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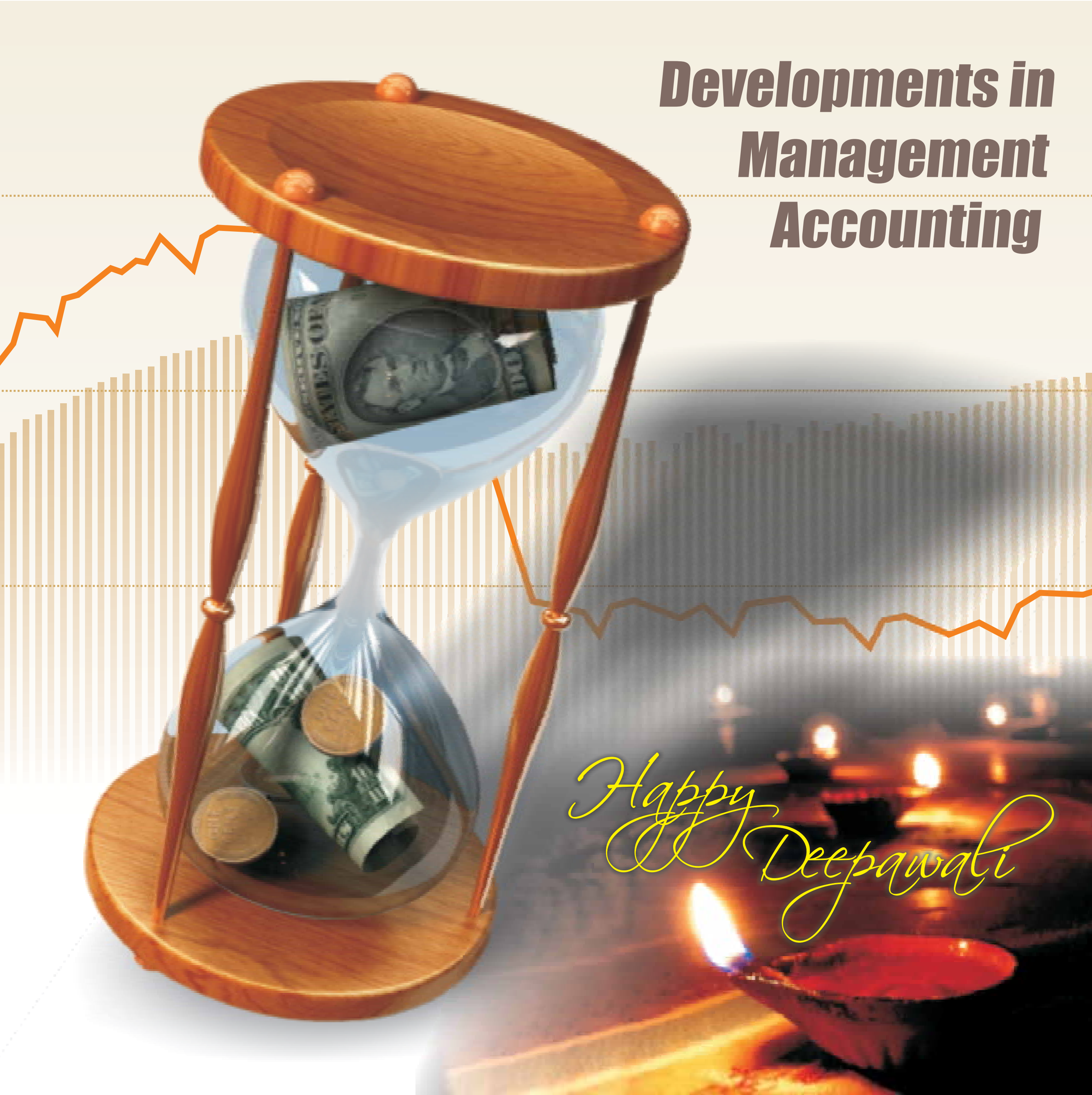
The Chartered Accountant Student

Your Monthly Guide to the CA News, Information & Events

STUDENTS' JOURNAL

November 2010 Vol SJ1 Issue 11 Pages 36

Developments in Management Accounting



President's Communication

Dear Students,

I convey my warm greetings to all of you on the propitious occasion of Deepavali and hope this festival of gaiety and prosperity will light up your professional career. I hope that even during this festive season, you are providing momentum to your examination preparation. Sustain your focus on studies and revise the course comprehensively. I extend my best wishes to all of you to tackle the examination successfully.

We are fully determined to redefine the process of learning through the dream project of Virtual Classrooms. The voyage of Virtual Classrooms has already begun. I am pretty sure that this IT enabled pedagogical drive would enable us to narrow down the geographical boundaries for our students to interact live with the senior experts of our Institute in an ideal learning ambience.

I am very pleased to inform you that under the aegis of our Board of Studies, the Pilot Campus Placement Programme for Articles Assistants held at Delhi received fabulous response from both CA Firms and student fraternity. After receiving positive feedback, the Institute has launched an Online Articles Placement Portal to cater to the requirements of CA Firms and Articles Assistants on PAN India basis. To avail this IT enabled facility, you have to enroll yourself online through this Portal at http://bosapp.icai.org. Once you register and upload your Bio-data, it will remain available on the Portal for 2 months from the date of your registration. I call upon all the eligible students and CA Firms to derive optimum benefit of this unique facility. For the details, you may visit our Institute's Website or Articles Placement Portal.

I am also delighted to inform you that an International Conference of CA Students would be organised on December 28-29, 2010 in Delhi by the Board of Studies and hosted the NIRC of the ICAI on theme of Indian Accountancy Profession - Marching towards Global Centre Stage. I personally feel that the seminars/conferences play a pivotal role in updating the students with the latest information and knowledge. I am sure that you will actively participate in this coveted conference to show your mettle in presentation skills.

Recently, our Institute has organized a Round Table Conference on "Commerce and Accountancy Education System in India: issues and Challenges" in which the Vice-Chancellors and eminent scholars from the leading universities and prominent academic institutions threw light on setting new paradigms for the commerce and professional accountancy education in India. The conference was successful in assessing the status of commerce and accountancy education in the changing global environment. Our Institute would like to lend its helping hand to suggest model course curriculum and reading material particularly in the area of IFRS. We hope that by establishing synergy between the University system and the professional accountancy education system in India, the nation can meet the global challenges.

Best wishes for your ensuing examinations

Yours sincerely,

CA. Amarjit Chopra
President, ICAI, New Delhi

Vice-president's Communication

Dear Students,

At the outset, I extend my best wishes on the festive occasion of Deepavali. The eternal message of the festival of lights is to dispel darkness and illuminate every minute of our life with the lamp of knowledge and bliss. I hope that you will understand the broad meaning of Deepavali and celebrate it with dignity without damaging the environment. Remember not to get carried away with fervor of festive season as it is also high time for you to speed up your examination preparation. My best wishes are always with you.

In today's professional world, effective communication skills are keys to unlock the doors of success. We are pretty sure that our Six Week Residential Programme on General Management and Communication Skills (GMCS) will enable our students to hone their hidden potentials in a better manner. The courseware of this programme is especially modeled to enhance your competence, communication skills as well as professional and leadership abilities. Recently, the first batch of this programme was successfully concluded at Centre of Excellence, Hyderabad. We have further decided to hold Six Week GMCS Programme at more centres so that large number of students can be benefited. It is also decided that top 10 rank-holders in the PCC/IPCC and Final examinations will be enrolled for the Six week course without any course fee. I expect that our students will be highly benefited by such initiatives and will show a positive response to attend the same.

I am extremely delighted to know that the theme of current issue of the CA Students' Journal is 'Management Accounting'. A thorough understanding of recent trends and developments in Management Accounting is required to bridge the gap between theory and practice. Management Accounting prepares a framework for the organizations to achieve their strategic objectives. A well planned Management Accounting system is meant to assist in making sound managerial decisions and enabling an organization remain unaffected in uncertain market conditions. Hence, the importance of Management Accounting is very vital in the sustainable socio-economic development of our country.

I feel really glad to witness a stupendous demand of the Chartered Accountants in the contemporary job market. Proposed introduction of IFRS and other changes in regulations need a large number of Accounting Professionals in all the prevailing sectors of trade and business. The latest campus placement programmes organized at different locations across the country is a pointer to this fact. I am sure that this trend will continue in future and with professional acumen, you will be able to attain towering success in all your endeavors.

Wishing you all the best, for a wonderful time ahead

Yours sincerely,

CA. G. Ramaswamy
Vice-President, ICAI, New Delhi

Message From The Chairman, Board of Studies

Dear Students,

I must convey my sincere good wishes to all the students appearing in November 2010 examination. I am sure that the festival of lights and joy – Deepawali – will bring a new enlightenment to you to enable you to perform effectively and efficiently.

The Board of Studies is blessed with a number of leading subject experts as full time faculty. The Board of Studies (BOS) faculty is always eager to respond to the students' queries received through e.mails, telephone and personal visits. We wish to make these facilities available across India, although currently they are available at Noida.

BOS has also commenced optional 6 weeks residential GMCS program at the Centre of Excellence, Hyderabad. Similar facilities will be set up in Bangalore and Jaipur and various other locations based on the success of present initiative. BOS is eager to provide residential education and training to all the CA students at least for a period of 6 weeks to 12 weeks and we are already moving in this direction. BOS needs support of the Council and the government to enable it to achieve this mission.

We are also launching live virtual classroom with 2-way video conference technology at select centers on a pilot basis from November-December 2010. The detailed scheme, timing and locations will be advised to the students through the website and other media. The objective of this exercise is to bring the best faculty in the country from various major towns and to enable them to interact with the student in a very far-flung area and remote centers also. We ultimately wish to take Live Virtual Classroom to all the locations where our students are available.

I am 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. Considering the good response, positive feedback and requests received from both CA Firms and Students, an Online Articles Placement Portal - ***http://bosapp.icai.org*** has been put in place since **5th October, 2010** to facilitate placement of Articles in CA Firms on pan India basis. I request both eligible candidates and CA firms to avail of this facility and register themselves online through the portal. The candidates short listed 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.

I am sure that with your kind good wishes and support, Almighty God will give all necessary strength to the Institute to come up to the expectations of the profession.

Companies Bill 2009

The Companies Bill 2009 read with 21st Report of the Standing Committee on Finance of Parliament of India proposes to make comprehensive changes for the profession. The proposals include mandatory rotation of audit firms, panel of auditors, severe penalties, prosecutions and imprisonment in case of non compliances, (most of which are technical in nature), prohibition of other services by auditors, separate auditor for subsidiary companies, scope of audit report, audit disqualification, auditors' remuneration justification disclosure, panel of independent directors, very severe procedures and compliance, prosecution and fine on Company Directors and the Company for various technical and substantive defaults. This legislation is too complex having serious impact on the profession and is to be opposed by all of us. Even the Hon'ble Parliamentary Committee did not get a chance to take our views into account on several radical proposals which were introduced before the committee without public debate.

Corporate democracy and freedom has to be respected. The law need not permit government interference into the day-today working of the company and should concentrate only on exceptionally large serious defaults. The audit profession stands committed to transparency, eradication of corruption and free and frank reporting. The Companies Bill does not provide any substantive protection to investors and is mandating very tough procedures even for smaller companies. There is no need to set up National Advisory Committee on Accounting and Auditing Standards (NACAAS). It is important to delegate this matter to the profession of Chartered Accountants with participation of all stake holders and only exceptional monitoring should be exercised by the government. The Companies Bill 2009 needs reconsideration and adequate public debate.

This may not be part of your curriculum but it is very important for each one of you to keep full track of development relating to your profession. I am sure each one of you is regularly reading a business newspaper and a business magazine as suggested by me in my earlier editorials.

With Best Wishes

Yours sincerely,

CA. Vinod Jain
Email : chairmanbos@icai.org

International Conference of CA Students

The 2010 International Conference of CA Students is being organized by the Board of Studies and NIRC of ICAI jointly with the theme **INDIAN ACCOUNTANCY PROFESSION : MARCHING TOWARDS GLOBAL CENTRE STAGE.** This would be the largest annual gathering of CA students from all over the Globe. The main goal is to provide a forum for exchange of ideas on a number of topics of professional interest. The conference will present the tools a student needs to stay ahead, stay efficient and be prepared for the challenges posed by the changing economic environment. It is also a chance to meet with students from all over the Country and abroad and share knowledge and experiences.

