EDITORIAL

The interface between environment and accounting is opening new areas of strategic importance. Accounting practitioners in India need to adapt themselves in the light of global scenario. Accountants have to prepare themselves to the problems of Banking Sector also. Performance benchmarking and NPA management are the two major issues in this regard. The issues like corporate governance and corporate tax administration generate more enthusiasm among professionals. The applications of Balanced Score Card are yet to be seen with enthusiasm in corporate world. Social Audit practices further forces us to think in terms of social responsibility. VAT and activity Based Costing are also becoming important in tax administration and Cost Control respectively. The impact of utilisation of Current Assets on operating profits in cement and tea industries is another useful study with empirical details. G. Vasanthi has assigned risk weights to various assets effectively in capital adequacy (Basle II). Venkat Rao has raised a few issues regarding Window Dressing of Corporate Financial Statements which may help our accounting practitioners in a better way.

Date: 31.12.2003

Professor Nageshwar Rao
Chief Editor
INDIAN ACCOUNTING ASSOCIATION

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IAA NEWS
ACCOUNTING EDUCATION AND RESEARCH: EMERGING SCENARIO

*N.M. Singhvi

Business and accounting education in India is as old as our history is. In ancient India we have gurus and they used to teach their disciples. Business tactics were transferred from father to his son. Business education in India in formal way started soon after the British traders and industrialists wanted to recruit clerical and accounting personnel from local sources. After getting independence higher education in commerce drifted in two separate streams viz. The commerce stream that was more popular because of its liberal character and the business management stream with accent on professional education. The attitude of the government has been one of traditional neglect than of conscious design. Business world and the educational institutions never tried to learn how to cooperate and interact with each other for drawing and utilizing the output of commerce graduates and post-graduates.

Globalization of Indian economy has changed the business world. This has created a challenge for teachers to equip their students in such a way that they can face this competitive world. Life in this century is considerably different from that in previous times. Money and material success are considered the goals of modern living. As a result, students often perceive their education to be irrelevant to their lives either today or in the future. The most important resource in most institutions is the textbook. Since the medium of the textbook continues to be printed matter, the cycle time for the production of new textbooks runs into years. As a result, course change is a very slow process. Slow change in curriculum leads to further loss of relevance in the society where quick acquisition of skills is considered more important than the learning of theory. The dramatic changes taking place in other fields are to be considered while preparing the course curriculum for accounting. If we do not prepare ourselves for the change, then the day is not very far when the process of de-investment in higher education will begin. Then, it will be handled by the private sector and the poor and intelligent students will suffer.

AIM OF STUDYING ACCOUNTS

This is the right time and right forum to discuss the aims of studying accounting. When our student enters the college he should have any of the following aims. He should be

*President Indian Accounting Association delivered his Presidential Address at XXVI All India Accounting Conference and International Seminar on Accounting Education and Research on December 27, 2003 at M.G. Kashi Vidyapith, Varanasi (U.P.)
clear in his mind that what he wants to do after studying accounting. Old courses are not suitable with the needs of the time. Old courses are obsolete and we should frame new courses looking into the needs for the future. Aim of making clerks should be removed and new concept of Accountant to CFO should be adopted.

- ACCOUNTANT
- COST ACCOUNTANT
- AUDITOR
- MANAGEMENT ACCOUNTANT
- FINANCIAL MANAGER
- CHIEF FINANCIAL OFFICER (CFO)
- CONSULTANCY IN ACCOUNTING
- FINANCIAL CONSULTANCY
- TAX CONSULTANCY
- TAX PLANNING
- TEACHING
- RESEARCH
- ACCOUNTING JOURNALISM
- FINANCIAL JOURNALISM

REDEFINING ROLE OF CFO

While redefining the role of CFO we should frame the course curriculum taking the following points into consideration.

- EMERGENCE OF NEW TECHNOLOGY
- LIBERALIZATION / PRIVATIZATION / GLOBALIZATION (LPG)
- MERGERS AND ACQUISITIONS
- AMALGAMATION
- BANKRUPTCIES
- DECLINING INTEREST RATES
- ENVIRONMENTAL CONSCIOUSNESS
- VOLATILITY
- DEMATERIALIZATION

Our students should be acquainted with the use of the new technology. We have insolvency, amalgamation, absorption and branch accounting in our course curriculum, but for practical training we can not make arrangements. So while framing the course curriculum one or two members from the industry and one meritorious student should be incorporated in our boards of studies as members. In this way user of our product can also have say in framing of the courses and the students can also say that what should be taught to them. So these courses should incorporate current job requirements and practical training may be in the form of summer project. Constitution of Board of Studies should be redrafted. Universities and Institutions of higher learning should change their acts and statutes for the reforms. If we can not do this then the whole system will collapse.
CURRENT JOB REQUIREMENTS

Our accountant's job was considered as custodian of books and he was even considered as 'UTCOUNTANT' instead of 'ACCOUNTANT'. When we think that our student should raise his status in the society and become CFO, we must make ourselves capable of pouring the full knowledge of business with market awareness. The CFOs' job requirement is altogether different and he should be equipped with the following qualities.

- Full Knowledge of Business
- Market Awareness
- Negotiation Ability
- Accounting Mentor
- Shift from custodian of Books to Business Means doing such things which add Value to Organization
- Confidence
- Great Communication Skills
- International Skills
- Becoming Faultfinder to Advisor

SHOULD KNOW

In our old economy the accountant was needed to know the basic knowledge of accounting and he was not needed to know about the new techniques of business with economy and cost reduction. The CFO should be capable of dealing with the financial options and the rules of international trade and business. Other people in the concern look toward him for advice. To inculcate the merits in our students they should be able to understand the new job requirements. The CFO should be aware of the new business environment. So the following topics should be included in our course curriculum:

- New Financial Instruments
- Venture Capital Funds
- Mutual Funds
- Derivatives, Futures and Options
- International Trade
- International Financing Methods
- Information Technology Law
- Copyrights and Patent Rights Law
- Brand Valuation
- Valuation of Knowledge Assets
- Human Capital

CFO CREATES CAPITAL FOR ORGANISATION BY

Dullness of accounts clerk should be removed and the confidence in our students should be poured in by us and the hard working students with firm determination with good leadership quality should be able to create capital for the organization with creativity. He should be good organizer and with effectiveness he should be able to streamline the operations of the concern where he works.

- STRATEGIC VISION
- HARD WORK
- CREATIVITY
- INNOVATIVENESS
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- FIRM DETERMINATION
- DISCIPLINE
- LEADERSHIP
- EFFECTIVENESS
- STREAMLINING OPERATIONS

POTENTIALS OF CFO

Re-engineering of accounting in the interest of the company is need of the hour without overruling the law. Improvement in the nature of corporate governance with systematic working to tape new financial resources at cheaper rates provides the key position to the CFO. When Finance Officer of the company re-designs the accounts for the benefit of the company for any specific purpose then he can show his potential to the management. So CFO can increase his potential by:

- IMPROVING CORPORATE GOVERNANCE
- BENCHMARKING
- SYSTEMATIC WORKING
- TAPPING THE NEW SOURCES OF CAPITAL i.e. EQUITY/CREDIT MANAGEMENT
- RE-ENGINEERING OF ACCOUNTING

EXPECTATIONS FROM CFO

Timely decision making lowers the risk in the business. Correct budgeting is also expected from the CFO. He is expected to know:

- RISK MANAGEMENT
- BUDGETING
- TREASURY OPERATIONS
- TIMELY DECISION MAKER

ADVANTAGES OF TECHNOLOGY

When CFO is convergent with the new technologies he can advice the introduction of new technologies for the benefit of the concern. If online order booking of inventory can reduce the cost of inventory by saving the space in the stores and then it becomes competitive. Real time book keeping and speeding up of the work of accounting is the need of the business. To keep himself in touch of all these he should be acquainted with the modern methods of communication.

- Minimization of Inventory
- Savings in Cost
- Watch on Activities
- Speeding the Work
- Easy Forecasting
- Data Base Management
- Real Time Book Keeping
- Faster Communication and Information
VALUE ADDED TAX

Going back into the history of the VAT, it has been established that the concept of the VAT was originated in the year 1921 by F Von Siemens when he proposed it, instead of newly imposed German Turnover Tax in Germany. Later on France was the first country to adopt it in the year 1954 which largely paved the way for it being accepted as instrument for harmonization of Tax. Since then, it has been adopted in 123 countries including Nepal and Bangladesh. This concept is not a new concept to our fellow countrymen. This concept of VAT is presently being used in the Central Excise Act.

The question going through the mind of every person is whether this will increase the cost of the product and how will it be helpful to the community as a whole. We can say in brief that the VAT for a retailer and wholesaler is "Tax on the profit earned and cost incurred on the value addition by way of processing on the raw material purchase." It is a tax on every point of sale till the goods reach the end customer. Under the present system of sales tax the tax is levied at the first point of sale and subsequently the goods sold as Sales Tax paid in the state. Thus, the major difference in the two systems is whereas the former one propagates tax on every sale but present system propagates tax on the first sale. The major benefit of VAT is that the tax incidence gets shifted and is distributed between the first dealer and the subsequent dealers whereas at present the tax is payable by the person purchasing the goods for the first time from a dealer within the state. The tax payable by the first and subsequent dealers within the state on every point of sale, the tax base also widens and it results in shifting of incidence of tax.

One would have to think that why VAT was not implemented when it was supposed to be the next big financial reform after the reform in Central Excise. When everyone was Gung ho about it there were certain factors behind VAT not being implemented. Various factors for non-implementation of VAT can be set out:

(i) First and foremost reason was the lack of political will and this lack of will existed right from the top-level officers to the bottom level officers. Neither the state government nor the central government was ready to bear the brunt in the year of elections that it spearheaded the implementation of VAT.

(ii) A hurdle in implementing of VAT was lack of preparation at the level of Sales Tax Department. Taking colour from the top bureaucrats, the officers at the department level started preparing for implementation of VAT in later stages of the year 2002 in a very hasty manner. The public was kept in dark about the provisions of VAT till March 2003.

(iii) Public was not aware of the facts of the VAT. No seminars and public discussions were taken place regarding the VAT. There were no efforts from the department side to make the public understand the provisions of the VAT. There was a strange fear in the minds of people with regard to VAT which was the result of the above mentioned reasons and a mindset was framed in the minds of people that VAT is too procedural and involves too much paper work. People were not satisfied with the contention of the department that VAT is a hassle free tax. What should have happened that public should have been taken right from the start and
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general provisions of VAT being explained to the people and the apprehensions in the mind of the people should have been removed.

(iv) It is not that there was mistake at the department level only but there was fault at the level of business community too. There was rigidity in their attitude that VAT should not be implemented as they would have to stop certain ill practices carried on by them like lack of preparation of accounts, sales of goods without invoices etc.

(v) VAT in its present form also had created procedural difficulties for the dealers having their turnover between 10 to 25 lakhs. A composition fees was prescribed for them that would have been exempted from keeping of records and accounts; but the exemption fees prescribed was too high in certain states and where the dealer had opted to maintain the records and other documents. The penalties for no - compliance of provisions of the act was too high and certain states had to bring down the penalties. Taxes are not to be enforced but complied.

We all know that some day or the other VAT has to be implemented. The problem which government will face at the time of implementation will be arising from the fact that in the year 2003 the government had once shown intention of implementing VAT and the dealers were required to give a large information regarding their stock position and business in general. When government will ask for the same information next time the dealers will be reluctant to give the information again as they will have in their minds the previous occasion when the government had required information and after their so much effort government could not implement VAT. The Government of Haryana only could implement VAT during this financial year and the results are quite good. They are able to achieve their target by more than 26 % without any hue and cry by the tax -payers.

CORPORATE DISCLOSURE AND GOVERNANCE

Knowledge is more powerful than stored money and machines. Creation of wealth through intellectual capital has changed the whole business world. Capital market is outperformed by the intellectuals. Investors have come to know that participation of their shareholders also add value to the market. Researchers have come to the conclusion that companies with strong democratic set up and stronger shareholders earn more profits and they have good human relations. The Indian corporate sector has spread in the other parts of the world and has noticed a good growth. This is because of the government's commitment to provide growth-oriented policy and regulatory framework. This growth has been questioned by securities scam, companies' mismanagement, growing shareholders dissatisfaction and unethical business practices. The Enron debacle and other US Corporations' frauds have aggravated the situation raised various issues of fair corporate governance. To overcome the situation of the Securities act of 1933 in the U.S.A. the government of the U.S.A. appointed a committee under the chairmanship of Sarbanes. They were five members and after the report the report was adopted and the new act Sarbanes-Oxley Act of 2002 came into force.

To simplify the procedural work of incorporation to winding up of companies Government of India had appointed Naresh Chandra Committee. This committee had worked
mainly on the Auditor and Company relationship and simplifying the corporate governance in the private companies. According to the report of the committee, there are over 6 lakhs companies registered with the Registrar of Companies throughout the country. Nearly, 90% of these companies are private companies. According to the DCA, almost half of the companies do not file their annual accounts and annual return. It is considered that who have not been filing their annual return and annual accounts, have no business operations. The committee has taken all the provisions of the Company Law into consideration and various recommendations have been made but the implementation is still awaited. The Naresh Chandra committee has not taken minorities interest into consideration. Minorities here I mean the shareholders

The shareholder, who hold less than 49% of the total holding in a private company, has made his future dark with the less voting right. At the time of the promotion of the private company, the promoters might have been good friends but after a long period when the shareholder who is holding majority of shares becomes envy of the others than the minority shareholders has got no relief in the Companies Act. The minority shareholder is always at the mercy of the other one.

I have great pleasure to invite you all to participate in identifying stress points and the problems arising out of the implementation of the VAT and improving the corporate governance. There have long been debates on the democratic set up of government and the importance of other aspects related with the set up. Democratic set up in the field of corporate governance will also provide a fertile ground for debate. Democratization and professionalism only can create good corporate governance, which can make our economy to compete with other developed economies of the world. I hope concrete suggestions for the improvement of Accounting education and research shall also come out.
POST-MORTEM OF FINANCIAL PERFORMANCE AND PREDICTION OF FUTURE EARNING CAPABILITY OF A BANK: AN APPLICATION OF CAMEL RATING AND BALANCED SCORE BOARD

*Kanchan Kumar Purohit
**Bidhan Chandra Mazumdar

ABSTRACT

In Bangladesh, CAMEL rating technique of performance measurement is used which is mainly a quantitative technique. Therefore, this technique of measurement should be supplement by another concept of performance measurement known as BSB (Balanced Score Board) to evaluate the long-term prospect of profitability. In this article, the performance of BASIC Bank is evaluated by using CAMEL and BSB and the areas of limitations that require attention are identified to ensure a sustainable growth of its performance.

Besides the above-described traditional banking institutions, Government of Bangladesh took part in a Joint-venture private bank. It was BASIC. BASIC stands for "Bank of Small Industries and Commerce" and it is a bank of some unique features. Its uniqueness lies in the area of its management pattern and its investment portfolio. The main objective of the article is to review the performance of the bank in a broader perspective i.e. to evaluate the bank both from qualitative and quantitative point of view. It demands the application of new and comprehensive measure of performance rather than the traditional measure of performance by ROI etc.

In Bangladesh, Bangladesh Bank as a regulatory body has been calculating this rating till now. The CAMEL covers five areas of performance measurement viz., 'C' for Capital Adequacy; 'A' for Asset Quality; 'M' for Management capacity; 'E' for Earning Available and 'L' for Liquidity. This performance measurement technique has an edge over the previous techniques because it measures the management capacity in addition to the financial measurement of performance. Now the ratios covered by this system for different areas of performance measurement are presented in the following chart:

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**Lecturer in Accounting, University of Chittagong, Chittagong, Bangladesh
Purohit & Mazumdar

Chart # 01
Chart Showing the Ratios Covered by CAMEL Ratings

<table>
<thead>
<tr>
<th>Aspects Covered</th>
<th>Ratios Calculated</th>
<th>Symbol</th>
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</thead>
<tbody>
<tr>
<td>Capital Adequacy</td>
<td>a) Capital Adequacy Ratio</td>
<td>C</td>
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<tr>
<td></td>
<td>b) Leverage Ratio</td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) Return on Equity</td>
<td></td>
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<tr>
<td></td>
<td>d) Net-worth Protection</td>
<td></td>
</tr>
<tr>
<td>Asset Quality</td>
<td>a) Percentage of Classified Loan</td>
<td>A</td>
</tr>
<tr>
<td>Management Capacity</td>
<td>a) Income per Employee</td>
<td>M</td>
</tr>
<tr>
<td></td>
<td>b) Expenses per Employee</td>
<td></td>
</tr>
<tr>
<td>Earnings Ability</td>
<td>a) Net Investment Margin</td>
<td>E</td>
</tr>
<tr>
<td></td>
<td>b) Return on Asset</td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) Diversification Ratio</td>
<td></td>
</tr>
<tr>
<td>Liquidity</td>
<td>a) Investment-Deposit Ratio</td>
<td>L</td>
</tr>
<tr>
<td></td>
<td>b) Liquid Assets to Total Deposit Ratios</td>
<td></td>
</tr>
</tbody>
</table>

The quantitative measurement of performance of BASIC Bank Ltd. has been made by the different ratios under five aspects: Capital Adequacy (long term solvency), Asset Quality, Management Capacity (employees' productivity), Earnings (profitability) and liquidity in the light of CAMEL rating. These aspects of measurement are presented in the following tables:

Table # A
Table Showing the Capital Adequacy of BASIC Bank (in percentage)

<table>
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<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy</td>
<td>15.30</td>
<td>14.27</td>
<td>14.01</td>
<td>12.45</td>
<td>12.39</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>13.68</td>
<td>8</td>
</tr>
<tr>
<td>Ratio</td>
<td></td>
<td></td>
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<td></td>
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<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Leverage Ratio</td>
<td>9.03</td>
<td>8.15</td>
<td>8.44</td>
<td>7.78</td>
<td>6.15</td>
<td>5.67</td>
<td>5.11</td>
<td>4.64</td>
<td>5.49</td>
<td>8.59</td>
<td>12.74</td>
<td>7.43</td>
<td>8</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>27.04</td>
<td>30.21</td>
<td>28.69</td>
<td>27.96</td>
<td>23.70</td>
<td>28.22</td>
<td>21.28</td>
<td>17.48</td>
<td>4.71</td>
<td>3.39</td>
<td>3.95</td>
<td>19.69</td>
<td>30</td>
</tr>
<tr>
<td>Net worth</td>
<td>404.53</td>
<td>350.57</td>
<td>262.14</td>
<td>226.78</td>
<td>139.27</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>276.66</td>
<td>100</td>
</tr>
<tr>
<td>Protection</td>
<td></td>
<td></td>
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</tbody>
</table>

Source: BASIC Bank Ltd., Annual Report 1990 - 2000 and Appendix # 01

In Table # A, Capital Adequacy, an indicator of long-term solvency, of BASIC Bank Ltd. has been measured by capital adequacy ratio, leverage ratio (shareholders' equity to total capital), return on equity and net worth protection ratio (shareholders' equity to non-performing loan). In the study period it is seen that the bank has been calculating the capital adequacy ratio and net worth protection ratio from the year 1996. In all the years both the ratios, however, were well above the normal acceptance level i.e., 8% for capital adequacy ratio and 100% for net worth protection. As such, average of these ratios, 13.68% for capital adequacy ratio and 276.66% for net worth protection was much higher than the standard level. Thus the bank was
able to maintain the confidence of investors and depositors while providing a satisfactory return to the Government. The average rate of return on equity was 19.69% which was lower than the standard rate of 30%. This was due to lower rate in the early years of this study period. But it was increasing satisfactorily from year to year at the end of the study period. Another important ratio for measuring long-term solvency is leverage ratio. This ratio has also been found well over the standard level of 8% in most of the years except a few years in the middle of the study period. The average rate of this ratio was very near to the standard level i.e., 7.43%. So the performance of the bank in this respect is very satisfactory.

Now the asset quality of the bank is tested by the following table.

**Table # B**  
Table Showing the Asset Quality of BASIC Bank  
(in percentage)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-performing loan to total loan</td>
<td>3.73</td>
<td>4.21</td>
<td>5.62</td>
<td>5.67</td>
<td>10.22</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5.89</td>
<td>10</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** BASIC Bank Ltd., Annual Report 1990 - 2000 and Appendix # 01

Table # B highlights the quality of assets by measuring the relationship between non-performing loan and total loan. Average rate of this relationship was 5.89% which was very much low compared to standard rate of 10%. This is an indication of the high quality of assets of the bank. The yearly rate of this relationship showed a remarkable decreasing trend over the study period. In 2000 it was only 3.73% with BASIC Bank whereas all other banks showed this ratio as 34.92% and DFIs (DFIs include BKB, BSB, RAKUB, BASIC, BSRS) as 62.56% (Source : Bangladesh Bank, Statistics Department and the Bangladesh Observer, June 17, 2001). So it can be said that when all other banks and DFIs are plunged in default loan, BASIC Bank Ltd. is performing with a tremendous success in the banking sector.

After judging the asset quality of the bank, management capacity is analyzed in the table C given on next page.

Table # C depicts the management capacity of the bank in terms of employees' productivity. Cost per employee, earnings per employee, deposit per employee and advance per employee were used for determining employees' productivity. The average cost per employee (TK. 0.84 million) and the average earnings per employee (TK. 0.66 million) were much higher than the standard level of TK. 0.30 million and TK. 0.50 million. These two measures showed an upward trend in the later years under the study period, while other two measures having no standard level have also shown an increasing trend in their value in the recent years under the study period.
Table C
Table Showing the Management
Capacity (Employees' Productivity) of BASIC Bank

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost per Employee Earnings</td>
<td>1.27</td>
<td>1.27</td>
<td>0.98</td>
<td>0.77</td>
<td>0.66</td>
<td>0.64</td>
<td>0.76</td>
<td>0.83</td>
<td>0.74</td>
<td>0.77</td>
<td>0.52</td>
<td>0.84</td>
<td>0.25</td>
</tr>
<tr>
<td>per Employee Deposit</td>
<td>1.36</td>
<td>1.04</td>
<td>1.32</td>
<td>0.94</td>
<td>0.47</td>
<td>0.46</td>
<td>0.32</td>
<td>0.54</td>
<td>0.32</td>
<td>0.47</td>
<td>-</td>
<td>0.66</td>
<td>0.50</td>
</tr>
<tr>
<td>per Employee Advance</td>
<td>12.9</td>
<td>13.54</td>
<td>12.24</td>
<td>10.09</td>
<td>10.66</td>
<td>9.24</td>
<td>9.42</td>
<td>10.08</td>
<td>8.6</td>
<td>6.8</td>
<td>5.29</td>
<td>7.9</td>
<td>9.9</td>
</tr>
<tr>
<td>per Employee</td>
<td>9.76</td>
<td>9.03</td>
<td>8.17</td>
<td>7.05</td>
<td>5.1</td>
<td>5</td>
<td>4.67</td>
<td>5.03</td>
<td>4.5</td>
<td>3.49</td>
<td>2</td>
<td>5.8</td>
<td></td>
</tr>
</tbody>
</table>

Source: BASIC Bank Ltd., Annual Report 1990 - 2000 and Appendix # 01

In 2000 deposit per employee and advance per employee stood at TK. 12.9 million and TK. 9.76 million respectively while in 1990 those were TK. 5.29 million and TK. 2 million only. Adverse trend was seen in the average cost per employee in comparison with its standard level. So it deserves attention of the management to this particular area of performance.

