



E – NEWS LETTER



Tuticorin Branch of Southern India Regional Council of The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)

March 2009

STUDENTS SPECIAL

Thoughts of Chairman



Dear Members & Students

Greetings,

Tuticorin Branch has launched ICAI - NSS on 03/03/2009 at Holy Gross Primary School, Tuticorin (Celebrant of 100 years) by Smt. X.Rosary Mary, Director of youth welfare, Manonmaniam Sundaranar University, Tirunelveli. Our Students gave a spectacular Programme in “Personal cleanliness and Hygiene Practices” through a small drama, power point presentation & powerful dance by

- 1) Selvi J.Anne Jose
- 2) Selvi M.Rajalakshmi
- 3) Selvi J.S. Deepikka Veermathy
- 4) Selvi S.Sundari
- 5) Selvi. A.Sri Devi
- 6) Selvi V.Gayathri Devi
- 7) Selvan. A.Antony Joshua
- 8) Selvan.F.Bonton Niraie Mathews

It was a great show participated by more than 1200 Children and our Members & Students joined together to make the event a memorable. Our social concept started, “A Beginning” it must go a long way with the support of Students & Members.

Every creation is born to a nature, lives within that nature and eventually dies to that nature. Man is the only creation who can transcend his very nature. Man alone can wonder and imagine. Man alone can experience gratitude, devotion, surrender and faith. Man alone can contemplate and meditate. Man alone can attain self-realisation.

All in all, you were born awake and do not fall asleep to the possibilities. God became man, so that, man can again become God. Let not man fall into animalistic possibilities. Even if a concept of rebirth exists, you will not be born again as you-not in this form and this name. This is the only chance you have got. Don't miss yourself and let the world not miss you. Make the most of this birth-this life. Bring forth every human faculty and live a complete human life. Remember, it is not in being born as a human being, but it is in living as a human being you live a complete human life.

With warm regards,

CA B.Francis Amal George

Promoter's Tricks

In the wake of the Satyam-Maytas debacle, I like to highlight the three most common tricks that Indian promoters employ to enrich themselves at the expense of shareholders. Soon after Satyam's now-jailed former chairman B Ramalinga Raju confessed to serious accounting irregularities in the company in early January, equity markets seemed a thriving ground for manipulators, with apprehensive investors running for cover as rumour-mongers succeeded in swinging stock prices at their will. In the currently depressed market conditions, the divergence between promoters' goals (around boosting personal wealth) and shareholders' objectives (around growing the value of the firm) has become sharper. Moreover, contrary to conventional wisdom, such shenanigans are not confined to small cap stocks; some of the largest companies in India have a penchant for such tricks. These tricks create the need for investors to use unconventional means, such as primary data and forensic accounting, to assess promoters' probity. Rather than blindly putting in their money in celebrated stocks, investors may be better off knowing the games promoters play. In a number of cases, promoters follow a set of tricks that include market operations as well as manipulation of books of accounts to their benefit, putting the shareholders at risk. There are three broad categories of tricks:

- ✓ Pump & Dump.
- ✓ Blab & Grab.
- ✓ Manipulation of Accounts.

