantra should be so construed to mean the interest



of Indian Chartered Accountants in the global context which would imply the imperative need for a level playing field for the Indian professionals vis-a-vis the foreign professionals abroad.

Conclusion

1. The statutes governing professions need to be amended to be GATS compatible.
2. A positive approach is necessary on the part of the Government and the professional institutes/bodies to ensure that the Indian professionals and firms grow to become globally competitive.
3. Professions enjoy certain monopoly rights of practice in their designated fields and the bodies administering the professions enjoy considerable autonomy in their administration. These monopoly rights and autonomy should be channelised for regulating quality of the professions, the standards of entry and discipline and accepted norms of performance. They should not be used to limit competition.
4. Professional bodies should channelise their rights of autonomy to counter the normal challenges of global integration. It is illogical to have a totally protected profession in an environment of global industrial integration. ■

Private Equity and Valuation



Private equity is a distinctive investment strategy with a buy-to-sell orientation. Private equity fund investors typically expect their money returned, with a handsome profit, within 10 years of committing their funds. Private equity investments in the portfolio companies need more careful analysis because, in most private equity transactions (involving high level of risk), there is no direct market evidence on the valuation of the company being acquired. The article throws light on various private equity structures and valuation issues of portfolio companies from the perspective of private equity fund.



CA. Nikhil Bagrodia

(The author is a member of the Institute. He can be contacted at eboard@icai.in.)

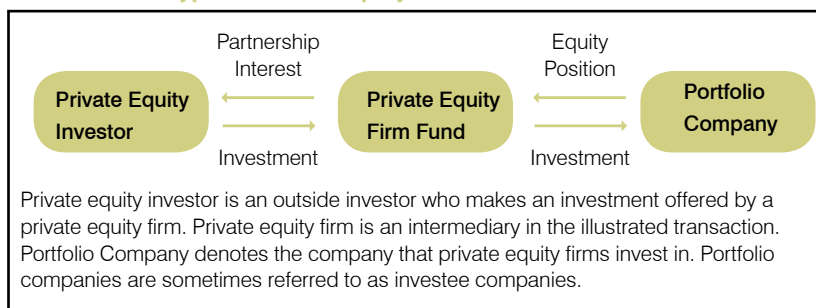
1. What is Private Equity?

Private equity is playing a great role in today's global economy. In the last decade, it has grown from a small, niche activity to a critical component of the financial system. Along with a huge amount of equity investment, private equity deals and employs significant amount of debt and, so, the value of the transactions involving private equity funds is often two to three times the actual equity raised. Until recently, few people even knew the names of main private equity players. But, now organizations like Blackstone, Kohlberg Kravis Roberts, and Texas Pacific Group are recognized as major players in global financial system. Private equity firms make investments

ranging from those in the less mature venture capital firms to those in the more mature buyout transactions.

One distinctive characteristic of private equity investment is a buy-to-sell orientation. Private equity fund investors typically expect their money returned with a handsome profit within 10 years of committing their funds. The economic incentives of the funds are aligned with this goal. Most of the money for the private equity fund comes from institutional investors such as insurance companies, pension funds and endowments, although many HNIs also invest directly or through fund-of-fund intermediaries who provide their investors with a more diversified portfolio of investments.

Structure of a Typical Private Equity Investment Transaction



The private equity class stretches from venture capital (VC) – working in early stage companies that in many cases have no revenues but have potentially good ideas or technology – all

the way to the large buyouts (leveraged buyouts or LBO) in which the private equity firm buys the entire company. In some cases, these companies might themselves be quoted on the

stock market, and a private equity fund performs public-to-private transaction thereby removing the entire company from the stock market. But in majority of cases, buyout transactions will

involve privately owned companies, and very often, a particular division of an existing company. There are many other forms of later-stage financing, e.g. providing capital to

back the expansion of existing businesses, but, for this reading, we would refer simply to venture capital and buyouts as the major forms of private equity:

Broad Category	Subcategory	Brief Description
Venture Capital	Seed stage	Financing provided to research business ideas, develop prototype products or conduct market research.
	Start-up stage	Financing to recently created companies with well articulated business and market plans.
	Expansion stage	Financing to companies that have started their selling effort and may be already breaking even. Financing may serve to expand production capacity, product development, or provide working capital.
	Replacement capital	Financing provided to purchase shares from existing venture capital investors or to reduce financial leverage.
Buyout	Acquisition capital	Financing in the form of debt, equity or quasi-equity provided to a company to acquire another company.
	Leverage buyout	Financing provided by an LBO firm to acquire a company.
	Management buyout	Financing provided to the management to acquire a company, specific product-line or division (carve-out)
Special situations	Mezzanine finance	Financing generally provided in the form of subordinated debt and equity kicker (warrants, equity, etc)
	Distressed securities	Financing of companies in need of restructuring or facing financial distress.
	One-time opportunities	Financing in relation to changing industry trends and new government regulations.
	Others	Other forms of private equity financing are also possible.

1.1 Classifications of Private Equity in terms of Stage and Type of Financial of Portfolio Companies

Private equity funds may also be classified depending upon their geographical locations, e.g. regional, national or global, and/or sector focuses, e.g. diversified industrial, telecommunication, healthcare, infrastructure, etc.

1.2 Value Creation in Private Equity

The question of how private equity funds actually create value has been much debated inside and outside the private equity industry. The survival of the private equity governance

model depends on some economic advantages it may have over the public equity governance model. These potential advantages can be broadly classified as:

1.2.1 Ability to reengineer the private firm to generate superior returns

In order to reengineer their portfolio companies, many private equity firms have developed in-house high-end consulting capabilities supported frequently by seasoned industry veterans, e.g. CEOs, CFOs and senior advisors, and have a proven ability to execute deals on a global basis. Assuming private equity houses

have a superior ability to reengineer companies would mean that public companies have inherently less ability to conduct reengineering or organizational changes relative to corporations held by private equity. However, many public companies have established long track record of creating value. Thus, only a part of value additions created by private equity houses may be explained by superior reorganization and reengineering capabilities.

1.2.2 Ability to access credit markets on more advantageous terms

Ample availability of credit at

favourable terms, e.g. low credit spreads and few covenants, led in 2006 and the early half of 2007 to a significant increase in leverage available to buyout transactions. In a private equity firm, debt is more heavily utilised and is quoted as a multiple of EBITDA (earnings before interest, taxes, depreciation and amortization) as opposed to multiple of equity, as for public firms.

When considering the impact of leverage on value, we would normally turn to one of the foundations of modern finance: the Modigliani-Miller theorem which states that, in absence of taxes, asymmetric information, bankruptcy costs and assuming efficient markets, value of the firm is not affected by how the firm is financed, whether by equity or debt. However, relaxing the assumption of 'no taxes' from their model, interest tax shield on the acquisition of debt would create a firm value. One would also expect that the financial leverage of a firm would be set at a level where the bankruptcy costs do not outweigh these tax benefits. Unlike public companies, private equity firms may have a better ability to raise higher levels of debt not only as a result of a better control over management, but also as a result of their reputation for having raised and repaid, such high levels of debts in the previous transactions.

Such debt financing is raised initially from the syndicated loan market, but, then, is frequently repackaged via sophisticated structured products,



e.g. collateralized loan obligations (CLOs) which consist of a portfolio of leveraged loans. In some cases, the private equity fund issues high-yield bonds as a way of financing the portfolio company, and these often are sold to funds that create collateralized debt obligations (CDOs). These transactions have resulted in a large transfer of risk to the credit markets. However, the markets have recently slowed, creating less availability of financing of large buyouts.

1.2.3 Superior alignment of interest between managers of the firm they control and private equity firm owners.

Another important factor that significantly explains the returns earned by private equity funds is the alignment of economic interest between private equity owners and the managers of the company they control, which can crystallize management efforts to achieve ambitious milestones set by private equity owners. Result-driven management pay packages along with various contractual clauses ensure that managers receive proper incentives to reach their targets and that they will not be left behind after the private equity house exits their investment. The following are some of the examples of contract terms contained in the term sheet that specifies the terms of the private equity firm's investment:

- **Compensation:** Compensations contract for the managers of the portfolio companies contains clauses that are closely linked to long-term goals and firm's performance.
- **Tag along, drag along clauses:** These are contractual provisions in the share purchase agreements that ensure any potential future acquirer of the company may not acquire control without extending an acquisition offer to all shareholders, including the management of the

company. Such clauses ensure management's loyalty to their firm.

- **Board representation:** Corporate board seats ensure private equity control in case of major corporate events, e.g. company sale, takeover, restructuring, IPO, bankruptcy or liquidation.
- **Non-compete clause:** Company founders must sign such clauses that prevent them from competing against the firm within a prescribed period of time.
- **Preferred dividends and liquidation preference:** Private equity firms generally receive their distribution before other owners often in the form of preferred dividends and sometimes may be guaranteed a minimum multiple of their original investment. They also have priority in the firm's assets, if the portfolio company is liquidated.
- **Reserved matters:** Domains of strategic importance, e.g. changes in business plans, acquisition or divestiture, are subject to approval or veto by the private equity firm.
- **Earn outs (mostly in venture capital):** These are mechanisms linking the acquisition price paid by the private equity firm to the portfolio company's future performance over a predetermined time horizon, generally not exceeding 2 to 3 years.

By specifying the appropriate control mechanism, venture capitals

“The private equity class stretches from venture capital (VC) – working in early stage companies that in many cases have no revenues but have potentially good ideas or technology – all the way to the large buyouts (leveraged buyouts or LBO) in which the private equity firm buys the entire company.”

“When considering the impact of leverage on value, we would normally turn to one of the foundations of modern finance: the Modigliani-Miller theorem which states that, in absence of taxes, asymmetric information, bankruptcy costs and assuming efficient markets, value of the firm is not affected by how the firm is financed, whether by equity or debt.”



make investments in companies of considerable risk. In particular, it may allow the private equity firms to significantly increase their control over time and even seize control in case the company fails to achieve the agreed goals.

2. General Valuation Issues for Private Equity

Public firms are bought and sold on regulated exchanges daily. Private firms, however, are bought by buyers with specific interests at specific points in time with each potential buyer possibly having a different valuation for the firm. Furthermore, valuing a private firm is more difficult than valuing a public firm, because private equity firms often transform and re engineer the portfolio company such that the future cash flow estimates are difficult to obtain.

There can be two perspectives of valuing private equity investments:

1. Perspective of a private equity

firm that is evaluating potential investments. Evaluation of potential acquisition by a private equity firm is particularly complex, because, in most cases except for public-to-private transactions, there will be no market prices to refer to. Private equity firms can face considerable challenges in valuing these companies and this reading discusses main ways in which valuation is approached.

2. Perspective of the outside investor who is looking at the costs and risks of investing in a fund sponsored by the private equity firm.

3. Perspective of a Private Equity Firm – using market data in valuation

In most private equity transactions with the exception of public-to-private, there is no direct market evidence on the valuation of the company being acquired. But, virtually all valuation techniques employ evidence from the market at differing stages in the calculation rather than relying entirely on accounting data and management forecasts. The two most important ways in which market data are used to infer the value of the entity being acquired are by analyzing the comparable companies that are quoted on public market and valuations implied by recent transactions involving similar entities. Typically, these techniques focus on trading or acquisition multiples that exist on public markets or in recent transactions. For instance, valuation is sought in food sector for a retail chain, which is currently a privately owned company; the comparison company approach would look at trading multiples, e.g. enterprise value to EBITDA, of comparable public companies and use this multiple to value the target. Similarly, if there are recent M&A transactions in the food retail sector, the transactions multiple paid could be used to inform the

current market value of the target. However, it is important to make sure that the comparisons are appropriate and this is not always possible especially in businesses that operate in niche sectors or that are pioneering in terms of their products or services.

The use of market data is also important in the DCF approaches, particularly in estimating an appropriate discount rate. Cost of capital of private companies is estimated generally using the same weighted average cost of capital (WACC) formula used for private companies. A serious challenge, however, in a private equity setting is the lack of public historical data on share prices and returns. Therefore, the beta that represents relative exposure of the company share to the market must be estimated by means of a proxy. This is performed typically by estimating beta for comparable companies and, then, by adjusting for financial and operating leverage.

3.1 Valuation Issues in Buyout Transactions

A buyout is a form of private equity transaction in which the buyer acquires from the seller a controlling stake in the equity capital of the target company. It comprises a wide range of techniques including but not limited to management buyouts (MBOs), leveraged buyouts (LBOs), or, takeovers. Our focus in this reading would be LBOs that consists of acquisition of a company using borrowed money to finance a significant portion of the acquisition.

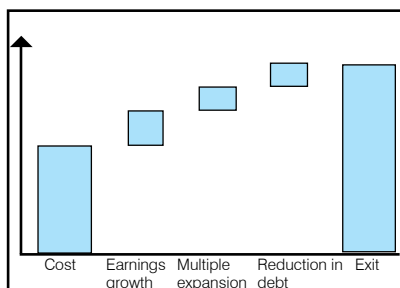
3.1.1 LBO Model

The LBO model is not a separate valuation technique but rather a way of determining the impact of the capital structure, purchase price and various other parameters on the returns expected by the private equity fund from the deal. The objective is not to value the

firm but to determine the maximum price in negotiation that the private equity firm should pay for its stake.

The LBO model has three main inputs: target firm's forecasted cash flows, expected return from the providers of financing, e.g. equity, senior debts, high-yield bonds, etc., and the amount of financing available for the transaction. The free cash flow forecasts are provided by the management of the target company and are subject to an extensive due diligence process (strategic, commercial, legal and environmental) to determine the reliability of such forecasts. The exit date, i.e. when the target firm is sold, is evaluated at different dates to determine its influence on the projected returns. The value of the firm at that time is forecast using a relative value of market approach.

3.1.2 Value Creation Chart in a Leverage Buyout (LBOs)



On the basis of the input parameters, LBO model provides the maximum price that can be paid to the sellers while satisfying the target returns for the providers of financing. Value creation comes from a combination of factors: earning growth arising from operational improvements and enhanced corporate governance; multiple expansions depending upon pre-identified potential exits and optimal financial leverage and repayment of part of the debt with operational cash flows before the exit.

3.2 Valuation Issues in Venture Capital Investments – The Venture Capital Method

In venture capital, pre-money valuation and post-money valuation are the two fundamental concepts. Pre-money valuation (PRE), refer to the agreed value of a company prior to a round of financing or investment. Post-money valuation (POST) is the value of the company after the financing or investing round. Therefore, the post-money valuation of the firm will be:

$$\text{PRE} + \text{Investment} = \text{POST}$$

The proportionate ownership of the venture capital investment is determined by: $\frac{\text{Investment}}{\text{POST}}$

Typically, both pre-money valuation and the level of venture capital investment are subject to intense negotiations between the founders and venture capital firm, bearing in mind the fundamental issue of dilution of ownership. Dilution of ownership is the reduction in the proportional ownership of a shareholder in the capital of a company resulting from the issuance of additional shares and/or of securities convertible into shares in some stage in the future.

In venture capital transactions, there is significant uncertainty surrounding the projected future cash flows. Consequently, discounted cash flow methodology is rarely used as the first method to determine value. Similarly, there are challenges in applying comparable companies approach, as start-ups generally have unique features and it may be extremely difficult to find comparable quoted companies operating in the same field. Alternative valuation methodologies like the venture capital method or the real option methodology are used to determine value.

In buyouts, given the significant predictability of cash flows, the income based approach (discounted cash flows, adjusted present value, LBO



“In most private equity transactions with the exception of public-to-private, there is no direct market evidence on the valuation of the company being acquired. But, virtually all valuation techniques employ evidence from the market at differing stages in the calculation rather than relying entirely on accounting data and management forecasts.”

model, target IRR) is frequently used as a primary method to determine the value of equity, considering the expected change in leverage until the time of exit of the investment. The initial high and declining financial leverage is the main technical issue that needs to be adequately factored into the income approach when applied to a buyout valuation.

Venture capital method is a simple approach to valuation that is sometimes expressed in the terms of Net Present Value (NPV) and sometimes in the language of Internal Rate of Return (IRR).

3.2.1 Venture Capital Method using the Net Present Value (NPV)

Previously, we used the pre-money (PRE) valuation as the starting point and using the venture capital investment in the portfolio firm by the private equity firm, the post-money (POST) valuation was determined. Post-money valuation could also be determined using the present value-future value formulae, and from that we determine the PRE value. Essentially, the PRE value is the net present value (NPV), accordingly this approach is referred to as venture capital method using the NPV.

The steps in venture capital method using the NPV are:

Step 1: Discount the future value of the company at exit back to the present

“The free cash flow forecasts are provided by the management of the target company and are subject to an extensive due diligence process (strategic, commercial, legal and environmental) to determine the reliability of such forecasts. The exit date, i.e. when the target firm is sold, is evaluated at different dates to determine its influence on the projected returns.”

to obtain the post-money (POST) valuation:

$$\text{POST} = \frac{\text{Future Value (FV)}}{(1 + r)^N}$$

where, r is the discount rate used by private equity

N is the number of years until exit

Step 2: Determine the pre-money (PRE) valuation by netting the Investment from the post-money (POST) valuation:

$$\text{PRE} = \text{POST} - \text{Investment}$$

Step 3: Determine the required fractional ownership (f) for the private equity firm:

$$f = \frac{\text{Investment}}{\text{POST}}$$

POST

Step 4: Determine the number of shares the private equity firm (S_{pe}) needs to obtain its fractional ownership where S_e is the entrepreneur's share. We start with the formula for private equity firm's fractional ownership:

$$f = \frac{S_{pe}}{S_{pe} + S_e}$$

And, then solve for S_{pe} :

$$S_{pe} = S_e[f/(1-f)]$$

Step 5: Determine the stock price per share (P):

$$P = \frac{\text{Investment}}{S_{pe}}$$

3.2.2 Venture Capital Method using the Internal Rate of Return (IRR)

Venture capital method can also be presented in the language of IRRs. While the IRR is often a problematic method in finance, our venture capital method is sufficiently simple that the IRR and the NPV methods give exactly the same result. For the NPV calculation, we started with a given future value and discounted back to get the post-money (POST) valuation. Here, we begin by going in the other direction, i.e. working forward in time. We start by compounding the investment out to the exit to get the investor's expected future wealth. In this method, the investor's discount rate will be used as the IRR.