Operational results of the bank are shown in Table D under the caption Profitability of BASIC Bank measured by some mostly used ratios like after tax return on average asset, net profit margin, return on capital employed, return on equity, net investment margin (actual profit on earning asset), earning per share and percentage of non-interest income (i.e., cost free income) to total income (diversification ratio). Though some profitability ratios and their average value were seen below the standard but these were increasing gradually. After tax return on average asset rose to 2.33% in 2000 from 0.61% in 1990. It is 282% higher than that of the year 1990. Similarly return on equity, net investment margin and diversification ratio have increased in 2000 by 585%, 171% and 235% respectively from the year 1990. All other profitability ratios also show a steady growth over the years. The net profit margin of the bank was 19.75% in 2000 as against 5.35% in 1990. Return on capital employed rose to 13.83% in 2000 from 2.86% in 1990. A remarkable performance of the bank is shown by the earning per share over the years under the study period. The earning per share was only TK. 1.36 in 1990 while it rose to TK. 72.23 in 2000 registering 5211% increase from the year 1990. However, all the average and individual values for after tax return average asset, equity, investment margin and non-interest income are below the standard. So it is clear that there is a scope for the improvement of profitability.
## Table # D

**Table Showing the Earning Capacity (Profitability) of BASIC Bank**

|-----------------------------|------|------|------|------|------|------|------|------|------|------|------|      | ard  |
| After Tax Return on Average Asset | 2.33 | 2.5  | 2.73 | 2.28 | 1.6  | 1.78 | 1.04 | 0.87 | 0.31 | 0.35 | 0.61 | 1.49 | 4    |
| Net Profit Margin Return on Capital Employed | 19.75 | 20.45 | 23.01 | 21.48 | 18.54 | 18  | 11.03 | 8.77 | 3.26 | 2.90 | 5.35 | 13.87 | - |
| Return on Equity Net Investment Margin | 13.83 | 16.78 | 16.62 | 15.47 | 13.12 | 14.91 | 10.14 | 7.54 | 1.91 | 2.5  | 2.86 | 10.52 | - |
| Earning per Share (TK.) Diversification Ratio (Non-interest income to Total income) | 27.04 | 30.21 | 28.69 | 27.96 | 23.70 | 28.22 | 21.28 | 17.48 | 4.71 | 3.39 | 3.95 | 19.69 | 30 |
| Source: BASIC Bank Ltd., Annual Report 1990 - 2000 and Appendix # 01 |

Table # E shows the liquidity position of the bank by measuring the ratio of total loan to total deposit, earning asset to total deposit, liquid asset to deposit and interest margin cover. The ratio of liquid asset to deposit showed that the bank had more than 60% ability on the average to meet the current obligations. But interest margin coverage ratio established that depositors' interest was fully secured in most of the years under the study period. In 1990 it was 102.43% while in 2000 it rose 150.67%, average rate of which was 114.54%. The main causes behind this performance of the bank are the allocation of funds among various lending and investing activities and different earning capacity of these activities. The earning capacity of the bank is high as indicated by Loan to deposit and earning asset to deposit ratios. The average yearly rate of loan to deposit was found to be 56.54% and earning asset to deposit 98.57%. Between these two ratios earning asset to deposit was more consistent over the years. In 2000 the ratio was 117.74% as against 102.99% in 1990. In fine, the liquidity ratio can be taken as satisfactory.
Table Showing the Liquidity Position of BASIC Bank

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan to Deposit</td>
<td>75.62</td>
<td>66.71</td>
<td>66.81</td>
<td>69.86</td>
<td>47.82</td>
<td>54.17</td>
<td>49.62</td>
<td>49.89</td>
<td>52.35</td>
<td>51.29</td>
<td>37.79</td>
<td>56.54</td>
<td></td>
</tr>
<tr>
<td>Earning Asset to Deposit</td>
<td>117.74</td>
<td>85.34</td>
<td>115.56</td>
<td>113.69</td>
<td>99.57</td>
<td>97.52</td>
<td>74.04</td>
<td>83.69</td>
<td>92.7</td>
<td>101.48</td>
<td>102.99</td>
<td>98.57</td>
<td></td>
</tr>
<tr>
<td>Liquid Asset to deposit</td>
<td>59.52</td>
<td>59.09</td>
<td>62.29</td>
<td>59.58</td>
<td>70.42</td>
<td>66.22</td>
<td>68.17</td>
<td>66.91</td>
<td>75.59</td>
<td>61.21</td>
<td>81.86</td>
<td>66.44</td>
<td></td>
</tr>
<tr>
<td>Interest Margin Coverage Ratio</td>
<td>150.67</td>
<td>112.67</td>
<td>192.07</td>
<td>194.64</td>
<td>112.45</td>
<td>109.68</td>
<td>60.33</td>
<td>84.98</td>
<td>57.85</td>
<td>82.15</td>
<td>102.43</td>
<td>114.54</td>
<td></td>
</tr>
</tbody>
</table>

Source: BASIC Bank Ltd., Annual Report 1990 - 2000 and Appendix # 01

The above analysis establishes that the bank is performing well in all areas except in management capacity and profitability. The position of driving forces leading to higher profitability and management efficiency of the sample bank is elaborated in the following section.

According to Balanced Score Board, qualitative aspect is an important and unavoidable part of performance measurement. The qualitative aspects of Performance came under Customers perspective, Internal Business perspective and Innovation and Learning perspective. As there is no direct tools of performance measurement in these areas, some surrogate measures can be applied for performance measurement. Now an analysis of Performance on the basis of said perspective is made below.

CUSTOMERS' PERSPECTIVE

Customers' satisfaction is the prerequisite of the success of a bank since the main job of a bank is to provide service to the customers. To achieve this goal an opinion survey of the customers on the related variables was made by a 5-point scale as explained on the next page.
On the basis of the above questionnaire, the authors interviewed some 50 customers and 50 direct clients of BASIC Bank Ltd. on the above subjects. They responded rapidly and their opinion is quantified below:

<table>
<thead>
<tr>
<th>Variables</th>
<th>Score</th>
</tr>
</thead>
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<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td><strong>Time taken for encashing a cheque</strong></td>
<td>Excess</td>
</tr>
<tr>
<td><strong>Co-operation given by the bank in opening account, receiving and</strong></td>
<td>Frustrating</td>
</tr>
<tr>
<td><strong>transferring remittance, depositing the money etc.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Evaluation time of loan application</strong></td>
<td>Excess</td>
</tr>
<tr>
<td><strong>Hidden cost in loan granting</strong></td>
<td>Excess</td>
</tr>
</tbody>
</table>

| Variables                                                                 | Score       |
|                                                                           | 1     | 2     | 3     | 4     | 5     | Total percentage of respondents |
| **Time taken for encashing a cheque**                                     | -     | -     | 15%   | 10%   | 75%   | 100% |
| **Co-operation given by the bank in opening account, receiving and**      | -     | -     | -     | 5%    | 95%   | 100% |
| **transferring remittance, depositing the money etc.**                     | -     | 8%    | 12%   | 15%   | 65%   | 100% |
| **Evaluation time of loan application**                                   | -     | -     | -     | 2%    | 98%   | 100% |
| **Hidden cost in loan granting**                                          | -     | -     | -     | -     | -     | 100% |
| **Average percentage of respondents**                                     | -     | 2%    | 7%    | 8%    | 83%   | 100% |
Purohit & Mazumdar

From the above table it is observed that 83% respondents were found highly satisfied with the bank's activities and the rest 17% were satisfied with some reservations. No body was found dissatisfied. BASIC Bank has a unique blend of development and commercial banking functions and offers full range of banking services to its customers and clients. Considering the needs of the customers and to ensure their full satisfaction, the bank has all traditional products in the name of Current Deposit (CD), Savings Bank Deposit (SB), Short Notice Term Deposit (STD), Fixed Deposit (FD) and Bearer Certificate of Deposit (BCD). The functions of the bank also include opening of Letters of Credit (L/C) and financing of all types of foreign trade, dealing in foreign exchange and making both domestic and foreign remittances.

INTERNAL BUSINESS PERSPECTIVE

In this area of performance, two important aspects for BASIC for evaluation are implementation of credit policy and development of human resources. BASIC Bank Ltd. has commenced its functioning with a view to invest at least 50% of its loanable fund in small scale industries. But it failed to achieve this target due to some external circumstances like lack of demand for loans, taking long time by the SSIs management to make quick decision, political unrest etc., BASIC Bank Ltd. has been providing loan to SSIs on priority basis since inception. The following chart indicates the percentage of loan provided to SSIs and Micro credit in terms of total loan over the study periods.

<table>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SSIs loan and Microcredit on total loan</td>
<td>46.97</td>
<td>40.09</td>
<td>42.21</td>
<td>35.83</td>
<td>40.99</td>
<td>43.44</td>
<td>46.25</td>
<td>22.16</td>
<td>15.38</td>
<td>15.56</td>
<td>23.84</td>
</tr>
</tbody>
</table>

Source: BASIC Bank Ltd., Annual Report 2000

It has also adopted state-of-the-art technology for improving working condition. Since inception it has continued its effort to meet the changing requirements of customers. BASIC Bank has its own software developed in 1991. Local Area Network (LAN) has been installed in its Head Office and 15 branches. Wide Area Network (WAN) has been set up between Head Office and branches using X.28 leased line of BTTB. As a result of these technological installations, instantaneous transaction and transfer of data are being easily done between branches and Head Office and between branches themselves. During the year 1999, the Bank moved forward another step in technological advancement becoming a member of SWIFT (Society for Worldwide Interbank Financial Telecommunication). These facilitates have ensured a swift transfer of funds, L/Cs and other messages worldwide electronically.
INNOVATION AND LEARNING PERSPECTIVE

Disciplined and innovative business approach and the ability of bank's management to capitalise on opportunities arising from changes in domestic market were the main aspects behind the remarkable success of the Bank. Persistent focus on prudent investment, a tight control on costs and the development of a fully operational computer network system are the prime objects of the Bank for the future. But the bank is lagging behind in the area of product diversification because it has no separate investment and deposit scheme as is evident in the multinational banks in Bangladesh. However, to face the challenge of the new millennium, the management is preparing a comprehensive perspective plan for product diversification to maintain a competitive edge in the market.

The Bank has undertaken a project for installing a more secured and reliable network using microwave and VSAT, and developing a modern banking software. By dint of this technological attachments the Bank will go for new IT-based products, such as "Any Branch Banking", "Automated Teller Machine", and "Debit Card and POS Terminal". Once the project is implemented, the valued customers will be able to withdraw or deposit their cash from any branch in Dhaka and Chittagong during office hours, and withdraw cash, transfer funds and pay utility bills at any time during 24-hour a day from any ATM.

CONCLUSION

Efficient and prudent credit management of BASIC Bank makes it a unique institution to hold lower percentage of non-performing loans of 3.77% in 2000 compared to 34.92% of non-performing loans of all other commercial banks. The recovery rate of its industrial credit was more than 86% and that of micro credit was 98% during the year 1998 to 2000 (BASIC Bank Ltd., Annual Report, 1999 & 2000). In terms of CAMEL rating the BASIC Bank Ltd. was ranked as "A-class" bank in 1997 (The Monthly Industry, DA-1204, VOL. IX, Issue 8, Dhaka, March 1, 1999) and in 1999 (The Daily Observer, 2001, quoted from Rahaman and Sarkar 2001) by the central bank. Nevertheless an adverse situation was observed in the management efficiency and profitability. To overcome this problem, the bank should give emphasis on new product development and service diversification. This will ensure sustained growth of long-term profitability.
CORPORATE TAX ADMINISTRATION: AN ANALYSIS

*Sugan C. Jain
**Monica D. Soni

ABSTRACT

A competent and fair tax administration is the pre-requisite for achieving the objectives of taxation. As the primary objective of taxation is raising of revenue, a tough administration capable of reaching the tax base and ensuring maximum collection of taxes will be recognised as the most successful administration. The tax administration must be capable of ensuring correct assessment of income and detecting any concealment of income intended for evasion of tax. The role of corporate income tax administration in India is still important, considering the fact that its role in the tax system of India is rapidly increasing. Equally important is the fact that Corporate Income Tax has direct impact on the income of corporate assesses. The present article proposes to analyze the working and efficiency of the tax administration of corporation tax. The working or operation of taxation of corporate income can be studied in relation to the number of assessee, assessments, income assessed and tax payable.

The working of the scheme of corporate taxation is presented in the table 1, which presents a consolidated account of the working of total income taxation as well as corporate taxation during the period 1961-1999. During this period, there has been all-round expansion in the number of assessees, income assessed to tax, tax demand raised and income tax collections.

An analysis of number of company assesses and assessments reveals that both have increased during the above period, registering an increase of about 1.2 times and 20 times respectively. Since proportionate increase in company assessments is more than proportionate increase in number of company assesses, this shows signs of better compliance as a result of reduction of tax rates and other simplification and rationalization measures of Income Tax department. Similarly, the proportion of company assessment to total number of assessments have also increased from 1.09 percent to 2.51 percent which substantiate the claim of better tax compliance of corporate taxation.

Moreover, the returned income of companies and tax payable by them has increased by more than 280 times and 220 times respectively. At the same time, their proportion to total

*Professor and Head, Department of Accountancy and Business Statistics, University of Rajasthan, Jaipur
**Lecturer, International College for Girls, Jaipur
## Table 1

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Assessments on Assessed Income Tax</th>
<th>% of Income of Companies to be Assessed</th>
<th>% of Returned Income of Taxpayers</th>
<th>% of Tax Payable on Demand</th>
<th>No. of Taxpayers</th>
<th>Returned Income (Rs. crores)</th>
<th>Payable Income (Rs. crores)</th>
<th>Total Income Tax (Rs. crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>1,116,713</td>
<td>0</td>
<td>0.16</td>
<td>0.02</td>
<td>10,383</td>
<td>1.09</td>
<td>0.89</td>
<td>11.25</td>
</tr>
<tr>
<td>1990-91</td>
<td>30,125,970</td>
<td>0</td>
<td>0.29</td>
<td>0.21</td>
<td>5,013</td>
<td>0.57</td>
<td>0.44</td>
<td>6.38</td>
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<tr>
<td>1990-91</td>
<td>4,74,47,111</td>
<td>0</td>
<td>0.57</td>
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<td>5013</td>
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<td>5.17</td>
<td>10.41</td>
</tr>
<tr>
<td>1990-91</td>
<td>1,65,2,70</td>
<td>0</td>
<td>0.29</td>
<td>0.21</td>
<td>11,15</td>
<td>1.05</td>
<td>1.01</td>
<td>2.06</td>
</tr>
<tr>
<td>1990-91</td>
<td>1,23,791</td>
<td>0</td>
<td>0.16</td>
<td>0.02</td>
<td>11,15</td>
<td>1.05</td>
<td>1.01</td>
<td>2.06</td>
</tr>
</tbody>
</table>

**Source:**
(1) Report of Comptroller and Auditor General of India, Union Government (Direct Taxes), No. 12 (Various Years) (Column 2.36 and 8) (Column 7.9.11 and 13: Self Calculations including figures for Miscellaneous other Assesses.)
(2) All India Income Tax Statistics, Directorate of Income Tax (Research, Statistics, Publications and Public Relations), Mayur Bhawan, New Delhi (Various Years) (Column 15.10 and 12)
(3) Columns 7.9.11 and 13: Self Calculations including figures for Miscellaneous other Assesses.)

**Note:**
- Percent-age Increase over the years calculated from the previous year's figures.
- Figures for Miscellaneous other Assesses are self-calculated.
income assessed and total tax payable has also increased from 20 percent and 51 percent to 44 percent and 65 percent respectively. All this reveals that burden of tax is not distributed equally among all types of assesses. Company assesses account for the single largest share in the total tax demand throughout the period under review. While assessments related to companies constitute less than 3 percent of the total number of assessments, they account for about 65 percent of the tax demand raised on all assessments.

So, on the basis of above discussion, we can say that income tax compliance both in aggregate and with respect to company asessees has improved. At the same time the importance of corporate tax in total tax structure of the country is continuously increasing.

### Table 2
Status-wise Break Up of Assessments Completed

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
<th>Non-Company</th>
<th>Total</th>
<th>2 as % of 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>1,46,998</td>
<td>65,66,416</td>
<td>67,13,414</td>
<td>2.19</td>
</tr>
<tr>
<td>1992-93</td>
<td>1,51,913</td>
<td>63,51,030</td>
<td>65,02,943</td>
<td>2.34</td>
</tr>
<tr>
<td>1993-94</td>
<td>1,81,130</td>
<td>72,42,046</td>
<td>74,23,176</td>
<td>2.44</td>
</tr>
<tr>
<td>1994-95</td>
<td>1,86,938</td>
<td>74,05,828</td>
<td>75,92,766</td>
<td>2.46</td>
</tr>
<tr>
<td>1995-96</td>
<td>1,99,086</td>
<td>81,00,767</td>
<td>82,99,853</td>
<td>2.40</td>
</tr>
<tr>
<td>1996-97</td>
<td>2,35,385</td>
<td>1,02,13,874</td>
<td>1,04,49,259</td>
<td>2.25</td>
</tr>
<tr>
<td>1997-98</td>
<td>2,71,481</td>
<td>1,10,04,146</td>
<td>1,12,75,627</td>
<td>2.41</td>
</tr>
<tr>
<td>1998-99</td>
<td>2,14,922</td>
<td>83,39,226</td>
<td>85,54,148</td>
<td>2.51</td>
</tr>
</tbody>
</table>

**Source:** Reports of Comptroller & Auditor General Of India, No. 5 and 12 (Various Years)

### EQUITY AND PROGRESSIVITY OF CORPORATE TAX

In this context, it is a matter of interest to examine how far the principle of equity is achieved through corporate income tax. Table 3 reveals that in 1990-91, the number of returns filed by lower income companies having Income below Rs. 50,000 constituted nearly 50 percent of total returns while returns filed by top income companies having income above Rs. 10 Lakh Constituted only 10.36 percent of total returns. However tax payable and returned income of the former was around 0.87 and 0.69 percent of the total, while in the latter case, the relevant percentages were 91.12 and 92.39 percent.

The trend remained same in the subsequent years with a slight increase in number of returns, returned income and tax payable by the low-income companies and slight decrease in case of high-income companies. So on the whole, we can say that Indian corporate tax structure is equitable whereby top companies (in terms of income) having income above Rs. 10 Lakh contribute maximum to the total tax payable and returned income.
**Indian Journal of Accounting**

**Table 3**

Income Range Category wise Break up of Company Assesses

<table>
<thead>
<tr>
<th>Range of Returned Income (Rs '000)</th>
<th>NOR</th>
<th>RI</th>
<th>TP</th>
<th>NOR</th>
<th>RI</th>
<th>TP</th>
<th>NOR</th>
<th>RI</th>
<th>TP</th>
<th>NOR</th>
<th>RI</th>
<th>TP</th>
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</thead>
<tbody>
<tr>
<td>All Ranges</td>
<td>55267</td>
<td>708957</td>
<td>3218.99</td>
<td>68692</td>
<td>6443.13</td>
<td>3432.69</td>
<td>138558</td>
<td>16481.97</td>
<td>7583.98</td>
<td>170527</td>
<td>23215.34</td>
<td>8070.73</td>
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<tr>
<td>0-50</td>
<td>27760</td>
<td>49.05</td>
<td>27.95</td>
<td>33684</td>
<td>50.27</td>
<td>22.72</td>
<td>75924</td>
<td>270.36</td>
<td>45.00</td>
<td>98365</td>
<td>283.90</td>
<td>103.08</td>
</tr>
<tr>
<td></td>
<td>(50.23)</td>
<td>(0.69)</td>
<td>(0.87)</td>
<td>(49.04)</td>
<td>(0.78)</td>
<td>(0.66)</td>
<td>(54.80)</td>
<td>(1.64)</td>
<td>(0.59)</td>
<td>(57.68)</td>
<td>(1.22)</td>
<td>(1.28)</td>
</tr>
<tr>
<td>50-100</td>
<td>7745</td>
<td>57.53</td>
<td>33.84</td>
<td>9476</td>
<td>57.31</td>
<td>26.94</td>
<td>22804</td>
<td>245.18</td>
<td>42.04</td>
<td>16630</td>
<td>122.55</td>
<td>46.28</td>
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<tr>
<td>100-200</td>
<td>5262</td>
<td>75.41</td>
<td>44.37</td>
<td>6880</td>
<td>54.63</td>
<td>26.22</td>
<td>9514</td>
<td>288.00</td>
<td>52.38</td>
<td>11632</td>
<td>170.71</td>
<td>68.25</td>
</tr>
<tr>
<td>200-300</td>
<td>3168</td>
<td>78.90</td>
<td>45.05</td>
<td>3927</td>
<td>117.87</td>
<td>58.46</td>
<td>5104</td>
<td>156.46</td>
<td>35.01</td>
<td>8169</td>
<td>201.24</td>
<td>79.12</td>
</tr>
<tr>
<td>300-400</td>
<td>2208</td>
<td>76.48</td>
<td>43.81</td>
<td>3184</td>
<td>80.30</td>
<td>40.07</td>
<td>3398</td>
<td>158.19</td>
<td>38.14</td>
<td>5533</td>
<td>192.47</td>
<td>75.02</td>
</tr>
<tr>
<td>400-500</td>
<td>1496</td>
<td>67.19</td>
<td>39.22</td>
<td>2457</td>
<td>103.96</td>
<td>51.77</td>
<td>2752</td>
<td>282.68</td>
<td>82.70</td>
<td>4427</td>
<td>198.82</td>
<td>77.28</td>
</tr>
<tr>
<td>500-1000</td>
<td>1871</td>
<td>134.93</td>
<td>51.76</td>
<td>2988</td>
<td>186.69</td>
<td>96.14</td>
<td>6987</td>
<td>438.82</td>
<td>170.90</td>
<td>10999</td>
<td>803.67</td>
<td>317.28</td>
</tr>
<tr>
<td>Above</td>
<td>5727</td>
<td>6550.08</td>
<td>2933.00</td>
<td>6156</td>
<td>5792.09</td>
<td>3110.35</td>
<td>12075</td>
<td>14642.28</td>
<td>7117.80</td>
<td>14772</td>
<td>21242.00</td>
<td>7304.50</td>
</tr>
<tr>
<td>1000</td>
<td>(10.36)</td>
<td>(92.39)</td>
<td>(91.12)</td>
<td>(8.96)</td>
<td>(89.90)</td>
<td>(90.61)</td>
<td>(8.71)</td>
<td>(88.84)</td>
<td>(93.85)</td>
<td>(8.66)</td>
<td>(91.50)</td>
<td>(90.51)</td>
</tr>
</tbody>
</table>

**Source:** CMIE (Public Finance), March 2000, Economic Intelligence Service, Mumbai.

Here

NOR = Number of Returns
RI = Returned Income
TP = Tax Payable

Note: Figures in Brackets show Proportion to total.