The event will be comprised of presentations, keynote lectures and panel discussions. Students are invited to register* for the Conference at the earliest. Interested students are also invited to submit Paper of about 5-7 pages and/or a proposal to organize a Technical Session. All accepted papers will be published in the respective conference proceedings/Paper Book. Topics of interest include, but are not limited to, the following :

Technical Session 1 : **Global Convergence**	1. Convergence to IFRS: Impact on Key Sectors 2. Accounting for Carbon Emission Credits 3. Convergence to IFRS: Need for Changes in Regulatory Requirements 4. Social Responsibility of Chartered Accountants in Converging World
Technical Session 2 : **Ushering an Era of Taxation Reforms**	1. Direct Tax Code Bill, 2010 – Change in Conceptual Approach 2. Issues in Transfer pricing 3. Profit Linked Tax Incentives Vs Investment Linked Tax Incentives 4. Goods and Services Tax in India – Way Forward
Technical Session 3 : **IT as a Tool to Simplify Audit Process in Chartered Accountancy**	1. Role of CA as IT Manager 2. Contours of eXtensible Business Reporting Language (XBRL) 3. Forensic Accounting using IT 4. IT Governance 5. Information Systems Audit – Salient Features
Technical Session 4 : **Legal Reforms – Steering India Ahead**	1. Limited Liability Partnership : A Pragmatic Approach to Business 2. The Competition Law, 2002- Its Developmental Factors 3. Compounding of Contraventions under FEMA,1999 4. Employees Deposit Linked Scheme – A Boon for the Employees
Technical Session 5 : **Present Global Financial Order**	1. Financial Crisis - Recession and Recoveries 2. Development of New Financial Order - G 20 Declaration 3. Towards Greener Accounting World 4. Role of CFO-Integrating Strategy and Finance 5. Globalisation of Capital Markets – Emerging Trends

Conference Dates : **28th – 29th December, 2010**
Venue : **Auditorium of Shri Ram College of Commerce, North Campus, University of Delhi, Delhi (India)**
Cultural Evening : **28th December, 2010 by CA Parivaar followed by Dinner**

Accommodation

Two Nights accommodation would be available for outstation students attending both days of the Conference ranging from ₹ 500/- to ₹ 2000/- per night including/excluding taxes.

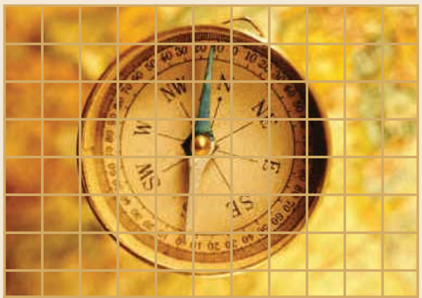
Participation Fee:

For Students from India : ₹ 500/- per student
For Overseas participants : US $ 30 participants without accommodation
US $ 100 with accommodation for two nights

For Registration, sending Papers and for further queries, please contact:

NIRC of the ICAI ICAI Bhawan, Annexe, 5th Floor Indraprastha Marg, New Delhi-110 002, INDIA Contact Nos. 011-30100503/507/500 Email : ***nirc_seminar@icai.in; nirc@icai.in***	Conference Section Board of Studies of the ICAI ICAI Bhawan, A-29, Sector 62, NOIDA-201 301 (U.P.) INDIA Contact Nos. 0120-3045930/931 Email: ***bosconference@icai.org***

*The Registration Form can be downloaded from the Website : ***www.icai.org*** or ***www.nirc-icai.org***



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Basics of Working Capital Management

Ramanujam Raghavan

Introduction

The most important area in the day to day management of a firm is the management of working capital. Working capital management is the functional area of finance that covers all the current accounts of the firm. It is concerned with management of the level of individual current assets as well as the management of total working capital. Working capital management involves the relationship between a firm's short-term assets and its short-term liabilities. The goal of working capital management is to ensure that a firm is able to continue its operations and that it has sufficient ability to satisfy both maturing short-term debts and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable and payable, and cash. For example, an organization may be faced with an uncertainty regarding availability of sufficient quantity of crucial inputs in future at reasonable price. This may necessitate the holding of inventory i.e., current assets. Similarly, an organization may be faced with an uncertainty regarding the level of its future cash inflows and insufficient amount of cash may incur substantial costs. This may necessitate the holding of a reserve of short term marketable securities, again a short term capital asset. The unpredictable and uncertain global market plays a vital role in working capital. Though the globalization of economy and free trading of products envisages the continuous availability of products but how much it is cost effective and quality based, varies from concern to concern.

Success in life can never be an accident. It is the result of right decisions at the right time. Champions are not the people who never fail, but the people who never quit…

What is Working Capital?

Working capital refers to the funds invested in current assets, ie., investment in stocks, sundry debtors, cash and other current assets. Current assets are essential to use fixed assets profitably. The term current assets refers to those assets which in the ordinary course of business can be converted into cash within one year without undergoing diminish in value and without disrupting the operations of the firm. The current assets are cash, marketable securities, accounts receivable and inventory. Current liabilities are those which are to be paid within a year out of the current assets or earnings of the concern. The current liabilities are accounts payables, bills payables, bank overdraft and outstanding expenses.

The working capital management includes decisions

i. How much stock/inventory to be hold?
ii. How much cash/bank balance should be maintained?
iii. How much the firm should provide credit to its customers?
iv. How much the firm should enjoy credit from its suppliers?
v. What should be the composition of current assets?
vi. What should be the composition of current liabilities?

For e.g., a machine cannot be used without raw material. The investment on the purchase of raw material is identified as working capital. It is obvious that a certain amount of funds is always

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tied up in a raw material inventories, work in progress, finished goods, consumable stores, sundry debtors and day to day cash requirements. However the businessman also enjoys credit facilities from his suppliers who may supply raw material on credit. Similarly, a businessman may not pay immediately for various expenses. For instance, the labourers are paid only periodically. Therefore, a certain amount of funds is automatically available to finance the current assets requirements. However, the requirements for current assets are usually greater than the amount of funds payable through current liabilities. The satisfactory level of working capital is the main object of working capital management. Any organization which fails to maintain satisfactory level of working capital may be forced to bankruptcy. The current assets should always be large enough to cover its current liabilities in order to ensure a reasonable margin of safety. Thus the interaction between current assets and current liabilities is the main aim of working capital management.

Objectives of Working Capital

The primary objective of working capital management is to ensure that sufficient cash is available to:-

- Meet day to day cash flow needs;
- Pay wages and salaries when they fall due;
- Pay creditors to ensure continued supply of goods and services;
- Pay government taxation and dividends to providers of capital;
- Ensure the long term survival of the business entity.

To accomplish your goals, you need personal drive-and active doing.

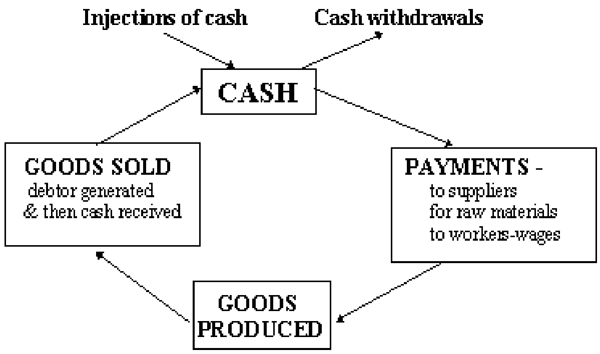
The basic objective of financial management is to maximize shareholders wealth. This objective can be achieved when the company earns sufficient profits. The amount of profits largely depends on the magnitude of sales. But, sales do not convert into cash instantly. There is time lag between the sale of goods and the receipt of cash. Working capital is required to purchase the materials, pay wages and other expenses in order to sustain sales activity and the time lag. The time gap between the sale of goods and realization of cash is called operating cycle. What operating cycle stands for?

a. Conversion of cash into raw materials
b. Conversion of raw materials to finished goods
c. Conversion of finished goods into receivables
d. Conversion of receivables into cash

Where is Working Capital Analysis Most Critical?

Working capital is quite important. This is especially true from the lender's or creditor's perspective, where the main concern is defensiveness: can the company meet its short-term obligations, such as paying vendors' bills?

Working Capital Cycle



Each component of working capital (namely inventory, receivables and payables) has two dimensions TIME and MONEY. When it comes to managing working capital TIME IS MONEY .If you can get money to move faster around the cycle (collect money due from debtors more quickly) or reduce the amount of money tied up (reduce inventory level relative to sales),the business will generate more cash or it will need to borrow less money to fund working capital. As a consequence, you could reduce the cost of bank interest or you will have additional free money available to support addition sales growth or investment. Similarly, if you can negotiate improved terms with suppliers e.g. get longer credit or an increased credit limit, you easily create freed finance to help fund future sales (a perusal of operational cycle reveals that the cash invested in operations are recycled back in to cash). However, it takes time to reconvert the cash. Cash flows in cycle into, around and out of a business. It the business's lifeblood and every manager's primary task to help keep it flowing and to use the cash flow to generate profits. The shorter the period of operating cycle the larger will be the turnover of the funds invested in various purposes.

Determinants of Working Capital

Working capital requirements of a concern depends on a number of factors, each of which should be considered carefully for determining the proper amount of working capital. It may, however, be added that these factors affect different units differently and these keeps varying from time to time. In general, the determinants of working capital which are common to all organization's can be summarized as under:

Nature of business

Need for working capital is highly depends on what type of business, the firm in. There are trading firms, which needs to invest a lot in stocks, bills receivables, liquid cash etc. Public utilities like railways, electricity, etc., need much less inventories and cash. Manufacturing concerns stands in between these two extends. Working capital requirement for manufacturing concerns depends on various factors like the products, technologies, marketing policies.

Production policies

Production policies of the organization affect working capital requirements very highly. Seasonal industries, which produce only in specific season, require more working capital. Some industries which produce round the year but sell during some special seasons need to keep more working capital.

Size of business

Size of business is another factor which determines the need for working capital.

Length of operating cycle

Operating cycle of the firm also influence the working capital. Longer the operating cycle, the higher will be the working capital requirement of the organization.

Credit policy

Companies that follow liberal credit policy need to keep more working capital with them. Efficiency of debt collecting machinery is also relevant in this matter. Credit availability from suppliers also affects the company's working capital requirements. A company that doesn't enjoy a liberal credit from its suppliers will have to keep more working capital.

Business fluctuation

Cyclical changes in the economy also influence level of working capital. During boom period, the tendency of management is to pile up inventories of raw materials and finished goods to avail the advantage of rising prices. This creates demand for more capital. Similarly, during depression when the prices and demand for manufactured goods reduce, the industrial and trading activities show a downward termed. Hence the demand for working capital is low.

Current asset policies

The quantum of working capital of a company is significantly determined by its current assets policies. A company with conservative assets policy may operate with relatively high level of working capital than other companies following aggressive policies.

Fluctuations of supply and seasonal variations

Some companies need to keep large amount of working capital due to their irregular sales and intermittent supply. Similarly, companies using bulky materials also maintain large reserves' of raw material inventories. This increases the need of working capital. Some companies manufacture and sell goods only during certain seasons. Working capital requirements of such industries will be higher during such seasons than during other seasons.

Other factors

Effective co-ordination between production and distribution can reduce the need for working capital. Well developed transportation and communication means helps to reduce the working capital requirement.

Concepts & Definitions

There are two concepts of working capital:

Gross Working Capital: It represents the total current assets and is also referred to as circulating capital because current capital as current assets is circulating in nature.

Net Working Capital: It is a measure of liquidity and it can be defined in two ways:

a. The most usually implied definition of net working capital is that it represents the difference between current assets and current liabilities. Some people also define it as excess of current assets over the current liabilities.
b. It is that portion of the firm's current assets, which is financed by long term funds.

Net working capital as a measure of liquidity is generally not very useful to compare the performance of different units due to difference in scales of operation, efficiency, and creditability in the market etc., between the different firms. However, it is a very useful measure for internal control purposes. It can also be used to compare the liquidity position of the same unit over a period of time. This will help in maintaining the acceptable level of net working capital.

Implementing an effective working capital management system is an excellent way for many companies to improve their earnings. The two main aspects of working capital management are ratio analysis and management of individual components of working capital.

A few key performance ratios of a working capital management system are the working capital ratio, inventory turnover and the collection ratio. Ratio analysis will lead management to identify areas of focus such as inventory management, cash management, accounts receivable and payable management.

Types of Working Capital

A. Permanent Working Capital

B. Temporary Working Capital

Permanent Working Capital:

The operating cycle is a continuous feature in almost all the going concerns and therefore creates the need for working capital and their efficient management. However the magnitude of working capital required will not be constant, but will fluctuate. At any time, there is always a minimum level of current assets which is constantly and continuously required by a business unit to carry on its operations. This minimum amount of current assets, which is required on a continuous and uninterrupted basis, is after referred to as fixed or permanent working capital. This type of working capital should be financed (along with other fixed assets) out of long term funds of the unit. However in practice, a portion of these requirements also is met through short term borrowings from banks and suppliers credit.