The steps in venture capital method using the IRR are:

Step 1: Using the IRR, compound the investment out to exit to obtain the investor's expected future wealth (W):

$$W = \text{Investment} (1 + r)^N$$

Step 2: Determine the required fractional ownership (f) for the private equity firm which is the investor's wealth divided by the terminal, future value (FV) of the firm:

$$f = W/FV$$

Step 3: Determine the number of shares the private equity firm (S_{pe}) needs to obtain their fractional ownership, where S_e is the entrepreneur's share:

$$S_{pe} = S_e[f/(1-f)]$$

Step 4: Determine the stock price per share (P):

$$P = \frac{\text{Investment}}{S_{pe}}$$

Step 5: Divide the investment by the fractional ownership to obtain the post-money (POST) valuation:

$$\text{POST} = \frac{\text{Investment}}{f}$$

or, perhaps more intuitively, we can use

$$\text{POST} = P (S_{pe} + S_e)$$

Step 6: Determine the pre-money (PRE) valuation by netting the investment from the post-money (POST) valuation:

$$\text{PRE} = \text{POST} - \text{Investment}$$

Or, use:

$$\text{PRE} = P \times S_e$$

4. Exit Routes: Returning Cash to Investors

The exit route is among the most critical mechanisms to unlock value in private equity. Most private equity firms consider their exit options prior to investing and factor their assessment of exit outcome into their analysis of target and expected internal rate of return. Generally, there are four exit routes for private equity investments:

4.1 Initial Public Offering (IPOs)

An IPO usually results in the highest

“The so-called venture capital method can also be presented in the language of IRRs. While the IRR is often a problematic method in finance, our venture capital method is sufficiently simple that the IRR and the NPV methods give exactly the same result. For the NPV calculation, we started with a given future value and discounted back to get the post-money (POST) valuation.”

exit value as a result of an enhanced liquidity access to large amounts of capital and the possibility to attract higher caliber managers. But an IPO comes at the expense of a cumbersome process, less flexibility and significant costs. Therefore, an IPO is an appropriate exit route for private companies with an established operating history, excellent growth

prospects and having a sufficient size. Timing of an IPO is also an important consideration.

4.2 Secondary market sale

In a secondary sale market, stake held by a financial investor is sold to another investor or to strategic investors (companies operating or willing to establish in same sector or market of the portfolio company). Secondary market sale is more frequent in the case of buyouts. The following are the two main advantages of secondary market sale:

The possibility to achieve the highest valuation multiple in absence of an IPO; and with the segmentation of private equity firms, specialised firms have the skill to bring their portfolio companies to the next level (restructuring, merger, new market) and sell either to a strategic investor seeking to exploit synergies or

to another private equity firm.

4.3 Management Buyout (MBO)

Management buyout is a takeover by the management group using a significant amount of leverage to finance the acquisition of the company. Alignment of interest is optimal under this exit scenario but may come at the expense of excessive leverage that may significantly reduce company's flexibility.

4.4 Liquidation

Controlling stakeholders have the power to liquidate the company, if the company is no longer viable. This exit route generally results in a floor value for the portfolio company but may come at the cost of negative publicity for the private equity firm, if the portfolio company is large and employee count is significant. ■

Producers and Distributors: Case of Organised Retail in India



Organised retail currently accounting for barely 4 per cent of retail sector in the country is evolving rapidly. Its share is increasing continuously and this segment is highly visible. Foreign retailers are eager to enter the country and are busy finding out Indian business partners, but many Indian businesses are taking rapid strides even without their support. Relation between producers and organised retailers can be full of tension. Large manufacturers in FMCG sector, who have not been much bothered about distribution so far, are in for a rude shock given by the economic strength of new retailers. While a close relationship between the two will result into more efficient distribution, quicker feedback from consumers and concentrated demand for the producers whereas pressure on price, delayed payments and competition of private labels will create difficulties. Farmers stand to benefit from the development of new and more compact supply chains connecting them with organised retail through collectors and distribution centres. Read on to know more.

Introduction

In the Western world, mass distribution followed mass production and together they brought about an unprecedented improvement in consumers' standard of living by providing them an ever-increasing variety of cheap goods. India too, is currently witnessing a phase of mass distribution in the form of large, organised supermarkets, hypermarkets, shops and malls. To be sure, improvements in mass distribution comprise better practices in marketing, transport and storage. Telecommunication technology, supply chain networks and logistics are making the real difference in distribution today. In comparison to them, retail is

but a small cog in the vast machinery of distribution; nonetheless, its last-mile operation is very important in marketing.

Organised retail currently accounting for barely 4 per cent of retail sector in the country is evolving rapidly. Its share is increasing continuously and this segment is highly visible. Foreign retailers are eager to enter the country and are busy finding out Indian business partners, but many Indian businesses are taking rapid strides even without their support. Future, Aditya Birla, Tata, Reliance groups and Raheja are some prominent names among them. Rapid urbanisation, a growing middle class,



Vasudha Joshi

(The author is Asst. Professor and Head of Department of Business Administration at Ness Wadia College of Commerce, Pune. She can be contacted at vasudha.joshi23@gmail.com)

“Modern retail is influencing consumers to loosen their purse strings. Retail therapy has become a favourite option to many. When consumers spend more, the whole economy is activated. Traditional retailers have been forced by the new competition to offer more services to customers and to gain focus in their dealings. Earlier, it was thought that new retail would be beneficial to consumers, but inimical to old retailers, particularly the kirana shops. We can now take a more nuanced view and concede that it provides important benefits to the economy: (a) Greater job creation, (b) Efficient supply chain, (c) Forcing traditional retail to change, and (d) Benefits for consumers.”

exposure to modern lifestyles through TV programmes and to a smaller extent, foreign visits are creating a huge demand for modern shopping experience. Malls with their posh locations and interiors, escalators and shopping trolleys, attractive displays to feast the eye, freedom to touch and feel the merchandise, fast moving stocks and attractive promotional offers have secured an important place in the psyche of householders, women and teenagers.

Overall benefits

Modern retail is influencing consumers to loosen their purse strings. Retail therapy has become a favourite option to many. When consumers spend more, the whole economy is activated. Traditional retailers have been forced by the new competition to offer more services to customers and to gain focus in their dealings. Earlier, it was thought that new retail would be beneficial to consumers but inimical to old retailers, particularly the *kirana* shops. We can

now take a more nuanced view and concede that it provides important benefits to the economy. They are:

1. Greater job creation
2. Efficient supply chain
3. Forcing traditional retail to change, and
4. Benefits for consumers

Greater job creation: Employment in traditional retail is essentially family-based. New retail is like an organised industry and it offers a large number of jobs, particularly front-end jobs to those who do not have high educational qualifications. Working conditions in organised retail are good, career prospects exist, training is imparted, jobs have some element of glamour (fashionable uniforms, conversation in English with customers) and salaries are good. A non-graduate who can speak in English can get ₹8000 p.m. as starting salary in these shops.

Efficient supply chain: Organised retail is strong in sourcing from a wide variety of suppliers and it develops a good distribution network. A number of benefits such as reduced lead time, fewer stock outs, reduced wastage and fewer inventories follow from them. Already, it is being seen that supply chains in sectors such as shampoo and detergents, readymade clothes, supply chains are becoming more compact resulting into greater margin with retailers. The following diagram shows the difference in prevalent and new supply chains in apparel sector.

Survival of traditional retail:

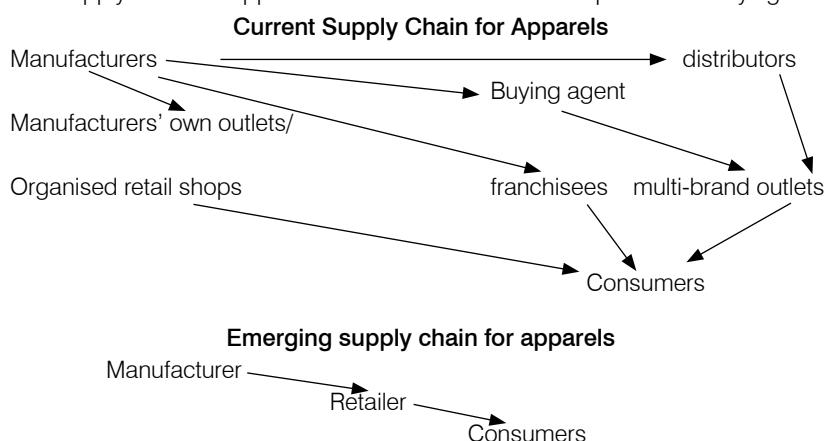
Traditional retail is being forced to upgrade and enhance the services it offers to retain its customers. It is being forced to become more efficient. However, it shows no signs of being wiped out. So it can be said that both new and old retail will exist and their competitive relationship with perhaps mutual dependence, will enhance the contribution of this sector as a whole.

Benefits for consumers: Greater choice, lower price, better quality, better shopping experience and enhanced service are all real benefits to consumers because of which they keep going to new retail shops and enjoy themselves.

How do Producers Look at New Retail?

Apart from consumers and traditional retailers, another group has very important links with retail. The group consists of manufacturers including agriculturists. Its relationship with organised retailer is however, complex. We are yet to reach a stage where mass production is counter-balanced by mass distribution. So tension exists between these two parts. Their interaction is marked by both positive and negative aspects. It is very interesting to understand this relationship between producers and new retailers.

A recent study has explored this relationship while carrying out



an in-depth study of new retail. (1) It distinguishes among three different types of producers viz. large producers, small producers and farmers. The study is based on interviews carried out with CEOs/Business Heads/Heads of Retail in 12 large manufacturing firms in FMCG and apparel sectors. These interviews were based on a semi-structured, open-ended questionnaire that was first circulated among these companies. Most of these firms are well-known and they include HUL, ITC Foods, Cargill Foods, GlaxoSmith Kline, Raymond, Madura Garments, United Colors of Benetton, FabIndia, etc. The same study interviewed 20 small and medium producers of packaged food, cosmetics, toiletries and apparel from Delhi. The annual turnover of these units varied from Rs.10 lakh to Rs. 10 crore. Three of the respondents had an all-India presence while the rest were regional players. The number of their employees varied between 10 and 50. The study also contacted farmers who were growing cauliflowers in Hoskote near Bangalore in Karnataka.

Large Producers and New Retail

Large businesses in the study were unanimous that emergence of organised retail was inevitable in the economy. Benefits of organised retail indicated by them were threefold:

Benefits:

1. **New supply chains:** Organised retail's sourcing and distribution network will help producers. At present, organised retail is using traditional supply chains which have very many middlemen. In due course of time however, it will set up its distribution centres and create IT-enabled networks of the involved parties. Then manufacturers will be able to bypass middlemen and supply directly to new retail shops. This will lead to reduced transaction costs as less

commission, credits, packaging will be required and transport costs will also be reduced. There will also be greater transparency in the flow of operations. Supply chains will become more efficient and they will carry large volume of goods. Traditional supply chains will remain and in addition, new chains between producers and large, modern retail stores will be worked out.

2. **New product categories:** New product categories in FMCG sector will develop. These will be expensive product categories which have greater customer involvement and in personal care products and eatables, they will benefit from personal handling by consumers which is facilitated by modern retail shops. These shops also facilitate faster customer feedback and once it is made available to producers, quicker improvements in products and brands can be effected. Thus a larger range of opportunities will be available to producers.

3. **Concentrated demand:** Orga-

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nised retail attracts customers in large numbers. So growth prospects for producers, particularly in FMCG and apparel sectors, will improve. Modern retail places large orders because of its large shelf space. These mean concentrated demand that producers will be happy to cater to. Organised retail means large buyers who insist on low prices and more services. Their pressure will force manufacturers to become more efficient by investing in people, processes and technology.

However, these benefits are counter balanced by following points.

Negative aspects:

1. **Pressure on price:** Lower prices that organised retail insists on for its bulk orders are mostly much beyond normal, reasonable limits. Wal-Mart, the biggest retail firm in the world, has got a slogan: 'Everyday, lower prices'. In fact, its search for lower prices is never ending and so it subjects its suppliers to immense pressure for cost cutting. It has long-term sourcing relations with companies such as Proctor and Gamble and these relations are buttressed by transparency and wide-ranging sharing of information about consumer off-take and stocks. Ordinary manufacturers are not used to such a relationship. Organised retail can also delay payment of bills which creates cash flow and working capital management problems for producers. Organised retail incurs high costs in two areas currently in India viz. real estate prices and manpower costs. To offset their effect, it has to squeeze its suppliers and this results in the above-mentioned price-payment pressure on producers.
2. **Threat of private labels:** These

“Finally manufacturers feel that in future, scales will not be loaded entirely in favour of modern retail as they are at present. High real estate prices and competition will become major threats to them in future. (Already, many shops are finding it difficult to generate adequate sales on weekdays and arrangements are being made to bail out Vishal Mega Mart. The near stampede on the opening of one of its outlets in Pune just a few years ago had to be seen to be believed. Subhiksha has faced similar problems.) Convenience of consumers and local conditions ultimately matter in retail business and so modern retail will have to carry out extensive research to know about local markets and customers.”

are retailers' own brands: not producers' but store brands. Modern retail shops allot greater shelf space to own private labels and by making them more visible, build them up systematically. In the days to come, consumers will become used to self-service in new retail stores and their buying decision will be made in stores rather than at home. Then private labels will steal a march over manufacturers' brands.

Large manufacturers are getting ready to counter these threats in different ways. They include:

1. Increasing own retail presence
2. Helping traditional, small retailers
3. Forming dedicated teams to deal with organised retail
4. Building brand strength
5. Forming common front

Apparel producers are thus opening exclusive showrooms to gain greater presence in the market. They

are trying to 'adopt' small retailers and to help them to upgrade their operations. They are encouraging them to come together and resort to combined buying of products from manufacturers. Manufacturers are also advising small shops that only by coming together and resorting to common action, they will be able to face the onslaught of organised retail.

Manufacturers have also made teams headed by accounts and category managers to deal with modern retailers. The exclusive job of these teams is to manage relationships with modern retail. Manufacturers are devoting special efforts to strengthen their brands. A report indicated that major FMCG companies had formed an informal group to deal with the problem of repeated delays and defaults on credit payments by organised retail. The group was thinking of referring the issue to Confederation of Indian Industries and even of boycotting new retail altogether. Organised retail had cited credit crunch in the market as the cause of its delayed payments, but FMCG companies doubted it. They thought that retailers faced a shortage of cash because of their very ambitious growth plans. The situation has eased somewhat now.

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about local markets and customers.

Small Producers and New Retail

The above is the perspective of large producers. How do small producers look at organised retail?

Most of the small producers in this survey have plans to increase their scale of operation in the next five years. So they are planning to hire more employees and machinery. At the same time, they foresee product market competition becoming more intense for them in future. On the one hand, large producers and private labels of big retailers will take away their business, but there exists an opportunity for them to cooperate with retail shops to help establish private labels and get stable business on the other. On the whole, they consider the emergence of new retail as a positive development and they are willing to work with them. They did not report any change in payment terms and credit periods while dealing with new retailers.

Farmers and New Retail

Agricultural marketing is of immense importance, but generally, in our country, supply chains of farm produce are long and middlemen take a large cut in the spread between market price and farmers' cost.

A recent study of marketing links of vegetable growers in Uttarakhand found that the average farmer spent 7.5 hours (2 to travel to the market, 2 to come back home and 3.5 hours at the wholesale market) to complete a transaction which was valued at ₹3000. It also found that regulated market rules were observed more in their breach and that brokers charged commission from retailers as well as farmers and their rates exceeded mandated rates. Under these conditions, transaction costs to farmers amounted to 25 to 38 per cent of the price paid by the retailer in the wholesale market. Thus, existing

markets are biased in favour of large margins to traders and low prices to farmers.

Benefits to Farmers

1. The biggest benefit of organised retail to farmers lies probably in the availability of an additional supply chain connecting them to retailers. Farmers can now supply fresh food items directly to supermarkets, food grains to processors and thence to supermarkets. By bypassing middlemen, transaction cost is lowered. This ought to reduce consumer prices and simultaneously leave greater income in the hands of farmers. It will eventually mean greater investment in agriculture.
2. Other benefits to farmers include better purchase conditions, transparent dealings, same prices

“The relationship between farmers and organised retail has its downside. Farmers complain that supermarkets pay after a time lag while wholesalers pay on the spot. Supermarkets also impose additional fees on farmers in the form of slotting allowances, promotion fees, discounts for special events, etc. Their quality and safety requirements are stringent and apt to be changed quickly. About contractual relations, both the parties harbour doubts. Farmers feel that relationship with organised retail is implicit, not formally inked into a contract and supermarkets charge that farmers are wont to sell to commission agents who visit farms at harvest times and offer better prices and spot payment. They feel that whenever this opportunity arises, farmers forget about their contractual obligations to supermarkets.”

to poor and better-off farmers, no cheating with weights and regular payments.

3. Farmers also stand to gain technical know-how and knowledge of international benchmarks of sorting, grading and packaging.
4. Once a stable relationship is established between farmers and supermarkets, the cropping pattern is also likely to change. Organised food retailing with the help of a local NGO in Rawain valley to the north of Dehra Dun has brought about a change in cropping pattern. The retail shop started a collection centre for farm produce and it was instrumental in making farmers reap some of the benefits mentioned above. The result is that instead of the former 5 per cent of cultivable area now 50 per cent is devoted to cultivating off-seasonal vegetables. Previously hardly 5 per cent of the farmers in this area turned to these vegetables. Now almost all of them do.

Benefit to Retailers

To organised retailers, it offers the benefit of procuring high quality, fresh products.

Downside

The relationship between farmers and organised retail has its downside. Farmers complain that supermarkets pay after a time lag while wholesalers pay on the spot. Supermarkets also impose additional fees on farmers in the form of slotting allowances, promotion fees, discounts for special events, etc. Their quality and safety requirements are stringent and apt to be changed quickly.

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agents who visit farms at harvest times and offer better prices and spot payment. They feel that whenever this opportunity arises, farmers forget about their contractual obligations to supermarkets.

