



# 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 2010*

## Chairman Writes



Dear Colleagues,

Greetings,

The profession of Chartered Accountancy is one of the most respected professions in India and abroad. Chartered accountants are held in very high esteem by the trade and industry, by individuals, Government and other entities that avail the services of Chartered accountants. Chartered accountants are known to possess a high degree of integrity, great depth of knowledge, inherent analytical skills, business acumen etc. Modern businesses rely on the Chartered accountants' advise on a day-to-day basis. Most Chartered accountants are engaged by large business houses for interpreting complex laws and evolve tax saving measures. A large number of business houses involve Chartered accountants to advise on business management, financial management, tax planning, product pricing and costing exercises to enhance the growth and profitability of such business houses.

The Union Budget presented by the Hon'ble Finance Minister Sri.Pranab Mukharjee has been a populist Budget and has been well appreciated by the industry and public at large. The Budget has rightly addressed the lifetime concerns of the citizens in housing, education, healthcare and employment through a combination of government schemes, budgetary support, stimulating funding by institutions and granting tax incentives.

During the 3rd week of February, we attended Chairman's Meet at Chennai and it was very interactive and brain storming session well organised & managed by our SIRC Chairman Sri.Babu Abraham and his Committee Members. On that day though we were at Chennai, our Past Chairman and our Members here well organized a "Live Telecast of Union Budget 2010" which was attended by APC Mahalakshmi college students numbering around 100 along with our usual members.

It was a great and memorable event. I convey our heart felt thanks to the Principal and Secretary of the APC College for deputing a large number of knowledgeable students to the above session.

This season of Bank Audits peaking with time-targeted audit schedules together with need to update our professional acumen by participating in Bank audit seminars, is one of the busiest yet rewarding seasons in our professional calendar. Our certification on the functioning of Banking Institutions, which are the backbone of our economy, will undoubtedly provide the Regulators, Bank Managements as well as society at large to have valuable information regarding the health and vitality of these institutions. No doubt, this daunting task gives us pride of place in our society.

Whatever we plan and envisage, unless our Members keep giving inputs and suggestions, any initiative howsoever proactive it might be, can not bear fruit. May I therefore request every one of you to contribute your mite by keeping in touch with me and I conclude with a Mantra which reads as under

Efforts never fail "Shine or Rain"

Yours ever loving,

**CA.H.Raman**



**CPE Seminar on Bank Audit Dt.06.03.2010**

## All Set for Super Regulation in Financial Sector

MUMBAI: The government has set the ball rolling for the creation of a super regulator in the financial sector with the proposed creation of Financial Stability & Development Council.

Announcing his budget, financial minister Pranab Mukherjee said that without prejudice to the independence of the regulators, the government would set up a Financial Stability & Development Council whose job would be to monitor conglomerates and improve coordination among financial regulators with a view to preventing future financial crises.

The central bank governor D Subbarao had called for the creation of such a body in the past by giving statutory power to the existing High Level Coordination Committee (HLCC) on financial markets. The committee which is headed by RBI governor includes heads of Sebi, IRDA, PFRDA, and the finance secretary. If the HLCC is formalised as the FSDC, the RBI will have a larger say in the regulation of the financial sector.

## Budget may have Long-term impact on various asset class

There are two ways for an investor to gain from the Budget proposals. The most common strategy is to pick up sectors or a group of companies most



likely to shine from various Budget proposals. Every Budget has its favourites in terms of tax proposals, sops and budgetary allocation. This tilts the playing field in favour of certain companies. The investor can juice-up his returns by betting on these stocks. And like every year, the Budget proposals for FY10-11 are likely to benefit some sectors and may hurt others..

The impact of the Budget, however, goes beyond simple sectoral arbitrage. The government is the biggest economic actor and the budgetary proposals touch everything and everybody in some manner or the other. While in a normal year, this cascading affect is small and short-term in nature; this Budget is likely to set in motion factors that may have significant and long-term impact on asset classes, especially fixed income and equities.