A more refined evaluation of equitability of corporate tax structure can be done in terms of effective tax rates of corporate income tax, which is shown in Table 5. In fact, from equity point of view, what is important is the effective tax rate and not the statutory rates. Generally, the effective tax rates are lower than the statutory rates for all income classes and this is so because of a number of deductions and exemptions allowed in determining the taxable income. Tax deductions and exemptions are normally provided for achieving some other objectives like promotion of savings in the form of specified financial assets, providing incentive for investment in specified sectors of the economy, for industrial development of the backward areas and such other matters; but these concessions considerably reduce the tax liability of those who have a higher capacity to pay taxes and are expected to contribute larger sums to the national exchequer.
Table 4
Effective Tax Rates of Corporate Income Tax

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>All ranges</td>
<td>45.40</td>
<td>53.27</td>
<td>53.28</td>
<td>49.59</td>
<td>46.01</td>
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<td>45.19</td>
<td>45.20</td>
<td>29.50</td>
<td>16.64</td>
<td>36.31</td>
</tr>
<tr>
<td>50-100</td>
<td>58.82</td>
<td>47.01</td>
<td>47.01</td>
<td>44.14</td>
<td>17.15</td>
<td>37.76</td>
</tr>
<tr>
<td>100-200</td>
<td>58.83</td>
<td>47.98</td>
<td>48.00</td>
<td>30.14</td>
<td>18.19</td>
<td>39.98</td>
</tr>
<tr>
<td>200-300</td>
<td>57.09</td>
<td>49.57</td>
<td>49.60</td>
<td>64.50</td>
<td>22.38</td>
<td>39.32</td>
</tr>
<tr>
<td>300-400</td>
<td>57.28</td>
<td>49.76</td>
<td>49.90</td>
<td>46.09</td>
<td>24.11</td>
<td>38.98</td>
</tr>
<tr>
<td>400-500</td>
<td>58.37</td>
<td>49.85</td>
<td>49.80</td>
<td>42.53</td>
<td>29.26</td>
<td>38.87</td>
</tr>
<tr>
<td>500-1000</td>
<td>38.30</td>
<td>51.48</td>
<td>51.50</td>
<td>49.80</td>
<td>38.95</td>
<td>39.48</td>
</tr>
<tr>
<td>Above 1000</td>
<td>44.78</td>
<td>53.68</td>
<td>53.70</td>
<td>50.04</td>
<td>48.61</td>
<td>34.39</td>
</tr>
<tr>
<td>Statutory Tax Rate</td>
<td>50</td>
<td>40</td>
<td>45</td>
<td>45</td>
<td>45</td>
<td>40</td>
</tr>
</tbody>
</table>

Note:  
1. Above data is based on self-calculations on the basis of data taken from CMIE (Public Finance), March 2000, Economic Intelligence Service, Mumbai. The formula used for calculating effective tax rate is Tax payable/ Returned Income x 100
2. Statutory tax rate is the Corporate Tax Rate for domestic companies in which public are substantially interested.

With the general curtailment of statutory tax rates and increasing volume of concessions provided, gradual decline is witnessed in the effective tax rates also. As depicted in the Table 5, the effective tax rates, in general have declined in 1995-96 as compared to in 1990-91. However, they have shown no definite trend over the period. This decline reflects that different companies in different income ranges are extensively taking advantage of different tax incentives and concessions. However, there is not much difference in effective tax rate for companies belonging to different income ranges.

ANALYSIS OF CORPORATE TAX COLLECTION AT PRE-ASSESSMENT AND POST-ASSESSMENT STAGE

Income Tax provides for a very comprehensive assessment procedure whereby pre-assessment collections are made by way of deduction of tax at source, advance tax and payment of tax on self-assessment. The post-assessment collection is of additional demand arising after assessment. On an average, nearly 85 percent of total collections are realized at pre-assessment stage as depicted by the Table 6. The gross collections have also increased. However, proportion of refunds to the total collections over period has increased which has had adverse effect on net collections.


Table 5
Analysis of Corporate Tax Collections at Pre-Assessment and Post-Assessment Stages

<table>
<thead>
<tr>
<th>Year</th>
<th>TDS</th>
<th>Advance Tax</th>
<th>Self Assessments</th>
<th>Regular Assessments</th>
<th>Other Receipts</th>
<th>Total Collections</th>
<th>Refunds (% of Total Collection)</th>
<th>Net Collections</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988-89</td>
<td>841.12</td>
<td>3,347.50</td>
<td>337.10</td>
<td>501.92</td>
<td>123.67</td>
<td>5,151.31</td>
<td>744.75 (14.46)</td>
<td>4,406.56</td>
</tr>
<tr>
<td>1989-90</td>
<td>1,684.89</td>
<td>3,017.30</td>
<td>364.31</td>
<td>1,029.75</td>
<td>80.19</td>
<td>6,176.44</td>
<td>1,462.25 (23.67)</td>
<td>4,714.19</td>
</tr>
<tr>
<td>1990-91</td>
<td>1,499.58</td>
<td>4,085.01</td>
<td>355.98</td>
<td>1,127.67</td>
<td>207.17</td>
<td>7,275.41</td>
<td>1,944.79 (26.73)</td>
<td>5,330.62</td>
</tr>
<tr>
<td>1991-92</td>
<td>2,348.13</td>
<td>5,962.38</td>
<td>455.31</td>
<td>1,157.09</td>
<td>543.56</td>
<td>10,466.47</td>
<td>2,613.67 (24.97)</td>
<td>7,852.80</td>
</tr>
<tr>
<td>1992-93</td>
<td>2,321.19</td>
<td>6,886.67</td>
<td>1,032.48</td>
<td>1,437.88</td>
<td>424.86</td>
<td>12,103.08</td>
<td>2,489.04 (20.57)</td>
<td>9,614.04</td>
</tr>
<tr>
<td>1993-94</td>
<td>2,772.27</td>
<td>7,303.43</td>
<td>1,250.58</td>
<td>2,382.51</td>
<td>397.46</td>
<td>14,106.25</td>
<td>4,045.96 (28.68)</td>
<td>10,060.29</td>
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<tr>
<td>1994-95</td>
<td>3,810.91</td>
<td>9,770.02</td>
<td>952.84</td>
<td>2,030.36</td>
<td>614.59</td>
<td>17,178.72</td>
<td>3,357.76 (19.55)</td>
<td>13,820.96</td>
</tr>
<tr>
<td>1995-96</td>
<td>5,096.71</td>
<td>11,477.04</td>
<td>1,112.19</td>
<td>4,598.40</td>
<td>665.27</td>
<td>22,949.61</td>
<td>6,462.48 (28.16)</td>
<td>16,487.13</td>
</tr>
<tr>
<td>1996-97</td>
<td>5,138.94</td>
<td>14,206.80</td>
<td>1,260.57</td>
<td>4,234.06</td>
<td>1,480.31</td>
<td>26,320.68</td>
<td>7,753.99 (29.46)</td>
<td>18,566.69</td>
</tr>
<tr>
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<td>3,984.32</td>
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<td>1,927.13</td>
<td>3,469.94</td>
<td>616.73</td>
<td>26,414.79</td>
<td>6,398.79 (24.22)</td>
<td>20,016.00</td>
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<td>4,502.06</td>
<td>19,077.46</td>
<td>2,386.64</td>
<td>5,255.02</td>
<td>1,388.22</td>
<td>32,612.40</td>
<td>8,083.53 (24.79)</td>
<td>24,528.87</td>
</tr>
</tbody>
</table>

Source: Reports of Comptroller and Auditor General of India, Union Government (Direct Taxes), No. 5 and 12 (Various Years)

COST OF COLLECTION

It is generally believed that collection cost of income tax is continuously increasing owing to detailed investigations, search and seizure proceedings and convictions and prosecutions through courts in order to curb large-scale tax evasion and avoidance practices on the part of income tax assessees. However, on the whole, the cost of collection of all categories has declined during the period.

Table 6 reveals that the cost of collection of corporation tax is much smaller in comparison to other taxes on income as well as other direct taxes. The cost of collection of corporation tax is less than half percent and it has continuously declined over the period under consideration. The main reason for this is increased collection of corporation tax and lesser amount of administration work involved with regard to assessment of companies.

The cost of collection of taxes on income other than corporation tax is comparatively much higher at about 3 percent of the total collections. Such a higher percentage cost of collection of income-tax in comparison to the decreasing cost of collection of other direct taxes certainly makes it a tax involving highest collection cost, but taking into consideration the importance of direct taxation and the problems involved in the administration of direct taxes, the combined cost of collection of the order of about 1.98 percent should not cause much concern. Further, by toning up the administration and ensuring better compliance on the part of income-taxpayers, the cost of collection of income tax will be further reduced.
Table 6
Cost of Collection of Corporate Taxes

(Amount in Rs. Crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Corporate Tax Collection</th>
<th>% Cost of collection (Corporate)</th>
<th>Taxes on Income other than Corp. Tax</th>
<th>% Cost of collection (Non-corporate)</th>
<th>Other Direct taxes</th>
<th>%Cost of collection of other direct taxes</th>
<th>Total Direct Tax Revenue</th>
<th>Cost of collecting Direct Taxes</th>
<th>% Cost of collecting Direct Taxes</th>
</tr>
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<tbody>
<tr>
<td>1989-90</td>
<td>4728.92</td>
<td>0.53</td>
<td>5008.98</td>
<td>3.28</td>
<td>269.88</td>
<td>7.90</td>
<td>10,007.78</td>
<td>210.39</td>
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<tr>
<td>1990-91</td>
<td>5335.27</td>
<td>0.52</td>
<td>5375.34</td>
<td>3.33</td>
<td>318.33</td>
<td>7.26</td>
<td>11,028.94</td>
<td>230.18</td>
<td>2.09</td>
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<tr>
<td>1991-92</td>
<td>7867.67</td>
<td>0.39</td>
<td>6705.80</td>
<td>2.98</td>
<td>768.89</td>
<td>3.34</td>
<td>15,342.36</td>
<td>256.46</td>
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<td>8889.24</td>
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<td>2.93</td>
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<td>2.27</td>
<td>18,097.29</td>
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<td>10060.06</td>
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<td>9122.62</td>
<td>2.85</td>
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<td>3.12</td>
<td>20,298.24</td>
<td>335.43</td>
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<td>13820.96</td>
<td>0.34</td>
<td>12030.12</td>
<td>2.51</td>
<td>1119.80</td>
<td>3.47</td>
<td>26,970.88</td>
<td>388.27</td>
<td>1.44</td>
</tr>
<tr>
<td>1995-96</td>
<td>16487.13</td>
<td>0.32</td>
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<td>1484.98</td>
<td>2.64</td>
<td>33,559.28</td>
<td>492.24</td>
<td>1.47</td>
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<tr>
<td>1996-97</td>
<td>18566.69</td>
<td>-----</td>
<td>18233.99</td>
<td>-----</td>
<td>2094.40</td>
<td>2.37</td>
<td>38,895.08</td>
<td>494.15</td>
<td>1.27</td>
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<td>1997-98</td>
<td>20016.00</td>
<td>-----</td>
<td>17100.59</td>
<td>-----</td>
<td>11163.81</td>
<td>-----</td>
<td>48,280.40</td>
<td>799.36</td>
<td>1.65</td>
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<tr>
<td>1998-99</td>
<td>24528.87</td>
<td>-----</td>
<td>20240.15</td>
<td>-----</td>
<td>1831.05</td>
<td>-----</td>
<td>46,600.07</td>
<td>925.62</td>
<td>1.98</td>
</tr>
</tbody>
</table>

Source: Reports of Comptroller and Auditor General of India, Union Government, (Direct Taxes), No. 5 and 12, Various Years.

Note: The details of cost of collection of Corporate Tax and Taxes on Income other than Corporation Tax after 1995-96 [1996-97 in case of other Direct Taxes] could not be found in CAG Reports; So data after this year is not available.

ARREARS OF COLLECTION

It is generally argued that if the assessment is regarded as fair by the taxpayer there should not be large arrears of tax collections. An analysis of total arrears of demand remaining uncollected have been presented in table 7.

However, while the proportion of non-companies in total uncollected demand increased from 37.84 percent in 1989-90 to 50.26 percent in 1998-99, the proportion of companies in total uncollected demand reduced from 62.16 percent in 1989-90 to 49.73 percent in 1998-99. This further strengthens the earlier conclusion of better corporate tax compliance.

CONCLUSION

In a nutshell, it can be said that corporate tax assumes a key place in Indian tax system in terms of revenue contribution and administrative effectiveness. So, it should be ensured that the trend of better corporate tax compliance by corporate assesses is maintained by making the tax payment more convenient and less pinching by providing various facilities and reliefs to corporate assesses.
BENCHMARKING PERFORMANCE OF INDIAN PUBLIC SECTOR COMMERCIAL BANKS

*Sheeba Kapil
**Kanwal Nayan Kapil
***Prof. Kailash Nath Nagar

ABSTRACT

The objective of this paper is to review and analyze the current financial health of the Indian public sector commercial banks in the light of banking reforms and predict the future and scope of the same. The viability of the 27 public sector banks has been analyzed on basis of off-site supervisory exam model i.e. CAMEL model (C for capital adequacy, A for asset quality, E for earnings, L for liquidity). These four components of each bank have been analyzed and rated on a scale to judge the composite rating of the same. The paper finds that the off-site supervisory exam model (CAMEL) has rated majority of PSBs as non-viable and they require immediate attention and government support. After 10 years of economic and banking reforms, the Indian banking sector has still miles to go. Low profitability, liquidity, capital adequacy and high non-performing assets will definitely make the majority of Indian PSBs a bad bargain in near future.

The onset of the '90s witnessed the winds of change ushering in an era of liberalization of the economy, which had its inevitable impact on the banking sector. The report of the Narasimhan Committee suggested structural changes, which were to be introduced in the existing banks in a phased manner. The old ideology of social banking was not abandoned, but the responsibility for development banking is blended with the paramount need for complying with norms of prudence and efficiency.

The study aims at determining as to how far the Indian public sector commercial banks have been able to adjust to the reforms and to what extent do they exhibit sound financial health after more than 10 years of reforms (since 1991). What are the future prospects of these banks and do the bank auditors & supervisors need a wake up call?

According to Robert DeYoung (2001), Bank supervisors pay closer attention to new banks than to similarly situated established banks. Federal reserve supervisors conduct full scope examination for safety and soundness at a newly chartered bank at six-month intervals.

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Kapil, Kapil & Nagar

(established banks are examined every 12-18 months) and will continue to schedule exams at this frequency until the bank receives a strong composite CAMEL rating i.e. rating of 1 or 2 in two consecutive exams. Berger, Davies, And Flannery (2000) and Deyoung, Flannery, Lang, & Sorescu (1998) find strong evidence that a large portion of information contained in CAMEL ratings remains confidential. Hence predictable component of CAMEL should be incorporated in the GDP forecasts.

METHODOLOGY

All 27 public sector commercial banks including state bank of India and its associates, and 14 nationalized banks operating in India are taken for the study. The data taken is for the year 2001 because it is felt that the first and the second phase of economic reforms including the banking reforms have had their impact on the functioning of these banks and from here will be decided the future prospects of the same.

Composite ratings are based on a careful evaluation of an institution's operational, financial, and compliance performance. For the current study the composite rating model selected is the CAMEL model. CAMEL evaluates five key components (capital, asset, management, earnings, and liquidity), to judge the institutions' financial condition and operations. However as the study being confined to PSBs the management component has been omitted altogether and hence only four of the camel components are considered i.e. capital, asset, liquidity and earnings.

The composite CAMEL score given to banks are based on the four categories, discussed above, in the preceding para, that are analyzed separately. Each bank is rated from 1, the highest to 5 the lowest, on each of the component categories and given an average composite score. 1 indicates the highest rating, strongest performance and risk management practices, and least degree of supervisory concern. While a 5 indicates the lowest rating, weakest performance, inadequate risks management practices and, therefore the highest degree of supervisory concern.

COMPONENT RATING

A. First component: capital adequacy: For measuring capital adequacy, capital adequacy ratio has been taken. High capital adequacy ratio signifies the ability of the management to address emerging needs for additional capital i.e. enough capital to provide cushion to absorb losses.

B. Second component: asset quality: For measuring asset quality net non-performing assets have been taken. High NPAs implies that the bank is not maximizing its asset potential. Rating of asset quality (NPAs)

C. Third component: Earnings: In the study the earnings have been measured by return on assets (ROA). High earnings signify high growth prospects and low risk exposure and smooth operations.
D. **Fourth component: Liquidity:** Liquidity implies the cash position of the bank. In the study the liquidity is measured by cash-deposit ratio.

**ANALYSIS**

**Rating 1:** No Indian public sector commercial bank can be rated to be under this group. Looking at the component ratings one can easily understand the reason for this. Any bank falling in this group would be considered sound in every respect and any weaknesses are minor and can be handled in a routine manner by the board of directors and the management. These banks are capable of withstanding the vagaries of business conditions and are resistant to the outside influence such as economic instability in their trade area.

**Rating 2:** State bank of Bikaner & Jaipur, State Bank of Patiala, Andhra bank, and syndicate bank fall in this group. They are fundamentally sound. These banks did not have any component rating more than 3. Only moderate weaknesses are present and are well within the board of directors' and management's capabilities and willingness to correct. These banks are stable and are capable of withstanding business fluctuations and are also in compliance with laws and regulations.

**Rating 3:** State Bank of Hyderabad, State Bank of Indore, State Bank of Mysore, State Bank of Saurashtra, State Bank of Travancore, Bank of Maharashtra, Corporation Bank, Oriental Bank of Commerce fall in this group exhibit some degree of supervisory concern in one or more of the component areas. They exhibit a combination of weaknesses that may range from moderate to severe. However the magnitude of deficiencies generally do not include any component rating above 4 except for in a few where only one such component may have a rating of above 4 like State Bank of Hyderabad, State Bank of Travancore & Corporation Bank have cash-deposit ratio rated 5. These banks have less capabilities of withstanding business fluctuations and are vulnerable to outside influences. The risk management practices may be less satisfactory compared to its size, complexity and risk profile. These banks are unlikely to become failure in future but are easy targets of acquisition and takeover under the given government regulations. Under the present consideration of the government of India to privatize the nationalized banks, these bank should fall in the priority list.

**Rating 4:** Allahabad bank, State Bank Of India, Bank Of Baroda, Bank Of India, Canara Bank, Central Bank Of India, Indian Overseas Bank, Punjab & Sind Bank, Punjab National Bank, Uco Bank, United Bank Of India, Union Bank Of India, And Vijaya Bank fall in this group. These banks are not at all capable of withstanding severe business fluctuations. Risk management practices may be zero in such banks. Close supervision and control and support are required by such banks from the government. These banks also pose a risk to the deposit funds and its investments are non-profitable. Failure in future is a distinct possibility if the weaknesses and problems are not resolved satisfactorily.

**Rating 5:** Dena Bank, Indian Bank fall in this group exhibit highly unsafe and unsound practices or conditions. They show critically deficient performance. And may have inadequate risk management practices. These banks need immediate outside financial or government
assistance to become viable. The supervisory attention provided to such banks should be ongoing. These banks pose a serious risk to the deposits and failure in future is highly probable.

DISCUSSION

Indian banks with their massive branching and deposit base are far below standardized financial performance and health. The study analyzed 27 Indian banks including the state bank and its associates and the 14 nationalized banks as shown in Appendix I. According to average composite score as shown in Appendix I, only 14.87% i.e. four banks could obtain a rating of 2, no bank falls under the rating 1 i.e. the best and most sound bank criteria. A few of banks (8 banks out of 27 banks i.e. 30%) fall in the average group of rating 3 in an environment where the future is still uncertain due to changing government policies and scope for further deregulation and privatization in near future. 15 banks out of 27 banks (56%) fall in the category of worst banks rated 4 & 5. Thus, majority of Indian nationalized commercial banks need good managerial support and government supervision to enhance their future prospects.

REFERENCES


Gilbert R A., Meyers, A. P. & Vaughan M. D. (1999); Role Of Supervisory Screens And Econometric Models In Off-Site Surveillance; Federal Reserve Bank Of St. Louis Review, 812, p 31-56.


### Indian Journal of Accounting

**Appendix I**

**Indian Public Sector Commercial Banks: CAMEL analysis**

(Figures in %age as on march 31st 2001)

<table>
<thead>
<tr>
<th>Bank</th>
<th>Capital adequacy</th>
<th>Capital CAR</th>
<th>Rating1</th>
<th>Net NPA (amt. Rs. in crores)</th>
<th>ROA</th>
<th>Earning Rating2</th>
<th>Liquidity</th>
<th>Rating4</th>
<th>Composite score (average)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI &amp; its associates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. SBI</td>
<td>12.79</td>
<td>3</td>
<td>6856</td>
<td>5</td>
<td>.5</td>
<td>3</td>
<td>7.62</td>
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<td>4</td>
</tr>
<tr>
<td>2. SBBJ</td>
<td>12.39</td>
<td>3</td>
<td>410</td>
<td>2</td>
<td>.8</td>
<td>2</td>
<td>12.99</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>3. SBH</td>
<td>12.28</td>
<td>3</td>
<td>555</td>
<td>2</td>
<td>.82</td>
<td>2</td>
<td>7.31</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>4. SB Ind.</td>
<td>12.73</td>
<td>3</td>
<td>202</td>
<td>1</td>
<td>.89</td>
<td>2</td>
<td>7.54</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>5. SBM</td>
<td>11.16</td>
<td>3</td>
<td>332</td>
<td>2</td>
<td>.27</td>
<td>4</td>
<td>8.77</td>
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<tr>
<td>6. SBP</td>
<td>12.37</td>
<td>3</td>
<td>336</td>
<td>2</td>
<td>1.12</td>
<td>1</td>
<td>9.41</td>
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<td>2</td>
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<tr>
<td>7. SBS</td>
<td>13.89</td>
<td>3</td>
<td>262</td>
<td>1</td>
<td>.18</td>
<td>4</td>
<td>9.56</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>8. SBT</td>
<td>11.79</td>
<td>3</td>
<td>496</td>
<td>2</td>
<td>.67</td>
<td>2</td>
<td>6.09</td>
<td>5</td>
<td>3</td>
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</table>

**Nationalized banks**

<table>
<thead>
<tr>
<th>Bank</th>
<th>Capital adequacy</th>
<th>Capital CAR</th>
<th>Rating1</th>
<th>Net NPA (amt. Rs. in crores)</th>
<th>ROA</th>
<th>Earning Rating2</th>
<th>Liquidity</th>
<th>Rating4</th>
<th>Composite score (average)</th>
</tr>
</thead>
<tbody>
<tr>
<td>9. AB</td>
<td>10.5</td>
<td>3</td>
<td>1074</td>
<td>5</td>
<td>.18</td>
<td>4</td>
<td>10.52</td>
<td>2</td>
<td>4</td>
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<tr>
<td>10. And. B</td>
<td>23.11</td>
<td>1</td>
<td>219</td>
<td>1</td>
<td>.59</td>
<td>3</td>
<td>8.91</td>
<td>3</td>
<td>2</td>
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<tr>
<td>11. BOB</td>
<td>12.8</td>
<td>3</td>
<td>1851</td>
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<td>.45</td>
<td>3</td>
<td>8.09</td>
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<td>4</td>
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<td>12. BOI</td>
<td>12.23</td>
<td>3</td>
<td>2138</td>
<td>5</td>
<td>.44</td>
<td>3</td>
<td>7.42</td>
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<td>4</td>
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<td>13. BOM</td>
<td>10.64</td>
<td>3</td>
<td>498</td>
<td>2</td>
<td>.24</td>
<td>4</td>
<td>10.86</td>
<td>2</td>
<td>3</td>
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<td>14. CB</td>
<td>9.84</td>
<td>4</td>
<td>1346</td>
<td>5</td>
<td>.43</td>
<td>3</td>
<td>6.58</td>
<td>5</td>
<td>4</td>
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<tr>
<td>15. CBI</td>
<td>10</td>
<td>4</td>
<td>1820</td>
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<td>.10</td>
<td>4</td>
<td>9.91</td>
<td>3</td>
<td>4</td>
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<td>16. Crpt.B</td>
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<td>3</td>
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<td>0</td>
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<td>5</td>
<td>6.58</td>
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<td>19. IOB</td>
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<td>4</td>
<td>918</td>
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<td>3</td>
<td>8.54</td>
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<tr>
<td>20. OBC</td>
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<td>397</td>
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<td>2</td>
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<td>3</td>
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<tr>
<td>21. PSB</td>
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<td>.10</td>
<td>4</td>
<td>8.11</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>22. PNB</td>
<td>10.24</td>
<td>4</td>
<td>1871</td>
<td>5</td>
<td>.73</td>
<td>2</td>
<td>9.56</td>
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<td>4</td>
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<td>23. SB</td>
<td>11.72</td>
<td>3</td>
<td>-</td>
<td>-</td>
<td>.91</td>
<td>2</td>
<td>7.8</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>24. UCO B</td>
<td>9.05</td>
<td>4</td>
<td>656</td>
<td>3</td>
<td>.14</td>
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<td>9.49</td>
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<td>4</td>
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<td>25. UBI</td>
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<td>3</td>
<td>1201</td>
<td>5</td>
<td>.40</td>
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<td>7.86</td>
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<td>.10</td>
<td>4</td>
<td>8.1</td>
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<td>4</td>
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<td>27. VB</td>
<td>11.5</td>
<td>3</td>
<td>356</td>
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<td>.53</td>
<td>3</td>
<td>6.74</td>
<td>5</td>
<td>4</td>
</tr>
</tbody>
</table>

**Source:** compiled from the annual accounts of banks for the year 2001.

**Note:** Rating scale for table I:

1 = [0-5 is 5, 6-10 is 4, 11-15 is 3, 16 to 20 is 2, 21-25 is 1]
2 = [100-350 is 1, 351-600 is 2, 601-850 is 3, 851-1000 is 4, and 1001 and above is 5]
3 = [0 is 5, .1-.3 is 4, .4-.6 is 3, .7-.9 is 2, and 1 and above is 1]
4 = [6.0-7.0 is 5, 7.4-8.4 is 4, 9.0-10.0 is 3, 10.4-.11.5 is 2, 12.0 and above is 1]
NEW FRAMEWORK OR CAPITAL ADEQUACY: BASLE II

*G. Vasanthi

ABSTRACT

The Basle committee report on the convergence of capital & capital standards (1988) was reviewed and amended in 1996. The new capital adequacy frame work issue by Basle committee in June 1999 is a subsequent - effort to strengthen capital adequacy in Banks. An attempt has been made in this paper to analyse capital Risk assigned to various assets, description of Basle II, committee and position of capital adequacy in public sector Banks.