Taking the case of cauliflower growers in Hoskote, Karnataka, the supply chains were as shown below:

1. Farmer — transporters — commission agent — wholesaler — retailer
2. Farmer — wholesaler — retailer
3. Farmer — wholesaler — commission agent — wholesaler — retailer
4. Farmer — shandi (regulated market, called ‘mandi’ in northern states) — consumer
5. Farmer — Safal Market (set up by National Dairy Development Board) — wholesaler — retailer
6. Farmer — group leader/consolidator — collection centre — supermarket
7. Farmer — collection centre — supermarket.

Chain no. 6 and 7 are used only by organised retailers while, in all other chains, the retailer may be an organised or traditional retailer. Most farmers use a mix of these chains.

The study found that profitability is the lowest for the farmer selling to the commission agent and the highest for the farmer selling to organised retailer through the consolidator despite his cost of production being the highest. Farmers who supply to organised retail through the consolidator invest a lot of money in crop care. Their product quality is far better than that of other farmers supplying to other channels. Transaction cost is the lowest for farmers associated with organised retail and highest for those selling to mandi. The percentage of farmers reporting rejection was lower for the mandi in comparison with the wholesaler or the consolidator supplying to the organised retailer.



Organised retail is particular about what it buys. In case of cauliflower, it buys only large heads and not the small and medium ones. So, farmers are usually able to supply only about half of their produce to organised retail. They sell the rest to wholesalers, local mandi or villagers.

In short, farmers now have a choice.

If they supply to organised retail, they will have to incur high production cost, but their transaction cost for distribution will be lower. Should they choose to opt for traditional supply chains, their lower cost of production will be offset by higher transaction cost. The study of cauliflower growers in Hoskote shows that the first is a more profitable choice.

Along with organised retail, corporate processors such as Nestle and ITC are also dealing with farmers directly and are developing what is known as contract farming. It also results in new, dedicated supply chains which improve the machinery of agricultural marketing.

Conclusion

Relation between producers and organised retailers can be full of tension. Large manufacturers in FMCG sector,

who have not been much bothered about distribution so far, are in for a rude shock given by the economic strength of new retailers. While a close relationship between the two will result into more efficient distribution, quicker feedback from consumers and concentrated demand for the producers whereas pressure on price, delayed payments and competition of private labels will create difficulties. Farmers stand to benefit from the development of new and more compact supply chains connecting them with organised retail through collectors and distribution centres. However, they will have to cater to the requirement of high quality and top-end grading and packaging techniques. With greater dissemination of information regarding what sells in the market, cropping pattern in agriculture may also change in future. ■

Significance of 'Zeroing' in Anti-Dumping Matters



Article VI of GATT 1994 that condemns the dumping *per se* is based on the assumption that artificial sales at lower prices may damage a domestic industry and distorts the dynamics of fair competition and international free trade, this provision allows WTO members to impose certain measures in order to offset and/or prevent dumping practices causing or threatening material injury to a domestic industry. The WTO's Dispute Settlement Understanding (DSU) has settled number of international trade disputes related to anti-dumping especially on 'zeroing'. Zeroing is a calculative methodology adopted by anti-dumping authorities in the course of obtaining final dumping margins, which excludes any negative margins occurring when export prices exceed the price in the home market. The WTO's Appellate Body (AB) has consistently struck down the zeroing practice as an asymmetrical calculative methodology. This article primarily deals with dumping, zeroing practice, the AB's jurisprudence on zeroing, legal position on zeroing and issues relating to zeroing.

Introduction

One of the most significant outcomes of the GATT *Uruguay Round* negotiations resulting in the establishment of the World Trade Organization (WTO) in 1995 was the creation of Dispute Settlement Understanding (DSU) whose primary objective is to settle trade disputes between members by means of bilateral consultations and mediation in the first instance. In the event of no resolution in a dispute, resort can be had to a dispute settlement panel comprising of three members. Questions of law and legal interpretation arising from rulings of a WTO Panel can be appealed to the WTO Appellate Body (AB) that has the power to modify or reverse the findings and *recommendations* of a Panel report following procedural rules that have been amended periodically since 1996. Technically speaking, the Panel and the AB rulings on the consistency or otherwise of a WTO member's measure at issue, are referred to as

recommendations that need to be adopted by the *Dispute Settlement Body* or DSB, which comprises of the entire membership of WTO. A Panel report, if it is not appealed against, or an AB report resulting from an appeal, are adopted by the DSB and unconditionally accepted by the parties to the dispute, unless they are rejected by consensus within the DSB.

Since a unanimous rejection of a ruling of the Panel or the AB is a remote possibility, this acts as an inherent check on the enforcement of the Panel or the AB recommendations. Panel is bound by the rule of *stare decisis*, i.e. the WTO Panels bound by rulings on law and legal interpretation made by the AB, which has consistently struck down the zeroing practice. The AB's anti-zeroing jurisprudence has caused further controversies, e.g. some members including the US have expressed their strong opposition to this case law and sought to change



Dr. P. Sree Sudha

(The author is a Faculty in the Department of Law, Dr. B. R. Ambedkar University, Srikakulam, Andhra Pradesh. She can be contacted at srisudha.k@rediffmail.com.)

it through negotiation. Moreover, in a surprising move, a recent WTO panel report (*US - Stainless Steel*) explicitly defied the AB's jurisprudence and ruled in favor of certain types of zeroing. In this context, the article aims to discuss the AB's jurisprudence on zeroing from *Bed Linen Case* to *US Steel Case* with a conclusion.

Zeroing Means

Zeroing is a calculative methodology, adopted by anti-dumping authorities in the course of obtaining final dumping margins, which excludes any negative margin occurring when export prices exceed the price in the home market, and, thus, only include positive margins occurring when home prices exceed export prices. What eventually therefore happens is systemic overestimation of dumping margins. The AB has consistently struck down the zeroing practice as an asymmetrical calculative methodology, adopted by antidumping authorities in the course of obtaining final dumping margins.³ The normal practice should be to add positive and negative dumping amounts separately in different transactions, and to reduce the negative amounts from the total of positive dumping amounts, to arrive at a dumping margin on the basis of which anti-dumping duties could be levied.

Following example throws a light on the zeroing method:

In one transaction, the normal value is \$100 and export price is \$80. The dumping margin of \$20 is positive. In another transaction, the normal value is \$120 and export price is \$100. The margin of \$20 in this case is negative. If negative and positive margins were to be offset in calculating the average on the basis of these two transactions, the products would not have been treated as being dumped. If, however, the negative margin is disregarded or treated as zero, the dumping margin would be positive and the importer may

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have to pay an anti-dumping duty of \$20.

Prior to the conclusion of the Uruguay Round, it was the standard practice of some active users of anti-dumping to apply this practice of zeroing. It is because of the pressure exerted by other countries during negotiations, Article 2.4.2 of the Agreement on Anti-Dumping (ADA) was adopted. WTO members generally used the weighted average method. However, within the weighted average method, some WTO members applied a new type of zeroing, i.e. inter-model zeroing. If, for example, model A was dumped while model B was not dumped, members would not allow the negative dumping of model B to offset the positive dumping in the calculation of dumping margin.

AB's Jurisprudence on Zeroing

There has been an incremental expansion in the AB's anti-zeroing jurisprudence that resulted from complainants' strategic use of "as such" complaints. In an early stage, complaining parties challenged specific applications of the zeroing methodology ("as applied") by defending parties. For those who advocate zeroing, a "dumping margin" under the ADA could be established "for each product type or for each individual transaction" as well as for the product as a whole. However, the

AB rejected this position and ruled that the dumping margin should be established "for the product...and not for the various types or models of that product." Because zeroing picks and chooses positive results of these intermediate calculations in the situation of multiple comparisons and disregards (zeroes) negative ones, it does "not take into account the entirety of the prices of some export transactions" and, thus, "inflates the margin of dumping for the product as a whole." The AB viewed that this failure violated the "fair comparison" obligation under Article 2 of the ADA.

EC - Bed Linen Case

In this case, the AB ruled that the practice of zeroing is not consistent with the objectives and rules of the ADA. Following the *EC Bed Linen* cases, a series of actions were undertaken at the EC level to implement the findings of the Panel and AB reports. A regulation was promulgated to empower the EC Council to "(a) repeal or amend the disputed measure; (b) adopt any other special measures which are deemed to be appropriate in the circumstances". This regulation did not explicitly concern the *EC-Bed Linen* report since it aimed, according to its preambles 4 and 5, at establishing a procedure:

"(4) With a view to permitting the Community, where it considers this appropriate, to bring a measure taken under regulation 11 into conformity with the recommendations and rulings contained in a report adopted by the DSB, specific provisions must be introduced." (5) "The Community institutions may consider it appropriate to repeal, amend or adopt any other special measures with respect to measures taken under Regulation 12 including measures which have not been the subject of dispute settlement under the DSU, in order to take account of the legal interpretations

made in a report adopted by the DSB. In addition, the Community institutions should be able, where appropriate, to suspend or review such measures."

A second regulation revised the findings of the investigation taking into account the recommendations set out in the *EC-Bed Linen* report. In particular and according to the Regulation, the reassessment of the dumping margin was carried out on the recommendations of the reports concerning "(a) determination of sales, general and administrative expenses and profit when applying article 2(c)(1) of the basic regulations for the purpose of constructed normal value and (b) the practice of 'zeroing' when establishing the weighted average margin of dumping". On this basis, the EC authorities carried out a reassessment of the findings of the original investigation and new calculations were made taking into account the finding of the AB report.

Overall, it has to be noted that the reassessment of the findings was carried out on the basis of the information collected at the time of the original investigation. As the EC authorities openly admitted in the regulation concerning the methods of calculating sales, general and administrative expenses and profit, the fact that some information was not collected at the time of the original investigation may have implications when a reassessment of findings is

carried out, e.g. on the issue of injury, one may argue that the reassessment falls short of establishing a level playing field for complainants and defendants.

This imbalance stems from the fact that, while filing the complaints, domestic industries are apparently not obliged to list all the 15 factors that must be considered among other relevant factors in examining the impact of imports on the domestic industry. In other words, examination and information on all the 15 factors is not a prerequisite condition for initiating an anti-dumping procedure. Thus, if the investigating authorities, like the Commission in the original investigation did not collect information on all 15 factors, it may be difficult to objectively carry out a reassessment of injury factors retroactively. Therefore, the exporters have to rely on the goodwill of the investigating authorities if the data were not collected at the time of the original investigation. The *EC-Bed Linen* Panel held:

"It appears from this listing [the listing of the factors enumerated in the provisional regulation] that data was not even collected for all the factors listed in Article 3.4, let alone evaluated by the EC investigation authorities. Surely a factor cannot be evaluated without the collection of relevant data."

An objective examination would have required at the beginning that the complaints by domestic producers should have included data on all 15 factors for an objective determination to be carried out. This burden of proof on the part of the complainants and the investigating authorities would strike a balance between this obligation and the one of the exporters to respond on time and with accurate information to the questionnaire of the investigating authorities. Eventually, this may be an issue to be raised, as it is an imbalance of rights and obligations between complainants and defendants. From

this perspective, the reassessment of the injury findings carried out by the Commission may not appear immune to criticism.

Under WTO jurisprudence, the rulings made by the Panels or the AB are binding only on the parties to the dispute. The ruling is that the practice of zeroing is inconsistent with the rules of the WTO Agreement and should not be applied and is, therefore, only binding on the EC. The EC has already taken steps to change its rules to comply with the decision.

As discussed in the case of EC, the ADA required that the dumping calculations be based on comparison of 'weighted-average normal value' to 'weighted-average export price'. Accordingly, US law provides for comparison of weighted-average home market prices to weighted average US prices in the original investigations. The DOC (Department of Commerce) calculates weighted-average prices by model, i.e. by control numbers, and by level of trade (to the extent that there are different levels of trades), and for the entire investigation period. However, the benefit of average-to average brought by the Agreement is offset by the DOC's practice of 'zeroing'. The DOC follows the same practice as discussed in the case of EC, to change the negative dumping margins at 'model' levels to 'zero' for the purpose of calculating the overall dumping margin for the company. This practice, like in the case of the EC, enhances the dumping margin significantly. The practice of 'zeroing' has been condemned in the WTO Appellate ruling in the case of EC practices and now it is contingent upon the US to change its rules accordingly. However, the AB ruling in this respect pertains to original investigations only. The US anti-dumping regulation has a distinct system of annual administrative review, which determines the actual amount of duty chargeable on the subject goods.

“Because zeroing picks and chooses positive results of these intermediate calculations in the situation of multiple comparisons and disregards (zeroes) negative ones, it does “not take into account the entirety of the prices of some export transactions” and thus “inflates the margin of dumping for the product as a whole.””

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Unlike in a new investigation, in an administrative review the DOC does not compare the average export price to the average normal value for the whole investigation period.

Instead, the DOC compares the export price for each individual transaction to the most contemporaneous monthly average normal value. The total value of the dumping margin is then calculated by aggregating only transaction-specific positive dumping margins and then multiplying the quantity sold in the US market for each model by the unit dumped value to arrive at the total dollar dumped. Comparison of individual export prices to weighted-average monthly normal prices that yields negative margins are ignored or assigned a 'zero' value. However, the AB decision on 'zeroing' does not appear to cover this practice in the administrative review process. In a recent communication to the DSB requesting for consultation, the EC has brought out at least 22 cases where the DOC has used the method of 'zeroing' in its dumping margin calculations.

It also shows the effect of 'zeroing' leading to higher margin determination by the DOC, even where the dumping margin in a normal situation (without zeroing) would have been negative. The DOC's methodology of calculating dumping margin to impose actual anti-dumping duty is described in the following case:

Soft Wood Lumber Products from Canada Case

On April 18, 2006, the WTO AB delivered its decision on the "zeroing" anti-dumping case which the EC brought against the U.S. In the decision, the AB upheld the panel's finding that the US' zeroing methodology employed in initial anti-dumping investigations was inconsistent with the fair comparison requirement under the Article 2.4.2 of ADA. In addition, the AB, reversing the panel's original finding, held that certain applications of the same methodology in the administrative review process were inconsistent with the Article 9.3 of ADA. This uncompromising ruling leaves the DOC nearly no option but to repeal the 'zeroing' methodology on the whole in the administrative review as well, even though the EC's claim here was "as applied" to the facts of the particular case.

A recent NAFTA Chapter 19 panel (NAFTA Soft Lumber) condemned this practice invoking the celebrated *Charming Betsy* doctrine (a US Supreme Court decision holding that US statutes should be interpreted, if possible, in such a way as to avoid placing the US in violation of international law) expressing the view that the US should follow the AB decision against it in *WTO Soft wood Lumber V*. It may be no coincidence that the EC challenged the US zeroing methodology after the EC's own applications of the same methodology were invalidated by the WTO.

US - Zeroing (EC) and US - Zeroing (Japan) Case

However, as the AB's anti-zeroing rulings gathered momentum, complainants began to challenge the zeroing policy itself ("as such"). The AB accepted above two complaints and ruled in favour of complainants (EC and Japan).

The AB's jurisprudence in these two cases is: Dumping and dumping margins must be defined

in terms of the "product as a whole" under investigation. Therefore, all intermediate, individual calculations (normal value minus export price) as to various sub-product categories must be "aggregated" to obtain the final dumping margin. In stark contrast, the panel viewed that dumping and dumping margin could be defined in terms of "a particular export sale" and that antidumping authorities need "not necessarily require an examination of different export sales at an aggregate level." The panel viewed that the AB's interpretation was not based on a "solid textual basis" and that it should adopt a "permissible interpretation" which accommodates a certain type of zeroing (simple zeroing) in this case.

The panel's unusual behavior raises many interesting legal questions. As it admitted itself, the AB expects panels to follow its jurisprudence, even in the absence of formal binding force. More importantly, such jurisprudence creates "legitimate expectations" among WTO members. It seems controversial whether a panel could reject the AB's established case law on the same issues in the presence of Article 3.2 of the DSU which underscores the "stability and predictability" of the multilateral trading system.

On the issue of "simple zeroing" by the US in periodic reviews (where the panel, disregarding past the AB rulings, found in favour of the US), the AB said that in applying "simple zeroing" in periodic reviews, the USDOC (US Department of Commerce) compares prices of individual export transactions against monthly weighted average normal values, and disregards the amounts by which the export prices exceed the monthly weighted average normal values, when aggregating the results of the comparisons to calculate the going-forward cash deposit rate for the exporter and the duty assessment rate for the importer concerned.

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Simple zeroing thus results in the levy of an amount of anti-dumping duty that exceeds an exporter’s margin of dumping, which operates as the ceiling for the amount of anti-dumping duty that can be levied in respect of the sales made by an exporter. Therefore, simple zeroing is, as such, inconsistent with the Article VI: 2 of GATT 1994 and the Article 9.3 of ADA.

For these reasons, the AB reversed the Panel’s finding that simple zeroing in periodic reviews is not, as such, inconsistent with the Article VI: 2 of GATT 1994 and the Article 9.3 of ADA. Instead, the AB found that simple zeroing in periodic reviews is, as such, inconsistent with the US obligations under those provisions. Also, the AB said, “simple zeroing” in periodic reviews is inconsistent with the Article VI: 1 of GATT 1994 and the Article 2.1 of ADA. As a result, the US is now obligated to repeal its zeroing policy in its entirety nearly on all fronts, both in the original investigations and in the administrative (periodic) reviews.