First, consider the macroeconomic background to the current Budget. The past two financials years were among the toughest for the Indian economy and its regulator, the government. First, the economy had to face spiralling crude oil prices, which came close to turning India's economic apple cart upside down, second was the tsunami of the global financial crisis, which nearly wiped-off all economic gains of the past decade. Ultimately, the government was able to contain both the crisis with clever use of various fiscal and monetary measures; but it was not a costless exercise. The measures such as oil and fertilisers bonds, sixth pay commission awards, farmer's debt waiver scheme and deep cuts in indirect taxes, did bring immediate succour to consumers, farmers and corporates, but it also burned a deep hole India's public finance that threatened the long-term viability of the country's growth story itself.

By the end of the FY09, India's fiscal deficit — excess of the government expenses over its revenues — was nearing 10% of the GDP forcing the government to scale-up its borrowing programme. This had two immediate effects. First, it greatly pushed up the demand for goods and services in the economy and helped in the build up of inflationary expectations. Second, a hike in government debt issuance sent the yield curve up for all kinds of debt instruments. This had an adverse impact on investment and consumption, especially high-value items which are bought on credit. Slowdown in investment means a lower capital formation that pulls down the long-term growth potential of the economy and manifests itself in the form of a lower GDP growth in the subsequent period. In normal course, the government can compensate for lower private investment by boosting the public investment but higher fiscal deficit comes in the way. Not surprisingly, bank credit — an indirect measure of the level of investment — has been slowing down since the beginning of 2009.

Historically, every episode of high fiscal deficit is followed by a period of poor economic growth. The lost decade of 1990s was preceded by a long-episode of persistent high fiscal deficit in the late 1980s and early 1990s. Inversely, declining fiscal deficit and falling interest rates preceded the economic and stock market boom that started in 2003.



Lower interest helps equities in many ways, such as it provides boost to corporate earnings by lowering companies' interest burden, it makes companies easier to finance large capital intensive projects and most-importantly lower yield on fixed-income instruments, such as bonds and bank deposits, improves attraction of equities and thus fuels a stock market boom.

So for investors, the biggest issue for FM in the run up to the Budget was India's rising deficit. And thankfully, FM delivered on this count despite all odds. A lot will, however, depended on the credibility of the Budget projections. If Pranab Mukjerhee achieves next year's target and sticks to the roadmap to bring fiscal deficit down to a sustainable level of below 4% in the next three years, it could be one of the biggest ever stimulus for India Inc and the stock market. It will translate into lower interest rate, greater investments, higher growth and a booming market. It will also have a rub-off effect on real estate and commodities and their investors. Fixed-income investors such as retirees and pensioners who mostly invest in bank deposits should, however, brace for declining yields on their investments.

The exact impact will however differ from sector to sector. One clear winner is the banking sector. Other beneficiaries will be capital intensive sectors such as power, infrastructure, metals, cement, capital goods, auto mobiles and oil & gas. The Budget proposals, such as rise in I-T slabs and expansion of welfare and social services also hint at a re-prioritisation of the government expenditure towards raising the level of consumption in the economy. In due course it will put more money in the hands of the consumers and lift the fortunes of companies in the entire consumer goods space.

### **Oil & gas: Win Some, Lose Some**

The budget indicates the government's intention to pay the oil subsidy only in cash and not in bonds, as was the practice till last year. This will automatically put a cap on how much the government can pay and indirectly encourages market-linked prices of fuels as suggested by the Kirit Parikh committee.

The Union Budget 2010-11 proved to be a mixed-bag of goodies for the domestic petroleum industry. The industry was looking for the solution for mainly two issues in the Budget — whether the government has taken any decision on Kirit Parikh committee report, and whether the anomalies created last year by excluding production of natural gas from income-tax benefits will be rectified . However, the Budget disappointed the industry on both these counts. The Budget mentioned the government's intention to pay the oil subsidy only in cash and not in bonds, as was the practice till last year. This is a positive move for oil marketing companies that together are looking at an aggregate loss of Rs 45,000 crore for the year 2009-10.

The finance minister's decision to restore customs duty on crude oil and petroleum products to pre-July 2008 levels and increase excise duty on petrol and diesel by another

Rs 1 per litre were totally unexpected. Since the marketing companies immediately passed on the tax burden their finances remain unaffected. The increase in customs duty, however, is a boon in disguise for the domestic petroleum refiners as the effective rate of protection goes up and will add a few cents to the gross refining margins. In the same way, as the landed cost of imported crude oil goes up, the domestic oil producers will be able to charge a little higher and earn a better realisation. Companies, such as ONGC, Oil India, Cairn India, Reliance Industries, Hindustan Oil Exploration and Selan Exploration stand to gain marginally. The reduction in surcharge on corporate tax from 10% to 7.5% will also benefit oil companies. However, increase in the minimum alternate tax (MAT) from 15% to 18% is a negative for companies like Reliance Industries, Essar Oil and Cairn India.