The Basle Committee report on the Convergence of Capital and Capital Standards, 1988, passed a directive that a Capital Adequacy Ratio (CAR) of 8% was necessary for banks operating internationally. Subsequently, the Narasimham Committee recommendation that all Indian banks should achieve a capital adequacy of 8% by March 1996 was implemented with successful results by the Reserve Bank of India (RBI). The capital Accord of Basle Committee was reviewed and amended in 1996. The Narasimham Committee on Banking Sector Reforms proposed an increase in the CAR of banks. Consequently, a CAR target of 9% by March 2000, was fixed. The RBI has proposed to increase CAR to 10% by March 2002. The New Capital Adequacy Framework issue by Basle Committee in June, 1999 is yet another step towards the strengthening of capital adequacy in banks.

CAPITAL TO RISK ASSETS RATIO

Capital adequacy is indicated by a minimum numerical ratio which the banks are expected to maintain to ensure stability and strength. International prudential norms stipulate the use of Capital to Risk Assets Ratio (CRAR) as a measure of capital adequacy. CRAR is the ratio of capital funds to risk weighted assets (both on and off balance sheet) expressed as a percentage.

\[
CRAR = \frac{\text{Capital Funds}}{\text{Risk Weighted Assets}} \times 100
\]

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All assets in the balance sheet, including off balance sheet items are given an artificial weight and their total is compared to the net worth of the bank.

RISK WEIGHTED ASSETS

Funded Risk Assets, i.e., on balance sheet items and Non-Funded Risk Assets, i.e., off-balance sheet items are ranked from less risky to more risky categories. BIS has prescribed five categories of risk weights viz., 0, 10, 20, 50, 100. The higher the risk, greater the weightage. Funded Risk Assets are those appearing in the balance sheet excluding equity investments in subsidiaries and intangible assets and losses. Non-funded assets are contingent liabilities viz., guarantees, letters of credit, forward exchange contract, etc.

Risk Weights of Various Assets

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Assets</th>
<th>Risk weight (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cash in hand</td>
<td>0</td>
</tr>
<tr>
<td>2</td>
<td>Balance with RBI</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>All claims on Banks</td>
<td>20</td>
</tr>
<tr>
<td>4</td>
<td>Investments</td>
<td></td>
</tr>
<tr>
<td></td>
<td>a. Investments in Govt. &amp; Govt. Guaranteed Securities*</td>
<td>2.5</td>
</tr>
<tr>
<td></td>
<td>b. Investments in Bonds/Debentures of Public Financial Institutions</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>c. All other Investments</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>Advances</td>
<td></td>
</tr>
<tr>
<td></td>
<td>a. Advances Guaranteed by Govt.**</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>b. Advances to Staff</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>c. Advances against Deposits</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>d. Advances against life policies, IVP, KVP</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>e. Advances to Banks / Guaranteed by Banks</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>f. Advances Guaranteed by DICGC / ECGC</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>g. All other Advances</td>
<td>100</td>
</tr>
<tr>
<td>6.</td>
<td>Fixed Assets (Premises, Furniture &amp; Fixtures)</td>
<td>100</td>
</tr>
<tr>
<td>7.</td>
<td>Other Assets</td>
<td></td>
</tr>
<tr>
<td></td>
<td>a. Tax Deducted at Source</td>
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</tr>
<tr>
<td></td>
<td>b. Interest Accrued on Govt. Securities</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>c. Claims on RBI</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>d. All other Assets</td>
<td>100</td>
</tr>
</tbody>
</table>

* RBI issued a directive in April, 2000 to assign a risk weight of 100% only on those State Govt. Guaranteed Securities issued by defaulting entities and not on all the securities issued or guaranteed by that State Govt.

** 20% risk weight for State Govt. Guaranteed Advances in default as on 31 March 2000. 100% risk weight for continued default after 31 March 2000.

Compiled from Report on Trend and Progress of Banking in India and RBI Reports.
Vasanthi

NEW FRAMEWORK

Basle I Committee had recommended CAR framework for credit risk only during 1988, which RBI had implemented during 1992. Subsequently the market risk for investment in securities, including govt. Securities, was implemented in India w.e.f. March 31, 2000. Meanwhile Basle II, in June 1999, suggested capital adequacy not only for credit and market risk but for operational risk also. The new framework will come into effect by 2005 and replace the earlier framework of 1988. In terms of the new framework, the capital fund will comprise Tier I (shareholders' equity and retained profits), Tier II (supplementary capital) and Tier III capital (subordinated debt with a minimum maturity of 2 years). Risk on the other hand, would comprise Credit Risk + Market Risk + Operational Risk. Operational Risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. So far, the measurement of operational risk has not been quantified but the committee has suggested a 20% risk weight for the operational risk. To monitor the operational risk, the information technology and MIS systems are expected to play very important role. The risk management is expected to lead to lower capital requirement but to implement risk management, banks will have to invest heavily in technology.

CRAR OF INDIAN BANKS

<table>
<thead>
<tr>
<th>Bank</th>
<th>March 99</th>
<th>March 2k</th>
<th>March 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI</td>
<td>12.51</td>
<td>11.49</td>
<td>12.79</td>
</tr>
<tr>
<td>SB Biknr / Jpur</td>
<td>12.26</td>
<td>12.35</td>
<td>12.39</td>
</tr>
<tr>
<td>SB Hyderabad</td>
<td>10.65</td>
<td>10.86</td>
<td>12.28</td>
</tr>
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Indian Journal of Accounting

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Source: Published reports - Collection courtesy: Banking events update

CRAR of 9% by March 2000, was the norm set by RBI. All Public Sector Banks (PSBs) except one attained 9% CRAR. 21 out of 24 Old Private Sector Banks, all 8 New Private Sector Banks and all 42 Foreign Banks in India achieved the norm.

The RBI hoped that all banks achieve 10% CRAR by March 2002. But 22 PSBs, 19 Old Private Sector Banks, 7 New Private Sector Banks and 37 Foreign Banks had CRAR excess of 10% by March 2000 itself.

CONCLUSION

All the banks except one have achieved capital adequacy. Banks in India are becoming competitive and sound in their financial health. But the CRAR has a few limitations, besides the weightage of assets. The risk weightage of government guaranteed assets are minimal. This necessitates constant review of CRAR as a measure of banking health. In order to ensure greater capital adequacy and strength of banks the RBI has come out with Prompt Corrective Action (PCA) framework which complies with the Core Principles of BIS. PCA is based on three parameters viz., CRAR, Net Non performing Assets (NPA) and Return on Assets (RoA). Each parameter has trigger points with discretionary and mandatory, preventive and corrective actions under each trigger point.
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THE BSC APPLICATIONS: WHAT TO VALUE?

*Lalit Gupta
**Vidhi Bhargava

ABSTRACT

The aim of BSC applications demands special consideration in the design, implementation and review for its success. Besides its general aspects under debate, this peculiar aspect of the technique comprises the main subject matter of this paper. For this aim the authors choose to highlight the features of the technique through an overview scrutiny of corporate experiences world over instead of usual theoretical elaborations. All possible efforts have been made to draw a variety of entities so as to have a balanced view of the balanced score card applications. In the course of review an attempt has been made to capture the organization specific peculiarities like the number of perspectives may be more than four as understood usually, leading to the end remarks on the factors responsible for the success/failure of the technique. The paper, thus takes into consideration the Indian experiences despite the fact that the concept is still new to the Indian corporate and summarizes the challenges before them.

Without a performance measurement system that reflects a balanced view of the organization's objectives, managers are performing as if they were driving a car by looking in the rear view mirror, or flying an airplane by watching the altimeter alone. Responding to these challenges, Kaplan and Norton expressed that financial reporting standards were insufficient to meet the needs of companies competing in an era where information and knowledge have become as critical as physical assets. Their solution, the Balanced Score card, seeks to redress the balance by focusing more on the need for a strategic approach and capture the actions which are most likely to shape the results in future.

The first balanced score card was created in 1987 at Analog Devices, a mid-sized semiconductor company. After the introduction of the present form of the BSC in 1992 by Kaplan and Norton, BSC has since been further developed as a strategic Management System (1996, Kaplan and Norton) now. Accordingly it lets managers introduce new management

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processes that, separately and in combination contribute to linking long term strategic objectives with short term actions. The processes involved are:-

Translating the Vision → Communicating the Strategy up and down the organization → Linking it to Departmental and individual objectives → Business Planning → Feedback and Learning i.e., modifying strategies to reflect real time learning.

In this latter version learning and innovation is replaced by learning and growth. Thus BSC is not just a measurement system, to clarify and communicate strategy, but also a tool to manage it. A review of the variety of BSC plans discussed here would give a feel for the fact that the four perspectives as pronounced provide just a template and not a strait jacket. Hence their presentation here is believed to help both the academics and practicing managers at this phase of 'the concept picking up its ground'. Companies should include perspectives on the score card as needed by their unique circumstances. The BS C should include measurements that are vital to the success of the unit's strategy and should be fully integrated into the chain of cause-and-effect relationships that describe the trajectory of the strategy. The Score cards are "balanced" in two main ways. Firstly, there is a balance between internal and external measures. Secondly, it is balanced by the various perspectives, which include financial and non-financial measures.

APPLYING THE BALANCED SCORE CARD TO AN NGO

The Swasthya Case uses the Balanced Score card in strategy formulation and implementation. Swasthya, an NGO operating in Delhi, India, began as a project in 1994. Its programmes are comprehensive community-based reproductive health model coupled with socio-economic development. The balanced score card was used firstly to measure the performance of Swasthya and eventually map out a strategy implementation schema to improve organizational performance.

GOODLASS NEROLAC PAINTS

Goodlass Nerolac Paints the market leader in industrial paints and India’s second largest paints company recently adopted the Balanced Score card for deploying it's business strategy and managing enterprise performance. Cedar assisted Goodlass Nerolac in building the Balanced Score card framework. The project was focused around creating a strategy road map across the industrial and decorative paints businesses. The project has special importance to Goodlass Nerolac in its endeavor to grow its business profitably over the next few years.

The Score card framework addresses the decorative and industrial paints businesses of Goodlass Nerolac. People across management levels and locations across the country participated in creating the Score card for the organization that involved business assessment, one-on-one meetings and workshops facilitated and managed by a consulting team from Cedar.

H M Bharuka, Managing Director, Goodlass Nerolac said, "As we accelerate our business growth, we need a performance management system which aligns the entire
organization and allows us to measure the delivery of our strategy. The Balanced Score card, deployed by Cedar will help us in reviewing our performance against targets appropriately. We have adopted the Balanced Score card to operationalise our long term strategy and to also allow us to measure our business performance clearly and give us a way to review business regularly.

The Score card will allow Goodlass Nerolac to define financial, customer, process and organizational priorities and align resources appropriately in the delivery of its strategy. It will enable Goodlass Nerolac to define market & customer segment priorities, short term & long term revenue drivers, cost management issues, key processes to be monitored and the alignment of enterprise performance with individual performance. Overall, the Score card framework will create a strategy deployment system which will monitor month-on-month achievement against defined strategic objectives.

**BSC IN EVERGREEN SOFTWARE**

A software start-up Evergreen Software adopted the Balanced Score card to track its non-financial performance, it implemented this innovative concept on its own in 1996. At that time the company was experiencing 6 per cent employee-turnover rate, and 80 per cent customer-retenion ratio, resulting in a modest rating of B+, which meant good, not excellent. But within a period of two years the company was forced to realize that there was a fundamental flaw in the technique. One of the senior executives, Sanjay Salwan remarked that what gets measured is, often, what is easier to measure—not what should actually be measured. The company officials believed what the Score card has actually done is contributed to the information-overload. They noted that they were generating far too much data, that they never needed and so the BSC had to be expelled.

Challenges in implementing the Balanced Score card in our region

- In our country generally there is lack of Business Planning Process where 9 of 10 companies can hardly implement any strategy. Their Business Planning Processes are underdeveloped. The planning procedures take a long time, and above all nobody owns them. Also further the Strategic Planning guys are not as equipped as their counterparts abroad in terms of knowledge, technique and experience.

- **Confusion between BSC/ TQM/ EVA**

In India the basic concept of the various management tools and processes are not very clear and it is always difficult to get expert and knowledgeable advise on the concept as was the experience of Evergreen Software that faced serious problems in implementing the BSC with the help of its CEO and Senior managers alone.

- **Do you have a strategy?**

Most Asian companies don't have a complete strategy. They do have a financial and customer strategy, but little beyond that 'lots of initiatives with no timelines & ownership'.

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Scared to be measured
Measurement in our part of world, often scares, doesn't motivate! Annual performance review is in any case not linked to quantifiable performance, so why bother? Score card will clearly define ownership at enterprise level.

Who owns the process?
Everything has to be approved by the CEO! Our corporate doesn't recognize the challenge in implementing the strategy. So, CEOs need to empower others and delegate more.

High percentage of family owned businesses
80% of corporations worldwide are family owned. Transition from Family Owned/Family Managed to Family owned/Professionally Managed is a challenge. Also the family members do not out of operations not realizing that Score card will allow the family to better articulate their/shareholder expectations. Score card will allow the family to get a comprehensive view of organizational performance without having to deal with it everyday.

Unwilling to spend
Advertising spend effectiveness is not quantifiable but that's OK! We want to be strategy focused organizations. Initiative expenditure is OK, but strategy deployment is not?

Selection of the wrong Score card coordinator and lack of resources
The coordinator Must be credible, senior, must have a comprehensive view of the organization, with Strong Analytics and he should be assigned a team.

Underdeveloped MIS systems/Data availability/Organisation charts
In India another challenge is lack of historical performance data, updated Org. Charts are missing, people are unwilling to do the hard work to get the data. Above all our managers are of the concept that 'Don't worry about 99.9% accuracy'

Unwilling to speak up! And intelligently
The general belief is that sharing views openly in a meeting is risky. We easily say "it won't work". We are worried more about the exception rather than the rule!

Too many measures!
People here look for the perfect measure but it doesn't exist. Too many measures, sometimes counting to more than 30 measures are chosen. Often it is too much. We can't get to agree on a sub sub-set of 20-25, confused on frequency, and unit of measurement.

Its raining projects!
Too many projects, Ownership & value is suspect and value to business is even more suspect. Moreover, no inventory of projects exists.
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- Lack of sustained CEO commitment
  What's important for the boss is important for me! He's moved on to a new toy, says
the wrong things, he doesn't act on lack of performance. He tampers with the Score
card to hide problems. The need is to formally mandate the Score card co-ordinator
collection of data on a monthly basis becomes difficult. The need is to automate the
Score card. Hence Annual budget submission must be accompanied by Score card.

- In India the monthly reviews are not conducted on time, the meetings are not focused.
  Monthly and focused meetings should be conducted, even if some members are
  missing. The score card design should not be tampered with every now and then.

- Own & Communicate!
  Owners must own, take responsibility of both objective and project that is important to
  them. Don't expect the Score card co-coordinator to do your job.
  Build a communication plan for the Score card.

- Stick with it
  For a successful implementation of the Balanced Score card, don't treat it as another
  project. Only then will it help you implement your strategy knowledgeably, measurably
  and rapidly.

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SOCIAL AUDITING PRACTICES IN INDIAN CORPORATE SECTOR

*G.L. Dave

ABSTRACT

Social Audit is a new concept developed recently in accounting area. An Analytical Study 100 Indian public & private sector companies are done to show whether they are conducting social audit or not. Finally, problems coming in way of conducting Social Audit are discussed and lastly a number of suggestions are given to conduct Social Audit in a systematic manner in Indian Corporate Sector.

In India one of India’s leading private industrial conglomerates TATA, initiated a social audit of their Iron & Steel Division (Tata 1979). The terms of reference were "To examine and report whether, and the extent to which the company has fulfilled the objective contained in Clause 3A of its articles of association regarding the consumers, employee, shareholders, society and local community". External auditors were appointed. The social audit committee consist of three persons viz Mr. Justice S.P. Kotval (Chairman of the Committee), Professor Rajni Kothari and Professor R.G. Mavalanker. The Committee gave its report in 1980, which covers eleven chapters in aggregate encompassing (i) Introduction & perspective (ii) The city (iii) The works & mines (iv) pollution (v) Employer employee relations (vi) Consumers (vii) Shareholders (viii) Community development & Social Welfare Programmes (ix) Rural Development Programme (x) Obligation to Society (xi) conclusions.

Again in 1990 The Tata Iron & Steel Company initiated Social Audit in this company. A three member Social Audit Committee was formed under the chairmanship of Justice D.N. Mehta (Retd.) and Professor P.G. Mavalanker and Professor Sachitananda as committee members. They gave their report in 1991 consist of 13 chapters. The chapter one deals with the search for the Right men and Right Place, Chapter second deals with Early awakening of the social conscience, chapter third was on 'Teething Problems', chapter fourth highlights on "Evaluation of Labour-Management relations, chapter fifth is on Town Division. The Chapter sixth is on pollution, the chapter seventh highlights on "crisis at the Doorstep. The chapter ninth summarises The Tata Steel Rural Development Society. The chapter tenth describes "The Ethos Today". The Chapter eleventh is on obligation to consumers. The Chapter twelfth deals on 'obligations to shareholders and last chapter is on summary of suggestions.

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In addition to Tata, Unit Trust of India has also conducted Social Audit on the completion of 30 years of successful operations and existence, U.T.I. appointed a Social Audit Committee to look into the working of U.T.I. The prime Objective of the Social Audit reviews is to consider how well the U.T.I. has been able to perform its task and achieve the objective with which it was set up under the U.T.I. Act 1963. The Social Audit committee was formed in 1993 as Shri Madhukar H. Kania as (Chairman) and Shri M.R. Pai, Shri Swaminathan A Ayer, Professor S.K. Chakraborty, Shri Madhu Patwardhan as members. The Committee submitted its report titled "Report of the Social Audit Committee on 26th October 1994". This report covers nine chapters. Chapter one covers an overall assessment of thirty years of U.T.I., Second chapter deals with range and utility of various U.T.I. schemes, their benefit to investors and U.T.I.'s overall performance vis-a-vis other financial Institutions. The Chapter third is on Investor Service, Chapter fourth is on U.T.I. agents & other Chief Representatives, Chapter fifth is on U.T.I. Stock Exchange & Brokers, chapter sixth is on U.T.I. and Corporate Sector & Chapter seventh is on U.T.I. and Employees, Chapter eighth is on U.T.I. sponsored Institution and diversification and chapter ninth is U.T.I. & Social objectives.

We have also analysed the annual report of 100 public & private companies to know how many companies are conducting Social Audit. We found that only one company in private sector that is Tata Iron & Steel Company has conducted Social Audit in 1980 and 1991 and in public sector only Unit Trust of India has conducted social audit in 1994. Analysis of the survey reveals that some companies are maintaining Social Accounts and report them as supplementary statements in their annual reports. But conducting Social audit in the manner done by Tata & U.T.I. is not done by any company in the country whether it is in public sector or in the private sector. (Annexure-1).

It is easy to say that Social Audit must be done by the corporate sector, but when we actually start the Social Audit we come across so many difficulties, following are the difficulties in conducting Social Audit.

2. There is a absence of well conceived information system.
3. Incapability of developing approval on the methods of organizing informations.
4. There is no compulsion of social audit by the Companies Act, 1956.
5. There is a non-availability measurement techniques.
6. No clear concept regarding Social Audit.
7. There is absence of professional social auditor.
8. Lack of training Schools, for social auditing
9. Indian Corporate Sector is unknown about the possible profits by having Social Audit.
10. There is no public pressure for initiating social audit.
11. There is no laid down procedure for conducting Social Audit.
12. Corporate Sector is afraid that if social audit is done it will unnecessarily increase the cost.
Dave

13. Government is not aware about having social audit in Indian Corporate Sector.
14. There is no professional body to regulate and monitor Social Audit for Corporate Sector.
15. There are no standards set for Social Audit.

The following are the Suggestions

1. The first work in this direction is to establish Training Institutes so that they can develop Social Audit through training.
2. It is necessary to develop a proper format and procedure for doing social audit.
3. As we have discussed that people confuse social accounting with social audit. So there is a need to develop a clear concept of social audit distinguished it from financial audit.
4. There must be a provision in the companies Act 1956 for the compulsion of Social Audit after every ten years.
5. There must be regular reporting for Social Accounting in a particular year.
6. Social Audit is not popular in India, programmes and seminars relating to social audit should be organized from time to time by the corporate sector as well as from the universities. In these Seminars the directors, stakeholders and government representatives should be invited. They should be informed about the Social audit progress in foreign countries and their benefits to Indian Corporate Sector and its process, techniques, issues and methodology should be disclosed.
7. It is necessary to develop the techniques of identifying social performance of the company. It is necessary to determine standards on the basis of which the auditor may take necessary decisions.
8. A well-conceived information system has required at the time of Social Audit of a company to enable the auditor in collecting and evaluating the social activities of a company.
9. The Government should help the companies by inviting foreign experts for social audit.
10. Those companies, who will start Social Audit in their companies, should be suitably rewarded by the Government.

Taking into account all these suggestions, we should start Social Audit in corporate Sector. It is suggested that Government should amend the Indian Companies Act 1956 and should make social Audit mandatory for all those companies whether it is public or private sector whose paid up capital is more than hundred crores. It should be done after every ten years and comprehensive Social Audit Report must be published. If this is done, companies will be more accountable to the society at large.
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#### Table 1
Analytical Chart of Private and Public Sector Companies Showing Different Aspects of Social and Environment Audit

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<td>Minerals and Metals Trading Corp. Ltd.</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Indian Oil Corp. Ltd.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Jindal Iron and Steel Co. Ltd.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Century Textiles and Industries</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Indian Aluminum Co. Ltd.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Indian Dye Stuff</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Motor Industries Co. Ltd.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Special Steel Ltd.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Hindustan Level Ltd.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Hindustan Photofilms Ltd.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Hindustan Antibiotics Ltd.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Bharat Aluminum Ltd.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Escorts Ltd.</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>
REFERENCE


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WINDOW DRESSING OF CORPORATE FINANCIAL STATEMENTS - SOME ISSUES

*Ch. Venkata Rao

ABSTRACT

This storehouse of information is in the form of Profit & loss Account and Balance sheet (B/S) of the company. These periodic financial statements report the efficiency with which the funds entrusted to the management have been deployed and the financial state of the company at a point of time. These statements attempt to furnish the relevant information for its various users like creditors, bankers, financial institutions, equity share holders, suppliers, consumers, government etc. for their decision making. These decisions by various users of financial statements are as accurate as the financial statements themselves. Therefore, they ought to exhibit the true and fair view of the state of affairs of the enterprise concerned. For the period 1992-2000, an attempt has been made to study the impact of window dressing in disclosures.