US Stainless Steel Case

In this case, AB’s rulings is rejected by Panel further it also explicitly rejected the AB’s established anti-zeroing position, in particular that expressed in *US – Zeroing (EC)* and *US – Zeroing (Japan)*, both of which addressed the same issue as the panel faced, i.e., a “simple zeroing” in the administrative (periodic) review. The Panel applied

judicial economy with regard to Mexico’s claims under: (a) the Article VI:1 and VI:2 of GATT 1994, the Articles 2.1, 2.4 and 18.4 of ADA, and the Article XVI:4 of WTO Agreement regarding model zeroing in investigations; and (b) the Article XVI:4 of WTO Agreement and the Article 18.4 of ADA regarding simple zeroing in periodic reviews. The AB reversed the Panel’s finding that simple zeroing in periodic review is not, as such, inconsistent with the Articles VI:1 and VI:2 of GATT 1994, and Articles 2.1, 2.4 and 9.3 of ADA; the AB found, instead, that simple zeroing in periodic reviews is, as such, inconsistent with the Article VI:2 of GATT 1994 and the Article 9.3 of ADA. It also reversed the Panel’s finding that the US did not act inconsistently with the Articles VI:1 and VI:2 of GATT 1994, and the Articles 2.1, 2.4 and 9.3 of ADA; and it found, instead, that the US acted inconsistently with Article VI:2 of GATT 1994 and Article 9.3 of ADA by applying simple zeroing in the five periodic reviews at issue in this dispute, and found it unnecessary for purposes of resolving this dispute to make an additional finding on Mexico’s claim that simple zeroing in periodic reviews is, as such, and as applied in the five periodic reviews at issue in this dispute, inconsistent with the Article 2.4 of ADA, and on Mexico’s related claim under the Article 11 of DSU; and did not make

“Simple zeroing thus results in the levy of an amount of anti-dumping duty that exceeds an exporter’s margin of dumping, which operates as the ceiling for the amount of anti-dumping duty that can be levied in respect of the sales made by an exporter. Therefore, simple zeroing is, as such, inconsistent with the Article VI: 2 of GATT 1994 and the Article 9.3 of ADA.”

an additional finding that the Panel failed to discharge its duties under the Article 11 of DSU by making findings that contradict those in previous Appellate Body reports adopted by the DSB. The AB recommended that the DSB request the US to bring its measures found in the AB report and in the Panel report as modified by the AB report, to be inconsistent with the GATT 1994 and with the ADA, into conformity with its obligations under those Agreements.

Conclusion

Since the old GATT era, zeroing has been controversial because it tends to inflate final dumping margins by preventing those negative margins from offsetting positive margins. The AB’s rulings are essential part (*acquis*) of WTO legal system. As an appellate tribunal which solely addresses issues of “law,” the AB’s decisions should be respected by a lower tribunal (panel), especially when a panel adjudicates on the same issues. It is especially so considering that the AB has rendered the same opinions continuously and consistently. Otherwise, the fundamental value of the dispute settlement system, and the WTO system in general, i.e., stability and predictability, would be seriously undermined. Considering diametrically opposite views on ‘zeroing’ among major WTO members as well as the inchoate stage of WTO negotiations on rules, any legislative breakthrough on ‘zeroing’, such as an amendment of relevant provisions (Articles 2 and 9) of the ADA, is highly unlikely in the near future. In the meantime, WTO members opposing ‘zeroing’ are liable to continue to challenge this practice before the WTO dispute settlement system. If we look at the saga of ‘zeroing’ from *Bed Linen Case* to recent *US Steel case*, the WTO AB acted in a positive direction and it was successful in putting an end to this controversial practice of ‘zeroing’. ■

■■■ Government Starts Audit of Economic Data

In a first-of-its-kind exercise, the National Statistical Commission (NSC) has ordered an audit of the process used in the construction of economic data, starting with the Index of Industrial Production (IIP). The move comes amid criticism of the quality of data dished out by various government agencies, including the Central Statistical Organisation. Just last month, the Reserve Bank of India (RBI) had termed the industrial growth figures highly volatile and expressed doubts about how effectively the index reflected the underlying momentum in the industrial sector. A few days before that, CSO had issued a corrigendum on the national accounts data. Even earlier, RBI had questioned the inflation data released by the government. We are just beginning this exercise and the first audit has been ordered for IIP. With this, we hope to learn both about how we will do statistical audits in future and then develop mechanisms to strengthen the system, Chief Statistician T C A Anant said in an interview. The audit will be undertaken by the Ministry of Statistics and Programme Implementation (Mospi), under the direction of the five-member NSC, headed by R Radhakrishna. The idea of a statistical audit was not new. One of the mandates of the NSC had been to conduct statistical audit for every important macroeconomic data series. In a decentralised statistical system, an audit went a long way in identifying and improving statistical gaps that resulted from difference in administrative processes and functions of various agencies involved in data collection, officials in the statistics ministry said. The results of the audit will be put in the public domain. This is expected to generate transparency and instill confidence in the way these numbers are generated, Anant added. The IIP data is compiled by Mospi after receiving data from different ministries and state agencies. Mospi is not directly involved with the primary data collection, though it is responsible for maintaining the quality of the data. For that purpose, Mospi, along with various state agencies, conducts periodic sample surveys used to maintain the quality of the data received on a monthly basis. Such a sample, in the case of the IIP, is the Annual Survey of Industries (ASI). The latest IIP numbers, which estimated the growth at 13.8 per cent, led by a 63 per cent growth in capital goods, was criticised for being exaggerated. An exercise conducted by Business Standard showed the growth should be around 22 per cent.

(Source: <http://www.business-standard.com>)

■■■ Tax Tribunal: Banks are Not Liable to Pay Minimum Alternate Tax

A leading tax tribunal has said that banks are not liable to pay minimum alternate tax (MAT) since they are governed by the Banking Regulation Act and prepare their accounts differently. The Income Tax Appellate Tribunal (ITAT), Mumbai,

which passed an order in the case of Krung Thai Bank, said that MAT provisions come into play only when the accounts are prepared under the Companies Act under the Income-Tax Act. A chartered accountant, who appeared for the foreign bank told ET, Going by this order, MAT will not be applicable to insurance, banking and electrical companies. According to the ITAT order on September 30, the provisions of MAT are applicable only when profit and loss accounts are prepared under the provisions of the Companies Act, under schedule VI. However, the Schedule VI of Companies Act is not applicable to banks as they are exempt under proviso to Section 211 (2) of the Companies Act. The final accounts of banks are to be prepared under the provisions of Banking Regulations Act. Therefore Section 115J B of Income-Tax Act governing provisions of MAT is not applicable to banks. In this case the bank was a foreign entity operating through a branch in India. It had shown a profit of over `78 lakh but after adjustments the bank has shown a profit of over `94 lakh. After setting off carry forward losses, the bank returned nil income. It is the declaration of nil profit that compelled the I-T department to apply the provisions of MAT. The department had argued before ITAT that there is no specific exclusion for banking companies from the requirement to prepare profit and loss accounts as under Chapter VI of the Companies Act. ITAT however, held that the departments stand is against the intent of the legislature. ITAT also cited an earlier judgement on similar grounds given out by a co-ordinate bench in the case of Maharashtra State Electricity Board. ITAT held that the provisions of MAT do not apply in this case and the assessing officer made an error in concluding that income had escaped the tax net.

(Source: <http://economictimes.indiatimes.com/>)

■■■ Tax Compliance Will Be Ensured by Direct Tax: Revenue Secretary

The Direct Tax Code (DTC) may result in ₹55,000 crore revenue loss in the first year of implementation, but tax collection will increase in the subsequent years because of greater compliance, Revenue Secretary Sunil Mitra has said. During the first year, revenue will certainly be low. But we hope the better compliance will boost tax collection in the subsequent years, Mitra said at an event organised by Confederation of Indian Industry (CII). He said total revenue loss in the first year of implementation is estimated to remain at around ₹55,000 crore. The major loss is likely to happen in corporate income tax collection, estimated at around ₹39,000 crore. The new norm, which proposes to raise the exemption limit on individual income tax from the current ₹1.6 lakh to ₹2 lakh will be effective from April 1, 2012. Corporate income tax will be reduced to 30 per cent from the current 33 per cent. The revenue secretary said the

key objective of the DTC was not to reduce tax rates, but to bring greater transparency, continuity, consistency and predictability in the tax system.

(Source: <http://www.financialexpress.com/>)

■■■ New Tax Code May Adversely Impact NRIs

India's New Direct Tax Code (DTC), described as generous to residents, unfortunately seeks to extract a mouthful from millions of non-resident Indians (NRIs). It is good news that the government is all set to replace the age-old Income Tax Act of 1961 and bring far reaching changes in the tax structure with an aim to tax those citizens in lower income bracket as little as possible, bring the growing number of rich people in the tax net and prevent tax evasion. With the possibility of archaic rules getting replaced with new ones from financial year 2011-2012, the emerging India seems to have welcomed the path-breaking initiative taken by the central government. However, scores of NRIs are disappointed and are sure to seek changes in the proposed laws that affect them negatively. For example, under the DTC, NRIs staying in India for more than 59 days in a year and 365 days or more over a period of four years prior to the financial year will be considered residents and are, therefore, liable to be taxed on their global income. Currently they can stay in India up to 181 days in a year and still have no tax liability on the income earned outside India. Such NRIs typically do not have citizenship of any other country and this is particularly true with those living in the Gulf countries where citizenship is extremely difficult to get. Most of the companies or employers send their employees on two to three month vacation period albeit once in two or three years. Some NRIs prolong their stay because of medical, social or business reasons. Whatever the reasons, what the DTC implies is henceforth NRIs must count their days whenever they visit India. The proposed 59-day stay restriction to save their hard earned money from being taxed has put them in fix.

(Source: <http://beta.profit.ndtv.com/news>)

■■■ M&A Deals Tally Rose to USD 20.76 Billion in the First Half

Led by Bharti Airtel, India Inc's outbound mergers and acquisitions deals tally rose to USD 20.76 billion in the first six months of the current fiscal from a meagre USD 527.8 million in the previous year, a study said. "The rise in outbound deals provides clear evidence that the Indian industry is consolidating, and at the same time aggressively working on global expansion," the study by Assocham said. Total 59 outbound M&A took place during April-September 2010-11 against 27 in the same period of the last financial year. The study said the total number of M&A deals (outbound, inbound and domestic) increased from

86 in first half of 2009 to 141 during April-September 2010. Of the 141 M&A, 68 were domestic deals and 14 inbound. In value terms, the overall M&A deals rose 345.16 per cent to USD 52.6 billion during April-September 2010 from USD 11.8 billion in the year-ago period. The major mergers and acquisitions occurred in telecom, metal and mining and energy sector, the chamber said.

(Source: <http://economictimes.indiatimes.com/>)

■■■ India Signs Pact with Bermuda on Exchange of Tax Information

India has signed a pact with Caribbean tax haven Bermuda, which will facilitate exchange of information between the two countries regarding tax evasion. The Tax Information Exchange Agreement (TIEA), as it is called, conforms to the guidelines issued by OECD for countries and destinations considered tax havens to share information. The concept of TIEA was developed by OECD for promoting cooperation in tax matters via exchange of information. As per agreement, signed by the Premier of Bermuda Ewart Brown and Minister of State for Finance S S Palanimanickam, both countries can share details on banking, ownership and past information on tax matters.

(Source: <http://www.financialexpress.com/>)

■■■ RBI to Look Into Functioning of MFIs

The Reserve Bank of India has announced constitution of a sub-committee to look into the functioning of micro finance institutions (MFIs), as they have drawn flak for using strong-arm tactics to recover loans. The MFI tactics have even prompted the Andhra Pradesh Cabinet to approve an ordinance to rein them in. We have constituted a sub-committee to look into the functioning of the MFIs sector and what bearing they have on RBI policy to take further action, RBI Governor D. Subbarao has told media. However, he did not commit to come out with any regulations to deal with the MFIs. Stating that the RBI regulates non-banking finance company, he, however, said there were a vast number of companies under the MFI sector falling out of the purview of the apex bank. A bill to regulate MFIs is being prepared to be tabled in Parliament. Commenting on the performance of banks' penetration in hinterlands, Dr. Subbarao said, There is a view that MFIs charge high rate of interest...but if the banks cover the last mile, many of the MFIs can get institutional credit at cheaper rate. He added: "We are marshalling all the arguments and I am not suggesting we will initiate legal actions but we will consult with the government. Capping of interest rates by MFIs has evoked a sharp division among stakeholders. A Bill on MFIs, however, is not likely to cap interest rates.

(Source: <http://www.thehindubusinessline.com/>)

■ ■ ■ IASB Proposes Severe Hyperinflation Amendment to IFRS 1

The International Accounting Standards Board (IASB) recently published for public comment, an exposure draft *Severe Hyperinflation*, a proposed amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The amendment proposes guidance on how an entity should resume presenting financial statements in accordance with International Financial Reporting Standards (IFRSs) after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe *hyperinflation*. The exposure draft, *Severe Hyperinflation*, is open for comment until 30th November 2010 and can be accessed via the 'Comment on a Proposal' section of www.ifrs.org.

(Source: www.ifrs.org/News/)

■ ■ ■ IAASB Proposes New Guidance on Auditing Complex Financial Instruments

The International Auditing and Assurance Standards Board (IAASB) recently released for public exposure a new proposed pronouncement—International Auditing Practice Statement (IAPS) 1000, *Special Considerations in Auditing Complex Financial Instruments*—that highlights practical considerations for auditors when dealing with complex financial instruments. The pronouncement gives particular emphasis to auditing considerations relating to valuation and disclosure issues for financial statement items measured at fair value. Through the proposed IAPS 1000, the IAASB seeks to raise awareness of issues being encountered in practice, in particular for fair value estimates and the valuation of assets in illiquid markets. Along with the proposed IAPS 1000, the IAASB is also exposing for comment proposed changes to the current *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services* (the proposed amended Preface), which explains the authority of this and future IAPSs. The IAASB plans to finalize proposed IAPS 1000 and the statement of authority in 2011. Auditors, however, may wish to consider the material in the proposed IAPS 1000 as they plan and perform their upcoming audit engagements. All stakeholders are invited to comment on its proposals. To access the exposure draft or submit a comment, visit the IAASB's website at www.iaasb.org/ExposureDrafts.php. Comments on the exposure draft can be given by February 11, 2011.

(Source: <http://press.ifac.org/news>)

■ ■ ■ IASB Finalises Enhanced Derecognition Disclosure Requirements for Transfer Transactions of Financial Assets

The International Accounting Standards Board (IASB), the independent standard-setting body of the IFRS Foundation, recently issued amendments to IFRS 7 *Financial Instruments: Disclosures* as part of its comprehensive review of off balance sheet activities. The amendments will allow users of financial statements to improve their understanding of transfer transactions of financial assets (for example, securitisations), including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period. The amendments broadly align the relevant disclosure requirements of International Financial Reporting Standards (IFRSs) and US Generally Accepted Accounting Principles (GAAP). The IASB had previously published for public comment proposals

to replace the existing derecognition model in IAS 39 *Financial Instruments: Recognition and Measurement* and the associated disclosure requirements in IFRS 7. However, in response to the feedback received, the IASB decided to retain existing derecognition requirements (to be incorporated into IFRS 9 *Financial Instruments*) and to finalise improved disclosure requirements. The new requirements are contained in *Disclosures—Transfers of Financial Assets* (Amendments to IFRS 7). The IASB and the US Financial Accounting Standards Board (FASB) will conduct additional research and analysis, including a post-implementation review of the FASB's recently amended requirements, before determining any further work to be undertaken. A Feedback Statement, outlining how the IASB responded to feedback received through the consultation process, is available at the website. A podcast introduction to the new disclosure requirements is also available.

(Source: www.ifrs.org/News/)

■ ■ ■ IFAC SMP Committee Releases Updated ISA Guide

The Small and Medium Practices (SMP) Committee of the International Federation of Accountants (IFAC) recently issued the second edition of its *Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities* (ISA Guide). The implementation guide is intended to help practitioners understand and efficiently apply the Clarified International Standards on Auditing (ISAs), which are effective for audits of financial statements for periods beginning on or after December 15, 2009. The updated ISA Guide provides IFAC member bodies—and ultimately the SMPs they represent—with a unique resource to help them implement the new requirements efficiently and deliver high-quality service. The second edition includes various improvements based on feedback from users of the first edition which was issued in December 2007 and was IFAC's second most popular publication during 2008. In addition, it features two integrated case studies, one of which focuses on an audit of a micro-entity, increased focus on SME audits, and a new colorful design. The ISA Guide also now comes in two stand-alone volumes: Volume 1 describes the basic concepts of a risk-based audit in conformance with the Clarified ISAs. Volume 2 provides practical guidance for the audit of SMEs. The PDF version of the ISA Guide can be downloaded free of charge for personal use from the Publications & Resources section of the IFAC website. For information on reproducing or translating publications issued by IFAC, contact permissions@ifac.org.

(Source: <http://press.ifac.org/news>)

■ ■ ■ Staff Draft of a Forthcoming IFRS on Consolidation

IASB recently posted to its website a staff draft of a forthcoming IFRS on consolidation that reflects the tentative decisions made to date by it. The draft IFRS has been prepared by the staff of the IASB for the board's project to replace IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities* with a single standard on consolidation. The staff draft reflects the cumulative tentative decisions made by the board, concluding with the meeting in May 2010. The board's deliberations are complete, apart from considering the effective date of the forthcoming IFRS. However the tentative decisions reached may be subject to change before the board issues the final consolidation standard. For more information and to read the staff draft the website may be referred.

(Source: <http://www.ifrs.org/News/>)

■ ■ ■ IASB and US FASB Complete First Stage of Conceptual Framework

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) recently announced the completion of the first phase of their joint project to develop an improved conceptual framework for International Financial Reporting Standards (IFRSs) and US generally accepted accounting practices (GAAP). The objective of the conceptual framework project is to create a sound foundation for future accounting standards that are principles-based, internally consistent and internationally converged. The new framework builds on existing IASB and FASB frameworks. The IASB has revised portions of its framework; while the FASB has issued 'Concepts Statement 8' to replace 'Concepts Statements 1 and 2'. This first phase of the conceptual framework deals with the objective and qualitative characteristics of financial reporting. A feedback statement on comments received through the consultation process is available. An IASB podcast summary of the project is available for download. Also a podcast posted by the FASB on www.fasb.org could be found explaining the purpose of a concepts statement.

(Source: <http://www.ifrs.org/News/>)

■ ■ ■ Forum of Firms Focuses on Practical Application of Group Audit Standard

Over 40 senior audit professionals from 20 international networks of accounting firms in a recent meet shared their experiences and industry perspectives in applying International Standard on Auditing 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (ISA 600). The symposium, organized by the Forum of Firms, assembled a group of experts to discuss several aspects of auditing a group, including those business activities and entities (components) that are included in the group's financial statements. "This symposium was designed to encourage participants to exchange views on challenges unique to auditing in a group environment, such as cross-border confidentiality considerations and differing ethics requirements," said chair, Transnational Auditors Committee. "More importantly, with an aim of seeking ways to more fully obtain the intended benefits of ISA 600, the participants also contributed practical solutions for further consideration." Commencing with an overview of the key requirements of ISA 600, the symposium participants discussed a range of application issues, such as the engagement of and reporting by component auditors, communication with both management and component auditors about the group audit process, and determining materiality in a group environment. Led by speakers from across the spectrum of the Forum's membership, including France, Germany, the United Kingdom, and the United States, the symposium concluded with a discussion on the importance of firm processes and controls that support group audit engagements. This event is the fourth symposium held by the Forum of Firms, and has been a unique way to bring its members together to share and openly exchange views on present-day issues.