Pump & Dump: The promoter "pumps" up the stock with the objective of generating liquidity and interest amongst market participants. Once the volume is pumped up, in the meanwhile of increasing their personal holdings (directly and/or through seemingly unrelated companies) a series of positive announcements following which the stock price surges. At this point of stock price reacting favourably with the stock now up very substantially from its levels a few months ago, the promoter sells his holdings. The SEBI's investigations have highlighted this pattern repeatedly and this abuse is probably as old as the stock market itself. To explain how these things take place in practice we provide in this section case studies from two SEBI investigations. I also provide two instances of currently traded large-mid cap companies whose share price and volumes profiles look "suspicious". Case of E-Star Infotech Ltd (E-star) came under the purview of section 11B of the SEBI Act (1992) and regulation 11 of SEBI (prohibition of fraudulent and unfair trade practises relating to securities market). The modus operandi was as follows: E-Star issues an advertisement in various financial newspapers in the week starting 24th June 2002 stating that a meeting of the Board of Directors is scheduled on 3rd July 2002 to consider a bonus issue of shares. An advertising agency named Garima Communications based out of Ahmedabad is given the role of issuing advertisements in various newspapers. The intent seems to be to project a positive picture of the company's future. The advertisement is followed by an unusual pick-up in volumes traded in E-Star shares. The promoter sells shares accumulated by him (these transactions seem to have been done off-market). On 4th July, 2002 the Board of Directors inform the stock exchange that they have deferred the proposal to discuss the bonus issue to 20th July 2002. On 20th July 2002, the Board of Directors recommends the capitalization of general reserve to the extent of \$0.5m. There is no announcement on the bonus issue. On the same day the share price crashes as minority shareholders started selling and there are no buyers. Table shows how the volumes traded moved in the wake of the announcements made by management.

Volumes across time periods		
Time	Periods	Period Volume (ADV)
I	June 1 to June 24, 2002	411172
II	June 25 to July 19, 2002	1840014
III	July 22 to July 31, 2002	242874
Source: SEBI		

The case of Blue Information Technology Limited BITL came under the purview of section 11 and 11B of the SEBI Act (1992). The modus operandi was as follows: BITL and Ashi Leasing Finance Ltd (ALFL) have the same promoters. BITL enters into a loan agreement with ALFL on 23rd December 1996. ALFL gives a loan of Rs 55 mn to BITL at an interest rate of 18% p.a. for a period of 9 months with interest payments every 3 months. The covenant has a clause of converting the entire loan plus the outstanding interest arrears into equity shares of BITL in the event of default in payment of interest for 2 consecutive quarters. In June 1997 BITL declares 100% interim dividend for the quarter ending June 30 1997. BITL's share price shoots up following this announcement. BITL defaults on interest payment sighting weak operating performance. Accordingly on 23rd September 1997 ALFL exercises the option of converting the entire loan plus the interest arrears into shares of BITL. BITL declares another 100% interim dividend for the quarter ending 30th Sept 1997 and 50% final dividend for March 2008. Once again, the share price starts rising following this announcement (accompanied by high volumes). The promoter through entities close to management sells shares. What prompted SEBI to investigate was the declaration of the dividend for the quarter ending June 1997. Given the fact that BITL defaulted on interest payments worth Rs 2.5 mn per quarter the declaration of dividends worth Rs 55 mn (5.5 mn shares x Rs.10 per share) seemed strange. On investigation, SEBI found that the declaration of dividend was false (i.e. it was never paid and the exchange was not notified about the dividend announcement despite advertisements being placed in newspapers). "Nobody can guard fully against such scams. One way to lessen chances of being trapped in such tricks is to study the past behaviour of the company management. See if the management has kept its word in the past after announcements. If the management has delivered on their promise in say, eight out of ten times, one could believe them and invest in the stock".

Blab & Grab: The promoter announces a new venture related to a "hot theme". This venture could be unrelated to the promoter's company's core competence (eg. a consumer goods company entering real estate). The objective of the exercise is to raise fresh funding using the pretext of the new venture. Once the funding is raised, the promoter sells the holding which he had acquired in anticipation of the stock surging. The new venture then gets "postponed" due to delays in land acquisition, problems in nailing down the supply chain, difficulty in reaching financial closure with banks, etc. Following the announcement of the "postponement", the share price usually falls sharply. Take the Case study of a \$6bn market cap trading company venturing into power generation and real estate development: Promoter buys shares in his trading company. Trading company creates a fully owned subsidiary to diversify into power generation. (This happened at a time when infrastructure and, especially power, was a hot story.) Trading company announces power projects to the tune of ~Rs 80 bn and follows it up with a stake sale to a private equity player at a punchier valuation. Subsequent to this development the share price rises on high volumes and FII participation. Another set of announcements follow wherein projects of another Rs.80 bn are announced. Company also announces an institutional placing by the parent company to raise funds which