Accounting mismanagement has become so rampant in today's world that even the best of the Companies are increasingly resorting to it to boost their earnings. Let us have a look at the accounting games played by three leading companies in the world, Companies that were house hold names across the globe and were considered the best in their specific domains - Enron, Worldcom and Xerox Corporations. The paper identifies a few specific areas where disclosures have created window dressing.

A suspicion has been growing, of late, regarding the propriety and, therefore the usefulness of these corporate reports. The preparers of these statements only maintain that they purport to certify nothing more than that the figures are derived on a consistent basis and are in accordance with generally accepted accounting principles. Auditors do not certify anything more than the fact accounting policy so long as it gives a true and fair view of the profitability and financial state of affairs and is followed on a consistent basis. Taxation authorities also accept these statements as accurate so long as they comply with the provisions of the Income tax Act. Therefore, they reflect a combination of recorded facts, accounting Conventions and policies and personal judgments of the preparers. Some of the most commonly used accounting policies, if charged, can influence the profit as well as the assets position of the concern. Following are some of the important areas of disclosure practices:

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Rao

(A) DEPRECIATION POLICIES

For all practical purposes, depreciation has been used as an arbitrary device to spread the cost of an asset as per the shims and needs of management. The amount of depreciation can be, easily changed without any legal or tax problems being invited to suit the needs of the management. Higher depreciation than what is permissible by income tax authorities may be charged during the profitable years. This excess may be written back during the lean years, to inflate the amount of profits. This is observed from the table given below:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Name of the Company</th>
<th>Year</th>
<th>Depreciation Policy</th>
<th>Effect on Profit/Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>01.</td>
<td>Stiles India Ltd.</td>
<td>1996</td>
<td>Change of straight line method to WDV method</td>
<td>Reduction in loss by 20%</td>
</tr>
<tr>
<td>02.</td>
<td>N.F.C.L.</td>
<td>1996</td>
<td>Deviation in Depreciation policy</td>
<td>Suppression of profit by Rs. 1,348.98 lakhs</td>
</tr>
<tr>
<td>03.</td>
<td>Sanghi Polyester Ltd.</td>
<td>1997</td>
<td>Non Provision of Depreciation</td>
<td>Suppression of Loss by Rs. 2.836.88 lakhs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1998</td>
<td>Change of Depreciation Rates</td>
<td>Inflating the Profits by Rs. 226.80 lakhs</td>
</tr>
<tr>
<td>04.</td>
<td>VST Ltd.,</td>
<td>1997</td>
<td>Change of depreciation from straight line to WDV method</td>
<td>Increase in Profits by Rs. 193.36 Crores</td>
</tr>
<tr>
<td>05.</td>
<td>RIL</td>
<td>1998</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1999</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(B) CAPITALIZATION OF LEASE EXPENDITURE

Lease can be of two types, finance lease and operating lease. The managements have the leeway to show it in either of the two ways. Moreover, no mandatory guidelines exists in this connection. Consequently, reporting practices for lease expenses vary depending upon the requirements of the management. Some companies prefer to disclose at all the leased assets in the balance sheet except in the footnotes. This practice was followed by Godavari fertilizers Ltd., Amar Raja Batteries, Vishnu Cement Ltd., thereby they had shown higher profits during 1996-2000 in their balance sheets.

(C) AMORTIZATION OF PRELIMINARY AND OTHER EXPENSES

A change in the policy of Amortization of preliminary and other expenses may easily mislead the users of financial statement regarding the real profitability position of the company adopting such a change as there is no hard and fast rule as to how much should be capitalized.

(D) INVENTORY VALUATION POLICIES

The method of valuation of inventories has a direct bearing on the amount of profits shown in the P & L Account and the worth of assets in the balance sheet at the end of the period. With the emergence and wide adoption of LIFO method of inventory valuation, the
managements of many companies have, more often than not, used it as a device for the income
smoothening which is said to have a favorable impact on he share prices. Similarly a change in
the method of inventory valuation from LIFO method to FIFO method during the periods of
inflation shall inflate the reported income as well as the value of assets. This practice was
followed by several companies referred in the table I.

(E) RETIREMENT GRATUITY *

Different approaches can be adopted to meet the financial obligations for payment of
retirement gratuity: In India the payment of gratuity is governed by the payment of gratuity
Act. 1972, which prescribes creation of the gratuity provision on accrual basis. However, they
avoid creating provision for gratuity to bolster up the profits figures. To the extent of this non-
provision, the reported profit figure of the company gets inflated and the reported liabilities
squeeze. Priyadarshini Cement Ltd. and VST Ltd., have not provided Gratuity Liability during
1996 and 1997 as a result profits are shown higher.

(F) CONTINGENT LIABILITIES

Since contingent liabilities like excise duty, sales tax, income tax, octroi are shown as
footnotes to the annual accounting reports, they do not gather much of the attention of varied
interested users of financial statement. Because these liabilities have serious implications when
the liability is to be met while setting the dispute. Therefore, investors should be wary of this
liability while assessing the real state of the company. This was adopted by several companies,
which is shown in the Table II.

(G) REVALUATION OF ASSETS

Some of the Companies had revalued the assets enable them to rise in a single stroke of
the pen the value of fixed assets as well as their Net Worth. The basic advantage from such
revaluation is that companies can raise future loans from financial institutions after years of
revaluation against the security of enhanced value of assets. Therefore, the investors / creditors
ought to be careful while assessing the real net worth of the company. This is shown in the
table given below practiced by the Indian Companies.

<table>
<thead>
<tr>
<th>Name of the Company</th>
<th>Year</th>
<th>Amount of revaluation</th>
<th>Effects on assets and net worth</th>
</tr>
</thead>
<tbody>
<tr>
<td>01. SSM Ltd.</td>
<td>1993</td>
<td>Rs. 9.00 Crores</td>
<td>+ 9 Crores</td>
</tr>
<tr>
<td>02. VST Ltd.</td>
<td>1996</td>
<td>Rs. 15.49 lakhs</td>
<td>Rs. 15.49 lakhs</td>
</tr>
<tr>
<td>03. L&amp;T Ltd.,</td>
<td>1999</td>
<td>Rs. 108.05 Crores</td>
<td>+108.05 Crores</td>
</tr>
<tr>
<td>04. RIL</td>
<td>1999</td>
<td>Rs. 2,771.06 Crores</td>
<td>+2,771.06 Crores</td>
</tr>
</tbody>
</table>
Rao

(H) NON-PROVISION OF LIABILITIES

Non-Provision for bad and doubtful debts, taxation liability, diminution in the value of investments are some of the accounting tactics widely adopted by company. This practices of non recognition or non-provision of liability is a simple technique to enhance the net profit figure and to reduce the amount of liabilities shown in the balance sheet. The observations made in respective of non-provision of liabilities by Companies are shown in table No: III

(I) WRITE BACK OF EARLIER EXCESS PROVISION

Write-back from provisions or from reserves, which are sheer work adjustments are often brought credit of profit statements from past depreciation provisions by changing the method of depreciation or from taxation and other provisions. This is one of the various ways in which a loosing concern may attempt to conceal its deteriorating profitability. Some of the other methods to boost up earnings may include defending the expenditure on repairs or advertisement, treating excise duty as a period rather than product cost etc.

U.S. GAAP

India has not experienced the kind of scandals that the rest of the world particularly the U.S. has seen. The U.S. GAAP is considered to be the most revered and feared among all. If the U.S. has seen the multi billion-dollar accounting scandals, then what is the case with India where there are far lesser stringent norms?

Credit rating firm Crisil has very recently analysed the 2000-2001 financial statements of over 639 companies and came with stunning results. Over 35% of the companies had resorted to some kind of accounting manipulations to transform their numbers. Over 139 companies had overstated their profits. Among the rest 87 countries understated them.

Some of the accounting practices observed are given below:

1. Some Companies have adjusted items like the premium paid on the redemption of a debenture or the losses on sales of investments against their reserves when they really have to adjust them against their P & L Account.

2. Other companies have shown the sales tax deferrals offered by various state governments to companies setting up units in backward areas as income, even though such deferrals are notional.

There is an overwhelming consensus among the concerned that reporting standards have become too complex, too difficult, and too costly to implement and also it does not reflect ground economic realities of a company. Experts say the complexity arises because U.S. Financial reporting unlike that of the U.K. and other countries is based on detailed rules rather than broad principles. The U.S. Model deals with more issues and applications than any other set of accounting standards- The U.S. rules contrast with the more subjective rules that apply in countries such as U. K. Companies are required to publish details of subsidiaries over which
they have a significant influence. Such a broad definition would have forced Enron to disclose the off-balance sheet interests as soon as they were set up. However experts say the SEC and its standards setting body Financial Accounting standards board (FASB), should now revisit GAAP. They suggest even to accept International Accounting Standards (IAS) instead.

List of the suggestions and solutions most favoured by experts to address the issues in GAAP were:

1. Standard setters should develop standards that reflect the economics of Business transactions and do not attempt to satisfy all diverse constituents.
2. Regulators should encourage the exercise of Judgment by preparers and auditors rather than the narrow interest focus on adhoc task forces.
3. New standards must meet a robust cost / benefit cost.
4. New standards should be principles-based rather than rule - based "Cook-Books". SEC has made it clear that it is expecting expanded and more consistent disclosures from 2001 annual reports. They are:
   a) Accelerating the reporting of company insider securities trading.
   b) Accelerating the filing of quarterly and annual reports.
   c) Expanding the list of events that require disclosures.

SUGGESTIONS

Though accounting is not a subject directly within the purview of SEBI in the interest of Investors, a special initiative was taken by SEBI in consultation with ICAI. Following these standards, financial statements in India, particularly after the recent changes, are comprehensive. However the issue is one of effective implementation. Thus the role of corporate managements and auditors are of crucial importance. This requires a blend of self-regulations and legal enforcement. Promoters, corporate and their trade bodies may have to seriously introspect and evolve a suitable code of conduct which if not followed, should be penalized. For the auditors already, there is code of conduct, which ICAI for the sake of credibility has to enforce both effectively and in timely manner. On the legal side DCA and ICAI again will have to see that the promoters companies and auditors are complaint, failing which they should be punished. The system of continuous disclosures in the form of quarterly and important event specific statements to stock exchanges will have to be further strengthened.

The following measures re suggested for reducing the practice of deceptive reporting.

1. It is essential that the impact of change in accounting policies on profits be computed before taking any decision.
2. There is an urgent need for some mandatory provisions, which prescribe for a clear portrayal in these accounting reports.
3. Curbs must also be imposed on manipulations of accounting policies in the guise of generally accepted accounting policies.
Rao

4. Until such mandatory provisions are brought about, companies must provide details of the repercussions of accounting policy changes on profitability, at least in the form of clear and understandable footnotes.

5. The changes in the regulatory framework shall go a long way in improving the credibility of accounting reports and thereby help in channalising the society's scarce resources in the desired directions. Otherwise, the resources shall be misdirected towards inefficient units.

6. Compare the companies in the same industry as well as the same sector and analyze the trends within the industry.

7. Analyze the long-term trends in the changes in Cash-flows versus the changes in earnings as per accounting standards.

8. Closely watch the corporate governance.

9. Compare planned and actual figures.

10. Readers of Financial statements should keep a watch on changes in accounting principles.

11. Readers of financial statements should favour companies with conservative accounting principles.

SUMMARY

Table I - Accounting Policies Regarding Inventory valuation

<table>
<thead>
<tr>
<th>Company</th>
<th>Year</th>
<th>Impact of accounting policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>NSL</td>
<td>1996</td>
<td>Inclusive of excise duty on finished goods valuation - No impact on working results</td>
</tr>
<tr>
<td>ARB Ltd.</td>
<td>1997</td>
<td>Inclusive of excise duty on finished goods valuation-No impact on working results</td>
</tr>
<tr>
<td>Rassi Cements</td>
<td>1998</td>
<td>Transfer of closing stock to subsidiaries-Profits is under valued by Rs. 49.05 lakhs</td>
</tr>
<tr>
<td>Sanghi Polyster</td>
<td>1996-97</td>
<td>Inclusion of excise duty in valuation of finished goods Profits were up by Rs. 143.69 crores, Rs. 126.82 crores &amp; Rs. 88. 27 Crores respectively.</td>
</tr>
<tr>
<td>SSM Ltd.</td>
<td>1996.97</td>
<td>Inclusion of excise duty in valuation of finished goods-profits were up by Rs. 2.42 crores and Rs. 2.23 crores respectively.</td>
</tr>
<tr>
<td>L&amp;T</td>
<td>1999</td>
<td>Change of methodology of calculation of closing stock as per AS2 (revised)-Profits were higher by Rs. 54.01 crores</td>
</tr>
<tr>
<td>Pennar Steels</td>
<td>1994</td>
<td>Calculation of finished goods and WIP include an element of interest on working capital loan-profits were increased by Rs. 1.46 crores.</td>
</tr>
</tbody>
</table>

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### Table II

<table>
<thead>
<tr>
<th>Name of the Company</th>
<th>Year</th>
<th>Item of contingent Liability</th>
<th>Amount of Liability (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Amar Raja Batteries Ltd.</td>
<td>1996</td>
<td>Additional Income tax in dispute</td>
<td>Rs. 5 Lakhs</td>
</tr>
<tr>
<td>2. GFCL</td>
<td>1996</td>
<td>Pending Disposal of customs duty</td>
<td>Rs. 36.06 lakhs</td>
</tr>
<tr>
<td>3. SSM Ltd.</td>
<td>1994</td>
<td>Income tax under appeal</td>
<td>Rs. 11 lakhs</td>
</tr>
<tr>
<td>4. DCL Polyester Ltd.</td>
<td>1999, 2000</td>
<td>Sales tax under dispute</td>
<td>Rs. 559 lakhs</td>
</tr>
<tr>
<td>5. GFCL</td>
<td>1996, 97 &amp; 98</td>
<td>Claims not acknowledged against the company as debts</td>
<td>Rs. 2,271.77 lakhs</td>
</tr>
<tr>
<td>6. SOL Pharma Ltd.</td>
<td>1997</td>
<td>Claims not acknowledged against the company as debts</td>
<td>Rs. 3.02 crores</td>
</tr>
<tr>
<td>7. IGFCL</td>
<td>1994, 95 &amp; 96</td>
<td>Claims not acknowledged against the company as debts</td>
<td>Rs. 3.70 crores</td>
</tr>
</tbody>
</table>

### Table III - Accounting policies for Non-Provision of Liabilities

<table>
<thead>
<tr>
<th>Name of the Company</th>
<th>Year</th>
<th>Liability not provided for</th>
<th>Effect on Non Profit (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Priyadarshini Cements Ltd.</td>
<td>i. 1995 to 98</td>
<td>Provision for estimated contracts remaining to be executed on capital account - not provided for</td>
<td>187.22 lakhs</td>
</tr>
<tr>
<td></td>
<td>ii. 1995-97</td>
<td>Provision for gratuity liability to the company - not provided for</td>
<td>154 lakhs</td>
</tr>
<tr>
<td>2. Suryavamshi Spinning Mills Ltd.</td>
<td>1996 to 98</td>
<td>Non provision of liability in respect of contingent liability</td>
<td>80 Lakhs</td>
</tr>
<tr>
<td>3. Godavari Fertilizers Ltd.</td>
<td>1995 to 98</td>
<td>Non provision for estimated contracts remaining to be executed on capital account</td>
<td>283.38 lakhs</td>
</tr>
<tr>
<td>4. Rassi Cements Ltd.</td>
<td>1996</td>
<td>Diminution in value of investments</td>
<td>348.07 lakhs</td>
</tr>
<tr>
<td>5. Sanghi Polyster Ltd.</td>
<td>i. 1995&amp;96</td>
<td>Non provision for estimated contracts remaining to be executed on capital account Excise duty</td>
<td>3,470.16 lakhs</td>
</tr>
<tr>
<td></td>
<td>ii. 1995 to 98</td>
<td></td>
<td>930.90 lakhs</td>
</tr>
<tr>
<td>6. Suryavamshi Spinning Mills Ltd.</td>
<td>i. 1995&amp;96</td>
<td>Excise duty</td>
<td>32 lakhs</td>
</tr>
<tr>
<td></td>
<td>ii. 1992</td>
<td>Non provision for estimated contracts remaining to be executed on capital account</td>
<td>9 Crores</td>
</tr>
<tr>
<td>7. SOL Phanna Ltd.</td>
<td>1994&amp;95</td>
<td>Gratuity liability</td>
<td>1.49 Crores</td>
</tr>
<tr>
<td>8. Sujana Steel Ltd.</td>
<td>1994</td>
<td>Contingent liability in respect of letters of credit</td>
<td>85.27 lakhs</td>
</tr>
<tr>
<td>9. Pennar Steel Ltd.</td>
<td>1995</td>
<td>Income tax - Contingent liability</td>
<td>7.74 lakhs</td>
</tr>
<tr>
<td>10. Indo Gulf fertilizers Ltd.</td>
<td>1994 to 96</td>
<td>Non provision for estimated contracts remaining to be executed on capital account</td>
<td>1,507.01 crores</td>
</tr>
</tbody>
</table>
Rao

ANNEXURE - I

List of Companies examined

1. Amar Raja Batteries Ltd. (Batteries manufacturing company) (ARB Ltd.)
2. Aurobindo Pharma Ltd. (Medicines manufacturing company)
3. Dr. Reddy's Laboratories Ltd. (Medicines manufacturing company)
4. Godavari Fertilizers & Chemicals Ltd. (Fertilizer manufacturing) (GFCL)
5. Nagarjuna Fertilizers & Chemicals Ltd. (Fertilizer manufacturing) (NFCL)
6. Priyadarshini Cement Ltd. (Cement manufacturing)
7. Rassi Cement Ltd. (Cement manufacturing)
8. Sanghi Polyster Ltd. (Polyester manufacturing)
9. Suryavamshi Spinning Mills Ltd. (Textile manufacturing) (SSM Ltd.)
10. Vazeer Sultan Tobacco Ltd. (Tobacco based products) (VST)

Companies added for study

11. Indo-Gulf Fertilizers & Chemicals Corporation Ltd. (Fertilizer manufacturing) (GFCL)
12. Styles India Ltd. (Tiles manufacturing)
13. Larsen & Tubro Ltd., (infrastructure industry) (L & T)
14. SOL Pharma Ltd., (Medicine manufacturing)
15. Pennar Steels Ltd., (Steel manufacturing)
16. DCL Polyster Ltd., (Polyester manufacturing)
17. Reliance Industries Ltd., (Basic Goods Industry) (RIL)
UTILISATION OF CURRENT ASSETS AND OPERATING PROFITABILITY: AN EMPIRICAL STUDY ON CEMENT AND TEA INDUSTRIES IN INDIA

*Santany Kumar Ghosh
**Santi Gopal Maji

ABSTRACT

The paper makes an empirical study on utilisation of current assets and operating profitability. Data for 11 firms of cement and tea industries were collected for the period 1992-93 to 2001-2002. The study concludes that the degree of current assets is positively associated with the operating profitability of the firm.

A firm is said to have utilized its current assets efficiently if an increase (decrease) in total current assets is accompanied with more (less) than proportionate increase (decrease) in sales revenue. Modern financial management aims at reducing the level of current assets without ignoring the risk of stock outs (Bhattacharya/ 1997). This may be achieved by reducing the operating cycle of a firm - which, in turn, is dependent upon the degree of utilization of the current assets. Consequent to the contraction of the operating cycle is the reduction of investment in current assets. Based on this basic proposition, an attempt has been made in this study to examine whether such theoretical relationship is valid is the context of practical business situation in this country or not.

METHODOLOGY AND THE DATA-BASE

In order to accomplish the objective of the present study, the utilisation index for the current assets has been worked out as under:

\[ UI_{CA} = \frac{S_t}{S_{t-1}} \times \frac{CA_{t-1}}{CA_t} \] .......................... (i)

Where, UI\textsubscript{CA} refers to the utilisation index (current assets), \( S_t \) stands for sales revenue at period 't'; and \( CA_t \) represents the 't' th periods' current assets. A value of \( UI_{CA}>1 \) indicates

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efficiency in the matter of utilization of current assets of the firm. Higher the value of the index, greater is the degree of efficiency in this regard and vice-versa.

Calculation of operating profit index has been done with the help of the following model:

$$\text{OPI}_{CA} = \frac{S_{t-1}}{S_t} \times \frac{OP_t}{OP_{t-1}} \quad (\text{ii})$$

Where, OPI stands for the operating profit index and OP
t refers to the operating profit at period 't'.

OPI value of greater than one is desirable. Higher the value above one, grater is the efficiency of the firm in the matter of management of its current assets for generating operating income.

Two industries, namely, Cement and Tea has been selected arbitrarily for the present purpose. Selection of companies have been governed by the availability of the relevant data from the 'capitaline date-base' for the entire study period of ten years starting from 1992-93 to 2001-2002. Altogether data for 22 companies [11 firms for each of the two industries] have been employed for examining the relationship.

The regression results for the firms belonging to the cement industry and those fall under the tea industry have been shown in table -1 and table -2 respectively. They reveals that for all the twenty-two firms the operating profitability has been influence positively by the degree of efficiency in utilization of current assets. The observed Beta values, which reflect the degree of such relationship as stated above, are statistically significant in case of six firms belonging to the cement industry and for only one out of eleven firms representing the tea industry. The observed $R^2$ values are also not very high. For the above mentioned seven firms this value ($R^2$) varies between .297 to .556. This means that apart from the efficiency in current asset management, the profitability (operating), to a significant extent/ is affected by some other factors.

But the influence of current assets management on profitability (operating) is not negligible. For example, in case of Priyadarshini Cement Ltd., the observed Beta value is .745 and is significant at 5% level. Such high degree of influence is found also in case of Dalmia Cement, Gujarat Ambuja Cement, India Cement, Panyam Cement and Kanoria Industries Ltd. In case of tea industry, however, the operating profitability of only the Assambrook Ltd. is seen to have been influenced to a large extent (.69%) by the degree of utilisation of current assets. The observed Beta values for the other fourteen firms (except for Birla Corporation Ltd.) are also not negligible. These values vary between .215 to .470.

The year-wise industry analysis (shown in table-3) also supports the theoretical relationship between these two variables. Excepting the year 1994-95 in case of cement industry, the observed Beta values are found to be positive. During the year 1994-95, the cement industry
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shows a significantly negative association, which requires further investigation. Apart from this, significant positive association is found in four years in case of each of the two industries. For cement industry, 1996-97, 1997-98, 1998-99 and 2001-2002 are the years during which strong significant positive association is observed and the Beta values for these years vary between .57 to .874. In case of tea industry the years of strong significant positive association are 1992-93, 1999-2000, 2000-2001 and 2001-2002. Among these years the minimum Beta value (.621) is seen to have occurred in the year 1999-2000, the maximum value (.818) is found in the year 2001-2002. For this industry, however, the minimum value of Beta is observed in the year 1996-1997, while that of cement industry (excepting the negative Beta value) is .243 occurred in 1992-93. The incidence of the negative association (in 1994-95) in case of cement industry, however, may be viewed as an exception. Very low $R^2$ values once again speak in favour of the existence of some other influential factors. However, $R^2$ values for the years during which the association is found to be significant are not negligible. In fact, in some cases these values are sufficient to speak in favour of hypothesised association already described.

