

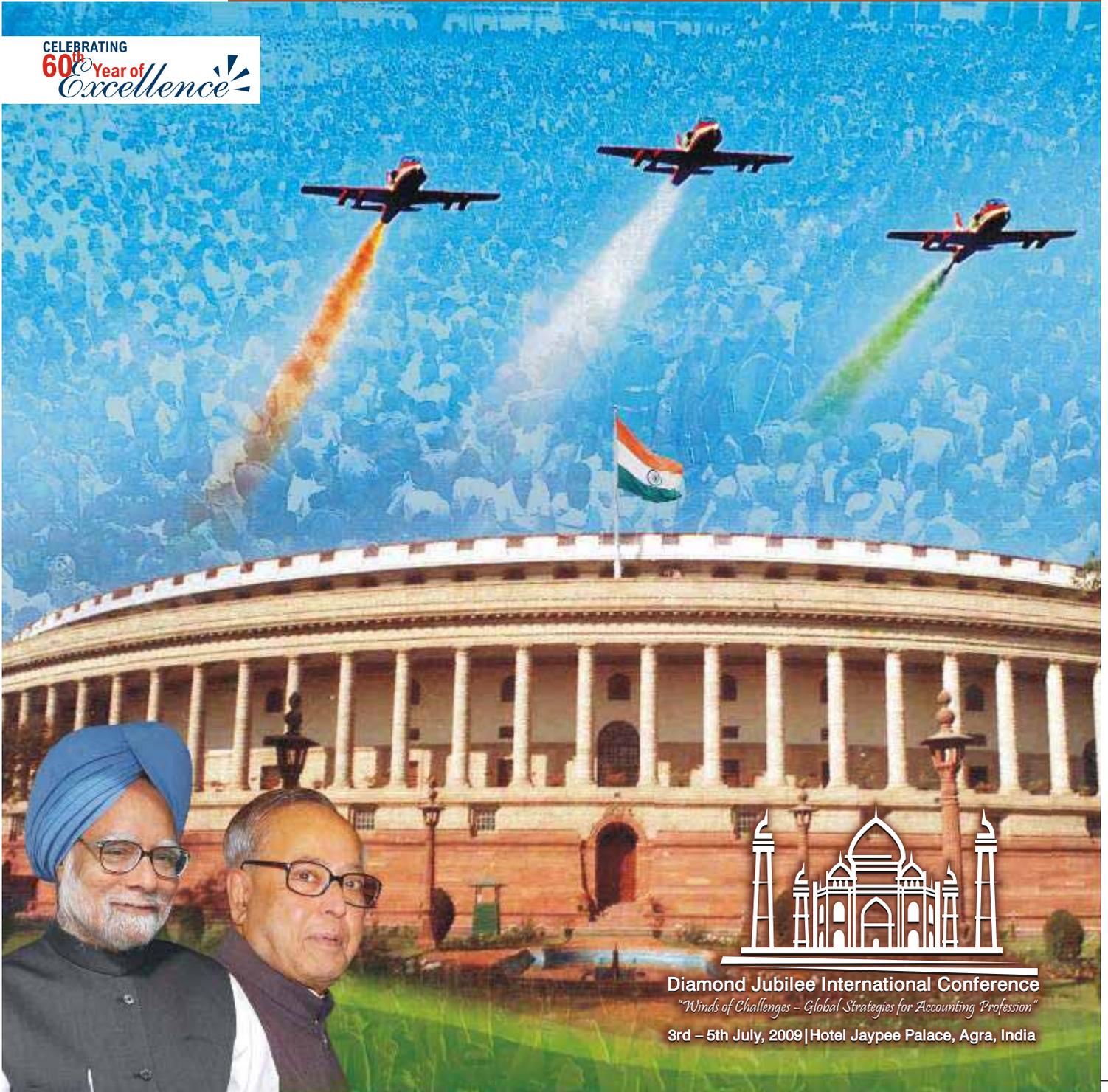
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THE CHARTERED ACCOUNTANT