(Source: <http://press.ifac.org/news/>)

■ ■ ■ Accountancy Summit on Corporate Governance Reform Looks Beyond Global Financial Crisis

Accountancy leaders from around the world in a meet in Geneva discussed next steps for global corporate governance reforms. With an eye to helping prevent future financial crises,

they collectively supported the significance the accountancy profession has to play in strengthening corporate governance and facilitating the integration of governance and sustainability into the strategy, operations, and reporting of an organization, boards should be focused on the long-term sustainability of their businesses. Governance to ensure that the right behaviors and processes are in place. Governance mechanisms need to be strengthened at banks and other companies to ensure better oversight of risk management and executive compensation. More dialogue is needed between policy makers, the accounting profession, and other financial industries. The conference was hosted by the International Federation of Accountants (IFAC) and the United Nations Conference on Trade and Development (UNCTAD). Participants from more than 50 countries were on hand to address key questions including: What lessons has the financial crisis revealed about corporate governance? What corporate governance reforms should be developed on a global basis? And what role should the accountancy profession play? The IFAC/UNCTAD conference was designed to allow professional accountants, corporate governance experts, and other participants to challenge current practices, exchange views on essential elements of corporate governance, and discuss best practices that will improve the current and future business and economic climate.

(Source: <http://press.ifac.org/news/>)

■ ■ ■ Duck-Koo Chung to Serve as Trustee of the IFRS Foundation

The IFRS Foundation, the oversight body of the International Accounting Standards Board (IASB), recently confirmed the appointment of Duck-Koo Chung to serve as a Trustee of the IFRS Foundation for an initial three-year term, with effect from 1 January 2011. Mr Chung is a former Minister of Commerce, Industry and Energy for the Republic of Korea. He is a visiting professor of international finance at Korea University and Renmin University in Beijing, and a founding member of the North East Asian Research (NEAR) Foundation, a research group finance experts. The appointment of Mr Chung, as well as the reappointment of Jeffrey Lucy (Australia) and Pedro Malan (Brazil) to serve as Trustees for a second three-year term, has been approved by the Monitoring Board of the IFRS Foundation. Chung, the first Trustee from Korea to join the IFRS Foundation.

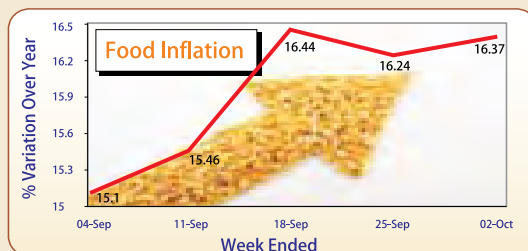
(Source: www.ifrs.org/News/)

■ ■ ■ Linda de Beer Appointed Chairman of IAASB Consultative Advisory Group

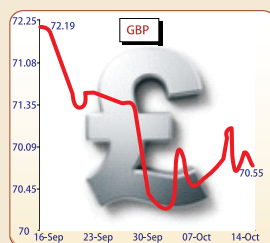
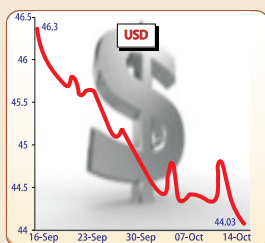
Prof. Linda de Beer has been appointed chairman of the Consultative Advisory Group (CAG) to the International Auditing and Assurance Standards Board (IAASB). As a representative of the Johannesburg Stock Exchange (JSE), Prof. de Beer currently represents the World Federation of Exchanges on the CAG. She was elected by the CAG membership to succeed the current CAG chairman, David Damant, who since June 2004 has served as the first independent IAASB CAG chairman. Prof. de Beer's appointment—a three-year term effective October 1, 2010—has been approved by the International Public Interest Oversight Board (PIOB). Prof. de Beer is an independent financial reporting and corporate governance advisor, and visiting professor at the University of the Witwatersrand in Johannesburg.

(Source: <http://press.ifac.org/news/>)

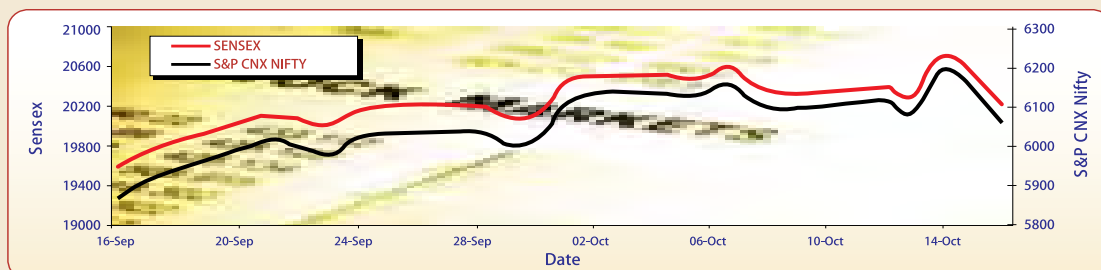
Economic Indicators



Indian Rupee vs. Major Foreign Currencies (September 16, 2010 to October 15, 2010)



Stock Markets



Selected Indicators

(per cent per annum)

Item	Unit/Base	2009	2010					
		Oct.02	Aug. 27	Sep.03	Sep.10	Sep.17	Sep.24	Oct.01
Cash Reserve Ratio ⁽¹⁾	Per cent	5.00	6.00	6.00	6.00	6.00	6.00	6.00
Bank Rate	Per cent per annum	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Base Rate ⁽²⁾	Per cent per annum	11.00-12.00	7.50-8.00	7.50-8.00	7.50-8.00	7.50-8.00	7.50-8.00	7.50-8.50
Deposit Rate ⁽³⁾	Per cent per annum	6.50-7.75	6.75-7.75	6.75-7.75	6.75-7.75	6.75-7.75	6.75-7.75	7.00-8.00
Call Money Rate (Low/High)	Per cent per annum	2.15/4.30	2.00/5.80	3.20/5.30	2.90/5.75	3.20/6.25	4.00/6.40	4.00/7.40

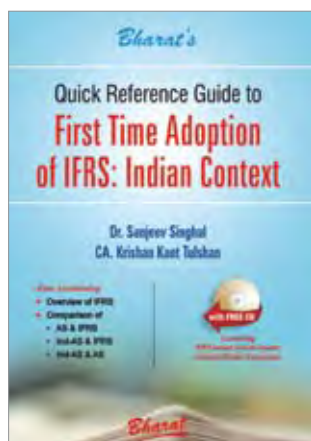
Notes: (1) Cash Reserve Ratio relates to Scheduled Commercial Banks (excluding Regional Rural Banks).

(2) Base Rate relates to five major banks since July 1, 2010. Earlier figures relate to Benchmark Prime Lending Rate (BPLR).

(3) Deposit Rate relates to major banks for term deposits of more than one year maturity.

Readers are Invited to contribute write-ups or any relevant and interesting piece of information for this feature at ebboard@icai.org.

Quick Reference Guide to First Time Adoption of IFRS: Indian Context*



Title :
Quick Reference Guide to
First Time Adoption of IFRS:
Indian Context
(With FREE CD
containing IFRS-
based annual reports of
Indian/Global companies)

Author :
Dr. Sanjeev Singhal and
CA. Krishan Kant Tulshan

Pages :
484

Price :
₹525

Publisher :
Bharat Law House Pvt. Ltd.

‘A book based on exposure drafts of Accounting Standards’ – surely a courageous effort. These exposure drafts are subject to change and shelf life of this book will be very short. Kudos to the authors for bringing out such a book so quickly. Both the authors are faculty members of ICAI certification course on IFRS and Dr Sanjeev is also member of Accounting Standard Board. Obviously the experience and authority on subject gets reflected in their writings. They have tried to address the basic but important issues in this book. The effort is commendable in today’s time when books on IFRS are being written left right and centre, and most of them are using a trick called ‘control c’ and ‘control v’, since lot of material is available on the net free of cost. Moreover both the authors are full time working in industry. No wonder a statement in preface is coming straight from their heart *“We also admire the patience of our family members...and kids...who were deprived of their share of attention in our already hectic schedules...”*

Coming to the contents of book, speed of bringing book in such short time might have surely thrown up challenges. A lot is expected when a book is from such experts. When I was asked to review the book – two questions came to my mind. Who is the target audience and what is objective of the book.

The book will be helpful for you if you have some basic questions in mind and want to refer something in simple manner – a *QUICK* capsule of latest information on IFRS adoption in India. First chapter will be of interest and that itself will be worth the money which you might have spent to buy this book, which is of course priced reasonable. Second chapter is general in nature – talking about challenges in easy language and coming directly out of personal experiences of the authors. ■

**Reviewed by CA. Parveen Kumar based in New Delhi*

Classifieds

4822 CA Firm requires 3 CA's and CA Inter having experience of 3 years for tax and audit work. Nagesh Behl & Co. 24/9 Moti Nagar, New Delhi -15. Contact: 9810611888.

4823 Baroda based practising CA having own office with 25 years industrial experience seeks assignment on partnership/contractual basis. Contact: 09376222666 or 0265-2324920.

4824 Ahmedabad based CA Firm seeks professional tie up with CA firms for Internal audit of construction

sector, audit of Consolidated accounts and IFRS conversion and indirect tax aspects of works contract. Contact: 9426024975, Statutory@smaca.in

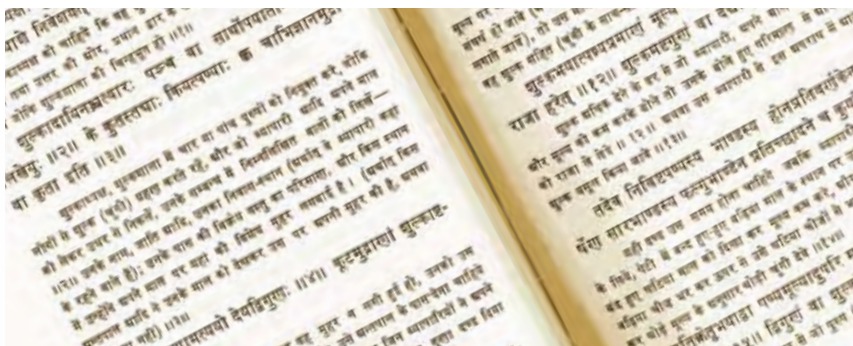
4825 We are a 30 years old firm with 5 partners at Mumbai. CA firms in Orissa, Chattisgarh, Madhya Pradesh, and Rajasthan with over 3 years experience, interested in networking as per norms of ICAI, on mutually acceptable terms, may please send their profile to Rajnikant Sahu, rajanikant@dgaca.net, Mob: 9869270425

The Institute of Chartered Accountants of India duly acknowledges the following members for making generous contributions to the Chartered Accountants Benevolent Fund (CABF):

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32		North Ex. CA Study Circle	21751.00

Tracing the Roots

Origin of Double Entry Book Keeping in India



"...In conclusion, a reference needs to be made to a pertinent observation made by Alexander Hamilton F.R.S., the noted orientalist. In the Book Review in "Monthly Review" 26(1798) page 129, he stated as under:

"We would remark that the Baniyas of India have been from time immemorial, in possession of the method of book-keeping by double entry, and what Venice was the emporium of Indian commerce at the time at which Friar Lucas's (Pacioli's) treatise appeared."

This observation has been quoted in the "Introduction of Studies in the History of Accounting" by B.S. Yamey, Sweet & Maxwell Ltd.-1956, at page 1. An observation has been appended to the effect that "Unfortunately, Hamilton did not indicate the basis for his remarks". Needless to say, the analysis attempted in the earlier paragraphs should more than provide that basis and establish beyond the shadow of any doubt that accounting and record keeping had taken roots in India from

time immemorial and accountancy as an occupation existed in our country even prior to the days of the Babylonian Empire. However, accounting with its present day refinements, no doubt, is of comparatively very recent origin. The profession of accountancy in the form familiar to us today is essentially a product of 19th century where the development of commerce, trade and industry engendered the need for competent persons with knowledge and ability to practice accountancy and the development of the corporate structure of business organization in the country resulting in a division between ownership of funds and their management has undoubtedly been one of the strongest influences on the evolution of both accounting and auditing as well as the profession of the accountancy as we know them now."

(Source: History of Accountancy Profession- Volume I by GP Kapadia)

Committee on Public Finance and Government Accounting – Invitation to Contribute Articles for E-Newsletter

The Committee on Public Finance & Government Accounting of The Institute of Chartered Accountants of India is regularly coming up with its E-Newsletter -'Prudence' featuring various articles on economic issues and measures on bi-monthly basis. The October-November 2010 issue of the E-Newsletter is available at the URL http://220.227.161.86/20669newsletter_cpfga_oct2010.pdf.

The Committee invites experts, researchers and writers to contribute articles in different areas of Public Finance and Government Accounting for publication in the December 2010 issue of its E-newsletter. If the article is published, a token honorarium of ₹2000/- per article shall be paid. Discretion of the Committee regarding publication /non-publication of the article shall be final and abiding therewith under copyright of the Committee. Material in this E-Newsletter may not be reproduced, whether in part or in whole, without

the consent of Editorial Board of Committee. Authors may only submit original work that has not been appeared elsewhere in any publication.

The articles may be sent to us in the form of soft copy through mail/CD or in printed format through post giving details of the subject matter.

Those desirous may please contact at the following address:

The Secretary
Committee on Public Finance and Government Accounting
The Institute of Chartered Accountants of India
'ICAI Bhawan', Indraprastha Marg
New Delhi-110002
Phone: 011-30110554(O)
Email: cpf_ga@icai.org

Residential Programme for PCC/IPCC/PE-II students/newly qualified Chartered Accountants

October 22, 2010

Residential Programme on Professional Skills and Development has been initiated by Board of Studies, ICAI for the benefit of Chartered Accountancy Students and newly qualified Chartered Accountants.

All the students who have passed PCC/IPCC/PE-II examination and pursuing last year of article training or newly qualified Chartered Accountants are invited to join the course. This programme offers an unique opportunity and would focus on development of communication skills, leadership skills, personal traits as well as technical skills for effective functioning in business organization and profession.

Six weeks Residential Programme shall commence from **December 1, 2010 at Centre of Excellence, ICAI, Hyderabad**, and Three months Residential Programme shall commence from **December 6, 2010 at National Institute of Financial Management, Faridabad**. Some of the

salient features are:

- An unique blend of Communication and Technical Skills;
- An integral part of Articleship Training;
- Exemption from 15 days GMCS course;
- Subsidised Fee Structure.

In view of the fact that there are **limited seats**, the registration will be done on **First -come-First-serve** basis.

Students interested to pursue this programme may visit website of the Institute (www.icai.org) for Announcement, details of programme and registration form.

Director, Board of Studies

ANNOUNCEMENT (For Mandatory compliance in terms of Clause (2) Part III of The First Schedule to the Chartered Accountants Act, 1949)

Indian CA firms having tie-up/affiliation with international entities/network

The Council of the Institute had recently considered the draft Report on Operation of Multinational Network Accounting Firms in India, which inter alia, was based on examination of documents/details provided by many CA firms registered with ICAI and having tie-up/affiliation with international entities/network and the relevant provisions of the Chartered Accountants Regulations, 1988. While considering the aforesaid draft report, the Council noted that announcements had been in the past hosted by the Institute in its website in June, 2009 and again in April, 2010, besides publishing the same in the July, 2009 issue of the journal, 'The Chartered Accountant' requiring all the Indian CA firms having tie-up/affiliation with international entities/network to furnish the following documents/details to the Institute:

- (1) Agreement/contract with the multinational entity
- (2) Terms and conditions for usage of name of multinational entity
- (3) Arrangement for sharing of fees/profit with other Indian CA firms with similar/identical name and with the multinational entity
- (4) Arrangement for sharing of human resources and infrastructure with other Indian CA firms with similar/identical name and with the multinational entity
- (5) Details of remittances made to and received from the multinational entity
- (6) Partnership deed (as on vogue in the last 5 years)
- (7) Income-tax assessment orders for the last 3 years. If assessment orders have not been received, then they may submit computation of income and copies of returns, and
- (8) Copies of letterheads and visiting cards generally used.

The Council further noted that pursuant to the above announcement, while many CA firms concerned had

responded by sending the documents however, there could still be some CA firms which might be having tie-up/affiliation with international entities/network, but have not disclosed the same to the Institute and thus have not submitted the required documents/details.

The Council, therefore, decided that suitable announcement be hosted in the website of the Institute once again, besides publishing the same in 'The Chartered Accountant' and the newsletters of the Regional Councils, so that the firms which have till now not responded is given a last and final opportunity. The Council also decided that in case on a later date, the Institute comes to know of any firms which have international tie-up/affiliation, but yet had not come forward to disclose the same and submit the documents/details called for, then necessary action under the provisions of the Chartered Accountants Act, 1949 be taken against them.

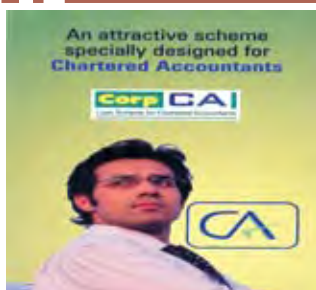
Accordingly, this announcement is published with a request that the CA firms which have till now not responded to the earlier announcements on the subject, now submit the documents/details to the below-mentioned officer of the Institute at the following address at the earliest, and thus comply with the requirements asked for by the Institute:

G. Ranganathan
Deputy Secretary
The Institute of Chartered Accountants of India
ICAI Bhawan
C-1, Sector 1,
Noida – 201 301.
Tel.: 0120-3054 823
Mobile.: 09350799933,
Email: ranga@icai.org

(T. KARTHIKEYAN)
Secretary, ICAI, New Delhi



An Initiative of the Committee for Capacity Building of CA Firms and Small & Medium Practitioners, ICAI.....