will ostensibly be used to fund the power projects announced to date. Share price touches 52 week high. Promoter sells his shares shortly thereafter. Company then floats a Draft Red Herring Prospectus for the Power generation subsidiary indicating that an IPO for this subsidiary is imminent. The share price of the parent company then falls by ~80% from its 52 week high as the IPO for the subsidiary gets delayed resulting in the power projects not achieving financial closure. Take another case study of a \$400m market cap consumer goods company venturing into real estate: Promoter buys shares in his consumer goods company. At a time when real estate was a hot area, the consumer goods company creates a 100% owned subsidiary aimed at developing office space in one of the premium locations in Mumbai. Subsequent to this development the share price rises on high volumes and FII participation. The subsidiary company buys commercial office space in a deal which is then valued by the parent at over Rs 10 bn (an incredible 60% of the market cap of the consumer company). The company announces plans to dilute its stake at the subsidiary level to private equity players and then list the subsidiary at a punchier valuation. The share price subsequent to these announcement rises by ~50% to reach its 52 week peak. This gives the promoter a golden opportunity to cash out some of his holdings. Investors for the real estate projects cannot be found (at least we have not seen any such investors emerge despite the company reassuring us that such funding is imminent). The share price has fallen by 85% from its high as the real estate projects struggle to gather traction in a slumping real estate market in Mumbai.

Manipulation of Accounts: Like Satyam Fiasco the financial statements are inflated with by booking fictitious sales, fictitious deposits and cash balances. But during bear phases when promoters find it difficult to play the pump-and-dump game the manipulation of expenses takes place. The underlying logic is that since in a bear market, healthy profits do not translate into a higher share price in any case, there is no use showing healthy profits. Instead, in bear markets some promoters simply pull cash out of the company by fiddling numbers under minor expense heads. Other widely used techniques include over-invoicing expenses on sales and promotional events and inflating administration and other expenses. Over-invoicing expenses on sales and promotional events include blowing up the expenses incurred on sales and marketing trips. Companies often have agreements with hotels to provide them with over-invoiced bills. The difference between actual bill and the over-invoiced one is neatly pocketed. Administration and other expenses being internal in nature, such expenses are easy to manipulate. These include items like training and recruitment, business promotion expenses. "Such practices are rampant and only the degree of manipulation varies. There are more or less some elements of it in every company. Earlier, businessmen used to decide how much tax they are ready to pay and work the balance sheet backwards. Things have changed now. People first see their income and expense and then derive tax figures. Not much has changed on the manipulation front. A study carried out on BSE 500 stocks in bear and bull market cycles from 2002 to 2008 revealed the following: "Miscellaneous expenses and other operating expenses as a percentage of sales increased by more than 20 per cent in bear markets as compared to bull markets. Since this jump could have been caused by flagging sales in a bear market, we then ran the same exercise but as a percentage of total cost (on the grounds that there is no reason for total operating costs to rise in a bear market). We found that even then these three seemingly innocuous expense items rose by 25 per cent in bear markets. On the basis that such expense items should be relatively easy to control in difficult market conditions, prima facie such a jump in expenses in bear markets suggests that some promoters are dipping their hands into the company's books when market conditions get tough. "In such a situation, what should the investor do to protect himself? Experts are of the opinion that fudging of accounts is commonplace across the

corporate world. Investors would, therefore, do well to be cautious and do some basic number crunching to analyse the health of the company before putting in money. "One can look at the liquidity ratio, which determines the financial strength of the company. Another important ratio is current ratio that helps identify whether outstanding debt has gone up. Investors should ask questions when there are discrepancies in the current ratio. They should also look at cash flows in the balance sheet which shows where the money has gone and from where it has come from".