JOURNAL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA



CELEBRATING
60th Year of
Excellence



Diamond Jubilee International Conference
"Winds of Challenges - Global Strategies for Accounting Profession"
3rd - 5th July, 2009 | Hotel Jaypee Palace, Agra, India

Volume 57 | No. 12 | June, 2009

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Rs. 100

DEMOCRATIC RENEWAL – THE VISION AHEAD

The rites of passage through a grueling General Election are over. This festival of democracy is the celebration of that quintessential quality of humanity – the exercise of one's individual right to decide whom to give an opportunity to govern our nation for the next five years. The elections have shown the will of the people. We are fortunate that the electorate has expressed its verdict with a certain element of exactitude. The electorate wishes that there should be continuity and appears to signal towards continuity for the doctrinal proclivities of the incumbent government.

The administration that will take over the reins of government has its work cut out for it. The primary issue is the economic challenge to ensure livelihood for our vast and burgeoning population in a recessionary global economy. The GDP growth projections are down from 8% to 6%. This implies a downsizing of the economy. Corporate margins are under stress. Export based industries are lagging and the services sector is also slumping. Our burgeoning middle class is facing pay cuts if not outright job cuts.

In the next few years it is likely that the financial leadership enjoyed by the Europeans during the 18th and 19th centuries and in the post 1945 period by the United States of America is likely to be diluted. Even as this issue goes to the press; China is interacting with trading countries to ensure that transactions are routed through the Yuan (Renminbi) instead of through the US Dollar. This is representative of the clout that the large reserve that the Chinese enjoy.

In a metaphorical way the iron is hot. The time to strike is now. The balance of economic power will over the next few decades shift in favour of the Asian Continent. For this to happen in our context we require to take a long hard look at the possibilities ahead and the ways and means that are at our disposal in order that we can achieve a decent standard of life for our citizens and in order that India

can take its rightful position in the pantheon of nations.

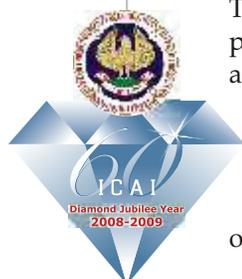
Whilst development requires industrialization at the same time the interests of the impoverished people has to be kept in mind. At this point of time our work force is unskilled and largely dependent on agriculture. It is the only skill set they possess and the rural poor have apprehensions; that in the event of their land being taken away they will be unable to find suitable employment for themselves and as a corollary for their future generations. The current economic downturn necessitates a higher level of support to Agriculture sector to ensure food security and to improve the lot of the rural poor.

Progress needs to be inclusive. The generation of wealth is a good proposition only if we can ensure equitable distribution. Riding roughshod over the opinions of others is morally reprehensible. Rural Health is an area that will increasingly require unswerving attention. We can hardly aspire to be a great nation if we have a population that is sick and unhealthy. Technology has to be harnessed in ways and means that can ensure the deliverance of medical facilities to our citizens. All this needs to be conducted efficiently and with minimal disruption to the ecosystem.

Presently, the Government is in the midst of a phase wherein we are experiencing ballooning revenue and capital deficits. The Government needs to ensure that oversight can be maintained into the utilisation and flow of funds to the beneficiary. The mechanics of accounting pursued by the Government needs to be brought in line with the expectations of the nation. The cost of governance needs to be brought down. The outlay of funds should be on improving skill sets of the populace. Monitoring and oversight of the funds deployed needs to be done concurrently to ensure that post-mortem examinations conducted will only lead to discovery of funds being spent post event occurrence.