For e.g., In a manufacturing unit, basic raw materials required for production has to be available at all times and this has to be financed without any disturbance.

Temporary Working Capital

Any amount over and above the permanent level of working capital is variable, temporary or fluctuating working capital. This type of working capital is generally financed from short term sources of finance such as bank credit because this amount is not permanently required and is usually paid back during off season or after the contingency. As the name implies, the level of fluctuating working capital keeps on fluctuating depending on the needs of the unit unlike the permanent working capital which remains constant over a period of time.

Sources of Working Capital

The company can choose to finance its current assets by

(i) Long term sources

(ii) Short term sources

(iii) A combination of them.

Various types of long term sources of working capital are summarized as follow:

- Issue of shares
- Retained earnings
- Issue of debentures
- Long term debt.

Some sources of temporary working capital are given below;

- Commercial bank
- Public deposits
- Various credits
- Reserves and other funds

Sources of Additional Working Capital

Sources of additional working capital include the following:

- Existing cash reserves
- Profits(when you secure it as cash)
- Payables(credit from suppliers)
- new equity or loans from shareholder
- bank overdrafts line of credit
- long term loans
- If you have insufficient working capital and try to increase sales, you are over stretching the financial resources of the business. This is called overtrading. Early warning signs include pressure on existing cash, exceptional cash generating activities, offering high discounts for clear cash payment.
- Bank overdraft exceeds authorized limit ,seeking greater overdrafts or lines of credit
- Part paying suppliers or there creditor.

Adequate Working Capital

The term adequate working capital refers to the amount of working capital to be kept with the organization to meet its daily operations. Large investment in fixed assets is not sufficient to run a business successfully. Adequate working capital is equally important.

Advantages of Adequate Working Capital

Adequate working capital provides certain benefits to the company they are:

- Increase in debt capacity and goodwill

- Increase in production efficiency
- Exploitation of favorable opportunities
- Meeting contingencies and adverse changes
- Available cash discount
- Solvency and efficiency fixed assets
- Attractive dividend to shareholders

Dangers of Inadequate Working Capital

Having inadequate working capital leads to so many of dangers. Some are given below:

- Loss of goodwill and creditworthiness
- Firm can't make use of favorable opportunities
- Adverse effects of credit opportunities
- Operational inefficiencies
- Effects on financial capacity
- Non achievement of profit target

Blueprint for a Good Working Capital Management Policy

General action

Set planning standards for stock days, debtors' days and creditors' days. Having set planning standards (as above) KEEP TO THEM. Impress on staff that these targets are important operating targets. Instill an understanding amongst the staff that working capital management produces profits.

Action on stocks

Keep stock levels as low as possible, consistent with not running out of stock and not ordering stock in uneconomically small quantities. "Just in time" stock management is fine, as long as it is managed properly. Consider keeping stock in supplier's warehouses drawing on its as needed and saving warehousing cost.

Action on debtors /customers

Assess ALL significant new customers for their ability to pay. Take references, examine account, and ask around. Try not to take on new customers who would be poor payers. Re assess ALL significant customers periodically. Stop supplying existing customers who are poor payers, you may lose sales, but you are after QUALITY of business rather than QUANTITY of business. Sometimes poor paying customers suddenly (and magically!!) find cash to settle invoices if their supplies are being cut off. If customers can't pay / won't pay let your competitor have them. Give your competitors a few more problems. Consider factoring sales invoices. The extra cost may be worth it in terms of quick payment of sales revenue, less debtor administration and more time to carry out your business (rather than spend time chasing debts). Consider offering discounts for prompt settlement of invoices, but only if the discounts are lower than the costs of borrowing the money owed from other sources.

Action on creditors

Do NOT pay invoices too early. Take advantage of credit offered by suppliers it's free!! Only pay early if the supplier is offering a discount. Even then, consider this to be an investment. Will you get a better return by using working capital to settle the invoice and take the discount than by investing the working capital in some other way? Establish a register of creditors to ensure that creditors are paid on the correct date not earlier an not later.

The Concept of Zero Working Capital

In today's world of intense global competition, working capital management is receiving increasing attention from managers striving for peak efficiency. The goal of many leading companies today, is zero working capital. Proponents of the zero working capital concept claim that a movement toward this goal not only generates cash but also speeds up production and helps business make more timely deliveries and operate more efficiently. The concept has its own definition of working capital: inventories+ receivables- payables. The rationale here is (i) that inventories and receivables are the keys to making sales, but (ii) that inventories can be financed by suppliers through account payables. Companies use about 20% of working capital for each sale. So, on an average, working capital is turned over five times per year. Reducing working capital and thus increasing turnover has two major financial benefits. First every money freed up by reducing inventories or receivables, by increasing payables, results in a one time contribution to cash flow. Second, a movement toward zero working capital permanently raises a company's earnings. The most important factor in moving toward zero working capital is increased speed. If the production process is fast enough, companies can produce items as they are ordered rather than having to forecast demand and build up large inventories that are managed by bureaucracies. This system is known as demand flow or demand based management. And it builds on the just in time method of inventory control. Clearly it is not possible for most firms to achieve zero working capital and infinitely efficient production. Still, a focus on minimizing receivables and inventories while maximizing payables will help a firm lower its investment in working capital and achieve financial and production economies.

Estimation of Working Capital Management

As discussed above a number of factors are responsible for determining the amount of working capital required by a firm. Let us know discuss the various methods/ technique used in assessment of firm's working capital requirements. These methods are:-

i) Estimation of components of working capital method.

   This method is based on the basic definition of working capital: excess of current assets over the current liabilities. In other words, the amount of different constituents of the working capital such as debtors, cash inventories, creditors etc are estimated separately and the total amount of working capital requirement is worked out accordingly.

(ii) Percent sales method

   This is the most simple and widely used method in combination with other scientific methods. According to this method, a ratio is determined for estimating the future working capital requirement. This is the generally based on the past experience of management as the ratio varies from industry to industry. For example if the past experience shows that the amount of working capital has been 20% of sales and projected amount of sales for the next year is ₹ 10 lakhs, the required amount of working capital shall be ₹ Two lakh. As seen from above the above method is merely an estimation based on past experience. Therefore, a lot depends on the efficiency of decision maker, which may not be correct in all circumstances. Moreover, the basic assumptions regarding linear relationship between sales and the working capital may not hold well in all the cases. Therefore, this method is not dependable and not universally acceptable. At best, this method gives a rough idea about the working capital.

(iii) Operating cycle approach

   The need of working capital arises mainly because of the gap between the production of goods and their actual realization after sales. This gap is technically referred as the "operating cycle" or the "cash cycle" of the business. If it were possible to complete the entire job instantaneously, there would be no need for current asset (working capital) but since it is not possible, every business organization is forced to have current asset and hence operating cycle.

Operating Cycle method points towards the length of time considered necessary to complete the following cycle of events:

a. Purchase of raw materials by converting cash
b. Storage of raw materials including for buffer stock and safety margin
c. Conversion of raw materials into work in progress
d. Conversion of work in progress into finished goods
e. Conversion of finished goods into debtors and bills receivable
f. Conversion of debtors into cash

Cash Conversion Cycle is a measure of working capital efficiency, often giving valuable clues about the underlying health of a business. The cycle measures the average number of days that working capital is invested in the operating cycle. It starts by adding days inventory outstanding (DIO) to days sales outstanding (DSO). This is because a company "invests" its cash to acquire/build inventory, but does not collect cash until the inventory is sold and the accounts receivable are finally collected.

Conclusion

Implementing an effective working capital management system is an excellent way for many companies to improve their earnings. The two main aspects of working capital management are ratio analysis and management of individual components of working capital. Thus, the importance of adequate of working capital in commercial undertakings can never be over emphasized. The various studies conducted by the Bureau of Public Enterprises have shown that one of the reasons for the poor performance of public sector undertakings in our country has been the large amount of funds locked up in working capital. This results in over capitalization. Over Capitalization implies that a company has too large funds for its requirements, resulting in a low rate of return a situation which implies a less than optimal use of resources. Insolvency risk is there in the case of under capitalization of working capital. Hence, working capital management plays a pivotal role in growth or to sustain in market for any organization.

Commodity Derivatives in India

An Evaluation

CA. Pardeep Tayal

Forward market for commodities has got a big boost by setting up of MCX and NCDEX in year 2003 permitting forward trading in commodities in India. Commodities markets boast of achieving huge volumes on commodity exchanges which has increased from INR 66530 crore in year 2003 to INR 7415613 crore in year 2010.

First and foremost objective of future commodity exchanges is price discovery mechanism for commodities and help producers/ farmers to get best price for their products.

It has been seven years as of now since the setting up of national level forward commodity exchanges, it is pertinent for all of us today to evaluate whether commodity exchanges have achieved the objectives for which they were set up.

1. Features of Commodity Market

1.1 No delivery requirement: As per guidelines for the commodity derivatives there is no system of delivery. All transactions are supposed to be settled on due date at the prevailing rate resulting into the booking of profit or loss for the transacting parties.

1.2 No underlying exposure required for trading: As per existing guidelines it is not necessary for any person to have underlying exposure in the particular commodity in which he intends to trade/ take exposure.

1.3 Nominal margins: Persons entering into forward transactions are required to provide only 3-5 per cent of total transaction value as margin money. Due to this very nominal margin requirements, one can take exposure upto 20-30 times of margin money deposited by him to the broker.

2. Analysis

2.1 Investment or speculation: Commodity derivatives have been projected as an investment tools for retail and corporate investors wherein one can trade upto 20-30 times of margin money. Clearly, putting money without any underline exposure or without any intention of price discovery or hedging this becomes a speculative transaction.

2.2 Hedging or speculation: Trading on commodity exchanges is very good hedging tool, but will be hedge transaction only if there is an underlying exposure. This is one of the main objectives for which commodities derivatives were introduced. But, if there is no underlying exposure to a transaction it is nothing but speculation. As there is no underlying exposure requirement to enter into a transaction with the commodity exchange, we understand that about 90% of volume nothing but a speculation volume.

2.3 Globalization: Commodity exchanges all over the world operate in tandem. Volumes in big international exchanges are many times to the volumes of Indian exchanges. Practically small exchanges in world are getting business from the operators of big exchanges, directly or indirectly. There is a common view that the big operators make cartels and act in concert to take market in a direction of their choice, in which they earn and counter party looses money. In real sense derivatives is a new business developed by western countries, causing losses to innocent persons of underdeveloped or developing countries. This aspect needs a detailed analysis so that necessary correctives measures may be put in place and investors may be duly educated.

2.4 All economic laws defied: Prices of commodities were used to set on basis of various economic laws of demand and supply etc. However by introduction of commodity exchange, prices of commodities are set up by operators of commodity exchanges, defying all laws on economics.

3. Advantages

3.1 Reduction of inventory: One very important advantage of Forward trading is that manufactures are not required to maintain inventory of orders in hand, (to hedge their risk of Price fluctuation). They can carry out a transaction at commodity

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exchange and hedge their risk on account of their raw material requirement on account of sale orders in hand.

3.2 Price information: Although price information of commodities etc. is available from real commodity market, however price information from commodity exchanges are additional source of price information.

4. Economic effects on

4.1 Price fluctuation: Prices of commodities, in which forward trading has been allowed, have shown sharp fluctuations in prices irrespective of prevailing economic factors, as to best of our understanding commodity exchanges all over the world are being operated by cartels.

4.2 Real life trade: Sharp price fluctuations have caused big problems for real time dealers/ manufacturers/consumers of commodities as they always have to remain on their toes to hedge themselves. Most of their time is consumed in watching the market price in real trade and on Commodity exchanges, instead of production and sales.

4.3 Small investors: Small investors on Commodity exchanges normally have no underlying exposure. They enter the market on the basis of rumors and just follow others who earned in recent past. Small investors normally do not have any understanding of the commodity in which they are dealing and not in a position to hire experts. Hence there is more possibility for them losing money than earning. Moreover, if the cartelisation is taken to be true then probability of earning of small investors diminishes further. Further, probability of small investors loosing money increases further in case of sharp fluctuations as they may not be in a position to meet out the margin requirements of commodity exchanges in absence of which their brokers will cut the deal by debiting his account with a loss.

4.4 Cascading effect on economy in case of default: In case of sharp fluctuations in prices many clients loses money causing default to their brokers and to their lenders which creates a big cascading effect on the whole economy.

4.5 Rich becoming richer increasing disparity of wealth

5. Social Effects

5.1 Urge to earn easy money increasing: Earning through speculation seems to be an easiest way to earn money. As a human tendency urge to earn easy source of money go faster and faster unless one burns his finger out of it. It makes persons lethargic and diverts them from their main stream activity. They pay less time to their business or profession and remain in speculation syndrome all the time.