CONCLUSION

A study based on the management of the firms' current accounts as a whole could provide better reflection of its relationship with the operating profitability. The reason behind the occurrence of the negative association in case of the cement industry in the year 1994-95 also needs to be investigated carefully. In view of the empirical results, however, the present study concludes that the degree of utilisation of current assets is positively associated with the operating profitability of the firm.

Table - 1: Firm specific regression results.

(Cement Industry)

<table>
<thead>
<tr>
<th>Sl.No</th>
<th>Name of company</th>
<th>Constant</th>
<th>Beta</th>
<th>$R^2$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Associated Cement Company Ltd.</td>
<td>.280 (.225)</td>
<td>.219 (.636)</td>
<td>.048</td>
</tr>
<tr>
<td>2</td>
<td>Biria Corporation Ltd.</td>
<td>.128 (.034)</td>
<td>.085 (.240)</td>
<td>.007</td>
</tr>
<tr>
<td>3</td>
<td>Normada Cement Company Ltd.</td>
<td>-.423 (-1.204)</td>
<td>.286 (.845)</td>
<td>.082</td>
</tr>
<tr>
<td>4</td>
<td>Dalmia Cement(Bharat) Ltd</td>
<td>-.078 (-.187)</td>
<td>.678* (2.609)</td>
<td>.460</td>
</tr>
<tr>
<td>5</td>
<td>Kanoria Industries Ltd.</td>
<td>-3.472 (-1.634)</td>
<td>.545** (1.837)</td>
<td>.297</td>
</tr>
<tr>
<td>6</td>
<td>Fanyam Cements &amp; Mineral Industries Ltd.</td>
<td>-12.623(-2.123)</td>
<td>.650* (2.417)</td>
<td>.422</td>
</tr>
<tr>
<td>7</td>
<td>Priyadarshini Cement Ltd</td>
<td>-1.425 (-1.798)</td>
<td>.745* (3.163)</td>
<td>.556</td>
</tr>
<tr>
<td>8</td>
<td>India Cement Ltd.</td>
<td>-.651 (-.794)</td>
<td>.654* (2.445)</td>
<td>.428</td>
</tr>
<tr>
<td>9</td>
<td>Decan Cement Ltd.</td>
<td>.689(2.228)</td>
<td>.420 (1.309)</td>
<td>.176</td>
</tr>
<tr>
<td>10</td>
<td>Gujarat Ambuja Cement Ltd.</td>
<td>.503 (2.524)</td>
<td>.665* (2.517)</td>
<td>.442</td>
</tr>
<tr>
<td>11</td>
<td>NCL Industries Ltd.</td>
<td>.311 (.535)</td>
<td>.425 (1.329)</td>
<td>.181</td>
</tr>
</tbody>
</table>

('t' values are shown in parentheses), *significant at 5% level, ** significant at 10% level.
Ghosh & Maji

Table - 2: Firm specific regression results.
(Tea Industry)

<table>
<thead>
<tr>
<th>Sl.No</th>
<th>Name of company</th>
<th>Constant</th>
<th>Beta</th>
<th>R2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>AFT Industries Ltd.</td>
<td>-1.833 (.603)</td>
<td>.321 (.958)</td>
<td>.103</td>
</tr>
<tr>
<td>2</td>
<td>Assambrook Ltd</td>
<td>.287 (1.077)</td>
<td>.696* (2.742)</td>
<td>.485</td>
</tr>
<tr>
<td>3</td>
<td>B&amp;A Ltd.</td>
<td>.699 (2.240)</td>
<td>.334 (1.004)</td>
<td>.112</td>
</tr>
<tr>
<td>4</td>
<td>Gillanders Arbuthnot &amp; Company Ltd</td>
<td>-4.486 (-.800)</td>
<td>.382 (1.094)</td>
<td>.146</td>
</tr>
<tr>
<td>5</td>
<td>Harrison Malyalam Ltd.</td>
<td>-.303 (.358)</td>
<td>.470 (1.408)</td>
<td>.221</td>
</tr>
<tr>
<td>6</td>
<td>Jayshree Tea Ltd.</td>
<td>-.613 (.396)</td>
<td>.409 (1.187)</td>
<td>.168</td>
</tr>
<tr>
<td>7</td>
<td>Ledo Tea Company Ltd.</td>
<td>.737 (3.012)</td>
<td>.221 (.641)</td>
<td>.049</td>
</tr>
<tr>
<td>8</td>
<td>Manjushri Plantation Ltd.</td>
<td>-.109 (.080)</td>
<td>.221 (.642)</td>
<td>.050</td>
</tr>
<tr>
<td>9</td>
<td>Parry Agro Industries Ltd.</td>
<td>.409 (.632)</td>
<td>.304 (.903)</td>
<td>.100</td>
</tr>
<tr>
<td>10</td>
<td>Tata Coffee Ltd.</td>
<td>-.044 (-.062)</td>
<td>.438 (1.463)</td>
<td>.192</td>
</tr>
<tr>
<td>11</td>
<td>Tezapore Tea Ltd</td>
<td>.496 (.709)</td>
<td>.215 (.662)</td>
<td>.046</td>
</tr>
</tbody>
</table>

(t' values are shown in parentheses), *significant at 5%level, **significant at 10%level.

Table - 3: Regression results (Industry specific year-wise)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cement Industry</th>
<th></th>
<th>Tea Industry</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Constant</td>
<td>Beta</td>
<td>R2</td>
<td>Constant</td>
</tr>
<tr>
<td>1992-93</td>
<td>.115 (.094)</td>
<td>.243 (.751)</td>
<td>.059</td>
<td>.536 (3.820)</td>
</tr>
<tr>
<td>1993-94</td>
<td>.442 (.743)</td>
<td>.295 (.925)</td>
<td>.087</td>
<td>.620 (.636)</td>
</tr>
<tr>
<td>1994-95</td>
<td>4.483 (2.847)</td>
<td>-.539* (-1.924)</td>
<td>.291</td>
<td>.117 (.126)</td>
</tr>
<tr>
<td>1995-96</td>
<td>-3.469 (-.822)</td>
<td>.412 (1.357)</td>
<td>.170</td>
<td>.877 (.993)</td>
</tr>
<tr>
<td>1996-97</td>
<td>.063 (.135)</td>
<td>.519** (1.822)</td>
<td>.269</td>
<td>.657 (.770)</td>
</tr>
<tr>
<td>1997-98</td>
<td>-.270 (-1.289)</td>
<td>.874* (5.387)</td>
<td>.763</td>
<td>.052 (.016)</td>
</tr>
<tr>
<td>1998-99</td>
<td>-145.154 (-3.008)</td>
<td>.689* (2.855)</td>
<td>.475</td>
<td>.432 (1.790)</td>
</tr>
<tr>
<td>1999-2000</td>
<td>-1.347 (-.763)</td>
<td>.274 (.854)</td>
<td>.075</td>
<td>-.389 (-.679)</td>
</tr>
<tr>
<td>2000-01</td>
<td>-3.737 (-1.132)</td>
<td>.441 (1.474)</td>
<td>.195</td>
<td>.038 (.254)</td>
</tr>
<tr>
<td>2001-02</td>
<td>.288 (.629)</td>
<td>.570** (1.835)</td>
<td>.325</td>
<td>-.011 (-.050)</td>
</tr>
</tbody>
</table>

(t' values are shown in parentheses), * significant at 5%level, **significant at 10%level.
ABM IN THE REALM OF HIGHER EDUCATION: AN APPLIED PERSPECTIVE

Mahesh Chand Garg

ABSTRACT

The present study makes an empirical study to apply activity based management in higher education.

Captured from the cross-currents of classic cash-flows, and remoulded into a powerful tool by Harvard University dons Robert S. Kaplan and Robin Cooper in 1988, activity-based management which encompasses the better known activity based costing (ABC) today is designed to wipe off the inadequacies in conventional cost accounting practices, and furnish more accurate cost information for strategic and management decision-making. It is simple, two-step premise: activities cause costs to the organization; and the precise cost of all activities that go into a product must be factored in to compute its actual total cost to the organization. The outcome: ABM promises not only to deliver a new costing model, but also to greatly impact your management decisions with the findings of that model.

To be more specific, the design of an ABC system features for steps: identity activity centres, assign resource costs to activity centres, identify outputs or cost objects and link activity cost to cost objects using cost drivers.

(a) Identify core process: In designing an ABC system in a college or university, first step is to identify and analyse all of its core processes. These core processes are considered activity centres for the purposes of ABC. In activity centres all tasks that result in a common goal or valuable output are grouped together. Examples of activity centres are:

- Enrollment activities: Admissions, registration and students accounts.
- Student services: Hostel, mess, counseling.
- Faculty development: Scholarly and professional activities, instruction.
- Academic activities (other than instruction): library, career services, learning centres.

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(b) **Assign Resource Costs:** In the second step, resource costs must be assigned to these activity centres. Costs that are directly related to a particular activity or service centre, such as salaries of employees only working in that centre, are directly assigned to those centres. Costs that are common to several activity or service centres, such as utilities, are assigned to centres using appropriate cost drivers. Because this process is the first part of a two-stage cost assignment, the cost drivers are called "first-stage cost drivers".

(c) **Define cost objects:** The third step in ABC system design is to identify the cost objects, defined as programmes that the institution operates. These may be identified as academic departments, such as the department of management, or programmes, such as finance programme within the department of management.

(d) **Link Activity Costs to Cost Objects:** The last step in designing an ABC system is linking the activity costs to cost objects using second-stage cost drivers. Similar to first-stage cost drivers, these are factors that cause activity costs to be consumed by cost objects.

**Example of Activity-based Costing:** The following example is based on the fictitious XYZ University. For simplicity, only four service centres, three activity centres, and two cost objects are considered. In real-life situations, most institutions will have several others.

XYZ University has two academic Programmes: Programme M is low volume (with 2000 students and a student-faculty ratio of 10:1), and Programme N is high volume (with 4000 students and a student-faculty ratio of 20:1). Costs for faculty salaries average Rs. 30,000 in each department and each department has 200 faculty members; thus, the total salary cost in each department is Rs. 6 million.

The total overhead costs of providing these programmes is Rs. 32 million per year (two and two-thirds the amount of salaries). Although each programme has the same number of faculty members and Programme N has more students, Programme M requires more space for laboratories and classrooms than Programme N. The cost per student for each programme was determined by dividing into faculty salaries by number of students. Using this method, the cost per student of Programme M is Rs. 3000; for Programme N, Rs. 1500. This approach ignores the overhead costs of operating the programmes. Last year, the college began to allocate overhead to programmes based on the total number of students in each programme (i.e., volume-based costing method). The overhead application rate is computed as follows:

\[
\text{Total overhead costs/Total students} = \frac{32,000,000}{6,000} = \frac{5,333}{\text{per student}}.
\]

will now be Rs. 8,333 (Programme M) and Rs. 6,333 (Programme N).

In the current year, XYZ University has decided to design and implement an ABC system. With ABC, costs that were considered to be indirect costs (overhead) are traced directly
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to cost objects (programmes). The first step in the design of the ABC system is to determine the activity centres. XYZ University analysed its operations and identified three activity centres: enrollment activities, student support activities, and academic activities. The second step in ABC system design is to assign costs to the activity centres. XYZ University has four service centres whose costs are assigned to activities - human resources, computing, duplicating and maintenance services. The determination of the costs per item for each of the service centres is presented in Table 1.

Table 1: Costs per Item

<table>
<thead>
<tr>
<th>Service Centre</th>
<th>Cost Driver</th>
<th>Traceable Costs</th>
<th>No. of Items</th>
<th>Cost per Item</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human resources</td>
<td>No. of employees</td>
<td>Rs. 1,000,000</td>
<td>1000 employees</td>
<td>Rs.1000/employee</td>
</tr>
<tr>
<td>Computing</td>
<td>No. of computers</td>
<td>Rs. 2,000,000</td>
<td>2000 computers</td>
<td>Rs. 1000/computer</td>
</tr>
<tr>
<td>Duplicating</td>
<td>No. of copies</td>
<td>Rs. 100,000</td>
<td>100,000 copies</td>
<td>Re. 1/copy</td>
</tr>
<tr>
<td>Maintenance</td>
<td>Square feet occupied</td>
<td>Rs. 5,000,000</td>
<td>50,000 square feet</td>
<td>Rs. 100/square foot</td>
</tr>
<tr>
<td><strong>Total costs</strong></td>
<td></td>
<td><strong>Rs. 8,100,000</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For simplicity, services provided among service departments, such as duplicating services provided to human resources, are ignored. However, service centres provide services to both activity centres and cost objects (programmes).

The number of items that are consumed by the activity centres (enrollment, student support, and academic activities) and the cost objects (Programme M and Programme N) are presented in Table 2. These items are the first-stage cost drivers for the service centres.

Table 2: First-stage Cost Drivers

<table>
<thead>
<tr>
<th>Activity/project</th>
<th>Human Resources (employees)</th>
<th>Computing (computers)</th>
<th>Duplicating (copies)</th>
<th>Maintenance (square feet)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enrollment activities</td>
<td>300</td>
<td>150</td>
<td>10,000</td>
<td>2,000</td>
</tr>
<tr>
<td>Student support activities</td>
<td>200</td>
<td>100</td>
<td>7,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Academic activities</td>
<td>100</td>
<td>50</td>
<td>3,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Programme M</td>
<td>200</td>
<td>1,100</td>
<td>30,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Programme N</td>
<td>200</td>
<td>600</td>
<td>50,000</td>
<td>15,000</td>
</tr>
<tr>
<td><strong>Total items</strong></td>
<td>1000</td>
<td>2,000</td>
<td>1,00,000</td>
<td>50,000</td>
</tr>
</tbody>
</table>

The cost of each activity centre is presented in Table 3.
Garg

Tables 3: Cost of Activity Centres

<table>
<thead>
<tr>
<th>Costs</th>
<th>Enrollment Activities</th>
<th>Student support Activities</th>
<th>Academic Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human resources</td>
<td>Rs. 300,000</td>
<td>Rs. 200,000</td>
<td>Rs. 100,000</td>
</tr>
<tr>
<td>Computing</td>
<td>Rs. 150,000</td>
<td>Rs. 100,000</td>
<td>Rs. 50,000</td>
</tr>
<tr>
<td>Duplicating</td>
<td>Rs. 10,000</td>
<td>Rs. 7,000</td>
<td>Rs. 3,000</td>
</tr>
<tr>
<td>Maintenance</td>
<td>Rs. 200,000</td>
<td>Rs. 500,000</td>
<td>Rs. 300,000</td>
</tr>
<tr>
<td>Direct Costs</td>
<td>Rs. 12,000,000</td>
<td>Rs. 8,000,000</td>
<td>Rs. 3,900,000</td>
</tr>
<tr>
<td>Total costs of activity</td>
<td>Rs. 12,660,000</td>
<td>Rs. 8,807,000</td>
<td>Rs. 4,353,000</td>
</tr>
<tr>
<td>Total of all activities</td>
<td>Rs. 25,820,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Costs, except for direct costs, are computed by multiplying the number of events consumed by each activity centre by the cost per event. The direct costs are the costs specifically related to that activity. The salaries of employees in the enrollment activities area is an example of a direct cost. Direct costs usually make up a large part of the total costs of an activity.

The third step of an ABC system design is to define cost objects. XYZ University has two programmes that are considered cost objects: Programme M and Programme N. The last step in ABC system design is to link activity costs to cost objects. This is done in a fashion similar to assigning service centre resource costs to activities. Before making this link, service department costs are assigned to cost objects. For activity centres, the costs per item are determined as shown in Table 4. The number of activities consumed by each cost object are:

<table>
<thead>
<tr>
<th>Activity Centre</th>
<th>Programme M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enrollment activities</td>
<td>500 new students</td>
</tr>
<tr>
<td>Student support activities</td>
<td>2,000 total students</td>
</tr>
<tr>
<td>Academic activities</td>
<td>200 faculty members</td>
</tr>
<tr>
<td></td>
<td>Programme N</td>
</tr>
<tr>
<td></td>
<td>1000 new students</td>
</tr>
<tr>
<td></td>
<td>4000 total students</td>
</tr>
<tr>
<td></td>
<td>200 faculty members</td>
</tr>
</tbody>
</table>

Table 4: Activity Centre Cost per Item

<table>
<thead>
<tr>
<th>Activity centre</th>
<th>Cost Driver</th>
<th>Total cost (Figure 5)</th>
<th>No. of Items</th>
<th>Cost per item</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enrollment activities</td>
<td>No. of students</td>
<td>Rs. 12,660,000</td>
<td>1500 new students</td>
<td>Rs. 8440/ new student</td>
</tr>
<tr>
<td>Student support</td>
<td>No. of students</td>
<td>Rs. 8,807,000</td>
<td>6000 total students</td>
<td>Rs. 1468/ student</td>
</tr>
<tr>
<td>Academic activities</td>
<td>No. of faculty member</td>
<td>Rs. 4,353,000</td>
<td>400 faculty members</td>
<td>Rs.10,883/ faculty member</td>
</tr>
</tbody>
</table>
The total cost and cost per unit of each cost object are computed in Table 5.

### Table 5: Total cost and cost per unit of cost objects

<table>
<thead>
<tr>
<th>Costs</th>
<th>Programme M</th>
<th>Programme N</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human resources (Rs. 1000/employee)</td>
<td>Rs. 200,000</td>
<td>Rs. 200,000</td>
<td>Rs. 400,000</td>
</tr>
<tr>
<td>Computing (Rs. 1000/computer)</td>
<td>Rs. 1,100,000</td>
<td>Rs. 600,000</td>
<td>Rs. 1,700,000</td>
</tr>
<tr>
<td>Duplicating (Rs. 1/copy)</td>
<td>Rs. 30,000</td>
<td>Rs. 50,000</td>
<td>Rs. 80,000</td>
</tr>
<tr>
<td>Maintenance (Rs. 100/square feet)</td>
<td>Rs. 2,500,000</td>
<td>Rs. 1,500,000</td>
<td>Rs. 4,000,000</td>
</tr>
<tr>
<td>Sub total (service costs)</td>
<td>Rs. 3,830,000</td>
<td>Rs. 2,350,000</td>
<td>Rs. 6,180,000</td>
</tr>
<tr>
<td>Enrollment (Rs. 8440/new student)</td>
<td>Rs. 4,220,000</td>
<td>Rs. 8,440,000</td>
<td>Rs. 12,660,000</td>
</tr>
<tr>
<td>Student support (Rs. 1468/student)</td>
<td>Rs. 2,935,667</td>
<td>Rs. 5,871,333</td>
<td>Rs. 8,807,000</td>
</tr>
<tr>
<td>Academic (Rs. 10883/Faculty)</td>
<td>Rs. 2,176,500</td>
<td>Rs. 2,176,500</td>
<td>Rs. 4,353,000</td>
</tr>
<tr>
<td>Sub total (activities costs)</td>
<td>Rs. 9,332,167</td>
<td>Rs. 16,487,833</td>
<td>Rs. 25,820,000</td>
</tr>
<tr>
<td>Total (service activity costs)</td>
<td>Rs. 13,162,167</td>
<td>Rs. 18,837,833</td>
<td>Rs. 32,000,000</td>
</tr>
<tr>
<td>No. of students</td>
<td>2000</td>
<td>4000</td>
<td>6000</td>
</tr>
<tr>
<td>Cost per student</td>
<td>Rs. 6.581</td>
<td>Rs. 4,709</td>
<td>Rs. 5,333</td>
</tr>
</tbody>
</table>

For comparison, the unit costs derived under both volume-based costing and ABC are shown in Table 6.

### Table 6: Comparison of Costing Methods

<table>
<thead>
<tr>
<th>Cost</th>
<th>Volume-Based Costing</th>
<th>Activity Based Costing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Programme M</td>
<td>Programme N</td>
</tr>
<tr>
<td>Salaries</td>
<td>Rs. 3,000</td>
<td>Rs. 1500</td>
</tr>
<tr>
<td>Other costs</td>
<td>Rs. 5,333</td>
<td>Rs. 5,333</td>
</tr>
<tr>
<td>Total per student</td>
<td>Rs. 8,333</td>
<td>Rs. 6,833</td>
</tr>
</tbody>
</table>

In the past, XYZ University has been charging Rs. 5,333 in overhead cost per student in either programme. The university should have been charging Rs. 6,581 in overhead cost to each student in Programme M and only Rs. 4,709 to each student in Programme N. As a result of using the volume-based costing method, too little overhead has been charged to Programme M and too much has been charged to Programme N. Through ABC, overhead costs that are traceable to each programme have been identified, and thus cost data are more accurately determined. If XYZ University charges tuition of Rs. 9000 per student, then the net income or loss per programme is computed as shown in Table 7.
Table 7: Net Income per Programme

<table>
<thead>
<tr>
<th>Items</th>
<th>Volume-Based Costing</th>
<th>Activity Based Costing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Programme M</td>
<td>Programme N</td>
</tr>
<tr>
<td>Tuition Revenue</td>
<td>Rs. 9,000</td>
<td>Rs. 9,000</td>
</tr>
<tr>
<td>Less: Total costs</td>
<td>Rs. 8,333</td>
<td>Rs. 6,833</td>
</tr>
<tr>
<td>Income (Loss)/student</td>
<td>Rs.667</td>
<td>Rs.2167</td>
</tr>
<tr>
<td>&quot;No. of students</td>
<td>2,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Total income (loss)</td>
<td>Rs. 1,333,333</td>
<td>Rs.8,666,667</td>
</tr>
</tbody>
</table>

Programme M looks like a profitable programme under volume-based costing but actually incurs a loss of Rs. 581 per student or a Rs. 1,162,167 total loss.

When an entity installs an ABC system, overhead cost is often shifted from the high-volume programmes to the low-volume programmes, resulting in a higher cost per student for the low-volume programmes. This shift is caused by the way overhead costs are treated. Rather than considering overhead costs as a lump amount and spreading it uniformly over all students, ABC attempts to trace costs to specific programmes. Low-volume programmes, with low student-faculty ratios, often require the same amount of total support such as space and maintenance as higher volume programmes, incurring a disproportionately large amount of overhead costs. Tracing this cost to the lower-volume programmes drives their cost per student upward.

EXPECTED BENEFITS

The benefits which universities and colleges can expect from the implementation of ABM are improvements in the effectiveness and efficiency of the processes, elimination of non-value adding work, increased service quality to internal and external customers, and reductions in the operating cost of the institution. By implementing ABM, the costs of all activities and all programmes are more accurately determined. More accurate activity and programme costs data allow college and university administrators to make better decisions relating to resource allocation, programme retention, marketing strategies, programme returns, and the like. ABM also provides a better understanding of the cost-implications of decisions such as:

• What is the effect of the addition or elimination of a graduate degree in an existing department?
• What is the impact of moving the MBA programme off campus, closer to some of the students?
• What are the costs of continuing education?
• How many resources should be allocated to activities and programmes?
• How well did the activity centre perform?
• How efficient were the programmes?
• What should the university/college charge for tuition?
REFERENCES


Corporate Governance: Strategic Issues

*Deepak Gupta
*D.D. Meena

ABSTRACT

The theme of Corporate Governance has gained importance in newly liberalised business environment. Corporate Governance is a process or a set of systems and processes to ensure that a company is managed to suit the best interests of all. Various entities are expected to perform supervisory, advisory and key role in ensuring effectiveness of corporate Governance. The Consultants, Auditors, Executive Officers and Outside Stakeholders play important role in effective Corporate Governance. In this paper, an attempt has been made to outline a few strategic issues regarding Corporate Governance.