– Editorial Board

ICAI- Celebrating 60th Year of Excellence



Editorial

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
 ICAI Bhawan, Post Box No.7100, Indraprastha Marg,
 New Delhi-110002, Tel: +91 (11)39893989.
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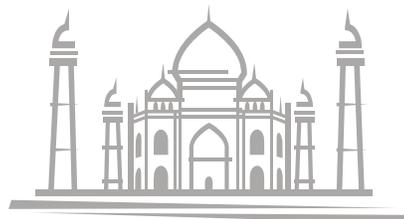
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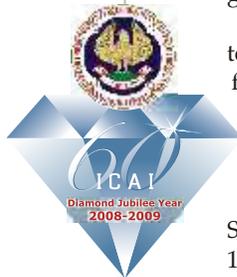
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Diamond Jubilee International Conference
Winds of Challenges - Global Strategies for Accounting Profession

IN THIS ISSUE



Dear CA Pariwar,

The past few days witnessed unprecedented optimism as the election results unfolded and the Congress emerged victorious with the highest number of seats won by any single party in the last twenty five years. The people have delivered their verdict. They have voted for a coherent and stable government.

All the potential king makers have been cut to size. This time round the Government formed at the Centre would be able to take bold decisions without fear of any arm-twisting tactics by any of its constituents.

No Government in recent memory has had it so good. Our prime minister Dr. Manmohan Singh is the only PM since Jawaharlal Nehru in 1961, who has been voted back to power after completing a full five-year term.

The stock market sky-rocketed by a historic 2,111 points, a feat never witnessed before in any part of the world. The rupee is gaining strength against the dollar and there is an all-round optimism in the air. It is sincerely hoped that this optimism puts India back onto a sustained growth trajectory.

We can definitely look forward to the UPA getting down to finish its unfinished agenda and take forward its bold proposals, which had hit the road block earlier by some of its constituents in the last Government. We can also expect the implementation of the second generation of economic reforms which would give a great impetus to the economy.

We as professionals will also have to gear up and rise to the occasion. There would be more opportunities and fresh challenges. As partners in nation building, we can ensure to take India to greater heights.

I wish to thank all of you to acceding to my request and voting in large numbers thereby voting to power a stable government, which can take decisions and implement plans without worrying about the support its proposals would receive on the floor of the Parliament.

Spreading wings abroad

In the past sixty years, our Institute has carved a niche for itself abroad and is widely recognised as one of the premier accounting bodies in the whole world. The services of the Indian Chartered Accountants are sought for by numerous clients across the globe. The recent MRA's signed with ICAEW and CPA Australia would also ensure more

opportunities for our members in the global arena.

Sensing growing opportunities in various African countries, the ICAI co-organised *Africa Day* along with Indo-Africa Chamber of Commerce and Industries on May 18 and 19, 2009. During the event, ICAI showcased its intent to collaborate with African countries to develop the accountancy profession and infrastructure and provide technical assistance in tandem with the economic development taking place in their countries. ICAI signed a historic MoU with the Republic of Djibouti wherein ICAI would provide full support to the University of Djibouti in establishing learning institute in that country on similar lines of the work done by ICAI in Nepal.

I had the opportunity to be a member of a high-profile delegation to Spain and Poland led by the Hon'ble President of India, Her Excellency Smt. Pratibha Devi Singh Patil on April 21st-24th, 2009. Both these countries hold great opportunity for development of closer trade and economic ties with India. This gave me an opportunity to present our Institute's activities to the business community of these two countries. The interactions in both countries proved very useful with both sides agreeing to support and strengthen economic partnerships with India.

In the next decade, more and more attempts will be made to make our presence felt across our borders. Our aim is to make our members the most sought-after professionals in the world. We have finalised the fee structure for members of ICAEW and CPA Australia to become members of the ICAI and *vice-versa* and am pleased to inform you that so far about 70 and 40 members have already applied for membership of ICAEW and CPA Australia respectively.

Diamond Jubilee Year Celebrations

To commemorate this landmark year, it has been decided to organise various events on various social, contemporary and emerging areas. In the last sixty years, the Institute has constantly been trying to hold more and more activities and provide better facilities and services to its members and students. However, on this auspicious occasion, we thought that it was time we did something for the society at large. Therefore, we have dedicated every month starting from July to some social cause.