5.2 Spendthrift society: Easy money go easily, it is spend lavishly. It creates a society of spendthrift people who repent later when the easy money do not come rather it goes out.

5.3 Suicidal tendencies: Traders (investors) who enter into this activity out of greed, when lose their own capital, lose even borrowed funds, sometimes commit suicides due to depression.

5.5 Sleepless nights: Due to their urge to earn easy money and due to speculative tendency, whenever there is abnormal loss or gains, losers as well as gainers have sleepless nights. Losers due to tension and gainers due to excitement.

Remedial measures

- The best solution to get rid of disadvantages of future trading is to make it mandatory that a person can carry out transaction only if he has underlying exposure. Members of commodity exchanges should be made responsible to ascertain the underlying exposure of their every client. This imposition will on the one hand provide benefits of Future Trading, achieve the objectives for which it was introduced and on the other hand all disadvantages can be overcome.
- The remedial measures as above will not be a corrective measure to many problems unless this is made mandatory in all commodity exchanges worldwide still it will save small investors of India from speculating in commodities, and will give a direction to world markets to follow us.
- Investigation of Cartels: Investigating agencies all over the world particularly, starting from India should investigate transactions of commodity exchanges, of members having huge turnover and earning unproportionate profits vis-à-vis their counterparts (other members). Antecedents of clients and their source of funds should also be investigated.

Conclusion

Our forefathers used to say "Gambling is a bad habit", taking a cue from that and moving towards modern financial system we should appreciate the role of commodity exchanges but should restrict it to hedging and save ourselves and our generations from the attitude of earning easy money. Let us make a society of "Karamyogies".

Potential of ABC Model in Service Industry of India

A P KAR

Introduction

Changes in the business environment, triggered by global competition and technological innovations have led to striking innovations in the use of financial and non-financial information in organizations. The new environment demands more relevant cost and performance information on organization's activities, processes, products, services and customers. As competition increased, the basis of competition shifted away from efficient use of direct labour and machines. Today, managers need more accurate information about cost of processes, products and customers than they could be obtained from a system used primarily for external reporting. Now, companies have more emphasis on one integrated system, which can serve all functions like financial reporting, operational improvement, performance measurement plus inventory and production planning, sales order fulfillment and customer administration. Focus of traditional costing system was on control and efficiency of isolated machines, works, and departments. To-day integrated system having a ABC model of costing serving the need of efficient operational feedback and external financial reporting. The efficiency of the integrated system is measured by its effectiveness in ensuring the flow of information to different functional areas and resolution of conflicts in reports generated by them.

Do not lower your goals to the height of your abilities. Instead, heighten your abilities to the level of your goals.

Scenario of Costing System in Service Industry in India

In India, almost all manufacturing companies have the product-costing system to satisfy the inventory valuation requirement of financial reporting. Activity based costing was an evolution towards bringing precision in allocation of overheads, finer assessment of cost of products, services and customers. Most of the service companies do not have the statutory requirements to measure the cost of products or customers. One common problem with them is that they have to supply most of the resources in advance and fluctuations in the level of activities are very natural. In traditional costing system, these costs are treated as fixed or irrelevant cost for decision making purpose. These limiting factors to a large extent were serious de-motivating issues for them to go for a costing system. What they normally do is absorbing the increased cost in the price of the services. They kept themselves comfortable to operate through budgetary control of responsibility centres. Financial performance are measured and managed by comparing actual with budgeted results.

In recent time, service industry in India has been able to generate formidable growth rate because of its potential strength of huge trained manpower and its low cost advantage in comparison to its global standard. Privatization of government owned monopolies, deregulation and intensive competition have generated urgent need of a costing system which can enable them to understand the cost base. Unlike manufacturing companies, the service organizations do not deploy large number of industrial engineers to study and

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standardize direct labour time for the services provided by them. It is high time that the service industry in India must emphasize on a sound costing system to enhance efficiency in managerial decision making process relating to most profitable use of resources and bringing in sound forward looking approach on a long term basis. In India, for application of costing system, the areas of huge potential are airlines, insurance companies, banks, hospitals, financial services, railways, hotels etc.

Suitability of ABC Model of Costing

The ABC model of costing is most suitably applicable in service organizations as most of cost components are indirect in nature. There are some distinct differences between a manufacturing company and a service organization in terms of operations, nature of cost components, standardization of cost etc. Unlike manufacturing companies, service organizations have virtually no material costs and involve large component of costs which appear to be fixed in nature. In manufacturing companies the costs associated with meeting customers demand and revenue associated with selling products to customers are linked by direct cost to produce them. Service companies do not have such direct connection. All linkage between the cost of resources supplied and their use by different products and customers must be inferred and estimated. This is a process identical to how ABC links indirect resources to products. Similar products may be clubbed into one group of products, which may be considered as one product for decision making purpose. For example, in case of banking operation, saving bank account, personal loan account and personal current account may be grouped into personal product whereas corporate current account, corporate loan and leases into corporate product. Next is to identify the appropriate cost driver. Some operating expenses being treated as business sustaining cost (indirect cost) may be allocated to products.

You have to overcome barriers and keep moving forward. Success, therefore, requires personal motivation.

The service organizations typically offer a highly diverse set of products. For example, Retail banks have many different sets of customers and wide range of products. Telecommunication companies offer variety of services like local, STD, long distance calls, video transmission capabilities etc. Their decision about product offerings, features, price and delivery must involve interplay between customer preferences and cost of satisfying them. Customers may be grouped suitably into different manageable market segments. Segmenting the customer base and determining profit earned by each segment is of utmost importance. Activity based cost analysis combined with reliable information about attributes and features valued by customers in different market segments will enrich the quality of decision-making. In this way, they can select the segments they wish to target for growth and profitability and customize their service offerings to these segments so that each one becomes individually profitable.

Many service organizations invest considerable resources in marketing campaign to attract new customers. In traditional costing system, cost of launching new products and acquiring new customers are spread across all existing products and customers, thereby the profitability of existing products are depressed downwards. Apart from it, they fail to understand the cost of new product development and launching process. Greater visibility is provided in the ABC system through the process of assigning the front-end-expenses to new products and customers that are specific beneficiaries of launch and acquisition activities. When product development costs, product launch costs and customer acquisition costs are high, focus should be there on life-time profitability of products or customers rather than looking at their year-by-year profitability. The cross-sectional variations of customers' demand over time are to be estimated to obtain life cycle profitability. ABC system which provides finer details required for intelligent management of different types of customers is capable of calculating cost and profitability of different segments. The profitability of each of these segments should be understood to match its core competence so as to maximize its operational efficiency and profitability. An accurate ABC model linking organizational spending to supply resources capabilities to the activities performed and the demand by the individual products or customers will facilitate decision on appropriate supply of resources.

The service organizations must develop their budgets in the annual negotiation process between responsibility centre heads and the senior executive team. An ABC model can be used as foundation of organization budgeting process. Without an ABC model, there is no scientific way of linking between supply of resources to different responsibility centres and demand of products and customers. Once, the ABC systems becomes the basis of organizational budget, authorizing the supply and expenditure of resources in all responsibility centres become linked to outputs demanded from these units by the anticipated volume and mix of products and customers. The model enables the service organization to supply its resources for product and customers that contribute long-run profitability and identify where cost reduction is possible for critical process in the service delivery chain.

Apart from service industry, ABC system has tremendous potential in its application in some Government departments or agencies which are involved in offering public services like Health services, Public Water Supply etc. Even application of ABC Model in the revenue collection system of the government will help them to understand the cost various activities involved in it and open the path of planning for alternative use of their resources more efficiently by aligning them to more value-added activities. One example of it is the submission of on-line tax return. The focus could be more on efficiency of revenue collection. With the help of ABC system, it could analyse the cost configuration of different activities involved in the process of earlier manual system and on-line submission of return and assessment procedure. The constraints of real analytical data will be taken care more meaningfully and it will open up a new direction in the decision making process to evolve more cost-effective approach towards public utility services and other activities of the government.

The steps to success are simple. Decide what you want. Determine the price. Pay the price.

ABC - a tool in Strategic Decision Making

Once the customers are identified as profitable or unprofitable, action can be taken to strengthen the strategic position of the organization. For profitable customers, an organization can undertake efforts to increase satisfaction by offering higher level of services, lower prices, new services or some of the combination of the three. For unprofitable customers, an organization can attempt to deliver the customers more efficient services (to decrease cost), increase prices or encourage them to leave or some combination of the three. Often, individual products, services and customers demand a complex mix of expensive activities for which business mix is not adequately compensated under current pricing and volume arrangement. Managers must understand the existence and frequency of such unprofitable demands so they can take actions to ensure that they are more adequately compensated. Alternatively, managers can shift the mix to less costly activities. The demand for activities ultimately arises from the decision about individual products, services and customers. Managers also need to understand how decisions made at this level affect the quantity and the cost of organizational activities.

The ABC model also signals where individual products, services and customers appear to be highly profitable. This information can be used by marketing and sales managers to explore whether demand for those products, services and customers can be expanded to generate incremental revenues that exceed their incremental costs. Thus, with strategic Activity Cost Management, managers need to shift their focus to activity mix towards more profitable uses. Strategic ABM also includes decision about product design, product development and supplier relationships that reduce the demand for organizational activities. In particular, it needs to understand how to increase the revenues, that is, the drivers of customer demand. To maximize the total profit managers need to combine their knowledge of the ABC cost curve with the organizational demand curve what creates and drives revenues. Thus, to optimize the benefits from the strategic components of ABM, managers must combine the cost driver knowledge from ABC model with information from their marketing and sales organizations on customer and market demand - that is the organization's demand curve and revenue curve.

Issues to make ABC more effective

Service organizations need an operational control system that provides feedback on expenses incurred in each unit as well as other measures to performance, such as quality and response time. These activity based budgets are then used by Operational Feedback Systems to compare and analyse the actual expenses incurred by each individual organizational units throughout the year. In return, Operational Feedback System provides the ABC with information about more recent efficiencies and capacity utilization of operations so that ABC system also updates their cost driver rates. This kind of continuous linking of different systems in an integrated environment gives additional robustness in the system by injecting real time response capability among the modules. The integrated system of ABC and Performance measurement may require monthly, weekly or even daily exchanges of information. For example, ABC system could be used to investigate the impact of different volumes on product and customer costs. In this kind of analysis, the ABC-calculated product costs must be embedded in the system that forecasts sales, production and profits. In a competitive environment, the demand for frequent and extensive information sharing is being highly intensified to understand effectiveness of new product launching. To make correct and meaningful decisions, an organization needs a broader information base than mere knowledge of costs.

With the increasing of competition, service organizations have to focus of improving services to satisfy the customers by providing more innovative value-added services and eliminating non-value-added services as much as possible to reduce cost. The biggest challenge before them is in identifying the value-added activities and non-value-added activities. The most common definition says that an activity that adds value in the eyes of customer is the value-added one and non-value-added activity represents the one that customer should normally not pay for. For example, timely responding to after-sales problems of customers is generally considered as value-added activity whereas rectification in defects of service is a non-value -added activity. Normally, the managers have to use a value ranking scheme to focus their cost reduction programmes. Perhaps proponents of value added / non-value-added coding scheme believe that it is easier to reduce the cost of non-value-added activities than the value-added activities. After all, industrial engineering resources have concentrated on direct labour reduction, automation and increasing the speed with which machines can operate, all activities aimed at value-added activities. Therefore, many indirect and support activities that do not directly or indirectly benefit end-users may have received virtually no industrial engineering attention and are still being performed inefficiently.

CROSSWORD

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Solution

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Parta System to Lean Management Accounting: A Way Forward.

DR. N.N. Sengupta

"With these tools, I have financial statements I clearly understand and trust to make solid, timely decisions - and receive them the day after the month closes."

JEAN CUNNINGHAM, CFO, LANTECH, INC

Introduction to Parta System:

The late Mr. Ghanashyam Das Birla, the grandfather of the late Mr. Aditya Birla developed 'Parta' system. Parta means what will be the return of pocket in net. Parta is a system of establishing return on Investment based on Cost Management. Parta is the financial performance monitoring system for any organization which indicates Profit/ Loss on daily basis. This helps in keeping a track of the organization on a daily basis.

Parta could be of different types:

1. **Production based -** Capacity of each equipment based on guarantee of production if given by the manufacturer of machinery. Manufacturers study the factors that enabled overshooting of rated production. Estimate of investment will give in the capacity of project (Where supply is in short of demand). - Birla super.
2. **Market Based -** With increased capacity in items where demand was lesser than supply, it was based on market research and projected estimates. Dynamics of changes in policy may give further moderation like Birla White.

Working of Parta to get details of:

(1) Input Raw Material (a) Capacity Utilisation; (b) Plant number of days running in year.