Courtesy:

1. Articles by Saurabh Mukherjea CFA, Noble Group Limited.
2. Articles by Vyas Mohan.
3. Articles by T.R.Ramaswami

By

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DEPRECIATION ACCOUNTING (AS – 6)

J.S.Deepikka Veermathy

A long wooden pier extends from the bottom center towards the horizon, illuminated with warm, glowing lights along its length. At the end of the pier is a small, dark-roofed pavilion structure. The sky is a deep blue with scattered white clouds, and the water reflects the light from the pier and the sky. The overall scene is serene and atmospheric.

MEANING - DEPRECIATION

Depreciation is a measure of wearing out, consumption or other loss of value of a depreciable asset arising from passage from time and use.

Depreciation is nothing but distribution of total cost over its useful life.



DEPRECIABLE ASSETS

- Used for more than one accounting period
- Limited useful life
- Used in production of goods and services



APPLICABILITY OF AS - 6

AS – 6 is not applicable to -

- Land
- Forests and Plantations
- Expenditure on Research & Development
- Goodwill and Livestock
- Wasting assets, Minerals and Natural Gas



CALCULATION OF DEPRECIATION

- Historical Cost / Revalued Cost
- Estimated useful life of depreciable assets
- Estimated residual / scrap value of depreciable assets

Depreciation = (Cost-Scrap value at the end of useful life) / Estimated useful life



HISTORICAL COST

- Amount paid / payable to the suppliers
- Cost of transportation
- Installation & Commissioning charges
- Cost of improvements or additions



USEFUL ECONOMIC LIFE

- Physical deterioration
- Technological obsolescence
- Legal considerations
- Others such as inadequacy



ESTIMATED Residual VALUE (ERV)

ERV is the estimated value of the depreciable asset at the end of its useful life.

ERV = Nil (If ERV is considered low / negligible)