The month of July is dedicated to the theme of "Go Green" wherein various activities will be undertaken throughout the country by Head Office, Regional Offices and Branches to create awareness and activation drives such as plantation of saplings, Go Green Run at Agra and other cities, collaborating with local municipalities and traffic police for a pollution free environment, advocating use of solar power or CFL bulbs and discouraging use of plastic bags amongst other initiatives.

Similarly, the month of August is dedicated to educational initiatives and IT training wherein school kits and educational aids will be distributed and IT training will be imparted to the economically poor section of the society. In the month of September, career counseling programs will be held to guide our students to choose a career path most suitable to his/her abilities and aptitude.

In the month of October, focus will be on the empowerment of people focusing on social empowerment, economic empowerment and empowering women. November will be dedicated to agriculture. Even though our country is an agro-based economy, our farmers are uneducated and are unaware of how to raise loans, insure their crops, increase productivity or market their produce. By collaborating with banks, insurance companies and agriculture-based institutions a mass awareness drive will be undertaken throughout the country in this regard. This will also enable our members to offer yeomen services to a sector that has generally remained neglected.

The month of December is dedicated to programmes on public awareness and January is dedicated to various sports and youth related activities.

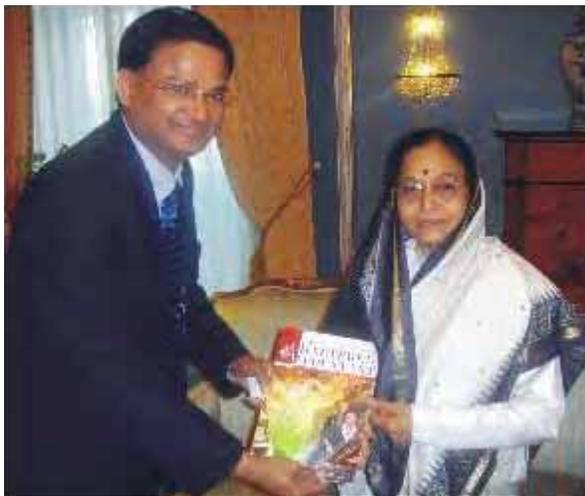
All these specialised activities throughout the country will provide you with abundant opportunities to involve yourself and play a proactive role in this Diamond Jubilee Year by contributing towards nation-building and betterment of society. So I hope to see all of you in large numbers to support the Institute in

carrying out its social objectives in the Diamond Jubilee Year.

Diamond Jubilee Conference

A Diamond Jubilee International Conference on the theme, "Winds of Challenges – Global Strategies for Accounting Profession" is being organised from 3rd to 5th July, 2009, at Hotel Jaypee Palace in Agra.

Agra is a historical city and a feather in the cap of "Incredible India", and a befitting place to hold an international conference. The city also possesses the most precious jewel of the country's crown, the "Taj Mahal".



President, ICAI with President of India
H.E. Mrs Pratibha Devisingh Patil

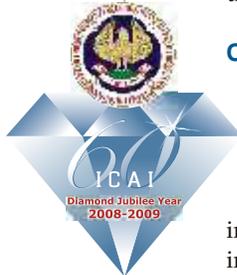
This forum would provide an ideal opportunity for members to interact with professionals from all parts of the world and provide exposure to professional opportunities from across our borders. As the world veritably transits into a 'Global Village' due to the onset of Internet and global network-

ing, dissolving business frontiers and shrinking distances, a new world is fast emerging. In this scenario, Accountants must acquire requisite knowledge and skills on one hand, and organisational and operational strength on the other, in order to be able to compete globally.