(2) Production Cost, (a) Capacity Utilisation; (b) Plant number of days running in year.

(3) Selling and Administrative Cost per Unit of Product; (1) Fixed; (2) Variable.

(4) Marketing and Advertising Costs: One-Time and Regular.

Excellence & Constraints in System:

Parta is a convenient and efficient mechanism for control and monitoring. The simplicity and continuity in control mechanism on a regular basis made the system very popular in adoption of it throughout a wide section of industries in earlier days. The business environment started to be complex due to intense competition from domestic and international players. Various parameters which need to be controlled become larger and a simple structure of Parta system seemed to be inadequate to handle them. To over come the limitations of Parta system, Lean Management Accounting System started getting momentum in its acceptability in India.

Introduction to Lean Management Accounting:

Lean Management Accounting brings together accounting, control and performance measurement methods that support the introduction of lean manufacturing and sustain a lean enterprise approach over the long term. Lean management accounting must not only actively support lean manufacturing; it must itself employ lean methods.

What is Lean Thinking?

Lean Management Accounting is driven by the principles of lean thinking, as set forth by Womack. The five principles of lean thinking presented by Womack are:

1. **Value:** Value deals with the value, which a company provides to its customers.
2. **Value stream:** Value stream recognizes that the company's processes create excellence and customer-driven performance.
3. **Flow:** Anything that interrupts the flow of products and services through the value stream and out to the customer is designated as a waste which is to be eliminated.
4. **Pull:** Pull (not push) is an important mechanism to enable flow of the products and services.
5. **Perfection:** Perfection within lean thinking has two elements. (i) TQM; (ii) Bench Marking.

What is lean management accounting? :-

Lean Management Accounting is a series of methods designed to support lean thinking. Lean management accounting methods must themselves be lean and not introduce additional waste. Lean management accounting seeks to eliminate transactions while maintaining control of the operation, recognizing that control of a value stream (or process) does not always require keeping detailed transaction information.

Example of lean management accounting:

1. An example of eliminating transactions is the backflushing* of materials and costs in a

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production process. Under a lean approach, instead of reporting the movement of raw material and of labor hit against a production job as it is made, all these transactions can be created when the product is completed on the shop floor.

2. Instead of using an Material Requirement Planning(MRP) or other shop-floor planning and scheduling system, replete with production work orders and shop-floor tracking systems to drive and control production, a lean manufacturer uses visual methods like kanbans.

Company's Performance: Current Management Accounting Practice

1. Produce financial statements that are unnecessarily complex and confusing - and are obstacles to critical decision-making, not the actionable tools that they were intended to be.
2. Reward the wrong behaviour, such as excess inventory and long lead times, masking real improvement with distortions and false negatives that can derail a solid Lean initiative.

Improvement through lean management accounting:
Standard accounting measures can slow down or block dramatic Lean improvement. Lean Management Accounting offers alternatives and solutions that will put your accounting on track with your Lean journey. (Explained in the table given below)

2. Any delay, wait time, inspection, correction, auditing, and so forth are regarded as waste. Lean management accounting goes to great lengths to expose this waste so it can be eliminated.
3. A lean accounting system for cost and budgeting is focused on value streams, requires very few transactions, is based upon an understanding of the activities required to complete the job (production, marketing, design, service, or support operation), and the costs associated with those activities.
4. Because the accounting system is focused on the value stream it can also facilitate continuous improvement. Continuous improvement is vital to lean enterprise thinking.

Purposes of Lean Management Accounting:

To provide the value stream leader with performance measurement and cost information that can be effectively used to control and continuously improve the value stream.

To provide information for performance measurement and cost reporting to senior people within the organization.

To provide relevant cost information that can be used to post to the general ledger and the P&L report.

Measure	Behavior	Results
Purchase- price variance	Negotiate price based on quantity discounts	Excess inventory & costs; best supplier may be overlooked.
Machine utilization	Machines run excess product to maximize utilization ratio	Excess inventory; wrong inventory
Setup time built into standard cost	Encourages high run quantities	Excess inventory
Scrap factors built into standard cost	No action if no variance	Inflated standard; scrap allowed to exist
Standard cost overhead assumption	Overproduce to avoid unfavourable variance	Excess inventory; wrong inventory
Direct/indirect labor ratio	Encourages inaccurate labor reporting	Total costs not in control; lack of integrity

Advantages of lean management accounting:

1. Many companies introduce kanban production control but their accounting systems continue to require the tracking of financial information through production work orders and other documents. Lean management accounting eliminates these requirements so that the accounting systems reflect the simplification and waste reduction efforts required in a lean environment.

Conclusion:
In India, traditional monitoring system like 'Parta' has given lot of success to the Marwari organizations. Lean Management Accounting can very well match the requirement of these organizations and other organizations too. By implementing the Lean Management Accounting methods, managements can be assured that lean will become more than an initiative. It will be a way of managing the enterprise for growth and profitability.

**Backflushing is automatic inventory accounting of material consumed for production.*

SA 560 - Subsequent Events

Nandhini Ramachandran

The scope of this auditing standard is to bring out the responsibility of the auditors in the consideration of events occurring after the balance sheet date in an audit of financial statements. The reporting framework, which governs this auditing standard, is AS 4, which deals with "Events occurring after the balance sheet date"

Why is it important to consider subsequent events in an Auditor's report?

As per para 8.1 of AS 4, "Events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure."

As per para 25 of SA 700 (The Auditor's Report on the Financial Statements), "The date of an auditors' report on the financial statements is the date on which the auditor signs the report expressing an opinion on the financial statements. The date of the report informs the reader that the auditor has considered the effect on the financial statements and on the report of the events and transactions of which the auditor became aware and that occurred up to that date."

On a reading of the above pronouncements of ICAI it can be understood that it is the responsibility of the auditor to consider the events and transactions that occurred up to the date of the auditor's report before issuing a report on the financial statements.

Terms relevant to the auditing standard

Date of financial statements: The date of the end of the latest period covered by the financial statements.

Date of approval of the financial statements: The date on which all the statements that comprise the financial statements have been prepared and those with the recognized authority have asserted that they have taken responsibility for those financial statements.

Date of the auditor's report: The date the auditor dates the report on the financial statements in accordance with SA 700 (Revised).

Date the financial statements are issued: The date that the auditor's report and audited financial statements are made available to third parties.

Subsequent events: Events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

Audit procedures in identification of events between the date of the financial statements and the date of auditor's report

While performing the audit of financial statements, there are routine procedures adopted by the auditors in order to obtain sufficient appropriate audit evidence either on the account balances or the classes of transactions that is being disclosed by the auditee. Examples of routine procedures include the cut off procedures subsequent to the balance sheet date, testing of inventory for its NRV, payments received from debtors etc. Though there may be circumstances where the auditor might become aware of the subsequent events while performing the above routine procedures, there are certain additional procedures, which needs to be performed by the auditor in order to identify any subsequent events that occurred after the balance sheet date.

Some of the procedures listed by SA 560 are as follows:

- Identify and review the procedures that the management has laid down in order to identify subsequent events and transactions, which may be in the form of reviewing the journal entries posted subsequent to the balance sheet date like bad debts etc.
- Reading the minutes of the meetings of the board of directors, compensation committee, audit committee or enquire of the proceedings of the meetings for which minutes are yet to be drafted by the Company secretary or the management
- Reading the entity's latest available interim financial statements like quarterly reports or the

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monthly management reports, budgets, cash flows etc.

- Oral or written enquiries with the lawyers of the entity
- Enquiring with the management on the
  - ♦ Current status of items that were accounted based on preliminary data that were available previously
  - ♦ Any developments on the risk areas like status of the litigations pending in the courts of law
  - ♦ Any unusual accounting adjustments contemplated by the management
  - ♦ Any events, which might question the appropriateness of the accounting policies, followed, eg. events that may question the going concern assumption of the entity.
- Similar enquiries with the component auditors from the date when the component auditor signs his report till the date of the principal auditor

Action to be taken by the Auditor

On applying the above procedures, if the auditor becomes aware of any events or transactions that materially affect the financial statements, the auditor should consider whether the same needs to be adjusted in the financial statements.

The auditor shall also obtain a written representation in accordance with SA 580 (Revised) "Representations by Management" that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

When there is a conflict of opinion between the auditor and the auditee and that the auditee does not account for such events, which the auditor considers it appropriate to disclose, the auditor should express a qualified opinion or an adverse opinion, as appropriate.

Audit procedures in identification of events after the date of the auditor's report but before the date when the financial statements are issued

There is no obligation on the part of the auditor to perform procedures to identify the events that occur after the auditor's report but before the financial statements are issued.

However, if the auditor comes to know of a fact subsequent to the auditor's report, which, if the auditor had come to know of the fact would have amended the auditor's report; the auditor shall perform the following procedures"

- Discuss the same with the management or those charged with governance, where appropriate and determine whether the financial statements need amendment
- If so, inquire how the management intends to address the matter

Action to be taken by the Auditor

If the management intends to amend the financial statements, the auditor shall

- Carry out relevant audit procedures on the amendment
- Extend the audit procedures performed above to determine the subsequent events between the date of the financial statements to the date of the auditor's report to this situation also
- Provide a new auditor's report. However, the same shall not be dated prior to the date of the previous audit report.

Audit procedures in identification of events after the financial statements are issued

As specified earlier, the auditor does not have any obligation to perform procedures to identify events or transactions that occur after the financial statements are issued to third parties.

However, if after the financial statements are issued, the auditor becomes aware of a fact, which, had it been known to the auditor before the auditor's report is issued, may have caused the auditor to amend the auditor's report, the auditor shall

- Discuss the same with the management or those charged with governance, where appropriate and determine whether the financial statements need amendment
- If so, inquire how the management intends to address the matter

Action to be taken by the Auditor

If the management intends to amend the financial statements, the auditor shall

- Carry out relevant audit procedures on the amendment
- Extend the audit procedures performed above to determine the subsequent events between the date of the financial statements to the date of the auditor's report to this situation also

Provide a new auditor's report. However, the same shall not be dated prior to the date of the previous audit report.

Dual dating or amendment of the auditor's report

When the management or those charged with the governance decide to amend the accounts to reflect the subsequent events, it is the duty of the auditor to carry out the relevant audit procedures and provide

- Either another date in the already issued auditor's report
- Or amend the auditor's report including an Emphasis of matter paragraph

In the former situation, when the auditor's report carries 2 different dates, such report is referred to as "Dual Dating". The following is an example of a dual dated report

"May 7,20XX except as to Note (x), which is as of the date is July 2, 20XX"

Thus in the above dual dating report, the auditor clearly expresses the fact that the audit procedures carried out for subsequent events is restricted to the amendment so made in the financial statements. However, if the auditor decides to amend the auditor's report, the auditor's report should clearly express the change through an emphasis of matter that relates to the notes in the financial statements where it is extensively discussed about the reason for the amendment to the financial statements and to the earlier report provided by the auditor.

Action to be taken by the auditor to prevent reliance on Auditor's report in certain situations

If the management does not take the necessary steps to ensure that everyone in receipt of the previously issued financial statements of the situation or does not amend the financial statements to give effect to the subsequent event, in circumstances where the auditor believes that the subsequent events require amendment to the financial statements, the auditor shall notify the management and all those charged with governance that necessary steps will be taken to prevent reliance on the auditor's report. Even after such notification, if the management does not take necessary steps to amend the financial statements, the auditor's course of action depends on the legal rights and obligations and thereby the auditor shall obtain legal advice.

In some circumstances like the Central / State government entities may be prevented from issuing amended financial statements due to certain statute. In such circumstances, the appropriate course of action for the auditor may be to report to the appropriate statutory body.

Accounting pronouncements and implications relating to subsequent events

The Companies Accounting standards rules adopted by National Advisory Committee on Accounting Standard, in AS 4 defines "Events occurring after the balance sheet date are those significant events, both favourable and unfavuorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity."

The Standard divides the subsequent events into 2, which are:

(i) **Adjusting events -** those which provide further evidence of conditions that existed at the balance sheet date;

(ii) **Non-adjusting events -** those that are indicative of conditions that arose subsequent to the balance sheet date. However, the auditee is required to disclose the same in its notes to accounts.

Examples of adjusting events:

- an adjustment may be made for a loss on a trade receivable account which is confirmed by the insolvency of a customer which occurs after the balance sheet date.
- A settlement of a legal case where the obligation of the enterprise is decided subsequent to the balance sheet date.

Examples of Non adjusting events:

- Decline in the market value of an investment subsequent to the balance sheet date. This is because there was no condition that existed on the balance sheet date to reflect the fall in the market value of an investment

Going Concern

Events occurring after the balance sheet date may indicate that the enterprise ceases to be a going concern. An unusual change affecting the existence or substratum of the enterprise after the balance sheet date may indicate the need to consider whether it is appropriate to use the fundamental accounting assumption of going concern in the preparation of the financial statements.