Corporate Governance broadly defines the scope, responsibility and accountability of all the concerned affected by the structure of the Corporate Entity. It encompasses the relationship amongst various participants in determining the direction and performance of the organization. It also provides for a mature and a trustworthy relationship of the members of the company inter-se as well as with the outsiders. The burgeoning Capital Market, the increasing role of the financial institutions and expectations of the public at large have put tremendous pressure on the corporate organizations to justify their actions at large to the public in terms of governance and prudent financial norms. The impact of globalization of the business has also necessitated the corporate entities to lay emphasis on transparent reporting and to clearly define the role of the financial institutions, non-executive directors, managing directors, chairman, audit committee, relationship of the stock exchange and the companies. The term governance finds prominent place in the studies on political science and in terms of the companies, it is used as a tool to measure the effective governance. In this paper, an attempt has been made to outline and analyse a few strategic issues relating to corporate governance.

STAKEHOLDERS AND DIMENSIONS

Corporate Governance refers to the set systems of procedures and rules to ensure the best possible management and administration of the company. It is a measure to justify the stakeholders of the organization that their interests are well protected. The terms stakeholders

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includes the internal stakeholders in the form of employees and shareholders as well as the external Stakeholders such as creditors, financial institutions etc. It is process of determination and fixation of responsibilities and duties on the board of the directors primarily in tandem with the overall corporate goals. It encompasses the expected standards of morality, values, diligence, honesty and transparency in corporate management. In designing the corporate governance structure, the role of the three prime entities is clearly defined. The role of the shareholders is to appoint the best and the most competent persons as the members of the board of directors of the company, the role of board of directors is to responsibly administer the affairs of the company and the role of the auditors is to check and ensure that the effective governance is in proper place and is being properly activated in the company. It is a system of making management accountable to the shareholders for effective management of the companies. The prime objective of the corporate governance is to maximize the shareholder’s wealth while maintaining highest standards of integrity and performance. It essentially consists of two elements, i.e., long-term relationship, which has to deal with the checks and balances, incentives of managers and communications between management and investors and the transactional relationship involving matters relating to disclosure and authority.

INDIAN AND GLOBAL SCENARIO

The Indian Corporate Sector predominantly was a family affair where the policies and procedures adopted by the companies were the ones, which were suited best to meet the interests of the family affairs. There was a marked lack of professionalisation and transparency in the operations. However, the winds of liberalization have necessitated the companies to restructure and reorganize their policies. The family managed companies were slowly replaced by the professionally managed companies. The Companies are now required to take a broader vision of enhancing the shareholders wealth and transparency and accountability are slowly being made the order of their day-to-day affairs. Financial Institutions as major stockholders and lenders of the finance are having their nominees on the boards and are playing pro-active role through audit committees to ensure better corporate governance. Chartered Accountants/ Company Secretary and Management Consultants are increasingly providing their expertise in reshaping sound corporate governance. A proposal to introduce secretarial compliance report for the companies which are not required by statute to appoint qualified chartered secretaries is a right step in this direction. Thus winds of change are being observed in the Indian Scenario also to ensure a better corporate governance structure.

The Indian Companies Act, 1956, owes its legacy to the English Company Law enacted in 1844. It provides details of Corporate Governance and the related issues. The same English Company Law is more or less practiced in many parts of the world including Hong Kong, New Zealand, Singapore, South Africa as well as the States in Australia and provinces of Canada. The Company Law of United States of America, though not exactly similar as to UK, have reflected similar ideological traditions. The German regulations empowers the shareholders to have a more say in the matters of corporate governance as compared to the workers. In most of the European Countries, shareholders exercise lesser controls than the
workers. In Germany, the representatives of the Union serve on supervisory boards. The Japanese shareholders, till recently, played no more role than the providers of the Capital. In the developing countries like Malaysia and Sri Lanka, the need of better corporate governance has been identified in the wake of liberalization process and the privatization of the state owned enterprises. Thus broadly the issues of the Corporate Governance have more or less been introduced and practices in major company law of different countries of the world.

MANAGERIAL ASPECTS

Management is essentially the process of implementation of the policies and procedures by the executives of the companies in accordance with the directions and procedures laid down by the Company. The issue of Corporate Governance is more related with wisdom and is an external focus and open system mainly dealing with the strategy. Management is essentially task oriented. However the issue of Corporate Management and Corporate Governance are so intensely related to each other and one is the tool for another to improve and sharpen the focus on better organization throughout the company. The increasing complexity of the business and massive growth in the size of the corporate entities requires that the system of sound governance and management needs to be put in proper place. A good management does not necessarily means better and effective organization culture but more on the vision, philosophy and policy statements of the board of directors of the company. A successful business organizations is one which is able to sustain the momentum of growth and leadership in the competitive environment while retaining the simplicity and audacity in its operations. Its in built operations systems needs to be strongly laid down, properly implemented with highest standards of transparency and integrity and should be in consonance with the larger interest of its stakeholders. This will ensure the professionalisation in corporate governance and in turn will lead to more professionalised company management.

The corporate entities are also required to decipher a new dispute settlement system. It will save a lot of company precious time and resources in endless costly litigations. This in turn will lead to a better corporate governance. In the developed world, a number of companies have introduced a whole system including persons trained in problem solving, dispute avoidance, negotiation and dispute resolution. The Companies have a Board of Arbitrators whose decision is binding on the company. Indian Corporate needs to follow these refined systems to ensure a climate for a better governance. They have to develop in-house system for settlement of disputes.

ROLE OF INTERNAL EXPERTS AND ANALYSIS

Experts associated with the Company in different capacities needs to play a more proactive role in ensuring a better climate for corporate governance. It is generally seen that the experts restrict themselves to align with the narrower interests of the promoters of the company in day to day governance rather than pragmatically viewing it from a broader perspective and horizon. This may be due to the fear of being reprimanded, isolated or being sacked from their
employment by the top management. They restrict their vision to the philosophy of what is good for the promoters and management is good for the company. The professionals need to be more open, frank and objective in their assessments before the management of the companies without fearing the consequences of reprisals. Ensuring this would lead to a better corporate governance and long term sustainability of the company. The management needs to respect such an open and frank assessment of their policies and practices. Restricting themselves to a narrower vision is bound to bring the decay, sooner or later.

ROLE OF AUDITORS IN CORPORATE GOVERNANCE

The auditors, being the watchdog of the company have a tremendous responsibility in ensuring truthness and fairness in the financial statements of the company. They are the best watchdogs to ensure effective corporate governance. The auditors need to appointed not as per the recommendations of the Board of Directors duly approved by the Shareholders in the AGM. On the contrary, they must be appointed from the panel decided by ICAI, Financial Institutions or some independent body. Their terms needs to be fixed for a specific years and be retired by rotation. Their remuneration needs to be fixed by Shareholders and not the Board of Directors. The auditors need to give properly and clearly defined qualifications (objectives) in their audit report to ensure better corporate governance and their qualifications needs to be properly addressed by the Board. The concept of joint auditors or a number of auditors to cross-check each other's work needs to be put into place. All these will ensure that auditors works independently and act as a true watchdog for ensuring effective corporate governance.

CONCLUSION

The investors in the present scenario will not depend on the regulators to protect their interest and will shift their allegiance with those companies which maximizes their wealth. Only the better and sound governed and professionally managed companies will be able to attract the investors money and the momentum of corporate growth and substance, in future, would solely depend on how well a company is being governed. The issue of Corporate Governance have now become a necessity rather than a matter of choice.

REFERENCES

THE ROLE OF NPA MANAGEMENT IN THE SUCCESS OF FINANCIAL SECTOR REFORMS IN THE INDIAN BANKS

*Ravi Kumar Jain

ABSTRACT

The phrase 'non-performing assets', popularly referred to, as 'NPAs' has become a worrying expression in banks and financial institutions. It is not that Banks and Financial institutions (FIs) heard of it for the first time in the eye of the financial sector reforms? The terminology may be new but the process is not new. Bankers were accustomed to handling sickly advances even earlier and had been making provisions, pending recovery, against such advances. If so, what is new, and why the sudden flutter? After all, the system of asset classification, income recognition and provisioning norms introduced by the Reserve Bank of India (RBI) in 1992 is no more than an explicit empirical model of assessing the credit risk a bank of financial institution carries in its balance sheet. The paper makes an attempt to analyse issues relating to MPAS in India.

When implemented across the industry, it brings in uniformly, transparency, objectivity, level playing field etc. besides it receives 'acceptance' both in the domestic and global financial markets. Till the mid-eighties, the banking system did not have the uniformity or objectivity in assessing the credit risk and even in those banks where it existed, transparency was lacking. The prudential norms have not only brought in objectivity, but also placed the actual credit risk position in a proper perspective so that the banks can take proper steps from time to time to keep the credit portfolio healthy and remunerative.

It will be observed from above that percentage of gross NPA to gross advances have come down from 13.91 in 1999-2000 to 9.72 in 2003-2004 for Nationalized banks. The decline is also evident in case of individual banks. Similarly, if we consider the over all picture of Public sector banks, the above percentage has declined from 13.98 in 1999-2000 to 9.36 in 2003-2004. The similar trend could be observed in the ratio of Net NPA to Net advances which has come down 4.77 for nationalized banks and 4.54 in case of total public sector banks. And during this period pace of reforms in financial sector reforms gathered increased momentum and Indian economy tended to integrate with world economy.

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MAGNITUDE OF NPA

In its report in ‘Trends & Progress of Banking in India 2001-2002’, the RBI has observed that the absolute magnitude of the level of gross as well as net NPA of Public Sector Banks still remains a major hurdle and acts as a deadweight loss for banks and an impediment to lower lending rates. As per the 2001-2002 reports, in absolute terms, the gross NPAs in the banking system have increased by Rs. 7163 crores, during 2001-2002 to Rs. 70904 crores and the net NPAs increased by Rs. 3085 crores to Rs 3556 crores. Moreover, the general perception is that public sector banks have under reported their NPAs. As per the reports of the rating agency standard & Poor’s, NPA levels of Indian Banks could be anywhere between 35 to 70% of their advances. NPAs as percentage of total assets differ from bank to bank and ranges from 10% to 34% for Indian public sector banks as against 2 to 4% for banks of developed countries.

However, there is a silver lining, on account of the steps taken by the banks under the Securitisation Act, the gross NPA of the banking system as on 31.3.03, has for the first time declined as compared to 31.3.02. As per latest report of RBI on ‘Trends & Progress of Banking in India 2002-2003’, the gross NPA as on 31.3.03 is Rs. 68,714 crore as compared to Rs. 70904 crore as on 31.3.02 and has declined to 8.8% from 10.4% of the Gross advances. Similarly, Net NPA has come down to Rs. 32,764 crore as on 31.3.03 as compared to Rs35,546 crore as on 31.3.02 and has declined to 4.4% from 5.8% of the Net advances.

The related tables are given below:

<table>
<thead>
<tr>
<th>YEAR March</th>
<th>GROSS NPA Amount</th>
<th>%Age</th>
<th>NET NPA Amount</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>39584</td>
<td>17.00</td>
<td>18928</td>
<td>8.90</td>
</tr>
<tr>
<td>1997</td>
<td>43577</td>
<td>17.84</td>
<td>20285</td>
<td>9.18</td>
</tr>
<tr>
<td>1998</td>
<td>45653</td>
<td>16.02</td>
<td>212232</td>
<td>8.20</td>
</tr>
<tr>
<td>1999</td>
<td>51710</td>
<td>15.90</td>
<td>24211</td>
<td>8.10</td>
</tr>
<tr>
<td>2000</td>
<td>53033</td>
<td>14.00</td>
<td>26187</td>
<td>7.40</td>
</tr>
<tr>
<td>2001</td>
<td>54773</td>
<td>12.4</td>
<td>27969</td>
<td>6.70</td>
</tr>
<tr>
<td>2002</td>
<td>56473</td>
<td>11.1</td>
<td>27958</td>
<td>5.8</td>
</tr>
<tr>
<td>2003</td>
<td>54066</td>
<td>9.4</td>
<td>24963</td>
<td>4.5</td>
</tr>
</tbody>
</table>
**TABLE 2**
Distribution Public Sector Banks by Ratio of Net NPA to Net Advances
(No. of Banks)

<table>
<thead>
<tr>
<th>FINANCIAL YEAR</th>
<th>Upto 10%</th>
<th>Above 10% to Upto 20%</th>
<th>Above 20%</th>
</tr>
</thead>
<tbody>
<tr>
<td>End -March</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>2</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>1996</td>
<td>19</td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>1997</td>
<td>17</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td>1998</td>
<td>17</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td>1999</td>
<td>18</td>
<td>8</td>
<td>1</td>
</tr>
<tr>
<td>2000</td>
<td>22</td>
<td>5</td>
<td>-</td>
</tr>
<tr>
<td>2001</td>
<td>22</td>
<td>5</td>
<td>-</td>
</tr>
<tr>
<td>2002</td>
<td>24</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>2003</td>
<td>25</td>
<td>2</td>
<td>-</td>
</tr>
</tbody>
</table>

**TABLE 3**
Bank Group-wise Gross and Net NPAs of Scheduled Commercial Banks as at end-March, 2003
(Amount in Rs. Crores)

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Bank Groups</th>
<th>Gross NPAs</th>
<th>Gross NPA %</th>
<th>Net NPAs</th>
<th>Net NPA %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Scheduled Commercial Banks</td>
<td>68714</td>
<td>8.8</td>
<td>32764</td>
<td>4.4</td>
</tr>
<tr>
<td>2</td>
<td>Public Sector Banks</td>
<td>54086</td>
<td>9.4</td>
<td>24963</td>
<td>4.5</td>
</tr>
<tr>
<td>3</td>
<td>Old private sector banks</td>
<td>4568</td>
<td>8.9</td>
<td>2741</td>
<td>5.5</td>
</tr>
<tr>
<td>4</td>
<td>New private sector banks</td>
<td>7232</td>
<td>7.6</td>
<td>4142</td>
<td>4.6</td>
</tr>
<tr>
<td>5</td>
<td>Foreign Banks of India</td>
<td>2829</td>
<td>5.2</td>
<td>918</td>
<td>1.8</td>
</tr>
</tbody>
</table>

**TABLE 4**
(Amount in Rs. Crore)

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Bank Group</th>
<th>Gross NPA</th>
<th>Net NPA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Scheduled Commercial Banks</td>
<td>7164.00</td>
<td>-1439</td>
</tr>
<tr>
<td>2</td>
<td>Public Sector Banks</td>
<td>1835.00</td>
<td>-2387</td>
</tr>
<tr>
<td>3</td>
<td>Old private sector banks</td>
<td>504.0</td>
<td>169</td>
</tr>
<tr>
<td>4</td>
<td>New private sector banks</td>
<td>5205.0</td>
<td>411</td>
</tr>
<tr>
<td>5</td>
<td>Foreign Banks of India</td>
<td>-380</td>
<td>360</td>
</tr>
</tbody>
</table>
TABLE 5
Bank group wise NPA Mix of scheduled Commercial Banks as at end-March, 2003

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Bank Groups</th>
<th>Gross NPAs</th>
<th>Substandard Assets Amount</th>
<th>% of GNPA</th>
<th>Doubtful Assets Amount</th>
<th>% of GNPA</th>
<th>Loss Assets Amount</th>
<th>% of GNPA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Scheduled Commercial Banks</td>
<td>68780</td>
<td>20078</td>
<td>2.6</td>
<td>39731</td>
<td>5.1</td>
<td>8971</td>
<td>1.2</td>
</tr>
<tr>
<td>2</td>
<td>Public Sector Banks</td>
<td>54089</td>
<td>14909</td>
<td>2.6</td>
<td>32340</td>
<td>5.6</td>
<td>6840</td>
<td>1.2</td>
</tr>
<tr>
<td>3</td>
<td>Old private sector banks</td>
<td>4567</td>
<td>1474</td>
<td>2.9</td>
<td>2772</td>
<td>5.4</td>
<td>321</td>
<td>0.6</td>
</tr>
<tr>
<td>4</td>
<td>New private sector banks</td>
<td>7231</td>
<td>2700</td>
<td>2.9</td>
<td>3675</td>
<td>3.9</td>
<td>856</td>
<td>0.9</td>
</tr>
<tr>
<td>5</td>
<td>Foreign Banks of India</td>
<td>2893</td>
<td>995</td>
<td>1.8</td>
<td>944</td>
<td>1.7</td>
<td>954</td>
<td>1.8</td>
</tr>
</tbody>
</table>

NPA MANAGEMENT -KEY TO ROBUST BANKING SYSTEM

While the percentage of non-performing assets (NPAs) to total advances/total assets has been declining over the years, the level of NPAs continues to witness an upward trend. As per the RBI report on Trends and Progress of Banking in India, 2001-2002, the gross NPA of Scheduled Commercial Bank (SCBs) increased to Rs.70,904 crore at end March 2001 from Rs.63,883 crore a year ago. Net NPAs on the same date amounted to Rs.35,546 crore compared with Rs.32,468 crore as at end march 2001. And the percentage of net NPAs to total net advances of SCBs declined from 6.2 as on end March 2001 to 5.5 as at end March 2002. The above observations hold good even when we analyze bank-groupwise data. Besides NPA percentage, the composition of loan assets indicate a factorable trend.

Broadly speaking, recovery measures could be classified into two categories, namely: legal measures and non-legal measures.

LEGAL MEASURES

1. Debt Recovery Tribunals (DRTs)

In the context of recovery from NPAs, DRTs are assuming great importance since efforts are on to set up 7 more DRTs during this year and also to strengthen them. Though the recovery through DRTs is at present less than 2 percent of the claim amount, banks and FIs have to depend heavily on them. Efforts are on to amend the Recovery Act to assign more powers to DRTs. More importantly, the borrowers tendency to challenge the verdict of the Appellate Tribunals in the High Court to seek natural justice needs to be checked. Otherwise, early recovery efforts through DRTs would be futile. Secondly, training of presiding officers of Tribunals about the intricacies of banking practices is very essential. Further, the number of Recovery officers has to be enhanced in every DRTs for effective recovery. Finally, banks and FIs have to come forward to provide liberal help to DRTs to equip them in terms of infrastructure, manpower etc.
2. **National Company Law Tribunal**

As per the announcement made in the Budget 2001-2002, Sick Industrial Companies Act (SICA) will be repealed and Board for Industrial Finance and Reconstruction (BIFR) will be wound-up. As an alternative arrangement, it is proposed to set-up NCLT by amending the Companies Act, 1056. In August 2001, the bill was introduced in the parliament. Accordingly, NCLT is expected to consolidate the powers of BIFR, High Court and Company Law Boards to avoid multiplicity of forums. In matters of rehabilitation of sick units, all concerned parties are supposed to abide by the orders of NCLT. There shall be 10 benches, which will deal with rehabilitation, reconstruction and winding up of companies. The entire process is estimated to be completed during a period of 2-3 years as against 20-27 years presently taken. The tribunal will have, in addition, powers of contempt of court.

3. **Corporate Debt Restructuring (CDR) body**

A need was felt to create a special agency to facilitate debt restructuring because there has been some hesitancy on the part of the banks and financial institutions to implement RBI guidelines on debt restructuring. Recently, a three-tier body, viz. CDR, has been set-up to coordinate corporate debt restructuring programme. CDR consists of Forum, Group and Cell. While the forum evolves broad policy-guidelines, the group takes decisions on the proposals recommended by the cell. Initially, the borrower approaches this Lead Bank/FI with a request to restructure debt, which in turn puts up the proposal to the Cell. The CDR covers only multiple banking accounts enjoying credit facilities exceeding Rs. 20 crores. Cases of DRT, BIFR and willful defaults, doubtful and loss accounts and suitfiled cases are outside the preview of the CDR shelter. Decisions of the group are based on the 'super majority' principle. If 75 percent of the secured creditors agree to the rehabilitation plan, it is binding on the other banks/FIs.

4. **Asset Reconstruction Corporation (ARC)**

It is proposed to set up ARCs in the private sector to take over NPAs of the public sector banks. The RBI will be the regulator of these ARCs. The ARC will buy the NPAs of the banks and financial institutions at the pre-determined discounted value and issue NPA Redemption Bonds which carry a fixed return. ARCs are expected to be managed by professionals to effect maximum recovery of NPAs which will help to redemption of bonds after some time. The Financial Ministry has finalized the draft bill to set up ARCs. Though the proposed scheme seems to be attractive, its success will depend upon the efficiency of DRTs and courts.

5. **Company Mergers**

Under the Companies Act, 1956, mergers are permitted. In 1977, section 72-A was inserted in the Income Tax Act to offer tax incentives to healthy companies which take over the sick companies and prepare revival plans. Response to this scheme has been limited because of delays in completing formalities as per the instructions of the High Court and Income Tax Department. Tax incentives are found to be inadequate to motivate healthy companies to come forward and take advantage of the scheme. Recovery of bank dues on company mergers is not assured since hardly 7.8 percent of sick companies are successfully revived. Encouraged
by the success achieved in company mergers in developed countries, a review of the scheme under section 72-A of IT Act is called for.

6. **Lok Adalats**

These are voluntary agencies created by the state governments to assist in matters of loan compromise. Lok-adalats meet at different places for the convenience of banks and borrowers. On the given date of the Lok-adalat meeting, both the bankers and the borrowers should be present. After looking into the evidence and listening to both parties, the Lok-Adalats issues a recovery certificate which will enable the bank in obtaining decree from the concerned court. This arrangement shortens the period in obtaining a court-decree, which is normally awarded after taking a much longer period. In view of this unique advantage, the government is thinking of strengthening them and raising the monetary limit set for referred cases. Alongwith this, efforts should be made to give wide publicity to the scheme, besides educating both banks and borrowers about Lok-Adalats.

**NON-LEGAL MEASURES**

1. **Reminder System**

The cheapest mode of recovery is by sending reminders to the borrowers before the loan installment falls due. Generally, the response to this arrangement particularly from honest borrowers is encouraging. But efforts need to be strengthened in banks in sending reminders in timely basis.

2. **Recovery Camps**

In respect of agricultural advances, recovery camps should be organized during the harvest season. To ensure maximum advantage, recovery camps need to be properly planned. It is also essential to take the help of outsiders, particularly, revenue officers in the state government, local panchayat officials, managers of the bank, etc. It also calls for professional approach to give a wide publicity of the recovery camps to be organized in the local area, mobilize as many farmers as possible and motivate the staff to get involved in the recovery drive.

3. **Rehabilitation of Sick Units**

Sick units both in SSI and non-SSI sectors should be identified on timely basis keeping in mind the official definitions. Causes of sickness should be genuine. If the project is found viable in terms of Debt Services Coverage Ratio (DSCR), rehabilitation package has to be prepared keeping in mind the broad parameters suggested by the RBI. The package should be implemented at the earliest by the bank and the borrower. Close monitoring of the progress of implementation is called for. There are several success stories on rehabilitation of sick units. But in general, it is observed that the success rate in revival of sickness is discouraging. Further, in the process of financial sector reforms, banks and FIs are hesitant to rehabilitate due to the threat of failure in rehabilitation. Recently, the RBI has permitted banks not to make provision for sick SSI units during the first year of implementation. New guidelines on rehabilitation of sick SSI units will also be issued soon by the RBI. For successful rehabilitation, it is essential to create a sense of urgency on the part of both banks and borrowers. Efforts on the part of the
government in terms of concessions, reliefs etc. should be made on timely basis. Understanding, between banks and SFCs should be strengthened. Above all, stern action against willful defaulors is called for.

4. **Loan compromise**

This is the last resort for recovery. This should be voluntary. It calls for a professional approach in preparing the compromise proposal for which each bank is expected to introduce a scheme. 'Committee-approach' should be adopted to decide on the loan compromise. Delays in taking decisions should be avoided. Recently, One Time Settlement (OTS) scheme was introduced by the RBI. The overall response to the scheme was limited. Hence, each bank is expected to come out with its own OTS scheme; in addition, training of operating staff is essential to change their mindset. For effective recovery, loan compromise should be taken up on priority basis.