This Conference will dwell on the topical issues related to Governance, Financial Engineering, Regulatory Compliance, Value Creation, Corporate Social Responsibility and the like. The International Conference would be congregation of renowned experts in the area of accounting, auditing and management from IFAC, IASB and other international bodies including leaders from Trade and Industry in India.

Radio-thon

As part of our Green initiative, "Planet Alert" has been taken up by the Institute in the Diamond Jubilee Year and I am pleased to inform you that we have tied up with Big FM for an 18-hour Radio-thon on June 5, 2009, which happens to be the World Environment Day. There will be a broadcast across 45 cities in



India creating awareness on how we can all contribute to combat climate change. A number of celebrities will air their concern about global warming followed by interviews, skits, activation drives and awareness messages. The Institute has taken up the issue of spreading awareness on climate change which is of global concern and will kick-start the campaign with this Radio-thon.

CPE Study Circles for Members in Industry

During the past sixty years our profession has been getting slowly but surely aligned towards industry. An increasing number of our members are joining the industry thereby outweighing the number of members in practice. This clearly proves that the industry is welcoming our profession with open arms thereby providing more employment opportunities to our members.

I have always considered that our members in industry are the brand ambassadors of our profession as they play an important role in the economic development of the country. The contribution of our members in industry to enable ICAI achieve the recognition as one of the most dynamic professional accounting bodies in the world has also been immense.

Like our members in practice, it is time that our members in industry also come forward and form CPE Study Circles for Members in Industry. This would further enhance their brand image and also provide a forum for interaction to update their knowledge on a continuous basis. The Committee for Members in Industry has been geared up to extend all possible support and guidance to these CPE Study Circles.

Corporate Standards

The globalisation and the emerging scenario of the corporate world require specialised professionals who can provide service with excellence, professionalism and objectivity to deal with various aspects of the corporate affairs. Corporates follow diverse principles, practices and procedures and therefore, there is a need to integrate, harmonise and standardise such principles, practices and procedures so as to promote uniformity and consistency. Technicalities of corporate laws, accounting and auditing have undergone and are undergoing important changes. Members and other stakeholders need guidance on various areas of corporate laws and practice. Since the members are expected to keep pace with recent

developments, the Institute decided in principle to issue the Corporate Affairs Standards (CAS) to guide the members and other stakeholders.

The CAS will set out concepts, principles, practices and procedures which are generally accepted internationally and which the Institute considers desirable in the light of prevailing legal framework, the applicable law, judicial pronouncement and the best global practices which are in conformity with the law of the land.

The main purpose of formulating CAS is not to interpret the Law but to set out the concepts, principles, practices and procedures that underlie the corporate law compliances, corporate governance and management of corporates. The CAS are not mandatory in nature but would serve as guiding principles for members and other stakeholders.

Widening the scope for SMPs

Nearly 85 per cent of the professional practitioners in the South Asian region constitute of SMPs and one has to pro-actively work to create awareness amongst SMPs towards capacity building, providing better infrastructure and opportunities and giving due recognition to them as catalysts for achieving sustainability in all aspects of economy. As the first Chairman of the SMP Committee of SAFA, I have prepared an Action Plan for the issues germane to SMPs & SMEs of the South Asian region. The experience I gained as Technical Advisor to the SMP Committee of IFAC has been immensely beneficial and instrumental in preparing this Action Plan, which would ensure that there is an adequate awareness amongst member bodies to help SMPs at respective Institute level in various areas of capacity building like venture capital, tie-up with banks for availability of funds at cheaper rates and facilitate the pooling of infrastructure facilities so that members can actually come together under one roof.

Campus for SMEs and SMPs

At a time when most Institutions are finding it difficult to get a good response for campus placement, we are adding a new dimension to our already successful placement programme. We are organising a new Campus Placement Programme for newly qualified chartered accountants exclusively structured for meeting the needs of small and medium-sized enterprises (SMEs) and small and medium-sized CA firms (SMPs). This clearly indicates the

growing demand for our profession at all levels despite the present economic slowdown. It is indeed heartening and encouraging to see that our profession is making rapid progress and is gaining in recognition.