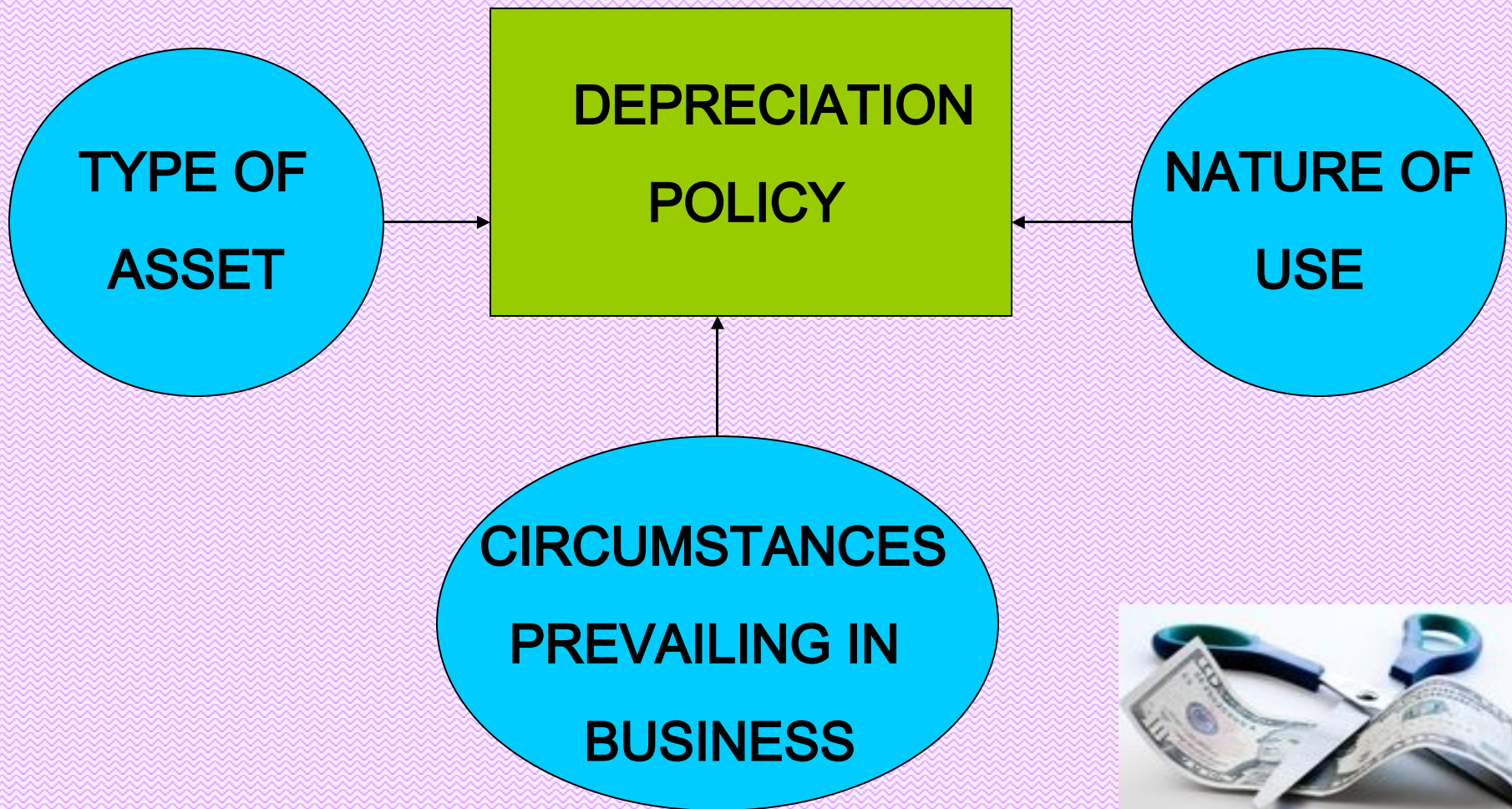
DEPRECIABLE AMOUNT

*Depreciable Amount = Historical
Cost – Estimated Residual Value*

[Then it is allocated over the
estimated useful life.]



Depreciation Policy



CHANGE IN DEPRECIATION

CHANGE IN DEPRECIABLE AMOUNT

OTHER CAUSES

CHANGE IN METHOD

HISTORICAL COST

EXPECTED USEFUL LIFE

ESTIMATED RESIDUAL VALUE



CHANGE IN METHOD

- Compliance of statute
- Compliance of accounting standards
- Appropriate preparations of financial statements.



CHANGE IN HISTORICAL COST

- Increase / Decrease in long term liability on account of exchange fluctuations
- Price adjustment
- Changes in duties
- Revaluation of depreciable assets
- Other similar reasons



CHANGE IN THE ESTIMATED USEFUL LIFE & SCRAP VALUE

- I. Outstanding depreciable amount on the date of change should be allocated over the revised remaining useful life of asset.
- II. The unamortised amount should be charged to revenue over the remaining useful years.