Even though there was no condition that existed on the balance sheet date, which doubts the going, concern assumption, this cannot be considered as a non-adjusting event. The fundamental accounting assumption is being affected and it becomes so pervasive that this requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognized within the original basis of accounting.

Conclusion:

Thus, it may be concluded that though the audit is being carried out for a particular period, the auditor is required to consider the events occurring after the balance sheet date also, which provides the required inputs for forming an appropriate opinion on the financial statements.

On Line Articles Placement Portal for selection of Articled Assistants by CA Firms

The Board of Studies of the Institute has introduced an optional Campus Placement Scheme for selection of Articled Assistants by CA Firms. The Pilot Campus Placement Programme held at Delhi in August 2010 has been a great success with an overwhelming response from both CA Firms and Students. Considering the positive feedback and requests received from both CA Firms and Students, it has been decided to start an Online Articles Placement Portal to facilitate placement of Articles in CA Firms on pan India basis. Both eligible CA firms and candidates who are willing to avail of this facility shall have to register themselves online through the articles placement portal at ***http://bosapp.icai.org.*** The Portal has become operational from 5th October, 2010. The services on the Portal would be available for two months from the time of registration by the firm. Similarly the bio data of a student will also be available on the portal for a maximum period of 2 months from student's registration.

The Articles Placement Portal has been put into place to provide a platform to the firms of Chartered Accountants having vacancies for Articled Assistants to shortlist eligible students for selection of articled assistants, and call them for Interview at their offices, as per date and time convenient to them. The candidates who have either (a) Passed Group-I or both Groups of the IPCC examination, or (b) Passed either of the Groups or both groups of PE-II examination; and are eligible for undergoing articled training for selection as articled assistants in the CA firms can register themselves on the portal, such that they can be considered for selection by the CA Firms. The candidates shortlisted by CA Firms would be automatically informed by e-mail through the Portal, to appear for interview at their respective Offices, at the designated date and time.

Please refer the detailed guidelines available at the institute's website ***www.icai.org*** under "Announcements" and on the Portal..

In case of any clarification, please contact the Board of Studies, ICAI Bhawan, A-94/4, Sector-58, Noida-201301, Tel. No. 0120-3045930/931; eMail: ***bosapp@icai.org***

Director, Board of Studies

Invitation to Contribute Articles in the Students' Journal

We are planning to bring out a few special issues of the Students' Journal in the forthcoming months. These will be on:

1. Company law and Company Bill
2. Security law including IPO, FPO, QIP issues, insider trading, takeover code and Stock Exchange compliances. This will also cover latest trends and potential in capital market as well as role of CAs in Fund raising and capital market.
3. Finance including Merchant Banking, Investment Banking, valuations, Mergers and Acquisitions, securitization, financial analysis and wealth management.
4. Information Technology
5. Taxation - direct Taxes and Indirect Taxes
7. Management
8. Economics
9. Latest trends in Management accounting, Role of CFO, Changing role of CAs, International Finance, international taxation and other topics of interest to CAs.

Articles are invited from members, academicians, students and others on the above subjects for inclusion in the Journal.

An article should comprise of 1600 to 2000 words only. The authors are advised to enclose the following along with their articles:-1.A signed undertaking stating that the article is original in all respects and does not infringe any copyright and has not been published or sent for publication elsewhere.2.A passport size colour photograph 3.A soft copy of the article with complete communication and E-mail address and contact number. Articles received without the above will not be considered. All correspondence in this regard should be addressed to The Director, Board of Studies, The Institute of Chartered Accountants of India, ICAI Bhawan, A-29, Sector-62, Noida-201301.

Indirect Taxes

A. **Excise Duty**

1. **Components, spares and accessories of motor vehicles, dumpers or tippers used for providing prescribed taxable services eligible for CENVAT credit as capital goods**

   Rule 2(a) of the CENVAT Credit Rules, 2004 has been amended 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.

   [Notification No. 29/2010 CE (NT) dated 24.09.2010]

B. **Service Tax**

1. **Optional Composition Scheme for Distributor or Selling Agents of Lotteries**

   An optional mode of payment of service tax has been provided 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.

   [Notification No. 49/2010 ST dated 08.10.2010]

2. **Persons marketing lottery tickets to authorized Distributors/Selling Agents opting for new Composition Scheme exempt from service tax**

   Persons marketing the lottery tickets, other than the authorized distributors or selling agents, have been exempted 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.

   [Notification No. 50/2010 ST dated 08.10.2010]

3. **New services introduced vide the Finance Act 2010 to be classified under the residual category of the Export of Services Rules, 2005 and Taxation of Services (Provided from Outside India and Received in India) Rules, 2006**

   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.

[Circular No. 129/11/2010-ST dated 21.09.2010]

4. **Monetary limits of adjudication under section 73 revised**

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 Circular No. 130/12/2010 ST dated 20.09.2010.

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

(i) The Superintendents would be competent to decide cases that involve service tax and / or CENVAT credit upto ₹ one lakh in individual show cause notices.

(ii) 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.

(iii) They would be competent to decide cases involving wrong availment of CENVAT credit upto a monetary limit of ₹ one lakh.

[Circular No. 130/12/2010 ST dated 20.09.2010]

Business and Corporate Laws

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

The Government on 15th September, 2010 raised the interest rate on employees' provident fund by one Percent to 9.5 percent for this fiscal. The announcement came after a meeting between Labour Minister Mallikarjun Kharge and the Central Board of Trustees (CBT), the policy making body of the Employees Provident Fund Organization (EPFO).

The Negotiable Instrument Act, 1881

As per the vide Reserve Bank circular DPSS.CO.CHD.NO.485/03.06.01/2010-11, in the case of dishonor or return of cheques, the cheque return memo need to mention the date of return without fail, keeping in view the larger interests of customers.

The Insurance Act, 1938

Securities and Insurance Laws (Amendment and Validation) Act, 2010 is an Act further to amend the Reserve Bank of India Act, 1934, The Insurance Act, 1938, The Securities Contracts (Regulation) Act, 1965 and the SEBI Act, 1992.

The above Act amended Section 2 of the Insurance Act, 1938. It inserted explanation after clause (11) whereby it declared that "life insurance business" shall include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a component of investment and a component of insurance issued by an insurer referred to in clause (9) of this section. This shall be deemed to have been inserted with effect from the 9th day of April, 2010.

The Securities Contracts (Regulation) Act, 1956

In the Securities Contracts (Regulation) Act, 1956, in section 2, in clause (h), after sub-clause (id), the following Explanation shall be inserted by the Securities and Insurance Laws (Amendment and Validation) Act, 2010 and shall be deemed to have been inserted with effect from the 9th day of April, 2010, namely:-

"For the removal of doubts, it is hereby declared that "Securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938".

The Securities and Exchange Board of India Act, 1992

In the Securities and Exchange Board of India Act, 1992, in section 12, in sub-section (1B), the following Explanation shall be inserted and shall be deemed to have been inserted with effect from the 9th day of April, 2010, namely:-

"For the removal of doubts, it is hereby declared that, for the purposes of this section, a collective investment scheme or mutual fund shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a component of investment besides the component of insurance issued by an insurer."

[All the above amendments are not applicable for November 2010, Examinations]

Illustrations from Published Accounts

As 29 : Provisions, Contingent Liabilities and Contingent Assets

Accounting Standard (AS) 29, Provisions, Contingent Liabilities and Contingent Assets, issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after April 1, 2004 and is mandatory in nature from that date. The objective of AS 29 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

This Statement should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, except:

- those resulting from financial instruments that are carried at fair value ;
- those resulting from executory contracts, except where the contract is onerous ;
- those arising in insurance enterprises from contracts with policy-holders; and
- those covered by another Accounting Standard.

The Standard lays down recognition and measurement criteria and disclosure requirements for provisions, contingent liabilities, contingent assets and restructuring provisions.

Relevant extracts on AS 29 from the Significant accounting policies and notes on accounts forming part of the Financial Statements of Infosys and BHEL are as follows:

Extracts from Annual Report of Infosys for the year ended 31st March, 2010

Provisions and contingent liabilities

A provision is recognized if, as a result of a past event, the Group has a present legal obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by the best estimate of the outflow of economic benefits required to settle the obligation at the reporting date. Where no reliable estimate can be made, a disclosure is made as contingent liability. A disclosure for a contingent liability is also made when there is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources. Where there is a possible obligation or a present obligation in respect of which the likelihood of outflow of resources is remote, no provision or disclosure is made.

Post-sales client support and warranties

The Group provides its clients with a fixed-period warranty for corrections of errors and call support on all its fixed-price, fixed-timeframe contracts. Costs associated with such support services are accrued at the time related revenues are recorded and included in cost of sales. The Group estimates such costs based on historical experience and the estimates are reviewed annually for any material changes in assumptions.

Onerous contracts

Provisions for onerous contracts are recognized when the expected benefits to be derived by the Group from a contract are lower than the unavoidable costs of meeting the future obligations under the contract. The provision is measured at lower of the expected cost of terminating the contract and the expected net cost of fulfilling the contract.

Provision for doubtful debts

Periodically, the Group evaluates all customer dues to the Group for collectability. The need for provisions is assessed based on various factors including collectability of specific dues, risk perceptions of the industry in which the customer operates and general economic factors, which could affect the customer's ability to settle. The Group normally provides for debtor dues outstanding for 180 days or longer as at the Balance Sheet date. As at March 31, 2010, the Group has provided for doubtful debts of ₹ 21 crore (₹ 66 crore as at March 31, 2009) on dues from certain customers although the outstanding amounts were less than 180 days old, since the amounts were considered doubtful of recovery.

The Group pursues the recovery of the dues, in part or full.

Extracts from Annual Report of BHEL, for the year ended 31st March, 2009

Claims by/against the Company

Claims for liquidated damages against the company are recognized in accounts based on management's assessment of the probable outcome with reference to the available information supplemented by experience of similar transactions.

Claims for export incentive /duty drawbacks/duty refunds and insurance claims etc. are taken into account on accrual.

Amounts due in respect of price escalation claims and/or variations in contract work are recognized as revenue only when there are conditions in the contracts for such claims or variations and/or evidence of the acceptability of the same from customers. However, escalation is restricted to intrinsic value.

Provision for Warranties

For construction contracts entered into on or after 01.04.2003:

Provision for contractual obligations is maintained at 2.5% of the contract value on completion of trial operation.

For all other contracts:

Provision for contractual obligations in respect of contracts under warranty at the year end is maintained at 2.5% of the value of contract. In the case of contracts for supply of more than a single product, 2.5% of the value of each completed product is provided.

Warranty claims/expenses on rectification work are accounted for against natural heads as and when incurred and charged to provisions in the year-end.

Illustrations from Published Accounts - Auditing

Mahanagar Telephone Nigam Ltd. (31.03.2009)

Addendum to Director's Report - 2008-09
Replies of Management to Auditors Report with regard to significant qualifications for the year 2008-09

Qualifications in Auditors Report	Reply of the Management
Claim of the company for deduction under section 80IA of the Income Tax Act, 1961 pending at various appellate authorities. We are unable to comment on the impact as the outcome of these cases is not ascertainable at this stage.	The matter is pending before concerned authorities and is being pursued for settlement.
The issue of pension, gratuity and leave encashment liability on account of absorbed employees is yet to be settled with the DOT which may have substantial favourable impact on the profitability of the company.(Refer Note No. 16)	The management has taken up the matter with the administrative ministry.
Non implementation of II wage revision due to pending pension issue with the DOT. We are unable to comment on the impact of the same on the accounts of the company.	This is under review by the management. However the impact of 50% DA merger, which is an interim measure, has already been accounted for.
The amounts recoverable from DOT and BSNL are subject to reconciliation and confirmation and in view of various pending disputes regarding each other's claims we are unable to comment on the impact of the same on the profitability of the company.	A committee has been constituted by BSNL by mutual agreement vide letter no 16-56/2001-PHA-(1) dated 25-04-2009 consisting of officers of both MTNL and BSNL to reconcile the differences. Management has taken up the matter of DOT related reconciliation with the Administrative Ministry