National Workshops for Statutory Auditors of PSUs

The PSUs are making fresh waves in India. After being considered as white elephants in the past, today PSUs have become drivers of economic growth and profitable ventures. Recognising the resurgence of PSUs, we are organising a series of Workshops for PSU auditors in association with the office of C&AG.

The need for organising the workshops for PSU auditors in association with C&AG was shared at the dinner meeting hosted on March 7, 2009, to felicitate Ms. Pravin Tripathi, Deputy C&AG (Commercial) and Ms. Bharti Prasad, Deputy C&AG wherein both sides aired their grievances. Members of C&AG felt that their expectations were not being met whereas our members expressed the considerable difficulty they face in getting allotment of PSU audits.

Therefore, it was decided to hold joint programmes so that the gap could be bridged. This is the first time that programmes are being organised in collaboration with C&AG. I am sure that these workshops would create a better understanding of both sides and immensely benefit our members in discharging their professional responsibility while carrying out audit of the PSUs.

Accountancy Museum

The Institute has created and maintained a Museum of Accountancy at Noida wherein the evolution of the accountancy profession in India is recorded and archived for future generations. I am very pleased to inform you that the Government of India has given due recognition to the Museum and approved the name *Accountancy Museum of India*. We now have the credibility and authority to communicate information on this often neglected but one of the great intellectual streams of study and profession in the world. It is indeed a matter of great pride and honour that the Institute has been entrusted with this task of creating permanent footprints of this great profession by way of a museum and I am sure that all the members and students would make it a point to contribute with their ideas and suggestions to make this Museum one of the wonders of the accountancy profession. Also, all of you must make it a point, during

your future trips to New Delhi or Noida to visit the Museum which would provide you a deep insight into the accountancy profession and bring you closer to the Institute that you are a part of. We also plan to create and maintain a similar Museum in Mumbai.

The Motto Song

To instill pride and a sense of belonging, you will be glad to know that the audio version of our motto of the Institute in form of composed song is now available on the Institute website. You may download the same and store it in your mobile phones and use it as a ring tone. This unique ring tone will distinguish you from others and make you feel part of a great profession. You may download this song from http://www.icai.org/resource_file/16068ICAIMottoSong1.mp3.

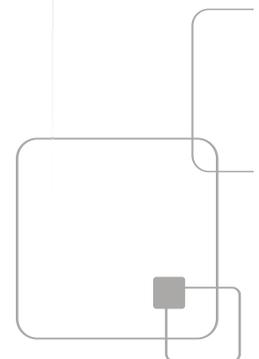
Website for Professional Opportunities

In order to provide timely and necessary information on practice development and professional opportunities to the members, we have launched a new website www.pdicai.org. This site has been designed to provide members with all the information that they need to enrich their own practice and provide value added services to their clients. On this website, you will find professional opportunities including invitation for tenders, consulting assignments etc., matters of professional interest, media reports, relevant court judgments, circulars and notifications of various government bodies, important contacts and links, ready reckoner and a forum where members can post their queries to be answered by the other users of the site.

Disciplinary Committee

After the hue and cry that followed the Satyam fiasco, I had assured you all that I would take up the pending disciplinary cases on top of my agenda. I am pleased to inform you that we completely revamped the process and brought the disposal of all the cases under the old Act at the prima-facie stage by the Council (Complaint/Information), upto 17th November, 2006 but for the last 25 cases which are included in the agenda of the Council for its prima facie opinion.

Moreover, in the last meeting of the Council, the Council had considered 12 Disciplinary Reports. Out of 12 reports, 6 reports pertained to the Second Schedule Matters. The Council had recommended the punishment in 4 cases, 1 case was referred back





President

for further enquiry and 1 case was decided not guilty under Second schedule. The following punishment(s) were awarded in aforesaid 4 cases:

Name removal for 5 year	1
Name removal for 3 years	2
Letter of Caution	1

Under the amended Act and Rules framed there under, approx 100 cases are on the verge of finalization and the exercise is on with top priority to the Public Interest Cases.