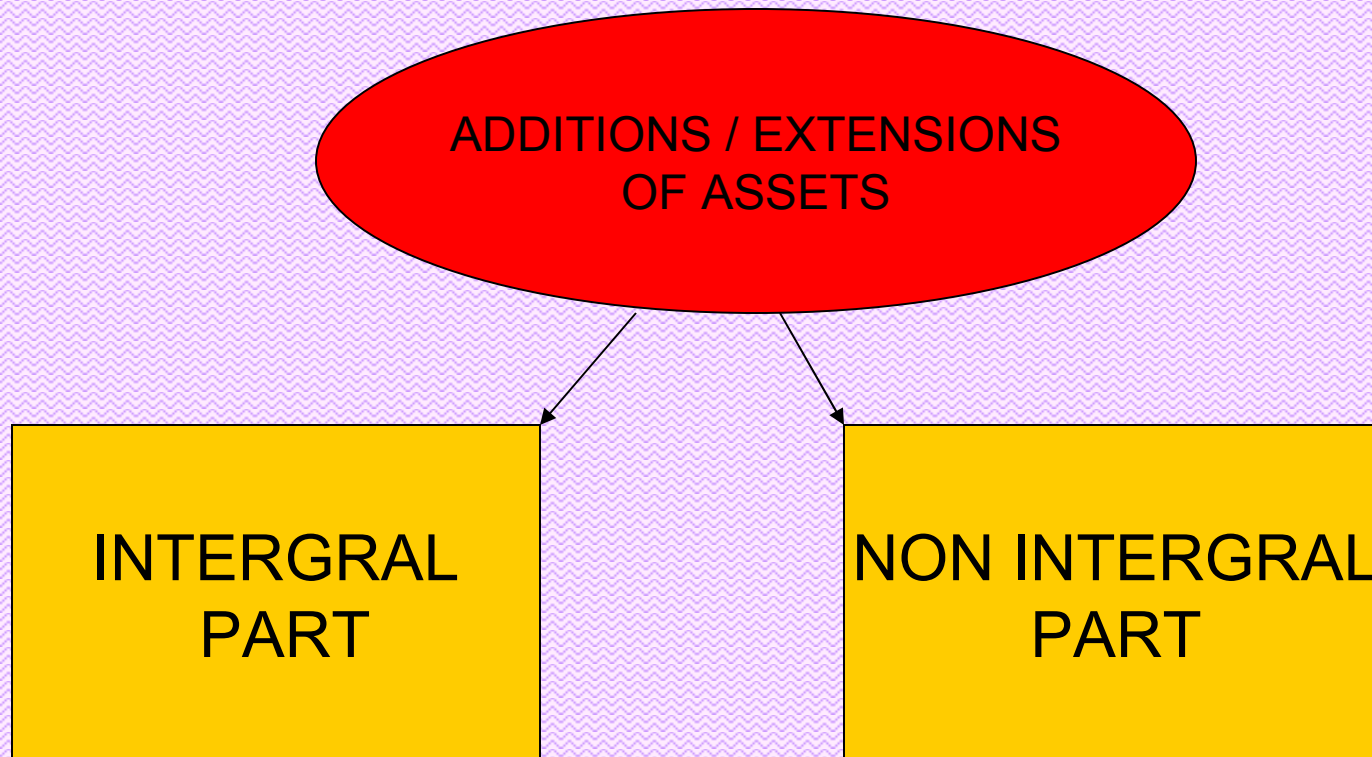


ILLUSTRATION: Plant has a useful life of 10yrs. Depreciable amount is Rs.39 lakhs .The company follows SLM. At the end of the 6thyr, the balance useful life was estimated at 8yrs.

$$\text{Depreciation} = 39 - (39/10 * 6) / 8$$
$$= 1.95$$



ADDITIONS / EXTENSIONS



DISCLOSURE

- Total cost of each class of assets
- Total depreciation for the period of each class of assets
- Accumulated depreciation of each class of assets
- Depreciation method
- Depreciation rates and useful lives
- Material net surplus / deficiency



AS Vs IFRS

<p>AS 6 (Depreciation Accounting)</p>	<p>IAS 16 (Property Plant & Equipment), 38(Intangible Assets) & IFRS 3(Business combinations)</p>
<p>AS 28 deals with it.</p>	<p>Impairment needs to be provided.</p>



RELIANCE CAPITAL LTD.

Auditor's Report :

- b. In our opinion and to the best of our information and according to the explanations given to us the said Balance Sheet and Profit & Loss Account together with the notes thereon, and in particular note nos.4 and 5 of the schedule 'N' regarding changes in the method of depreciation and conversion of investment into stock in trade respectively, give the information as required under the Companies Act, 1956 in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India.



Notes to Accounts :

- The company has changed the method of providing depreciation for buildings from Straight Line Method to Written Down Value (WDV) with effect from 1st April 2001 to make the method of charging depreciation uniform for all the assets for own use.

In compliance with accounting standards(AS-6) on Depreciation Accounting issued by the Institute of Chartered Accountants of India, depreciation has been recomputed from the date of capitalization of these assets at WDV rates applicable to those years.

Consequent to this, there is an additional charge for depreciation in the Profit & Loss Account during the year of Rs.3.29 crores which related to the previous years.