The Committee for Capacity Building of CA Firms and Small & Medium Practitioners, ICAI has taken a major initiative to arrange financial assistance to all members in practice/firms in the form of specially designed loan scheme through Corporation Bank. Through the scheme, eligible Chartered Accountants can avail finance for setting up offices including cost of furniture/fixture/office equipments-computers and other accessories. The scheme would also enable the Chartered Accountants to finance a part of the working capital for building their profession and will also take care of the needs of fresher (CAs with experience below three years)

* Members & firms are requested to avail the benefits of this loan scheme. For further details, please contact nearest branch of Corporation Bank.

Highlights of the loan scheme are given below:

Eligibility: # Chartered Accountants, individually/jointly or Proprietorship Concern or a Partnership Firm/ Partnership with Limited Liability # Age of the individual/ proprietor shall not exceed 65 years. # The applicants/ Firms are registered and also holding valid certificate/ license for carrying out the practice. # The applicant's/ firm's name shall not appear in the RBI defaulters list/ CIBIL report. # In case of Firms, all partners shall join as co applicants. # The applicants/firms should not have been subjected to disciplinary action by the Institute.	Purpose: # For construction of office premises # For acquisition of ready built new office premises, partly or fully constructed # To finance cost of land and construction thereon # To finance cost of furniture & fixture, fittings of office equipments /computers/ other accessories, etc. # To finance working capital and/or financing receivable
Nature of facility: # Demand Loan/Term Loan for acquisition of fixed assets and/or Cash Credit/Overdraft for working capital	Margin: # For Term Loan/Demand Loan: Uniform margin of 20% # For Working Capital: 25% for Book Debts/ Receivables for cash credit or clean overdraft # Value of land shall not exceed 50% of project cost in case of purchase of site and construction of premises

Quantum of loan:

Applicable For Freshers: (Experience below 3 years)				
		Metro	Urban	Other Centres
I.	Maximum eligibility: TL/DL * Out of which:	₹20 lakh	₹15 lakh	₹10 lakh
a.	For office premises	₹15 lakh	₹12 lakh	₹8 lakh
b.	For furnishing & Other assets	₹5 lakh	₹3 lakh	₹2 lakh
II.	For Working capital requirement	₹2 lakh	₹1 lakh	₹1 lakh

Applicable For Existing Firms (Having Practice for 3 Years & Above)

A) WHERE LATEST GROSS ANNUAL INCOME IS UPTO ₹5 LAKH (income includes professional fees/consultancy fees etc..)

		Metro	Urban	Other Centres
I.	Maximum eligibility : TL/DL * Out of which:	₹30 lakh	₹20 lakh	₹15 lakh
a.	for office premises	₹20 lakh	₹15 lakh	₹12 lakh
b.	For Furnishing & Other assets	₹10 lakh	₹5 lakh	₹3 lakh
II.	For Working capital	₹2 lakh	₹1 lakh	₹1 lakh

B] WHERE LATEST GROSS ANNUAL INCOME IS ABOVE ₹5 LAKH & UPTO ₹10 LAKH AS PER LATEST IT RETURN (with experience of 3 years and above)				
		Metro	Urban	Other Centres
I.	Maximum eligibility: TL/DL * Out of which:	₹50 lakh	₹25 lakh	₹20 lakh
a.	For office premises	₹40 lakh	₹20 lakh	₹15 lakh
b.	For Furnishing & Other assets	₹10 lakh	₹5 lakh	₹5 lakh
II.	For Working capital	₹5 lakh	₹2 lakh	₹2 lakh

C] WHERE LATEST GROSS ANNUAL INCOME IS ABOVE ₹10 LAKH, AS PER LATEST IT RETURN (WITH EXPERIENCE OF 3 YEARS AND ABOVE)				
		Metro	Urban	Other Centres
I.	Maximum eligibility : TL/DL * Out of which:	₹125 lakh	₹65 lakh	₹30 lakhs
a.	For office premises	₹100 lakh	₹50 lakh	₹25 lakh
b.	For Furnishing & Other assets	₹25 lakh	₹15 lakh	₹5 lakh
II.	For Working capital	Need based		

Security:

Term Loan /Demand Loan: Assets acquired out of the loan. # For Working Capital Loan: Assignment of Book Debts/Receivable. #Collateral security: Suitable third party guarantee or Tangible securities.

Repayment:

Term Loan – Repayable in maximum period of 10 years by EMI/PMI, initial moratorium of upto 18 to 24 months. # Demand Loan – Repayable in maximum 3 years by EMI/PMI, including initial moratorium of 6 months. # Repayment to commence from date of commercial operations or after completion of initial repayment holiday or as per the terms of sanction. # Interest shall be serviced as and when debited.

Rate of interest:

Upto ₹10 lakh – Min. 10% (Base Rate + 2.25%)

Above ₹10 lakh – Min. 10.75% (Base Rate + 3%)

(Investment in fixed assets less than ₹100 lakh)

Above ₹10 lakh – Min. 11.75% (Base Rate + 4%)

(Investment in fixed assets above ₹100 lakh)

*** Subject to gradation of the borrower**

Rate of interest at floating rate linked to Base Rate

Rate of interest is subject to review

Note: Concession of 0.50% extended, if additional collateral security viz., property, LIC policies, Deposit, etc., to the extent of 25% of loan amount is provided.

Processing Charges:

0.25% of loan amount subject to a minimum of ₹5000/-

Prepayment charges:

-Nil-

Special Placement Programme through Video Conferencing Mode for Organisations functioning in Gulf Council Countries (GCC)/Middle East, November - December, 2010

The Committee for Members in Industry of the Institute of Chartered Accountants of India provides opportunity to the employers to interact with newly qualified Chartered Accountants providing a cost effective mode of recruiting newly qualified Chartered Accountants.

Special Placement Programme is a step ahead as an extension to the same programme but with a different objective. For the first time CMII has taken an initiative to organise a separate Special Placement Programme through video conferencing mode for Chartered Accountants. Chartered Accountants are getting placed not only within the country but are also taking up jobs abroad. Many CAs are

providing their services to the organisations in GCC/ Middle East. To facilitate employment of chartered accountant in the GCC/Middle East, CMII of ICAI is organising Special Placement Programme.

This programme would enable the corporates working in **Gulf Council Countries (GCC)/Middle East** to recruit Chartered Accountants through video conferencing mode from Chennai, Kolkata, Mumbai and New Delhi centres from India.

Invitation to Chartered Accountants

It has been decided to organise Special Placement Programme at 4 centres, viz., Chennai, Kolkata, Mumbai and New Delhi centres through video

conferencing mode. A large number of leading organisations are expected to participate.

The schedule of the Special Placement Programme is as below:

Centre	Registration of the Companies	Registration of the Candidates	Short-listing by Companies	Consent sending by	Interviews
Chennai, Kolkata, Mumbai and New Delhi	Upto 22 nd November, 2010	23 rd November to 26 th November, 2010	1 st December, 2010	2 nd -3 rd December, 2010	7 th -8 th December, 2010

Eligibility of candidates for Special Placement Programme

Chartered Accountants fulfilling the following conditions are eligible to take part in Special Placements.

1. Having the membership number of Institute as on 20th November, 2010. The membership number should be available with you and would be required for registration.
2. Passed C.A. final examination on or before May, 2010.

The members who have got placements through the placement programme organized by the Institute between 01.10.2009 to 1.11.2010 are not eligible to apply.

Invitation to Employers

Corporates working in **Gulf Council Countries (GCC)/Middle East** can now end their search by participating in Special Placement Programme wherein they would have access to a vast database of members of The Institute of Chartered Accountants of India.

The event would provide an opportunity to companies to select Chartered Accountants as per their requirement criterion.

Organisations intending to recruit Chartered Accountants through the above scheme of Special Placement Programme are requested to get in touch with Committee for Members in Industry, Indraprastha Marg, New Delhi - 110002, Tel. No. (0091) (11) 30110450/491 E-mail: placements@icai.org, mii@icai.in.

An organisation can participate in one or more centres, as per its requirements. Firms of Chartered Accountants are also welcome to join. For further details please logon to www.cmii.icai.org.

Chairman
Committee for Members in Industry



ICAI Seek Space and Infrastructure to Conduct Campus Interviews

The Institute invites "Expression of Interest" from reputed Institutes (Colleges/ Schools)/ Chartered Accountants and others to provide furnished AC Rooms and other infrastructure for conducting placement activities like campus interviews, orientation programmes, etc on pan India basis for 2 to 6 days on periodic basis. The space in the room should be sufficient enough for conducting Group discussion of around 15-20 people simultaneously. Larger capacity Halls like theatres and auditoriums are also required to accommodate the candidates and to be used as announcement cum waiting area. There should also be a separate dining area.

CITY	MINIMUM NUMBER OF ROOMS	CAPACITY / APPROX. NUMBER OF CANDIDATES
Bangalore	6	200-300
Bhubaneswar	4	50

Delhi	6	700-800
Jaipur	5	300-400
Kanpur	4	50-100
Kolkata	6	250-350
Ludhiana	4	50-100
Mumbai	6	800-1000
Pune	5	300-400

Those interested may send the details of facilities available, within 15 days, to the undersigned at "The Institute of Chartered Accountants of India, 'ICAI Bhawan', Post Box Number 7100, Indraprastha Marg, NEW DELHI - 110 002." Emails can be sent to cmii@icai.org.

Secretary, CMII of ICAI



TRAINING WORKSHOPS ON AUDIT EXCELLENCE

24 CPE
HOURS

Organised by the Auditing and Assurance Standards Board

The Auditing and Assurance Standards Board of the Institute is organising *Training Workshops on Audit Excellence* to impart in depth knowledge on implementing the new/ revised Standards on Auditing issued by the ICAI under the Convergence and Clarity Project in the recent past.

Workshop highlights

- ✓ Practical case study-based approach
- ✓ Interactive classes
- ✓ Professionally developed reading material

Will also include industry specific Standards on Audit implementation issues eg Bank audit, Audit of PSE's etc.

Trainers

Senior and experienced members from the profession as well as faculty from reputed academic Institutions

Duration

Four days with six hours of technical sessions in each day

Participants

Maximum fifty per workshop

Fees

₹5000/- per participant (includes cost of reading material and lunch, Tea etc.)

Workshop schedules

The workshops will commence from the third week of November 2010. To start with, Training Workshops would be launched at New Delhi on 3rd December, at Chennai on 4th December, at Mumbai on 10th December, at Kolkata on 11th December, 2010.

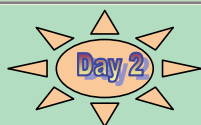
Registration will be strictly on first come first served basis.

Workshop structure



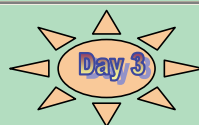
Topics Covered:

- Understanding the Clarity project & Convergence process (SA 200)
- Basic concepts of Assurance Engagements (Framework for Assurance Engagements)
- Terms of Audit Engagement (SA 210)
- Engagement Planning (SA 300)
- Risk Assessment Procedures (SA 315)
- Risk Assessment
 - Fraud Considerations (SA 240)
 - Laws and Regulations (SA 250)



Topics Covered:

- Materiality in Audit Planning & Performance (SA 320)
- Evaluation of Misstatements (SA 450)
- Evidence Gathering-I
 - Audit Evidence (SA 500 & SA 501)
- External Confirmation (SA 505)
- Analytical Procedures (SA 520)
- Audit Sampling (SA 530)
- Accounting Estimates (SA 540)
- Related Parties (SA 550)
- Subsequent Events (SA 560)
- Going Concern (SA 570)



Topics Covered:

- Risk responses (SA 330)
- Initial Engagement Considerations (SA 510)
- Management Representations and Communications with Management (SA 580, SA 260 & SA 265)
- Using Work of Others (SA 600, SA 610 & SA 620)
- Documentation (SA 230)



Topics Covered:

- Audit reporting (SA 700, SA 705, SA 706, SA 710 & SA 720)
- Quality Control of Audit (SQC 1)
- Additional Reporting Requirements (CARO, 2003)
- Industry Specific Audit Issues:
 - Bank Audits
 - Audit in Public Sector Enterprises
- Specific Audit Issues
 - Implementing auditing standards in smaller audit clients

For further details please contact:

Secretary, Auditing and Assurance Standards Board at 93507 99938

Email: auditworkshop@icai.org, Cc: aasb@icai.org

CPE
6
Hours

Seminar on Capacity Building Measures & New Professional Avenues

Organised by: Committee for Capacity Building of CA Firms and Small & Medium Practitioners

Hosted by: Hyderabad Branch of SIRC of ICAI

Date & Time	Venue
13 th November, 2010 8:30 a.m. to 5:30 p.m.	Centre of Excellence, ICAI, Plot no. 10 & 11, Nanakramguda, Hyderabad
Theme	
With advent of globalization and challenges posed by the liberalization process taking place worldwide, a need is felt for strengthening competencies of CA firms and small practitioners. ICAI's initiative is to enlarge visibility of CA profession and to rejuvenate practice portfolio of Small and Medium Practitioners. ICAI has formed CCBCAF&SMP Committee for popularizing effective union of CA firms by facilitating consolidation through Networking, Mergers and setting up Management Consultancy Services etc. Committee's focus is on enriching SMPs through Capacity Building measures for bringing up world class competency and brand image. This seminar will concentrate on issues & impediments related to capacity building as well as highlight emergent issues of profession.	
8:30 am to 9:30 am	Registration of Participants
9:30 a.m. to 9:45 a.m.	Inaugural Session
First Session 10:00 a.m. to 11:30 a.m.	Capacity Building Measures-Networking, Merger and Corporate Form of Practice
Second Session 11:30 a.m. to 12:30 p.m.	Limited Liability Partnership-Benefits to the Profession
Third Session 12:30 p.m. to 1:30 p.m.	Strategies for Wealth Creation, Wealth Maximization and Wealth Management
Fourth Session 2:30 p.m. to 3:30 p.m.	Practice Management, Partnership Deed and LLP Agreement
Fifth Session 3:30 p.m. to 4:30 p.m.	Service Tax & Roadmap to GST
4:30 pm to 5:30 pm	Open House & Valedictory Session
Registration Fees: ₹ 600/-	
For registration and further details, please contact	
Hyderabad Branch of SIRC of the Institute of Chartered Accountants of India, ICAI BHAWAN, 11-5-398/C, Red Hills, HYDERABAD – 500 004 ✉ : hyderabad@icai.org , ☎ : (040) 23317026, 23393182	

CPE
6
Hours

Conference on Capacity Building Measures & New Professional Avenues

Organised by: Committee for Capacity Building of CA Firms and Small & Medium Practitioners

Hosted by: Varanasi Branch of CIRC of ICAI

Date & Time	Venue
4 th December, 2010 8:30 a.m. to 6:00 p.m.	Hotel Ideal Tower, The Mall Cantt. Varanasi
Theme	
With advent of globalization and challenges posed by the liberalization process taking place worldwide, a need is felt for strengthening competencies of CA firms and small practitioners. ICAI's initiative is to enlarge visibility of CA profession and to rejuvenate practice portfolio of Small and Medium Practitioners. ICAI has formed CCBCAF&SMP Committee for popularizing effective union of CA firms by facilitating consolidation through Networking, Mergers and setting up Management Consultancy Services etc. Committee's focus is on enriching SMPs through Capacity Building measures for bringing up world class competency and brand image. This conference will concentrate on issues & impediments related to capacity building as well as highlight emergent issues of profession.	
8:30 am to 9:30 am	Registration of Participants
9:30 a.m. to 9:45 a.m.	Inaugural Session
First Session 10:00 a.m. to 12:00 a.m.	Capacity Building Measures-Networking, Merger and Corporate Form of Practice.
Second Session 12:00 p.m. to 1:15 p.m.	Tenders in Audit & ethical standards
Third Session 2:00 p.m. to 3:30 p.m.	Taxation on Charitable & Religious Trust
Fourth Session 3:30 p.m. to 4:30 p.m.	Scope of practice in Commercial Economic & Labour Laws
Fifth Session 4:30 p.m. to 5:30 p.m.	Service Tax: Key issues
5:30 pm to 6:00 pm	Open House & Valedictory Session
Registration Fees: ₹ 600/-	
For registration and further details, please contact	
Varanasi Branch of CIRC of ICAI , Plot No. 152, Shree Hari Apartment, Jawahar Nagar Ext. Colony, Near Chetmani Chauraha, Bhelupur (Durgakund), Varanasi, U.P.-221 005 , ✉ : varanasi@icai.org , ☎ : (0542)2390106	

ICAI AWARDS - 2010 – CORPORATE CA ACHIEVERS' ACCLAIM

The Committee for Members in Industry of the ICAI annually conducts a mega event Corporate Forum. In the forum contributions made by the chartered accountants who are working in corporate are recognized by way of awards in different categories. CEO's, Directors; CFO's and other managers who have achieved professionally are considered for different awards. It is a great opportunity for the members of the Institute to get their contributions recognized by their alma mater. The awards seek to:

- Acknowledge Chartered Accountants in industry who have demonstrated excellence in the way in which they conduct their profession.
- Acknowledge Chartered Accountants who are exemplary role models in the industry.
- Acknowledge Chartered Accountants who have created value to their company's stakeholders on a sustainable basis.

Award Categories		
CA Business Achiever (CEO/Directors/Equivalent Positions)	CFO	CA Professional Achiever (Managers in the early or middle part of their careers)
Financial Services Corporate SME CA Global Achiever Woman Others	Manufacturing sector Financial Sector Service Sector Information Technology Media and Entertainment Sector Telecom Sector FMCG Sector Infrastructure & Construction Healthcare Sector Engineering & Capital Goods sector Public Sector Woman Others	Manufacturing sector Financial Sector Service Sector Information Technology Media and Entertainment Sector Telecom Sector FMCG Sector Infrastructure & Construction Healthcare Sector Engineering & Capital Goods sector Public Sector Woman Others

The process of selection shall include inviting nominations, shortlisting and final selection. An eminent jury being chaired by Shri Adi Godrej, Chairman, Godrej Group, will finalise the recipients of awards. Chartered Accountants who would be interested to participate for the awards may fill in the nomination form available at www.icaai.org or www.cmii.icaai.org. You may also send a mail to cmii@icaai.org for a copy of the nomination form. The last date of receipt of nominations by the Committee for Members in Industry is **15th December 2010** to: The Secretary, Committee for Members in Industry, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Bag 7100, Indraprastha Marg, New Delhi - 110 002. You may contact us at cmii@icaai.org or call at 011-30110491.