Infrastructure build-up

The building up of infrastructure continues in full swing. Better infrastructure and facilities not only enable us to provide better service to our members and students but also go a long way to improve the brand image of our Institute. On 26th April, I inaugurated an ITT Lab at Sikar and on 1st May at Amravati. On 3rd May, 2009 I had the opportunity to lay the foundation stone for a new building at Ahmednagar and on 12th May I attended the inauguration ceremony for construction of branch building at Nashik. It is my vision to see that the Institute and all its constituents have the best of infrastructure so that it is able to provide quality service to its members, students and society at large.

Online CPT Examination - A Milestone

With online CPT examination becoming a reality this year, aspiring CA students would now have the option to appear either online or by the traditional paper-pencil method. And taking into account the futuristic vision and great positive feedback, I have decided to hold CPT examinations 10 times in a year in addition to paper-pencil mode of examination in June and December every year. The online CPT examinations have been introduced primarily to popularise the online media and to familiarise the students with this media right from the time they enter the profession. As a pilot project, it would also enable us to study the feasibility of conducting all examinations online in the next four to five years.

You will all appreciate that the online examination would make the examination process more transparent and efficient. It has been reckoned by experts as an improvement over the conventional system, where the emphasis is on memorising rather than understanding concepts. The online examination system will test the student's in-depth understanding and force him or her to think before arriving at a solution. Let's

encourage students to take CPT examinations online.

Certification Courses

The Certification Courses started by the Institute have become immensely popular as they provide perfect medium for our members to hone their professional skills on a wide variety of specialized areas of practice. These also provide opportunities for members to be exposed to new and emerging areas of practices such as IFRS, Forex and Treasury Management, ERM, Derivatives, Valuation, etc. The popularity of these Certification Courses can be judged by the huge number of members enrolling for them. I am sure these timely courses will attract and benefit even greater number of members in days to come, particularly in the backdrop of plethora of opportunities being offered in current globalised economy.

Bank MEF Form

As you all are aware, this year we had ensured that the Multipurpose Empanelment Form (MEF) is simplified to a great extent so as to evoke a greater response from our members. Our efforts have indeed paid off as we have received more than 10,500 applications till date within such a short duration of its availability. Members receive confirmation of their application immediately by SMS and queries are solved immediately. The feedback received on the simplified Empanelment Form from different parts of the country is indeed encouraging.

Many of you must be now homeward bound after having a relaxed holiday with your loved ones. Hectic days lie ahead with all statutory deadlines fast approaching. The new government will also announce the Budget once various ministries are formed. I take this opportunity to wish you the best for timely completion of your professional assignments with dedication.

In the words of Swami Vivekananda, *"By doing well the duty which is nearest to us, we make ourselves stronger; and improving our strength in this manner step by step, we may even reach a state in which it shall be our privilege to do the most coveted and honoured duties in life and society."*

With pranaams to all,

CA. Uttam Prakash Agarwal
New Delhi, May 25, 2009

Journal Now More Informative and Interesting

I really appreciate the efforts put in by the Editorial Board and leadership of ICAI to bring out such an attractive, informative and interesting journal. The overall quality of the journal, selection of topics and presentation of contents deserve all the praise. The journal has really become a source of knowledge update and inspiration for members, students, allied professionals and society at large. The publication of MEF Form with web page in the May 2009 issue of the journal was particularly useful for the members.

– maniyars_jal@yahoo.com



The May 2009 issue of the journal was very informative and interesting, particularly because of the inclusion of topics like 'Health Tips', 'Chartered Accountancy & Bharathanatyam' and 'Prosperity through Feng Shui' which were all contributed by Chartered Accountants. Such offbeat topics really make the journal more interesting.