Had there been no change in the policy on depreciation, the depreciation charge for the year would have been lower by Rs.2.21 crores, excluding the charge related to the previous year. Consequently, the net block of fixed assets and Reserves & Surplus are lower by Rs.5.50 crores.



THANK YOU



Accounting Standard - 7

CONSTRUCTION CONTRACT

Presented By ,
A.Senthil Arumugam



PREAMBLE

- Issued in December 1983
- Mandatory in Nature

KEY FEATURES

- Contract between two parties
- Combination of Task
- Extend one Accounting Period

OBJECTIVE

- Allocation of Revenue
- Allocation of Cost
- Appropriate accounting Treatment
- Practical Guidelines



DEFINITION

- Construction Contract
- Types of Contract
 - Construction
 - Destruction
 - Restoration



Types of Construction Contract

- Fixed Price Contracts



- Parties agree to a fixed price

(OR)

- Parties agree to a fixed rate per unit of output.

- Cost plus Contract



Two Elements

- Reimbursement of defined cost AND
- Either a % of such cost OR a fixed fee

CONTRACT REVENUE

```
graph TD; A[CONTRACT REVENUE] --> B[Basic Price]; A --> C[Price Variations]; A --> D[Claims]; A --> E[Incentives]; A --> F[Residual Value];
```

Basic
Price

Price
Variations

Claims

Incentives

Residual
Value

CONTRACT COSTS

```
graph TD; A[CONTRACT COSTS] --> B[Direct Costs]; A --> C[Allocable costs]; A --> D[Costs as per Contract Terms]; B --> B1[➤ DM]; B --> B2[➤ DL]; B --> B3[➤ DE];
```

Direct Costs

- DM
- DL
- DE

Allocable costs

Costs as per
Contract Terms

PRINCIPLES FOR RECOGNITION OF CONTRACT COSTS AND REVENUE

- Percentage completion method should be adopted
- Cost and revenues recognized
- Outcome of the Contract can be really estimated



ESTIMATING OUTCOME OF CONTRACT

- IN FIXED PRICE CONTRACTS

- Total contract revenue is measured reliably
- y Economic benefits flow to the enterprise
- f Cost for the entire contract measured
- i Contract cost attributable to the contract are measured reliably . ‘Actuals incurred’ compared with prior estimates

- IN COST PLUS CONTRACTS

-
- Economic benefits will flow to the enterprise
- r -----
- r Cost attributable to contracts whether or not specifically reimbursable can be
 - * Identified clearly
 - ** Measured reliably



ESTIMATING OUTCOME OF CONTRACT (NEGATIVE ELEMENTS)

- SITUATIONS
 - In the Area Revenue
 - n In the Area Cost
 - n General
 - ACTION
 - Revenue should be recognized
 - * cost incurred
 - **recovery is possible
 - s Cost incurred should be recognized as an expense
 - Apply percentage completion method .



DISCLOSURE REQUIREMENTS

- QUANTITATIVE DISCLOSURES

CPROFIT & LOSS A/C

Amount of contract revenue recognized as revenue “ in the period “

BALANCE SHEET

- Aggregate amount of cost incurred
 - Advance payments received
 - Amount of retentions
 - Gross amount dues to customers as Liability
 - Gross amount dues from customers as Assets
- s Contract Contingent Liabilities

- NARRATIVE DISCLOSURES

- Accounting Policy and changes

- y Methods used to determine

- Contract Revenue

- Stage of Completion of Contracts

- i Notes on Accounts



1875

1876

Revenue Recognition (AS-9)

by R.Mageswari

OBJECTIVE

- ***The standard explains as to when the revenue should be recognized in profit and loss account and also states that the circumstances in which revenue recognition can be postponed.***

Applicability

- *This accounting standard is not applicable to following revenue or gain -*
- *Revenue arising from construction contracts(AS-7)*
- *Revenue arising from hire purchase, lease agreements (AS-19)*
- *Revenue arising from Government grants and subsidies (AS-12)*
- *Revenue of insurance companies arising from insurance contracts.(covered by separate statute)*
- *Gain-realized or unrealized gain.*

Revenue

*Revenue means gross inflow of cash ,
receivable or other consideration arising
in the course of ordinary activities of an
enterprise such as*

- The sale of goods*
- Rendering of services*
- Use of enterprises resources by others yielding interests , dividend and royalties.*

What is Extraordinary Activity of an enterprise?