CPE

6

Hours

ONE DAY WORKSHOP

Organised by: **COMMITTEE FOR MEMBERS IN INDUSTRY OF ICAI**Hosted by: **SURAT BRANCH OF WIRC OF ICAI**

Date & Time		27 th November 2010
Timing of Sessions	Details	
9.00 AM	Registration and Inaugural Session	
TOPICS:	1. IFRS 2. XBRL	
Participation Fees	₹ 700/- Cheque (local)/draft in favour of "Surat branch of WIRC of ICAI" payable at Surat and sent it to the address given below. Limited Seats, Registration on First Come First Serve Basis.	
Contact Details		
For Registration & further details, please contact	Surat Branch of WIRC of ICAI 3- A, Jaldarshan Apartment, Opp.Multistoried Bldgs., Nanpura, SURAT – 395 001 ✉ : surat@icaai.org ☎ : 0261-2472932,2464413,3207911	
		Chairman. CMII

CPE
12
Hours

TWO DAYS WORKSHOP ON Excellence in Profession

Organised by: **COMMITTEE FOR MEMBERS IN INDUSTRY OF ICAI**
Hosted by: **JABALPUR BRANCH OF CIRC OF ICAI**

Date & Time		Venue
24 th & 25 th November 2010		At Hotel Gulzar Palace, Jabalpur
Day 1: 24 th November, 2010		
Timing of Sessions	Details	
9.00 AM - 11.00 AM	Registration and Inaugural Session Inaugural Address by CA. Amarjit Chopra, President, ICAI	
Technical Session I 11:00 AM – 12:45 PM	Professional opportunities for chartered accountants in industry and in practice.	
Technical Session II 12:45 PM – 13:45 PM	Certification World—Key Issues.	
Technical Session III 14:30 PM – 16:30 PM	Service Tax- How to identify scope of levy & classification.	
Technical Session IV 16:30 PM – 18:00 PM	Construction of Business Correspondence—Deeds & Documents.	
Day 2: 25 th November, 2010		
Timing of Sessions	Details	
Technical Session V 10:00 PM – 12:00 PM	Income Tax- How to handle search & seizure proceedings.	
Technical Session VI 12:00 PM – 13:30 PM	Tenders in Auditing- Ethical Issues.	
Technical Session VII 14:15 PM – 16:00 PM	Scope for members in Commercial, Labour & Economic Laws	
Technical Session VIII 16:00 PM – 17:15 PM	CENVAT Credit for Service Tax	
17:15 PM – 18:15 PM	Open House and Valedictory Session	
Participation Fees	₹ 1250/- For ACA ₹ 1500/- For FCA Cheque (local)/draft in favour of “Jabalpur Branch of CIRC of ICAI” payable at Jabalpur and sent it to the address given below. Limited Seats, Registration on First Come First Serve Basis.	
Contact Details		
For Registration & further details, please contact	2095, Tayab Ali Chowk, Napier Town, Jabalpur - 482 002 (M.P) ✉ :jabalpur@icai.org ☎ : [+91] (761) 4063 656, 2627 236	
Chairman. CM		

Chairman, CMII

CPE
12
Hours

Two Days Residential Refresher Course at Bodhgaya

Organised by: **Committee on Economic, Commercial Laws & WTO**
and **Committee on Professional Education**
Hosted by: **Patna Branch of CIRC**

Date & Time		Venue
November 27 & 28, 2010 [Saturday & Sunday] The Programme will commence at 11.30 AM on November 27, and conclude at 2.15 PM on November 28, 2010.		Sambodhi Resort, Bodhgaya
Theme		
In the era of globalization and increasing competition across the world over, at every stage the need arises to adopt different strategies to combat the emerging competitive issues tactfully. The objective of this two Days Residential Refresher Course is to provide a forum to discuss the emerging issues and Impacts related to the dynamics of the various sectors.		
Topics to be Discussed	Speakers	
Professional Opportunity in Economic, Commercial & Allied laws and WTO	Moderator: CA. S. P. Sinha Resource: CA.Rajkumar S. Adukia	
Internal Audit especially valuation rules of Central Excise, Service Tax and VAT Laws,	Moderator: CA. Rakesh Sangreria Resource: CA. P. Rajendra Kumar	

Audit documentation including peer review, quality review and review by financial report review board (with special reference to tax audit documentation)	Moderator: CA. Saba Mahmood
Social Audit	CA. Vijay Garg
Overview of IFRS	CA. Shiwaji Zaware
Government Accounting with Special Reference to Accounting of the Local Urban Bodies & Panchayati Raj	Eminent faculty(ies)
Fees - Residential (including accommodation, breakfast, lunch, dinner and course material): ₹4000/- For Member on twin Sharing basis ₹3000/- For Spouse, other family member/ guest each, ₹1000/- For Children each (Age 5 to below 10 years) - Non Residential (without accommodation & Transportation): ₹2500/- For members and ₹2,300/- For Spouse, other family member/ guest each, ₹1000/- For Children each (Age 5 to below 10 years) Children up to 05 years Complimentary.	
For registration and further details, please contact	
☎: 0612-2238750, 3200796 ✉ patna@icai.org; icai_patna@yahoo.co.in Ph: 011 – 30110499, ✉: ctlwto@icai.org; cecl@icai.in. The detailed announcement will be hosted on the website www.icai.org shortly.	

CPE
12
Hours

TWO DAYS WORKSHOP ON Excellence in Service Tax

Organised by: **COMMITTEE FOR MEMBERS IN INDUSTRY OF ICAI**
Hosted by: **MATHURA BRANCH OF CIRC OF ICAI**

Date & Time	Venue
17 th & 18 th December 2010	At Hotel Brijwasi Royal, Mathura
Day 1: 17th December, 2010	
Timing of Sessions	Details
9.00 AM - 10.00 AM	Registration and Inaugural Session
Technical Session I 10:00 AM – 12:00 PM	Service Tax: How to decide taxability & classifications.
Technical Session II 12:00 PM – 13:30 PM	Service Tax: Key Issues on Real Estate Transaction..
Technical Session III 14:30 PM – 16:00 PM	Other key services.
Technical Session IV 16:00 PM – 18:00 PM	Exemption Notification—How to decide the scope.
Day 2: 18th December, 2010	
Timing of Sessions	Details
Technical Session V 10:00 AM – 12:00 PM	How to handle departmental proceedings—Search, Seizure, assessments, ad-judication & appeals proceedings.
Technical Session VI 12:00 PM – 13:30 PM	Valuation of taxable services.
Technical Session VII 14:15 PM – 16:45 PM	CENVAT Credit
16:45 PM – 17:45 PM	Open House and Valedictory Session
Participation Fees	₹1500/- Cheque (local)/draft in favour of "Mathura branch of CIRC of ICAI" payable at Mathura and sent it to the address given below. Limited Seats, Registration on First Come First Serve Basis.
Contact Details	
For Registration & further details, please contact	Bohre Ji Ka Bada, Near K. R. Degree College, Bhens Bahora, MATHURA - 281 001 (U. P.) ✉ :mathura@icai.org ☎: [+91] (565) 2501 122
Chairman, CMII	

CPE
12
Hours

NATIONAL CONFERENCE

Organised by: **Direct Taxes Committee of ICAI and Committee for Members in Industry of ICAI**

Hosted by: **The Ahmedabad branch of WIRC of ICAI**

Date		Venue	
4 th December, 2010 and 5 th December, 2010		Sindhu Bhavan, Off. S.G.Road, Ahmedabad.	
Programme structure			
Date	Timing	TOPICS	Faculty
04/12/2010	10.00 AM to 11.00 AM	Inauguration Chief Guests: Shri S. S. N. Moorthy, Chairman CBDT Shri Amarjeet Chopra, President of ICAI	
	11.00 AM to 12.15 PM	CFC/GAAR/Place of effective management under DTC	Pranav Sayta
	12.15 PM to 1.30 PM	Provision of Section 56(2)	Rajesh Kadakia
	2.30 PM to 3.15 PM	Opportunities & Challenges for the profession	Y. M. Kale*
	3.15 PM to 4.30 PM	Business Valuation (Including under FEMA)	Sujal Shah
	4.30 PM to 5.45 PM	Penalties – Recent Trend	Saurabh Soparkar
05/12/2010	9.30 AM to 10.30 AM	Future of the Profession	G. Ramaswami, Vice President of ICAI
	10.30 AM to 12.15 PM	IFRS Convergence in India - Challenges	N. P. Sarda*
	12.15 PM to 1.30 PM	Business Deductions including impact of Section 14A	Padamchand Khincha
	2.30 PM to 3.00 PM	Speech by Industrialist	Eminent Industrialist
	3.00 PM to 4.15 PM	Import & Export of Service Tax	A. R. Krishnan
	4.15 PM to 5.30 PM	Transfer Pricing – Practical Perspective	Vijay Iyer
For registration and further details, please contact			
Ahmedabad Branch of Western India Regional Council, The Institute of Chartered Accountants of India 'ICAI BHAWAN', 123, Sardar Patel Colony, Near Usmanpura Underbridge, Naranpura, Ahmedabad - 380 014 ☎: +91 (79) 39893989 / 27680537 / 27680946/ 39821002			

*Subject to confirmation

CPE
12
Hours

TWO DAYS NATIONAL CONFERENCE

Organised by: **COMMITTEE FOR MEMBERS IN INDUSTRY OF ICAI**

Hosted by: **GUWAHATI BRANCH OF EIRC OF ICAI**

Date & Time		Venue	
17 th & 18 th December 2010		At Pragjyoti ITA Centre for performing Arts, Machhowa, Guwahati	
Day 1: 17 th December, 2010			
Timing of Sessions	Details		
9.30 AM - 10.30 AM	Registration and Inaugural Session Inaugural Address by CA. Amarjit Chopra, President, ICAI and CA. G. Ramaswamy, Vice-President, ICAI		
Technical Session I 10:45 AM – 13:45 PM	IFRS and AS and AAS.		
Technical Session II 14:45 PM – 17:45 PM	Corporate Laws		
Day 2: 18 th December, 2010			
Timing of Sessions	Details		
Technical Session III 10:00 AM – 13:00 PM	Direct Taxation.		
Technical Session IV 14:00 PM – 17:00 PM	Session on India Economy.		
Participation Fees	CAs – ₹ 2000/-	CA Students – ₹ 700/-	Others – ₹ 2000/-
	Cheque (local)/draft in favour of "Guwahati Branch of EIRC of ICAI" payable at Guwahati and sent it to the address given below.		
	Limited Seats, Registration on First Come First Serve Basis.		
Contact Details			
For Registration & further details, please contact	Please send your registration to Guwahati Branch of EIRC of ICAI ICAI Bhawan, 2 nd Bye Lane, Manik Nagar, R G Baruah Road, Guwahati – 781005 ✉ : icai.guwahati@gmail.com , guwahati@icai.org ☎: 0361-2207660		
Chairman. CMI			

Chairman, CMII

**Jointly Organised by the CPE Committee & Auditing and Assurance Standards Board
of the ICAI**

**confirmation awaited*



ICAI's Corporate Forum

Committee for Members in Industry (CMII) of ICAI is pleased to announce the conduct of the comprehensive three days Corporate Forum event in January 2011. Creation of Employment Opportunities, Enhancing Knowledge and Skill Sets and Recognition of the exemplary work of members in Industry are the primary goals of the CMII. Keeping this in mind, the CMII will organise this unique Annual Corporate Forum tentatively from 28th January to 30th January, 2011. The ICAI forum comprises of high-profile concurrent events, i.e.

- Career Ascent – Mid Career Campus
- Special Campus Placement Programme
- Corporate Conclave – In Pursuit of Excellence
- Capital Advantage – Invest & Buy Mart
- ICAI Awards 2010 – Corporate CA Achiever's Acclaim

Brief details of the programmes are as under:

1) CAREER ASCENT – Mid Career Campus (28th, 29th, 30th January 2011):	To provide Chartered Accountants who have one year or more of industry experience with growth and career prospects, enabling them to realize their full potential and aspirations and widen their horizon. It will also enable employers seeking experienced CAs to identify and recruit talent best suited to their (organisations') requirements.
2) SPECIAL CAMPUS PLACEMENT PROGRAMME (28th, 29th, 30th January 2011):	For Chartered Accountants who had undergone three months Residential Programme of ICAI on Professional Skills Development wherein prospective employers and candidates interact and explore the possibility of taking up employment careers in various organisations.
3) CORPORATE CONCLAVE – In pursuit of Excellence (28th, 29th, 30th January 2011):	Three one day National Conclaves on contemporary topics to enrich the knowledge and to enhance the skill sets of members.
4) CAPITAL ADVANTAGE – Invest & Buy Mart (28th, 29th, 30th January 2011):	Capital Advantage exhibition is a platform where Chartered Accountants and Corporates from all over India would mark their presence. This would enable various organisations involved in Banking, Insurance, Mutual Funds, Capital Markets, Real Estate, Information Technology products and services and other technological products to interact with Chartered Accountants, Investors, Finance Fraternity, and Corporate Decision Makers.
5) ICAI AWARDS 2010 – Corporate CA Achievers' Acclaim (30th January 2011):	Would honour the exemplary work of Chartered Accountants in Industry by recognising those who have demonstrated excellence in the professional life, personal life and are the role models for others in industry. These Corporate CA Achievers Acclaim Awards of ICAI also seek to acknowledge Chartered Accountants who have created value to their company's stakeholders on a sustainable basis.

For registration and further details, please contact

ICAI Corporate Forum will be a unique opportunity for the members of ICAI to participate in an event which will provide them knowledge, Career Opportunities and the chance to be recognised amongst the best in the profession. For details, please visit, www.cmii.icai.org, www.icai.org. If you need any assistance/details regarding any of the events in the Corporate Forum 2011, feel free to get in touch with us at service_mii@icai.org or 011-30110549.

CPE

12
Hours**International Conference on Accountancy Profession:**
Catalyst to Sustained Economic Growth' on 4 – 6 January, 2011 at
Vigyan Bhawan, New Delhi

As the world becomes 'The Global Village', the accounting profession as an integral instrumentality in the process of transition has witnessed a paradigm change in its contributory role in every sphere of the transformation. The shift in the business philosophies further emphasises on a broadened role for the accountancy professionals as strategy formulators and facilitators. While moving to such role of a value creator, the Institute of Chartered Accountants of India (ICAI) has endeavoured to imbibe the best practices model by analysing the best approach as available amongst varied corporates in different parts of the world and has been playing the role of an enabler by getting the relevant stakeholders exposed to such best practices.

The ICAI, recognizing its role and responsibilities to the stakeholder community at large is organising an International Conference on the theme '**Accountancy Profession: Catalyst to Sustained Economic Growth**' on 4th – 6th January, 2011 at Vigyan Bhawan, New Delhi to dwell deeper

in to emerging paradigm of Accountancy Profession and bring the Indian and global perspective together on the following broad issues that are of contemporary relevance:

- Economic Resilience through Good Governance
- Harmonisation of Global Standards on Accounting: Sharing Lessons Learnt so far
- Perspective for Emerging Context
- Landscaping Brand Indian Chartered Accountant Globally
- Journey from Financial Reporting to Business Reporting
- Bridging Expectation Gap: Addressing Public Perspective Post Satyam Fiasco
- Global Paradigm of Auditing Standards
- Meeting Governance Mandate through Entrepreneurial Vision
- Panel Discussion on Country Perspective on Governance & Ethics
- Professional Panorama

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‘Unique Identification Number’ to Pave Way for a New India

India's ambitious Unique ID project, dubbed 'Aadhaar', which aims to provide every Indian citizen (1.2 billion approx.) a unique 12-digit number mapped to biometrics, was recently launched in Nadurbard district of Maharashtra. The programme to provide UID is an opportunity for India to design a 21st century system of identification that could be a significant improvement over the 19th and 20th century systems in use in developed countries like United States of America and Italy. The unique identification numbers will take into account the database of the poor and the marginalized people, mostly living in the rural areas. The numbers will, for the first time, provide an identity to those who need it the most. The project has great potential as it sets out to take within its purview the not-so-privileged residents of India. Read on to know more.

Mushtaque Ali

(The author is a banking professional. He can be reached at mushtaq112@gmail.com)



One of the key challenges faced by people in India is difficulty in establishing identity. People have multiple identity documents, each serving a different purpose. The most important characteristic of 'Aadhaar' is its universality and it is assumed that the biometric card with the number will be gradually accepted across the country as the identification number by all service providers and government agencies. It is assumed by the Unique Identification Authority of India (UIDAI) that the card will increase the trust between private and public agencies and reduce the denial of services to people who have no identification. The number will also hopefully reduce the hassle of repeatedly proving identity by various documents to avail services like opening a bank account and obtaining passport or driving licence and so on. For the people living below the poverty line and the ones who are entitled to various government-run welfare programmes, the number and the biometric data will help in identifying the beneficiaries.

India's ambitious Unique ID project is a step towards putting India in the club of more than 50 countries around the world that have some form of national identity cards. These include most of continental Europe (not the UK), China, Brazil, Japan, Iran, Israel

and Indonesia. The number will be stored in a centralized database and linked to the basic demographics and biometric information photograph, ten fingerprints and iris of each individual. The number will be unique and would be available for online and offline verification and, hence, will rule out the possibility of duplicate and fake identities from government as well as various private databases.