The Delhi mobile service Unit has not made provision in the accounts for the balance of ₹ 141.75 millions outstanding for more than 3 years in respect of dues from operators. Thus, the profit of the company is overstated by ₹ 141.75 millions and Claims Recoverable have been overstated by the same amount.	As per significant accounting policy of the company no provision is required to be made in respect of dues from operators as the outstanding amount is being pursued with them for settlement and there are ongoing transactions with most of them.
The Delhi Unit has not made provision in the accounts for the balance of ₹ 24.14 millions outstanding for more than 3 years in respect of dues from operators. Thus, the loss of the company is understated by ₹ 24.14 millions and debtors have been overstated by the same amount.	As per significant accounting policy no provision is made with respect to dues from operators as the outstanding is being pursued with them for settlement and there are ongoing transactions with most of them.
Non provision of certain claims of the BSNL on account of signaling charges, Transit tariff, MP Bills ,IUC Claims and IUC claims of MTNL rebutted by BSNL, Service Connection billing& TAX charges recoverable and payable, pending identification, reconciliation and settlement of these and other similar claims of the company the impact of the same is not ascertainable	The duct and Tax usage and other charges recoverable from BSNL have already been referred to a joint committee of officers from both MTNL and BSNL constituted by BSNL vide their letter no 16-56/2001-PHA-D dated 25-04-2009 for settlement of all such pending dues and sharing of networks.
Non provision of stamp duty for the properties where the conveyance/lease deed is yet to be executed and the amount is unascertainable.	As per the Sale Deed executed between the company and DOT, stamp duty is not payable on the properties acquired by/ vested in the name of the company by DOT. As regards properties acquired after 1/4/86 the matter is taken up with concerned authorities and is in process.
Non provision of impairment of assets in terms with Accounting Standard 28.	There is no impairment as per the opinion of Board of Directors as calculated by discounted future cash flow method.
Non valuation of vacant land and Guest Houses/ Inspection quarters at fair market value as at the year end for the purpose of wealth tax provisions.	The properties have been acquired by the company for self use only hence the same were valued at cost.
Non provision of LTC/ encashment of LTC not availed by the employees, amount unascertained. Non confirmation and reconciliation of amounts receivable and payable from various parties.	LTC block is ongoing and the claims get lapsed after completion of the block hence no provision needed. The process of reconciliation is being pursued.
Balance in subscriber's deposits account of ₹4526.22 Million and interest accrued thereon of ₹ 58.49 Million, unlinked receipts from subscribers ₹ 82.31 Million are subject to reconciliation. Balance of sundry debtors as per Ageing Summary is short by ₹ 62.24 Million with comparison to balance is general ledger though the same has been fully provided for. The reconciliation of metered and billed calls in various units is in process. The reconciliation of leased, operational and billed circuits is in progress. The final impact of above on the accounts is presently not ascertainable and the same may have an impact on the Profitability of the company. [Refer Note No. 15(b)].	The reconciliation is in process. Necessary adjustment entries, if any shall be passed as per the reconciliation process.
During the year no reconciliation of roaming receivables has been carried out. The impact of non-reconciliation of roaming debtors on profitability if any is unascertainable.	The reconciliation is in process. Necessary adjustment entries, if any shall be passed as per reconciliation process

The system of issuance of completion certificates by engineering department needs to be strengthened. The impact due to the delay in issuance of completion certificate on Fixed Assets and Depreciation is not ascertainable.	Noted.
The balance of amount payable to GPF Trust is subject to confirmation, reconciliation and subsequent adjustments.	The reconciliation is in process.
The Bank Reconciliation Statements as at 31st March, 2009 include the unmatched/ unlinked credits and debits aggregating ₹ 55.25 million and ₹ 63.23 million respectively, which have not been properly accounted, in the absence of adequate particulars. The impact of such entries on the Accounts cannot be ascertained.	The reconciliation is in process.
In absence of agreement between the company and DOT/BSNL for interest recoverable/ payable on current account, no provision has been made for interest payable/ receivable on balances during the year.	The interest shall be accounted for at the time of settlement, as considered necessary by mutual agreement.
Retaining of outstanding liability of ₹ 470.1 Million on account of decommissioned assets pending arbitration case.	Noted.
Claims receivables include ₹22.50 Million towards ADC charges receivable from certain operators accounted for on conservative basis in the financial year 2007-08 and which may have a favourable impact on the results on settlement/acceptance.	The matter is being pursued.
The requisite information & details for the identification of Micro, Small & Medium enterprises as such we are unable to comment upon the compliance of section 15 & 22 of the Micro Small & Medium Enterprises Development Act-2006.	Company has addressed all the creditors seeking information whether they come under MSMEDA2006. As no response has been received, no action is required towards compliance of the sections of MSMEDA 2006.
The unit has not made following disclosures required under Schedule VI of the Companies Act, 1956 as per references given after each items:	
i)Consumption of stores and spares (Para no.3 (x)(a) of part II)	Not Applicable.
ii) Consumption of imported and indigenous stores and spares and Percentage to the total consumption (Para no.4 D (C) of Part II)	Not Applicable.
iii) The classification of sundry debtors as unsecured without considering the security deposit that the unit has received from subscribers.	The debtors are secured upto the extent covered by security deposit received from subscribers however the same fact has been disclosed in schedule H of Balance Sheet.
iv) Debtor's figures outstanding for more than six months and up to six months are ascertained by the management and relied upon by the auditors.	This is as per the system generated reports.

Clarification in Revision Test Paper-November, 2010

Students may note that in Revision Test Papers for November, 2010, in Paper:8: Indirect Tax Laws/ Indirect Taxes, question no. 5 should be read with following note:-

It may be assumed that CENVAT credit in second financial year is taken on 01.07.2009.

The Joint Cost Problem at VGCL

R.K.Srivastava

The case relates to an Indian company, which is a pioneer in the manufacturing of solid state electronic components. The case highlights certain Joint Cost problems which may be faced by companies producing multiple products out of the same manufacturing process. Similar problems can also arise in other industry like oil refinery, railroads, airlines, slaughterhouses, mining etc.

About Vinkas General Carbon Ltd (VGCL)

Vinkas General Carbon Ltd (VGCL) , is a leading manufacturer and supplier of high-quality application specific standard products within the broad discrete, logic, and analog semiconductor markets. Diodes serve the consumer electronics, computing, communications, industrial, and automotive markets. Diodes' products include diodes, rectifiers, transistors, amplifiers and comparators, power management devices, including LED drivers and linear voltage regulators. The Company’s corporate headquarters, logistics centre, and India's sales office are located in Delhi, India. Design, marketing, and engineering centres are located in Bangalore, India; Taipei, Taiwan; and Neuhaus, Germany. The Company’s silicon rod fabrication facilities are located in Solan,(HP) accompanied with two other factories, one of which is exclusively built for the manufacture of rectifiers, an important product of the company accounting for more than 30% of total cost of production.

This particular factory initiated work in 1992 as professional manufacturer of all kinds of rectifiers. In the past years, by keeping the principle of "Satisfying Customers with Excellent Quality and Superior Services", the company has obtained very good reputation in the whole world.

Rectifier and its characteristics'

1906 was one of those years that would shape the world for years to come, although few people, if any, realized it at the time. In October 1906, Greenleaf Whittier Pickard (the grandnephew of the poet John Greenleaf Whittier) received a patent on a method for receiving radio signals that included a silicon point-contact diode. {U.S. Patent 836,531 was filed on August 30, 1906 and issued November 20, 1906}. The seed of thought of the use of silicon for controlling waveforms was probably born then, the tree came into being much later. Development in the theory and practice relating to the family of diodes(rectifiers included) has been rather slow. Although people didn't know for long how point-contact diodes worked, it didn't stop them from manufacturing and using them.

Rectifiers are used in power supplies to convert alternating current (AC) to direct current (DC), a process called rectification. Rectifiers allow electricity to flow in only one direction. Rectifiers are in reality diodes, the latter being the electrical version of a valve and early diodes were actually called valves.

Electricity uses up a little energy pushing its way through the rectifier, rather like a person pushing through a door with a spring. This means that there is a small voltage across a conducting rectifier. It is called the 'forward voltage drop'.

When a reverse voltage is applied a perfect rectifier does not conduct, but all real rectifiers leak a very tiny current of a few ?A or less. All rectifiers have a maximum reverse voltage and if this is exceeded the rectifier will fail and pass a large current in the reverse direction; this is called 'breakdown'/blockage.

The quality concept

The end user primarily assesses the quality of a rectifier by two distinct characteristics viz the rapidity of response in blocking current reversals and the maximum voltage level the rectifier can withstand. However, engineers at the factory are not aware of any method which could be used to produce rectifiers having exact specific characteristics. It has been noticed that every batch produced differs from the other although the conditions in which the manufacturing is done is the same for all batches. Also, the characteristics of rectifiers within a batch are significantly different. It has been empirically seen that over a period of time concerning several production runs the distribution of rectifier characteristics resembles a normal distribution.

The production process

Silicon is used as the intrinsic semiconductor, to which the proper dopants are added. A dopant, also called a doping agent, is a trace impurity element that is added to silicon (in very low concentrations) in order to alter the electrical and physical properties of the end product. Typically,

The author is Cost Accountant and Corporate Trainer

the production process is initiated with a batch of 50 silicon rods being heated in a furnace with a temperature of around 1400 degree Celsius. The dopants are added in the same process. In case one alters the quantity of dopants one could bring about significant changes in the characteristics of the ultimate product. However it is difficult to predetermine the exact quality of rectifier which shall be produced with some standard quantity of dopant added to standard amount of silicon. It has been noticed that the enhancement of one characteristic is accompanied with a reduction of some other quality. In fact it is extremely difficult to get exact quality of the finished product because a small variation in the temperature of the furnace and variability in gas distribution could alter substantially, the final product characteristic.

Once the silicon rod is heated in the furnace and dopants added, the following process of production is followed;

1. Each silicon rod is cut into 2,000 silicon chips, each approximately the size of a small pebble possibly as big as a black hole.
2. Every chip is subsequently placed between two metallic cylinders and compressed between them.
3. The above mentioned is then enveloped in a glass sleeve which is then heated in order to form the desired bond with the silicon chip.
4. Silver and copper wires are attached after which the finished product is painted and marked with the product name.

It has been noticed that only 60% of the 1,00,000 chips initiated in production reach step 3. Out of the ones so processed, only 33.33% are saleable as part of the regular product line. .5,000 rectifiers are produced below quality and are sold in the market as seconds. Marketing efforts are not needed to sell these seconds and they are also not assigned any inventory value.

Data relating to Cost of Production is given below;

		Annual Costs (₹)
Batch Costs		
Direct Material	2,50,000	
Direct Labour	1,60,000	
Variable Overheads	2,30,000	
Total	6,40,000 ×20#	1,28,00,000
Non variable costs##		32,00,000
Factory Overheads##		40,00,000
Total Manufacturing Costs		200,00,000

Production of rectifiers is done in batches approximating 20 Nos in a year.

Allocated to N Series rectifiers based on direct labour.

Accounting Issues: How to Account for Joint Costs

Direct material and Direct Labour are costs which can be economically and feasibly be traced to the ultimate product, the N series rectifiers. However, Indirect Costs popularly known as Overheads are not directly assignable and hence need to be allocated. It is popularly understood in the industry that a detailed absorption cost per unit is required for decision making and inventory valuation purposes.

In the case of silicon rectifiers, different quality finished products are created because of differing impurities (dopants) and variable temperature in the furnace. These different quality rectifiers have different sales value; however, the cost to produce them is "Joint". This implies that VGCL has no mechanism to match any of the costs with any of the individual component produced in one batch. In a nutshell, all costs are incurred to produce rectifiers with varying electrical and physical characteristics.

Allocation of Joint Costs at VGCL can be done by any of the following two popularly known techniques;

1. All Joint Costs are divided by the total number of saleable units produced during the process. The method is known as the average or physical unit method. Such a method shall normally yield a different Gross Profit percentage because different quality rectifiers are sold at different sale value.
2. Joint Costs are assigned to units based on their relative sale value e.g. in case Joint Costs incurred for producing products A, B and C are ₹ 1000 and the sale value of the products is ₹ 500, ₹ 300 and ₹ 200 respectively, the allocation of cost to "B" is 30% of ₹ 1000 or ₹ 300 and so on. In this particular method the Gross Margin percentage of all the products remain the same.

The Decision Making Dilemma

The following table provides a list of the sales price and present inventory levels for the N series rectifiers. The projected annual sales and production are also shown. The breakdown of the products in each batch is similar.

TABLE

Product	Blockage	Maximum Voltage	Annual Sales Orders	Sale Price per unit(₹)	Current Inventory	Annual Production in units
N71	.30 -.79	200	1,00,000	40	3,000	90,000
N72	.80-1.25	300	1,40,000	60	10,000	1,20,000
N73	1.26 - 1.75	400	1,00,000	70	9,000	90,000
N74	1.76 - 2.30	500	48,000	80	8,000	60,000
N75	2.31 - 2.80	600	20,000	100	5,000	40,000
			4,00,000		35,000	4,00,000

(Note : As mentioned earlier, a typical batch of rectifier produces approximately 5,000 units of the lower quality rectifiers known as Seconds. These rectifiers are not assigned any inventory value and whatever revenue is generated through their sales is credited to miscellaneous income. At present 65,000 such rectifiers are in stock. The demand for such rectifiers is extremely price sensitive. At present VGCL sells these rectifiers at a rate of ₹ 25 per unit.)