*Extraordinary activities are transactions that are clearly distinct from ordinary activities. They are **not** expected to **recur frequently or regularly**.*

Example – Attachment of property of the enterprise or loss due to earthquake.

Treatment of inter divisional transfers

- *Inter divisional transfers / sales are not the revenue as per AS – 9 “Revenue Recognition”*

Reason:

In the case of inter divisional transfers , risks and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole , the recognition criteria for revenue recognition are also not fulfilled in respect inter – divisional transfers.

Revenue does not include certain transactions or events that results in unrealised gains from

- *Holding of non-current assets ,holding of current assets*
- *Natural increases in herbs and agricultural or forest products, or*
- *Restatement of carrying amount of an obligation*

Realised gains from

- *Disposal of fixed assets*
- *Discharge of an obligation at less than carrying amount*

Realised or Unrealised gains from

Changes in foreign exchange rates and adjustments arising on transactions of foreign currency financial statements.

An adjunct to the definition of revenue:

*In the case of **Agency relationship** ,
the revenue is the amount of commission
and not the gross inflow of cash
receivable or other consideration.*

Revenue from sale of goods

It is recognized when the following conditions are fulfilled.

- Seller has transferred the ownership of goods to buyer for a price Or all significant risk and rewards of ownership have been transferred to buyer.*
- Seller does not retain any effective control of ownership of the transferred goods.*
- There is no significant uncertainty in collection of the amount of consideration (i.e.) cash, receivables etc.,*

Revenue from rendering of services

Revenue from services are recognized as the service is performed. The performance of service is measured in two methods.

- 1. Completed service contract method.*
- 2. Proportionate completion method.*

Completed Service Contract Method (CSCM)

Revenue is recognized when service is about to be completed and no significant uncertainties exist about the collection of amount of service charges.

Proportionate Completion Method

Revenue is recognized by reference to the performance of each act. The revenue recognized under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. Further no significant uncertainty exists about the collection of amount of service charges of performed acts.

Use of enterprises resources by others:

- ***Revenue from Interest:***

Revenue from interest should be recognized on time proportion basis.

- ***Revenue from Royalties:***

Revenue from royalties should be recognized on accrual basis as per the terms of agreement.

- ***Revenue from Dividend:***

Revenue from dividend should be recognized when the declaring company declares dividend.

Disclosure requirements

When revenue recognition is postponed, the disclosure of the circumstances necessitating the postponement should be made.

SALE OF GOODS

- *Buyer requests delayed delivery, but takes title and accepts billing*

- *Recognise revenue even if delivery is not made ,ensuring that the item is held in stock ready for delivery*

- *Goods sold subject to installation and inspection*

- *Recognise revenue only when the customer accepts delivery ,and installation is complete*

Sale on approval

Recognise revenue only when (a) buyer accepts goods, or (b) time period if any, for rejection, has elapsed or a reasonable time has elapsed.

Guaranteed sales (unlimited warranty)

Enquire into the substance of the agreement. If there is a money back clause, recognise revenue at the time of sale, but make a provision based on past experience of claims.

General warranties

Revenue on sale is recognised, and provision is made based on past experience

Consignment sales

Recognise revenue only when consignee reports sale to third parties

Cash on delivery

Revenue should not be recognised until cash is received by seller or his agent

Installment sales

Segregate interest element from cash price element. Recognise cash price as revenue. Recognise interest in proportion to unpaid dues to seller.

Admission fees

Recognise revenue on “critical events concept basis”

A close-up photograph of a hand holding a yellow daffodil flower. The word "THANKYOU" is overlaid in a bold, black, serif font. The background is a soft, out-of-focus white surface.

THANKYOU