Concept: Name and Logo

Brand Name: The brand name of the Unique Identification number (UID) has been decided to be 'Aadhaar'. 'Aadhaar' translates into 'foundation', or 'support' and is present across most Indian languages. As Mr. Nandan Nilekani, Chairman of the UIDAI notes, "The name Aadhaar communicates the fundamental role of the number issued by the UIDAI the number as a universal identity infrastructure, a foundation over which public and private agencies can build services and applications that benefit residents across India." Aadhaar's guarantee of uniqueness and centralised, online identity verification would be the basis for building these multiple services and applications, and facilitating greater connectivity to markets. Aadhaar would also give any resident the ability to access these services and resources, anytime,

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anywhere in the country. Aadhaar can for example, provide the identity infrastructure for ensuring financial inclusion across the country – banks can link the unique number to a bank account for every resident, and use the online identity authentication to allow residents to access the account from anywhere in the country. Aadhaar would also be a foundation for the effective enforcement of individual rights. A clear registration and recognition of the individual's identity with the state is necessary to implement their rights – to employment, education, food, etc. The number, by ensuring such registration and recognition of individuals, would help the state deliver these rights.

The Logo: The design, which has been selected as the logo for Aadhaar, is a sun in red and yellow, with a fingerprint traced across its centre. The logo effectively communicates the vision for Aadhaar. It represents a new dawn of equal opportunity for each individual, a dawn which emerges from the unique identity the number guarantees for each individual.

What is Aadhaar?

Aadhaar is a 12-digit unique number which the Unique Identification Authority of India (UIDAI) will issue for all residents. The number will be stored in a centralised database and linked to the basic demographics and biometric information – photograph, ten fingerprints and iris – of each individual. Aadhaar will be easily verifiable in an online, cost-effective way. It will be unique and robust enough to eliminate the large number of duplicate and fake identities in government and private databases. It will be a random number generated, devoid of any classification based on caste, creed, religion and geography.

Why Aadhaar?

Aadhaar-based identification will have two unique features:

- Universality, which is ensured because Aadhaar will over time be recognised and accepted across the country and across all service providers.
- Every resident's entitlement to the number.

The number will consequently form the basic, universal identity

infrastructure over which Registrars and Agencies across the country can build their identity-based applications. UIDAI will build partnerships with various Registrars across the country to enrol residents for the number. Such Registrars may include state governments, state Public Sector Units (PSUs), banks, telecom companies, etc. These Registrars may in turn partner with enrolling agencies to enrol residents into Aadhaar.

Aadhaar will ensure increased trust between public and private agencies and residents. Once residents enrol for Aadhaar, service providers will no longer face the problem of performing repeated Know Your Customer (KYC) checks before providing services. They would no longer have to deny services to residents without identification documents. Residents would also be spared the trouble of repeatedly proving identity through documents each time they wish to access services such as obtaining a bank account, passport, or driving license, etc.

By providing a clear proof of identity, Aadhaar will empower poor and underprivileged residents in accessing services such as the formal

WHAT AADHAAR IS	WHAT AADHAAR ISN'T
• A number (12 Digits)	• Another Card
• For every individual, including infants	• One per family
• Enables identification, and is for every resident	• Establishes citizenship and is only for Indians
• Will collect demographic and biometric information to establish uniqueness of individual	• Will collect profiling information such as caste, religion, language
• Voluntary	• Mandatory
• For every resident, irrespective of existing documentation	• Only for individuals who possess identification documents
• Each individual will be given a single unique ID number	• Individual can obtain multiple AADHAARs
• UIDAI will enable a universal identity infrastructure that any ID based application like ration card, passport, etc. can use	• AADHAARs will replace all other IDs
• UIDAI will give a "Yes" or "No" response for any identification authentication queries	• UIDAI information will be accessible to public and private agencies

“Banks in India are required to follow customer identification procedures while opening new accounts, to reduce the risk of fraud and money laundering. The strong authentication that the UIDAI will offer, combined with its KYR standards, can remove the need for such individual KYC by banks for basic, no-frills accounts. It will thus vastly reduce the documentation the poor are required to produce for a bank account, and significantly bring down KYC costs for banks.”

banking system and give them the opportunity to easily avail various other services provided by the Government and the private sector. The centralised technology infrastructure of the UIDAI will enable 'anytime, anywhere, anyhow' authentication. Aadhaar will thus give migrants mobility of identity. Aadhaar authentication can be done both offline and online, online authentication through a cell phone or land line connection will allow residents to verify their identity remotely. Remotely, online Aadhaar-linked identity verification will give poor and rural residents the same flexibility that urban non-poor residents presently have in verifying their identity and accessing services such as banking and retail. Aadhaar will also demand proper verification prior to enrolment, while ensuring inclusion. Existing identity databases in India are fraught with problems of fraud and duplicate or ghost beneficiaries. To prevent these problems from seeping into the Aadhaar database, the UIDAI plans to enrol residents into its database with proper verification of their demographic and biometric information. This will ensure that the data collected is clean from the beginning of the programme. However, much of the poor and under-privileged population lack identity documents

and Aadhaar may be the first form of identification they will have access to. The UIDAI has said that it will ensure that its Know Your Resident (KYR) standards do not become a barrier for enrolling the poor and has accordingly developed an Introducer system for residents who lack documentation. Through this system, authorised individuals ('Introducers') who already have an Aadhaar, can introduce residents who don't have any identification documents, enabling them to receive their Aadhaar.

UID and Financial Inclusion

In the last 20 years, India has undergone a transformation of its economic and regulatory structures. Policy reforms in this period have led to the increasing maturity of our markets, as well as healthy regulation. The emphasis on de-licensing, entrepreneurship, the use of technology and decentralisation of governance to the state and local level have in particular, shifted India from a restrictive, limited access society to a more empowered, open access economy, where people are able to access resources and services more easily and effectively.

But despite these efforts, access to finance has remained scarce in rural India, and for the poorest residents in the country. Today, the proportion of rural residents who lack access to bank accounts remains at 40 per cent, and this rises to over three-fifths of the population in the east and north-east parts of India. This exclusion is debilitating. Economic opportunity is after all, intertwined with financial access. Such financial access is especially valuable for the poor—it offers a cushion to a group whose incomes are often volatile and small. It gives them opportunities to build savings, insure themselves against income shocks and make investments. Such savings and insurance protect the poor against potentially ruinous

events—illness, loss of employment, droughts, and crop failures. However, due to the lack of access to financial services, many of the Indian poor face difficulties in accumulating savings.

To mitigate the lack of financial access in India, the regulator has focused on improving the reach of financial services in new and innovative ways — through no-frills accounts, the liberalisation of banking and ATM policies, and branchless banking with business correspondents (BC's), which enables local intermediaries such as self-help groups and kirana stores to provide banking services. Related efforts have also included the promotion of core-banking solutions in Regional Rural Banks; and the incorporation of the National Payment Corporation of India (NPCI) to provide a national infrastructure for payments and settlements in the country.

Advancements in technology such as core banking, ATMs, and mobile connectivity have also had enormous impact on banking. Mobile phones in particular present an enormous opportunity in spreading financial services across India. These technologies have reduced the need for banks to be physically close to their customers, and banks have been consequently able to experiment with providing services through Internet as well as mobile banking. These options, in addition to ATMs, have made banking accessible and affordable for many urban non-poor residents across the country.

Besides challenges of access and identity, a third limitation has been the cost of providing banking services to the poor who transact in smaller amounts, commonly referred to as micropayments. Banks consider such payments unattractive since transaction costs may be too high to bear. The Unique Identification number (Aadhaar), which identifies individuals uniquely on the basis

of their demographic information and biometrics will give individuals the means to clearly establish their identity to public and private agencies across the country. It will also create an opportunity to address the existing limitations in financial inclusion. The Aadhaar can help poor residents easily establish their identity to banks. As a result, banks will be able to scale up their branch-less banking deployments and reach out to a wider population at lower cost.

An efficient, cost effective payment solution is a dire necessity for promoting financial inclusion. The Aadhaar and the accompanying authentication mechanism coupled with rudimentary technology application can provide the desired micropayment solution. This can bring low-cost access to financial services to everyone, a short distance from their homes.

The key features of Aadhaar-enabled micropayments outlined are as follows:

(a) UIDAI Know Your Resident (KYR) sufficient for Know Your Customer (KYC):

Banks in India are required to follow customer identification procedures while opening new accounts, to reduce the risk of fraud and money laundering. The strong authentication that the UIDAI will offer, combined with its KYR standards, can remove the need for such individual KYC by banks for basic, no-frills accounts. It will thus vastly reduce the documentation the poor are required to produce for a bank account, and significantly bring down KYC costs for banks.

(b) Ubiquitous BC network and BC choice:

The UIDAI's clear authentication and verification processes will allow banks to network with village-based BC's such as self-help groups and kirana stores. Customers will be able to withdraw money and make

deposits at the local BC. Multiple BC's at the local level will also give customers a choice of BC's. This will make customers, particularly in villages, less vulnerable to local power structures, and lower the risk of being exploited by BCs.

(c) A high-volume, low-cost revenue approach:

The UIDAI will mitigate the high customer acquisition costs, high transaction costs and fixed IT costs that we now face in bringing bank accounts to the poor.

(d) Electronic transactions:

The UIDAI's authentication processes will allow banks to verify poor residents both in person and remotely. Rural residents will be able to transact electronically with each other as well as with individuals and firms outside the village. This will reduce their dependence on cash, and lower costs for transactions. Once a general purpose Aadhaar-enabled micropayments system is in place, a variety of other financial instruments such as micro-credit, micro-insurance, micro-pensions, and micro-mutual funds can

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be implemented on top of this payments system.

The Aadhaar-enabled micropayments solution is just one of the many developmental applications of the Aadhaar.

Financial Institutions as Registrars:

The UIDAI has appointed various registrars and partners for its ambitious UID project. These are the following:

- Bank of India
- Bank of Baroda
- Central Bank
- United Bank of India
- Corporation Bank
- Indian Bank
- Punjab and Sind Bank
- Punjab National Bank
- State Bank of India
- Union Bank
- Canara Bank

Partners:

- Department of Posts
- Life Insurance Corporation of India (LIC)
- Ministry of Petroleum and Natural Gas
- MNREGA
- National Coalition of Organisations for Security of Migrant Workers
- Oriental Bank of Commerce

Who Can Get an Aadhaar?

An individual who is a resident in India and satisfies the verification process laid down by the UIDAI can get an Aadhaar.

How to Get an Aadhaar?

The process to get an Aadhaar will be circulated by the local media across the country upon which residents need to go to the nearest Enrolment Camp to register for an Aadhaar. A technoholik.com team recently got a sneak peek at the UIDAI tech centre in Bangalore to find out what a common man need to know about the enrolment process. Following is process as found by technoholik.com.

The Setup: The enrolment office (EO) sits at right angles to the candidate and enters data into a laptop. The insight of the Aadhaar team here is that the person getting enrolled must see what is being entered. Thus, there's a monitor in front of you, which mirrors the enrolment officer's screen so that you can point out spelling mistakes or other errors. If the person getting enrolled is illiterate, he or she can nominate someone to accompany and verify. There's a small laser printer behind the EO's laptop and a webcam, fingerprint reader and iris scanner account for the remainder of the hardware setup.

Compulsory Information: Name (first and last name compulsory, but middle name optional), Gender (Male/Female/Transgender) and Date of Birth are the compulsory fields. Whereas postal address is also required, it's more for the sake of mailing you UID number than strictly being a proof of residence. The EO asks you for a PIN code and city/district fields are automatically populated.

Supporting Documents: The UID team acknowledges the fact that a large number of people may not have any supporting documents to prove their identity. In this case, one is allowed to bring another resident who is already in possession of an Aadhaar number to be an 'introducer' by vouching for the person seeking to enrol. Of course, there is scope of fraud either with a colluding introducer or by just using fake supporting documents. However, the whole point of Aadhaar is that one can only fake one's identity once and this prevents large-scale 'ghost identity' creation, which is the bane of most Indian government schemes. The great PAN (Permanent Account Number with Income Tax department) card scam after all involved a single person creating thousands of different PAN numbers.

Photograph: A photograph is taken of the person getting enrolled, purely for the purpose of printing it out on

the enrolment receipt, so that illiterate residents have some way of knowing that the receipt indeed belongs to them. Beyond that, the photograph serves no biometric or authentication purpose.

Biometrics: First there's an iris scan where you look into a binocular-like device held up to your eyes by the EO. After that it's the four fingers of each hand, followed by both thumbs (a process similar to those entering the US) for your fingerprints.

The wait: The EO makes you review the data entered one final time before giving you a laser-printed receipt. One has to walk away with their receipts and have to wait for the actual number to be delivered by India Post within 20 to 30 days.

Contact Centre Details: The UIDAI will set up a Contact Centre to manage all queries and grievances and serve as a single point of contact for the organisation. The details of the Contact Centre will be published on the website as and when enrolment begins. The users of this system are expected to be residents, registrars and enrolment agencies. Any resident seeking enrolment is given a printed acknowledgement form with an Enrolment Number, that enables the resident to make queries about her/his enrolment status through any communication channel of the contact centre. Each enrolment agency will be given a unique code that will also enable faster and pointed access to the Contact Centre that includes a technical helpdesk.

Why is the UID Criticized by Some people?

The main criticism of the UID is based on privacy concerns. The project is criticized because, unlike Western countries, India is not known for stringent data protection laws and the opposing group fears data theft and selling of the vital information to a third

“The compulsory information for enrolment for UID includes- Name (first and last name compulsory, but middle name optional), Gender (Male/Female/Transgender) and Date of Birth are the compulsory fields. Whereas postal address is also required, it's more for the sake of mailing you UID number than strictly being a proof of residence. The EO asks you for a PIN code and city/district fields are automatically populated. The UID team acknowledges the fact that a large number of people may not have any supporting documents to prove their identity. In this case, one is allowed to bring another resident who is already in possession of an Aadhaar number to be an 'introducer' by vouching for the person seeking to enroll.”

party by corrupt officials. Apart from this, they argue, it's an individual's right to protect his or her privacy from any unlawful interference, even by the state. Article 21 of the Constitution, the Hindu Marriage Act, the Copyright Act, Juvenile Justice (Care and Protection of Children) Act, 2000 and the Code of Criminal Procedure all place some form of restrictions on the release of personal information.

Is it mandatory or voluntary?

Considering privacy concerns, UIDAI has kept provision of voluntary registration at enrolment camps to obtain the number. Critics, however, argue that once the programme gets linked to welfare programmes, the PDS system and availing of various services, it will lose its true voluntary nature. Hence, it's also important to have stringent laws to prevent denial of service in such situations. ■

CROSS

WORD 053

ACROSS

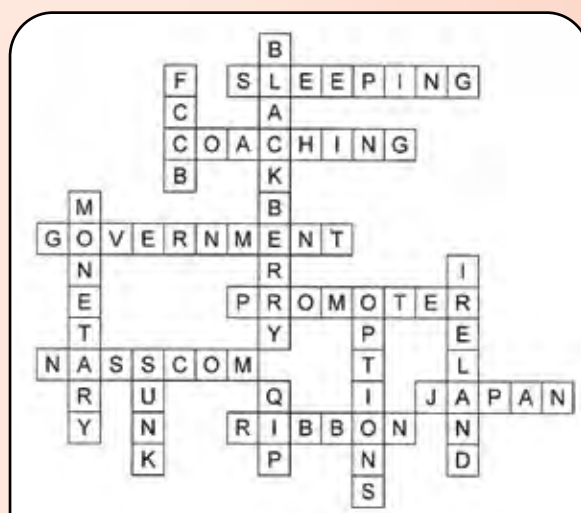
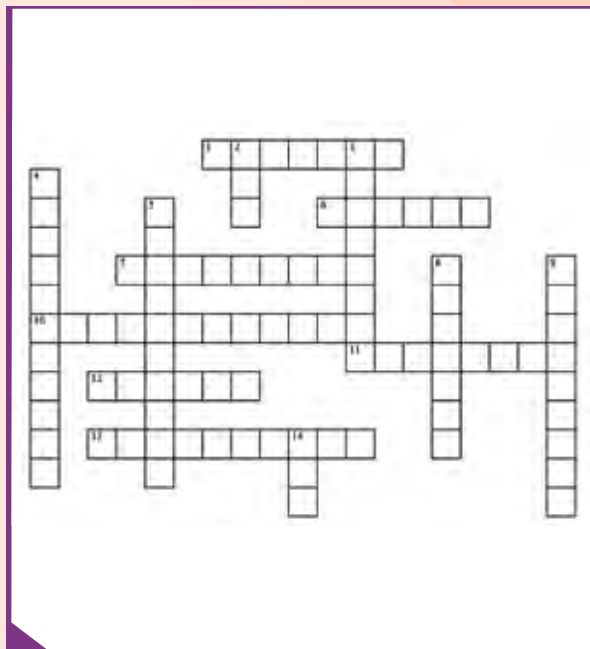
1. SEBI has recently permitted the NSE and USE to start trading in currency _____. (7)
6. Total number of digits in the Unique Identification Number proposed to be given to all Indian citizens. (6)
7. All IFRS-converged Accounting Standards have been cleared by the Council of the ICAI except that on _____ contracts. (9)
10. 22nd Chapter of the ICAI. (3,2,7)
11. Balkans and Middle East Countries Auditing and Accounting History Conference was held at _____. (8)
12. Brand name of Unique ID project of Government of India. (6)
13. Levy named 'Vartanam' or 'Dwarodaya' mentioned in Kautilya's Arthashastra, which were collected on all foreign commodities imported in India, is today known as _____. (6,4)

DOWN

2. SEBI has mandated that no stock broker or depository participant shall deny services to the client if the client refuses to execute a _____ in their favour.
3. ICAI has decided to hold the international conference of CA Students at _____ in December 2010. (3,5)
4. The ICAI has entered into an MoU with the _____ bank to arrange financial assistance to all members in practice / firms in the form of specially designed loan scheme. (11)
5. SAFA meeting was recently held at _____. (10)
8. A sum payable for the use or right to use intellectual property like patent, invention, model, design, secret formula or process or trade mark. (7)
9. Name of the company which recently floated biggest public offering in the history of Indian Capital Markets. (4,5)
14. Abbreviation of ICAI's proposed unique code numbers for its members in practice.

Note:

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SOLUTION Crossword 052



- 1 An auditor is checking the books of an airline. He is puzzled by the excess use of fuel on a Mumbai to Delhi flight. He rings up the pilot and asks for an explanation. "It was late at night says the pilot, Delhi was covered in fog and I lost my bearings." "I m sorry," says the auditor, "but you'll have to bear the cost yourself." "The cost of what?" asks the pilot. "Of the bearings you lost."