Geetika, a Chartered Accountant had just begun a six months training programme at the Solan factory of VGCL. She was summoned by her immediate senior, Arvind, who called her attention to a order of 6,000 units of series N71 rectifiers. The inventory level of N71 was not sufficed. Since customers were perfectly OK with units that met their needs or exceeded them, VGCL could also deliver from the other units of the N series. However, customers were not willing to pay extra for the higher characteristics.

Arvind asked Geetika to decide from amongst the following options;

1. To fill the order with N72 rectifiers.
2. To initiate a fresh batch of production so as to fulfil the order with N71.
3. To turn down the order because of lack of stock.

The fresh batch of production was an extremely good idea, however, it would entail the production of other units along with, thereby increasing inventory. Since Arvind's performance was evaluated as a function of the "profits generated less inventory carrying cost", he was not too eager to adopt the second option. Also there was a chance of this increased inventory getting obsolete. All along, Arvind had maintained inventory levels of one months sale as according to him a turnover ratio of 12 times was an appropriate balance between stock outs and excess investment.

Another matter which Arvind discussed with Geetika was an offer which had recently been received from a electrical manufacturing company to buy 4000 units per month of the N series seconds rectifiers at a price of ₹ 15 per unit. The company was willing to sign a yearly contract for the same. Arvind told Geetika about his discussions on the same with the production manager. Apparently, the production manager was dead against the order maintaining that the price offered was throw away and would not even recover the out of pocket expenses of ₹ 32 per unit in the production process of the same. According to him, it was silly to lock an order which would not even recover the variable costs incurred. Arvind , however, was deeply concerned over the growing inventory levels, even though they were carried at zero inventory value. He asked Geetika whether she agreed with the production manager that it was naive to sell seconds rectifiers at ₹ 15 per unit. According to him it represented pure profits as seconds inventory was assigned zero value by the cost accounting department.

Another problem which Arvind shared with Geetika concerned a one time Indian Navy request for bids on1,00,000 units of N74 rectifiers. The Indian Navy had asked for a cost plus bid, however, Arvind was not sure about what constituted cost. Delivery was to be made uniformly for a period of eighteen months at about 5,500 units per month. Although VGCL was not dependent on the government, the concerned work on a prestigious new Indian Navy system would certainly enhance its Goodwill.

Questions

1. Assuming zero opening inventory, how should VGCL assign the production output (4,00,000 units) to the sales orders (4,00,000 units)?
2. Calculate and compare per unit cost of the series N rectifiers under an average costing system and under a relative sale value costing system?
3. Compute revenue, cost and profit if the order of 6,000 units of N71 was accepted for immediate shipment? Computations need to be done using both physical unit costing and relative sale value costing systems.
4. What should Geetika advice regarding the order of the electrical manufacturing company?
5. Discuss the behavioural implications of using the physical unit method and the relative sale value methods of costing systems?
6. Give your opinion on the price and manufacturing strategy for the Indian Navy contract?

(Students are requested to mail their answers to the questions to "prem@icai.org" latest by November 30, 2010. The best answers will be published in the January 2011 issue of the Students' Journal)

ITC – E-Choupal

Shaleen Suneja

ITC is one of India's flagship private sector companies with diverse portfolio consisting of cigarettes, hotels, paperboards & specialty papers, packaging, agro-business, packaged foods & confectionery, information technology, branded apparel, personal care, stationery and safety matches. It is a market leader in its traditional businesses consisting of cigarettes, hotels, paperboards, packaging and agro-exports. The company is also rapidly gaining market share in its other businesses that are in nascent stages.

A century ago, the company ITC was incorporated with the name Imperial Tobacco Company of India Limited on August 24, 1910. The ownership of the Company was progressively Indianised. In the year 1970, the name of the Company was changed to India Tobacco Company Limited and then to I.T.C. Limited in 1974. To recognize the Company's multi-business portfolio the full stops in the Company's name were removed from September 18, 2001 and since then the company is known as ITC Limited. The company employs over 26,000 people at more than 60 locations in the country.

With tobacco business its main area, ITC expanded the businesses on account of its competency in agriculture sector. ITC's Agri-Business is India's second largest exporter of agricultural products. The exports of the division run over ₹ 1000 Crores. The domestic sales of agro-products also exceed ₹ 1500 crores. Being in the agriculture sector the farmers are an important force in its supply chain.

Indian Agriculture

Majority of Indian population lives in villages and earns their livelihood through farming. In spite of improving manufacturing and service sector, the dependence of the economy on agriculture is quite significant. It would not be a misnomer to term agriculture as backbone of Indian economy. However, in spite of being fundamental sector of the economy, the condition of Indian farmer is not encouraging. Traditionally, Indian farmers have a very low risk bearing ability.

Indian farmers have less money for making investments. They purchase seeds and fertilizers from local retailers. To sell their produce, they bring the agriculture output to "Mandies". A "Mandi" is a big market often open or in spread out-sheds. The produce is auctioned in "mandies" to the traders and agents of the processing companies through open outcry method. Successful bidders, pay in cash to the farmers. The produce is then transported and sold to processing units or other intermediaries through brokers. The sale and transfer of produce between different middlemen add margins and increases the costs to the ultimate consumer. However, farmers who are first in the chain often get unattractive price with low margin. Middlemen to gain advantage will also withhold critical information and use it for their own benefit. Much of the benefit in the supply chain is often taken by the middlemen in the agriculture sector. (Exhibit 1: Traditional agriculture produce value chain)

E-Choupal

ITC could visualize that if timely information is available to the farmers, it would be beneficial to both, the farmers as well as the company. Through the use of Information Technology the company created infrastructure to disseminate information and market signals to the farmers. The farmers were empowered through timely information that was distributed through internet kiosks established by ITC in villages. The company created extensive backward linkages with the farmers and made them strength of its agri-business. Through the process the company was also able to give back to the society. The project, christened as 'e-Choupal', started in the year 2000, comprises to about 6500 installations serving nearly 40,000 villages at present. Through this initiative the company serves over 4 million farmers spread across the 10 States. Through a farmer-friendly website the company provides information on weather, crop conditions, best practices in farming, prevailing international prices and other relevant information. The model was a win-win for both farmers and the company.

Relevant and real-time information that is provided by 'e-Choupal' greatly improved the ability of farmers and helped them take correct decisions. Empowered with the knowledge, the farmers are able to align their farm output with the demand. The internet kiosks were managed by farmers themselves. The in-charge of the

The author is Senior Assistant Director, ICAI

Choupals was one of the local farmers and was designated as sanchalak. He helped the agricultural community with the knowledge in local language.

Setting up of the e-Choupals was not free from difficulties. Often problems were encountered on account of inadequate infrastructure, no-availability of continuous power supply, telecom connectivity and geographical inaccessibility. The company overcame the challenges. Apart from timely information and quality decision making, ITC was able to set up a direct marketing channel virtually linked to the "mandi" system for the purposes of price discovery. At the same time it eliminated wasteful intermediation, multiple handling and reduced transaction costs. Overall logistics was made efficient and cost effective. The e-Choupal model demonstrates that a commercial organization can play a significant role in increasing the efficiencies of a traditional agricultural system, in ways that benefits farmers as well as owners of the company.

Questions:

1. Do you think large commercial organization should interfere with the established processes? Discuss
2. Why mandies are not an optimal procurement channel for processors?
3. Was IT-driven solution a wise decision to implement in rural India?
4. Why does the ITC select local farmers as sanchalaks?
5. What are the social benefits of e-Choupals?

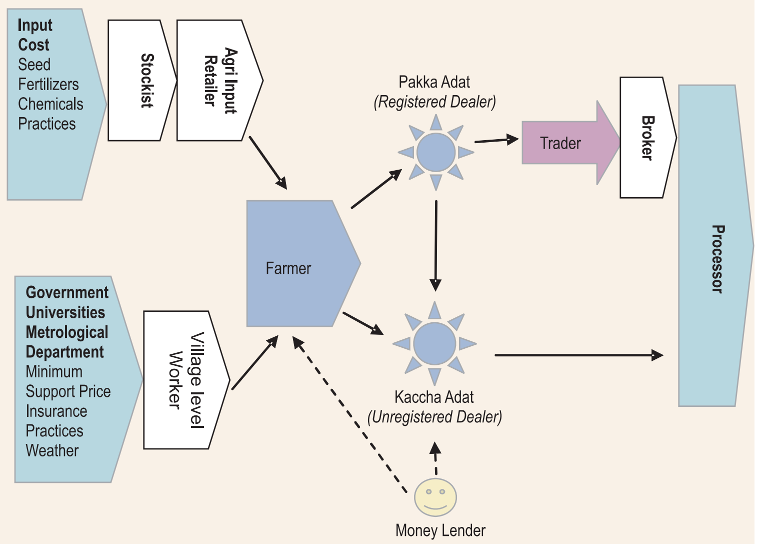

Exhibit 1 : Traditional agriculture produce value chain (Source: http://www.itcportal.com/itc-business/agri-business/e-choupal.aspx)

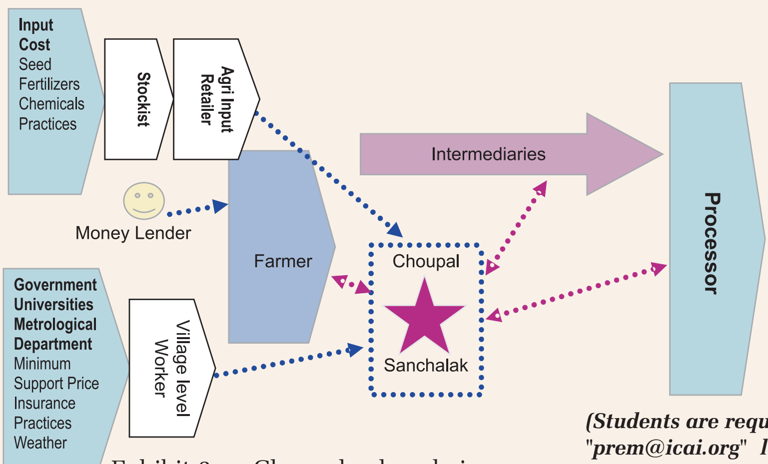

Exhibit 2 : e-Choupal value chain

(Students are requested to mail their answers to the questions to "prem@icai.org" latest by November 30, 2010. The best answers will be published in the January 2011 issue of the Students' Journal)

Residential Programme for PCC/IPCC/PE-II students/ newly qualified Chartered Accountants

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, 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.

October 22, 2010

Director, Board of Studies

National Convention of CA students: Coimbatore

Coimbatore branch of ICAI is organizing a National Convention of CA students with the theme "Strong Foundation for Young Pillars".

Date: 29th& 30th of December 2010

Venue: PSG College of Arts and Science Auditorium, Coimbatore

Students are invited to register for the Convention at the earliest. Interested students are also invited to submit paper of about 6-7 pages on any of the following topics.

Technical Session I Recent trends in Financial Reporting	1. Presentation of Financial Instruments 2. Fair Value Accounting 3. Financial Reporting requirements for non-corporate entities
Technical Session II Auditing in Practice	1. Forensic Audit and Fraud Deduction 2. Audit Evidence and Documentation 3. Internal Audit Function
Technical Session III Issues in Taxation	1. Direct Tax Code Bill, 2010 2. Issues in Capital Gains 3. International Taxation
Technical Session IV General Awareness	1. Practical Training: Essence of CA Profession 2. Developments in capital markets 3. Interpretation of Statutes

Registration Fee: ₹ 300/-

Cultural Events: 05:00 PM - 07:00 PM (29/12/2010)

Contact Details: P Viswanathan, Chairman, Coimbatore Branch of SICASA

Mob : 91-90470-17006 .Email: chairman@coimbatoresicasa.org

For more details Students can visit coimbatoresicasa.org

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CA. Vinod Jain, Chairman, Board of Studies, addressing the CA students at the Articles Campus Placement Programme held at the new premises of ICAI, Sector 62, Noida. Also seen in picture, Mr. Rajesh Bhalla, Deputy Secretary, ICAI.

CA. Vinod Jain, Chairman, Board of Studies, addressing the participating CA firms and students at the Articles Campus Placement Programme held at the new premises of ICAI, Sector 62, Noida. Also seen in picture, Mr. Rajesh Bhalla, Deputy Secretary, ICAI.

The CA Students participated in the Articles Campus Placement Programme awaiting their turn to make their presentations.

The representatives of the CA firms participated in the Articles Campus Placement Programme listening to the presentations made by the students.

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