The Budget has also raised the cost for the upstream E&P industry that routinely avails technical services from the foreign companies. As informed by Sanjay Grover, partner (Oil & Gas), Ernst & Young, earlier, the fees paid for such technical services were taxable in India only if the services were both rendered and utilised in India. However, the Budget proposes to tax these fees if paid by a resident Indian, irrespective of whether rendered or utilised in India. Similarly, foreign upstream services providers having an establishment in India were assuming 10% of their net receipts as profits. However, the Budget has proposed to remove this benefit. Both these developments could have a negative impact on upstream companies and may lead to increased cost and litigation.

## **Budget 2010: FM delivers a masterful performance on all fronts**

First Sachin Tendulkar, and now, the finance minister; this seems to be a week for veterans to dazzle us with their deft footwork.

The FM must have had an unenviable task in front of him, at the time of drafting the budget proposals. He had to consolidate the growth momentum, rein in the fiscal deficit, improve the climate for investment and spending, and to do all this while keeping a keen eye on inflationary pressures. It's been a virtuoso performance on all these fronts.

The broad numbers look very positive on the macro-economic front — a fiscal deficit of about 5.5% and targeted deficits of 4.8% in 2011-12 and 4.1% in 2012-13 are extremely positive signs. That he has managed to limit government borrowings to Rs 3.45-lakh crore is also positive.

The market was expecting this to be somewhere around Rs 4-lakh crore. The reduced number leaves enough headroom for private sector borrowing. An increase in 15% of plan expenditure while non-plan expenditure has grown by only 6% is another positive.

FM's decision to include hidden deficit-spending like oil bonds and fertiliser bonds in the fiscal deficit accounting is the right move and will bring in greater transparency. Another move towards greater transparency is his promise to release a status paper on public debt in six months.

Some of his policy moves are long overdue and most welcome. These include the promise of a comprehensive FDI regulation, an apex level Financial Stability Council, Financial Sector Legislative Reforms Commission, especially the latter. I also hope that he is able to implement his promises to adopt the Kirit Parikh Committee report on

decontrol of oil sector pricing and allowing of FDI in the retail sector, especially in the retailing of food and farm items.

FM's announcement of additional banking licences, including for those NBFCs complying with various norms and his promise of extending banking services to clusters habitation of 2,000 people using the banking correspondent route, will go a long way towards financial inclusion and expanding the reach of banking services. His provision of Rs 16,500 crore towards recapitalisation of PSU banks is also welcome, especially for some of the weaker PSU banks.

The finance minister has targeted Rs 25,000 crore through disinvestment and has promised to raise more through the same route next year. This will add further depth to the market, though I hope that these are spread out and priced correctly to attract retail investors.

The FM has increased the allocation to the infrastructure sector by a whopping 46%. He has allowed an investment of Rs 20,000 in designated infrastructure bonds to be deducted from taxable income. This will also help divert household savings in the infrastructure sector. Given the state of India's infrastructure and the enormous investments required, both these are positive moves.

Another positive move, which will remove several procedural anomalies, is the establishment of a Coal Regulatory Authority and the decision to allocate captive coal blocks for power plants by a system of competitive bidding. This will raise additional resources as well for the government.

By broadbasing the direct tax slabs and by removing the surcharge from corporate income tax, the FM has left more money in the hands of both the household as well as the corporate sector. This will lead to enhanced spending and investment and can only add to the growth story.

The rollback of excise duties was expected and while it might will raise fuel prices as well as hit some sectors like auto, cement etc, given the fact that food prices have been falling for the past couple of months and crude prices are also softer in the international market, this is unlikely to have too much of an impact on inflation.

Overall, I believe this is an extremely positive and balanced budget that will help propel India into the next growth orbit. I expect, with this budget, GDP will grow by about 7.7% to 8%.