5. **Appointment of Professional Agencies for Recovery**

Recently, IBA has worked out certain guidelines for banks on matters concerning the appointment of outside professional agencies whose services can be utilized to ascertain the whereabouts of the borrowers and enforcement of securities. There is some hesitancy on the part of public sector banks in engaging them for recovery purpose due to unpleasant experiences in certain cases. But during the post-VRS scenario, it is suggested to seek such outsourcing. This should be done after examining the credentials of the professionals. It is also essential to keep a constant vigil on their practices.

CONCLUSION

In any financial institution, NPAs are inevitable in the loan portfolio. But efforts should be made to maintain a reasonable level of NPAs. Keeping in mind the RBI plan to introduce the concept of 'one quarter' for identification of NPAs by 2004, it is high time to go in for recovery drive on a war-footing. While doing so, prevention of NPAs should not be forgotten. These are the major challenges before banks which have gone in for VRS. But sincerity and hardworking alongside professional approach on the part of bank management may help in the fulfillment of challenges. Towards this end, banks have to go a long way. Besides, the newly introduced tools of credit risk ratings would eventually help a bank to assign a probability of default for the borrower according to its risk category. The probability of default is determined statistically from past data by observing the behavior of various rated clients over a number of years. The expected losses from a loan can be determined using this probability of default. This probability will then help to determine the terms and conditions for the loans in terms of the amount, interest rate to be charged, maturity etc. In the times to come credit risk rating would be one of the important inputs which will be used in making the credit decisions, besides other factors like collateral provided, period and quality of relationship with the borrower, concentration risk in the individual/group/portfolio, etc. And all this would lead to better credit management and eventually lesser accumulation of NPAs and thus the objective of reforms in the Financial sector would be achieved.
ENIRONMENTAL ACCOUNTING

*B.C. Sanjeevaiah

ABSTRACT

Since the late 1980's the amount of concern shown by the general public on issues such as global warming, depletion of the ozone layer, and acid rain, demonstrates that environmental awareness has steadily increased. Environmentalism, far from being the concern of a radical minority, has entered mainstream consciousness, through initiatives such as the United Nations World Commission on Environment and Development conference, the 'Earth Summit', in Rio de Janeiro in June 1992. Governments' and Organisations have had to respond to this changing environmental agenda, and have begun to assess their impact on the environment. The paper makes an attempt to address a few specific issues of environmental accounting.

Bebbington (1997) identifies two main concerns at the core of environmental accounting: Firstly, dissatisfaction with conventional accounting practices, either in terms of the social and environmental consequences that arise from the application of accounting tools and techniques, or with the theoretical basis that underlies conventional accounting. Secondly, concern with exploring and developing new forms of accounting which are more environmentally benign and which have the potential to create a fairer more just society, Environmental accounting therefore provides a critique of existing practice and develops alternative accounting practices.

A CASE FOR ENVIRONMENTAL ACCOUNTING

Governments around the world develop economic data systems known as national income accounts to calculate macroeconomic indicators such as gross domestic product. Building a nation's economic use of the environment into such accounts is a response to several perceived flaws in the System of National Accounts (SNA), as defined by the United Nations and used internationally. One flaw in the SNA often cited is that the cost of environmental protection cannot be identified. Consequently, money spent, say, on putting pollution control devices on smokestacks increases GDP, even though the expenditure is not economically productive, some argue. These critics call for differentiating "defensive" expenditures from others within the accounts. Also misleading is the fact that some environmental goods are not marketed though they provide economic value. Fuel wood gathered in forests, meat and fish gathered for consumption, and medicinal plants are examples. So are drinking and irrigation water, whose sale prices reflect the cost of distribution and treatment infrastructure, but not

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the water itself. While some countries do include such goods in their national income accounts, no standard practices exist for doing so. When non-marketed goods are included in the accounts, they still cannot be distinguished from those that are marketed. Valuing environmental services such as the water shed protection that forests afford and the crop fertilization that insects provide is difficult. Though some experts call for their inclusion in environmentally adjusted accounts, typically neither the economic value nor the degradation of these services is included. On the other hand, however, the alternate goods and services needed to replace them-water treatment plants, for example-do contribute to GDP, which can be rather misleading. Still another problem is that national income accounts treat the depreciation of manufactured capital and natural capital differently. Physical capital—a building or a machine, for instance—is depreciated in accordance with conventional business accounting principles, while all consumption of natural capital is accounted for as income. Thus the accounts of a country that harvests its forests unsustainably will show high income for a few years, but will not reflect the destruction of the productive forest asset. While opinions vary on how to depreciate natural capital, they converge on the need to do so.

ENVIRONMENTAL ACCOUNTING METHODS IN USE

How environmental accounting is being done varies in a number of respects, notably the magnitude of the investment required, the objectivity of the data, the ability to compare different kinds of environmental impacts, and the kinds of policy purposes to which they may be applied. The following are some of the methods currently in use.

Natural Resource Accounts. These include data on stocks of natural resources and changes in them caused by either natural processes or human use. Such accounts typically cover agricultural land, fisheries, forests, minerals and petroleum, and water. In some countries, the accounts also include monetary data on the value of such resources. But attempts at valuation raise significant technical difficulties. It is fairly easy to track the value of resource flows when the goods are sold in markets, as in the case of timber and fish. Valuing changes in the stocks, however, is more difficult because they could be the result either of a physical change in the resource or of a fluctuation in market price. For environmental goods and services that are not sold, it is that much harder to establish the value either of the flow or of a change in stock.

Emissions Accounting. Developed by the National Accounting Matrix including Environmental Accounts (NAMEA) structures the accounts in a matrix, which identifies pollutant emissions by economic sector. Eurostat, the statistical arm of the European Union, is helping EU members apply this approach as part of its environmental accounting program. The physical data in the NAMEA system are used to assess the impact of different growth strategies on environmental quality. Data can also be separated by type of pollutant emission to understand the impact on domestic, transborder, or global environments. If emissions are valued in monetary terms, these values can be used to determine the economic cost of avoiding environmental degradation in the first place, as well as to compare costs and benefits of environmental protection.
Disaggregation of conventional national accounts. Sometimes data in the conventional accounts are taken apart to identify expenditures specifically related to the environment, such as those incurred to prevent or mitigate harm, to buy and install protection equipment, or to pay for charges and subsidies. Over time, revelation of these data makes it possible to observe links between changes in environmental policy and costs of environmental protection, as well as to track the evolution of the environmental protection industry. While these data are of obvious interest, some people argue that looking at them in isolation can be misleading. For example, while end-of-pipe pollution control equipment is easily observed, new factories and vehicles increasingly are lowering their pollutant emissions through product redesign or process change rather than relying on special equipment. In such cases, no pollution control expenditures would show up in the accounts, yet environmental performance might be better than in a case where expenditures do show up.

Value of non-marketed environmental goods and services. Considerable controversy exists over whether to include the imputed value of non-marketed environmental goods and services in environmental accounts, such as the benefits of an unpolluted lake or a scenic place. On the one hand, the value of these items is crucial if the accounts are to be used to assess trade-offs between economic and environmental goals. Otherwise, the accounts can end up reflecting the costs of protecting the environment without in any way reflecting the benefits.

Green GDP. Developing a gross domestic product that includes the environment is also a matter of controversy. Most people actively involved in building environmental accounts minimize its importance. Because environmental accounting methods are not standardized, a green GDP can have a different meaning in each project that calculates it, so values are not comparable across countries. Moreover, while a green GDP can draw attention to policy problems, it is not useful for figuring out how to resolve them. Nevertheless, most accounting projects that include monetary values do calculate this indicator. Great interest in it exists despite its limitations.

CONCLUSION

Environmental accounting would receive a substantial boost if an international consensus could be reached on methodology. The UN Statistics Department has coordinated some of the ongoing efforts toward this end since the 1980s. In 1993, the UN published the System for Integrated Economic and Environmental Accounting (SEEA) as an annex to the 1993 revisions of the SNA. SEEA is structured as a series of methodological options, which include most of the different accounting activities described above; users choose the options most appropriate to their needs. No consensus exists on the various methods that the UN recommended. In fact, SEEA is now undergoing revision by the "London Group," comprised primarily of national income accountants and statisticians from OECD countries. The group's work will be an important step toward consensus on accounting methods.
REFERENCES


VAT - MAJOR DOUBTS IN THE MINDS OF BUSINESSMEN

*Nand Kishore Sharma

ABSTRACT

The concept of VAT has been gaining increasing recognition lately and it has been regarded as world’s fastest growing tax system. In 1963, it was recommended by Neumark Committee as the standard form of sales tax for the Common Market Countries which was supported by to directives of Council of Ministers of EEC in 1967. In European and Latin American countries this tax system gained immumise popularities. The European Economic Community adopted this tax system as a tool for tax harmonisation. The present study is empirical and results of a study based on 200 businessmen are analysed.

In India State Government of Maharashtra in the year 1995-96 proposed to start VAT as replacement of Sales tax in a phused manner. But the same was not perhaps successful because documentation part was not complete and the idea was strongly opposed by businessmen. State Government of West Bengal also in the year 1995-96 propose to start VAT on certain goods but the response was not very encouraging due to many reasons and the rules of the State Government framed were reported as cumbersome and not comprehensive in character.

The Empowered Committee of State Finance Ministers, on February 3, 2003 has endorsed the suggestion that all State Legislations on VAT should have a minimum set of common features. In view of the apprehensions expressed by a large number of our estate Government about the possible revenue loss in the initial years of introduction of VAT, the Central Government has agreed to compensate hundred percent of loss in the first year, 75 percent. If loss in second year and 50 percent of loss in the third year of introduction of VAT.

A survey of two hundred businessmen situated in different parts of Rajasthan State with the help of telephone about the different aspects of VAT was conducted. The result of this survey is given in this research paper. The time period of this survey is from 1st Sept. to 30th Sept. 2003.

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WHETHER SALES TAX IS REPLACED BY VAT OR NOT?

79 percent businessmen included in my survey are not in favour of replacement of sales tax by VAT. They gave following argument in support of their reply:

(i) The VAT needs more accounting work.
(ii) It will increase Inspector Raj.
(iii) It will increase more corruption in tax department.
(iv) The system of calculation of VAT is very difficult.
(v) It is difficult to understood toy businessmen as well as consumers.

WHETHER VAT IS INTRODUCED ONLY ON SALES OF GOODS OR ON GOODS AND SERVICES BOTH?

40 percent of such businessmen who support introduction of VAT are of the view that VAT should be introduced on goods and services both, and remaining 60 per cent are of the opinion that VAT should introduced only on sales of goods.

WHETHER VAT IS INTRODUCED ONLY ON LOCAL SALES OR ON LOCAL END EXPORT SALES BOTH?

All the Businessmen under study are of the view that VAT is introduced only on local sales.

WHETHER VAT IS APPLIED AT A SINGLE RATE OR RATES DIFFERENTIATION?

52 percent of my simple is of the opinion that only a single rate is used and remaining 48 of this staple is in favour of rates differentiation.

WHETHER VAT IS SUPPLEMENTED BY ADDITIONAL TAX LEVIES OR NOT

In most of the countries who are following VAT are also supplemented VAT by additional tax levies on certain products such as Motor fuels. Tobacco and Alcohol either for revenue reasons or to discourage their consumption. Above additional tax levies are generally levied at relatively higher rates at the first point of sale and are additional to VAT. All the businessmen selected in this staple are of the view that present excise duty on Tobacco and Alcohol will continue in addition to proposed VAT.

WHAT EXCISE SYSTEM IS USEFUL WITH PROPOSED VAT?

The popular excise systems are: Limited excise system, Intermediate excise system, and Extended excise system. The limited excise system comprise the traditional excise goods, such as Alcoholic beverages, Tobacco products and petroleum products. Some food products like sugar, confectioneries, tea, cocoa and coffee. Intermediate excise system covers a large number of luxury products in addition to goods covered by first system, such as household
appliances, audio-video equipments, precious stones and cosmetics. The extended excise system covers both two systems and also produces goods.

In this survey 80 per cent businessmen are of the view that limited excise system will be used together with proposed VAT and only 20 per cent are in opinion of following Intermediate Excise system. But not even a single businessman is of the view to use extended excise system.

WHETHER VAT IS COVERED SALES TAX OR ALL INDIRECT TAXES?

Ninety percent businessmen of my sample are of the view that proposed VAT is only covered by sales tax and other indirect taxes will continue as usual. Only ten percent businessmen are of the view that it should be in place of all indirect taxes.

WHAT METHOD OF CALCULATION IS USED FOR VAT

There are three popular methods of calculation of VAT. These are: Addition method, Subtraction method and Credit method. Above three methods are similar theoretically, but they are related to different principles of VAT. Thus, above three methods are not substitute of each other. In addition or income method the basis of the tax is the payment made to every factor of production i.e. rents, wages, interest and profit. This method is similar to income method of calculating National Income. In subtraction method, we deduct the cost of materials from total sales to find at value added.

In credit or invoice method registered businessman charge tax on its total sales and claim a refund for tax paid for inputs used in producing sales. This tax credit is given only when tax paid on purchase is supported by invoice issued by registered firm. In present survey 85 percent businessmen are in favour of invoice method, ten percent businessmen are in favour of addition method, and only five percent in favour of subtraction method.

SUGGESTIONS

VAT is in accordance with the principle of destination based consumption. It is the best alternative mechanism of collection of sales tax. Use of VAT simplifies the indirect tax system of our country, it helps in transparency of tax burden and reduction in its evasion. An important step in the introduction of VAT is that tax payer should understand that VAT will be levied on its value added and not on the gross value of good and services. This understanding will not cause any pressure and compliance problems from tax payer’s side.

(1) It is necessary to educate the tax payer, consumer and businessmen through T.V., Newspaper and other mass media about the merits of VAT.

(2) Our Union Government should take initiation to implement the VAT in place of existing indirect taxes. The Union Government must compensate our state governments for the loss of indirect tax revenue due to VAT for at least five years.
Sharma

(3) VAT should be introduced on all such goods and services on which present indirect taxes are levied.

(4) Invoice method will be used for VAT in which VAT is levied on sales in the period and deduct the tax already paid on the purchase of the same period.

(5) Single rate is used for VAT, because it is better in achieving administrative convenience and easy calculations by the dealer.

CONCLUSION

Sales tax is the mainstay for revenue to the states, the idea of a change over has invited much resistance from state governments. In terms of incidence of tax, the VAT is to be collected as a partial payment at various production and distribution points as compared to collection of sales tax at one point in the whole chain of transactions. It helps in ensuring a build-in-mechanism against evasion. There will be a need for more elaborate administrative setup for collection under the VAT.

The VAT system of taxation does not encourage vertical integration as it is independent of number of stages in the production and distribution channel. Therefore, in my view VAT may prove a better resources mobiliser than the present sales tax system. But replacement of general sales tax by the VAT be a path breaking attempt in the field of indirect tax system in our country.
BOOK REVIEW

Accounting Education in South Asia
Author: K.R. Sharma, Concept Publishing Company, New Delhi, 2004, Price Rs. 400, Pages 238

This book is based on the research project entitled Accounting Education in South Asia sponsored by the Indian Council of Social Science Research, New Delhi. The book has been very successful in highlighting the fact that "Accountants have to be conscience keepers of the business and protectors of the public interest. Given the above backdrop, this book contains six chapters and seven Appendices containing a few set of questionnaires, list of respondents etc. The introductory chapter describes conceptual framework scope and research objectives. The chapter two is mainly devoted to socio-economic profile of SAARC countries and various parameters like per capita income, demographic variables, medical and health standards, national income have been studied. The chapter three presents a sketch of education structure and system. The chapter four of this book explains accounting education scenario prevailing in the region with special focus on curriculum development issues. The chapter five offers an overview of education system of professional accountants and recent developments. The role of the institutes of chartered accountants in various countries of the region has been streamlined. Finally the last chapter - sixth, provides summary in form of conclusions. The language of the book is very simple, clear and has got logical structures. This book can serve as an excellent reference for policy makers, accounting educators, professional at different levels in governments, universities and bodies of professional accountants.

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PRINCIPLES AND PRACTICE OF ACCOUNTANCY
Authors: RL Gupta and VK Gupta, Edition: Eleventh, 2004,
Publishers: Sultan Chand and Sons, Educational Publishers, New Delhi, Price: Rs. 250, Pages: 1345+

The subject matter of the book is divided into five parts. They are basics of financial accounting, partnership accounts, special accounting problems, company accounts and analysis of financial statements. Short and comprehensive illustrations, summery, objective type questions, theory question and unsolved short and long answer questions, with suitable hints to have been given in all chapters. This facilitates students to test their understanding of the subject matters. It has also included the illustrations and unsolved practical questions. The book is useful to the academicians, students of commerce, management, CA, CS and ICWAI.

STUDIES IN ADVANCED ACCOUNTANCY
Authors: Dr. S.N. Maheshwari Dr. S.K. Maheshwari, Edition: Second, 2004,
Publishers: Sultan Chand and Sons Educational Publishers, New Delhi, Price: Rs. 250, Pages: 1302+

The book is mainly designed to meet the scheme of syllabus for professional education examination-II of ICAI. It contains questions-answers, problems and Solutions relating to partnership accounts, company accounts, and financial analysis. The each chapter is starting with an introduction giving overview of the subject matter covered in the chapter and it incorporates both theoretical and practical questions. This approach makes the students to understand the problems thoroughly by step-by-step process. At the end of each chapter 'points to remember' have been given for recapitulation and better grasp over the subject. It also contains new accounting standards issues by the institute of chartered accountant of India. The book is useful to the academicians, students of commerce, management, CA, CS and ICWAI.

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IAA NEWS

News on the XXVI All India Accounting Conference and International Seminar of the Indian Accounting Association

The XXVI All India Accounting Conference and International Seminar on Accounting Education and Research was held during 27-28 Dec., 2003 in the Faculty of Commerce and Management Studies, Mahatma Gandhi Kashi Vidyapith University, Varanasi. Prof. Surendra Singh, the Vice-Chancellor of MGKV University graced the Inaugural Session as the Chief Guest. Prof. Rajendra Prasad Srivasthava of Kansas University, USA., delivered the Key-Note Address while Dr. NM Singvi of Ajmer, delivered the Presidential Address. The International Seminar on Accounting Education and Research was chaired by Prof. Dinesh K Gupta of Punjab University. Prof. BM Lal Nigam served as the Chief Guest of this International Seminar. A number of thought provoking research papers were presented followed by a discussion. The First Technical Session on Corporate Disclosure and Governance was chaired by Prof. D. Obul Reddy of Osmania University. The Second Technical Session on Value Added Tax was chaired by Prof. Sujit Sikidar of Guwahathi University. Both the sessions witnessed keen participation by the delegates and contributed several new ideas. The Association conferred IAA Fellowship on Late Prof. K.S. Mathur, Prof. Bhagwathi Prasad and Prof. Y. Ranga Rao. The IAA Young Research Award was given to Dr. S.C. Mishra of ICFAI.

Some of the important decisions taken at the Special AGM, AGM and EC meetings of IAA at Varanasi during 27-28, Dec.2003, include (i) Increase in the number of EC members (Election category) to 15 from the present 9; (ii) Increase in the number of EC members (Cooption category) to 10 from the present 7; (iii) Sending 25% of the Branch Subscription amount to the Chief Editor, IAA; 50% to the Treasurer, IAA while retaining the balance 25% in the branch; (iv) Organisation of First International Conference of IAA at the University of Rajasthan during Sep.2005 as proposed by Prof. Sugan Chand Jain, Head, Dept of ABST, University of Rajasthan; (v) Bhubaneswar Branch to host the 27th All India Accounting Conference during Nov. 2004; (vi) Election of Prof. B. Mohan as the President; Prof.B.S. Rajpurohit as the Sr.VicePresident; Prof. MB Shukla as the Jr. Vice President; (vii) Election of Prof. M Srinivvas, Dr. S.K. Kanodia, Dr. PK Nath Dr. AK Sarkar to the Executive for a period of three years; (viii) Coption of Dr. K.L. Jain; Dr. G.Soral; Dr. Lalit Gupta; Dr. Sanjay Bayani, Dr. RV Keswala, Prof. BC Sanjeevaiah, Dr. PK Bhandgar, Dr. OP Rai, Dr. SS Modi, besides Prof. R.K. Bal the 27th Conference Secretary.

Prof. Pratap Sinh Chouhan of Sourashtra Branch; Dr. PG Gopalakrishna of Mumbai Branch; Prof. KV Achalapathi of Hyderabad Branch, Prof. Ranjan K Bal of Utkal Branch promised to enroll Institutional members for Journal Subscription. The following contributions are made/announced in the AGM:

1. The President of IAA, Dr. N.M. Singvi contributed Rs.20000 (twenty thousand) by way of cheques dated 31.3.2004 (post dated).
2. Prof. Sugan C. Jain promised to contribute Rs.5000, to the journal (five thousand) in addition to Rs. 10000 (ten thousand) pa. Prof. Jain also promised to pay Rs. 5000 from Jaipur Branch to the Corpus of IAA.
3. Barrely Branch promised Rs. 5000 to the IAA Corpus.
Indian Journal of Accounting

4. Prof. Sikidar of Gauhati Branch contributed Rs. 1000 in cash.
5. Prof. RK Bal of Bhub Branch promised Rs. 5000 to the IAA Corpus
6. Prof. MB Shukla of Kasi Branch promised Rs. 5000 to the IAA Corpus
7. Prof. Pratap Sinh Chouhan, of Sourashtra Branch promised Rs. 5000 to the IAA Corpus

The delegates expressed high degree of delight with the rich academic contributions and comfortable stay arrangements of the good host Prof. MB Shukla of Mahatma Gandhi Kashi Vidyapith University, Varanasi.

Prof. D. Prabhakara Rao
General Secretary, IAA

27th All India Accounting Conference

The 27rd All India Accounting Conference will be held at Utkal University under the joint auspices of the Department of Commerce, Utkal University and Bhubaneswar branch of the Indian Accounting Association (the dates of the conference will be notified in due course), with the following topics:

- **International Seminar**
  - Accounting Education and Research
    - Prof. B.M. Lal, Delhi

- **Technical Session - I**
  - Corporate Mergers and Acquisitions
    - Prof. K.V. Achalapati, Hyderabad

- **Technical Session - II**
  - Environmental Accounting
    - Prof. T.C. Saha

Prof. Ranjan K Bal of the Dept of Commerce, Utkal University, Bhubaneswar will be the Conference Secretary.

Proposals for Young Researcher Award-2004

Indian Accounting Association invites research proposals on research work done during the last five years in the area of Accounting by scholars/faculty members of not more than 35 years of age as on 31.12.2003 for the consideration of IAA Young Researcher Award-2004. The proposals may be submitted, on or before 15th July, 2004 to Prof. D. Prabhakara Rao, General Secretary, IAA, Faculty of Commerce and Management Studies, Andhra University, Visakhapatnam-530003. (Cell: 094401 31863 Phone: 0891-2755538 dprabhakararao@eth.net )

Proposals for IAA BEST PUBLISHED ACCOUNTS Award-2004

Indian Accounting Association invites proposals from Companies/Corporations/Autonomous Bodies for the consideration of IAA BEST PUBLISHED ACCOUNTS Award-2004. The proposals may be submitted, on or before 15th July, 2004, to Prof. D. Prabhakara Rao, General Secretary, IAA, Faculty of Commerce and Management Studies, Andhra University, Visakhapatnam-530003. (Cell: 094401 31863 Phone: 0891-2755538 dprabhakararao@eth.net)
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(1969-78)

Prof. Mukund Lal  
(1978-1993)

Dr. S.K. Singh  
(1993-94)

BRANCH SECRETARIES

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10, New Readers Qtrs.  
Gujarat University,  
Ahmedabad - 380 009

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