– CA. Abhishek A. Jain, Ahmedabad

The knowledge we gain by reading the ICAI journal is immense. It gives us pleasure to read informative and interesting articles on a variety of subjects published in the journal. The journal also enables us to share the knowledge with non-members and members of ICAI.

– CA. N. Syed Nafiz Ahamed, Chennai

CA Pariwar a Novel Concept

I would like to share with the readers an incident after which I really felt proud to be member of the vibrant and helpful CA Pariwar.

I recently faced a critical situation when my son, who was travelling with his mother by train from Delhi to Pune, fell sick with acute dehydration and needed urgent medical assistance. My extremely worried family could not think of a way to provide immediate medical help to my son. And then I remembered the concept of CA Pariwar. I contacted some CA members of Ahmednagar and explained them the situation. They immediately arranged a doctor at railway station itself to treat my son and extended great moral support to my wife who was alone and finding it difficult to handle the situation. I am really grateful to those CA Pariwar members and wish that this concept lives on globally for ever. I salute the ICAI leadership for promoting the concept of CA Pariwar.

– CA. Vinod Kumar Sharma

First National ICAI WebCast

The programme was awesome. Being abroad and attending such online programme was really a great experience for me. I always wanted to be a part of institute

seminars and this WebCast facilitated the same. The topic of the WebCast was also wisely chosen keeping in view the present scenario.

– CA. Mohini

The first national WebCast for members was a great effort on part of the Institute. The special address by Mr. Mohandas Pai was very enlightening and it would have certainly brought a lot of hope to fresh Chartered Accountants in the markets and industry.

– CA. Moiz Wangrelwala

I congratulate the Institute and related technical team for organising the ICAI's first national WebCast. It was well presented and very well organised. The talk of Mr. Mohandas Pai was very informative.

–CA. PM Jain

Congratulations on this latest development. It is nice to see ICAI taking all steps to adopt the latest means of technology available for the benefit of members and society at large. Keep it up. I would appreciate if such programmes are made interactive as soon as possible and CPE hours are also allowed for the same.

–CA. Shashi Gupta, New Delhi

I thank the ICAI for its latest initiative of organising a WebCast for members. It is indeed a great way of sharing knowledge and ideas on important issues affecting our profession from the comfort of our home and places of work.

– CA. Nanda Kishore

Congratulations to all concerned for the first successful WebCast (Webinar). It is really a very good and effective initiative – a Green IT initiative. Through it is possible to reach more number of CAs and also it is very convenient and useful for CAs from remote locations.

–CA. Niranjana Laddha, Nagpur

EDITOR

For the Attention of Readers

Readers' attention is specifically invited to the fact that the views and opinions expressed or implied in *The Chartered Accountant* journal are the views and opinions of the authors only, and not those of the ICAI. The ICAI bears no responsibility of any sort whatsoever in case of an action taken by any reader based on any article published in the journal.

Write to Editor

'Information is Power' and our ever-evolving profession needs more and more of that today than ever before. Do you have any relevant points to make, experiences to share, and views to spread among the CA fraternity? If yes, e-mail us at eboard@icai.org / nadeem@icai.org or write to:

The Editor, The Journal Section, ICAI Bhawan, C-1, Sector 1, Noida (U.P.) 201 301.





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PHOTOGRAPHS



REACHING OUT

Presentation of memento by CA. Uttam Prakash Agarwal, President, ICAI to Shri S. S. N. Moorthy, CBDT, Chairman (Left) and to Dr. George Joseph, Ambassador of India to the Kingdom of Bahrain (Right) at 287th Council Meeting on April 17, 2009 at New Delhi. Also seen in picture – CA. Amarjit Chopra, Vice President, ICAI and Shri T. Karthikeyan, Secretary, ICAI.



SAFA

CA. Uttam Prakash Agarwal, President, ICAI chairing the SMP Committee Meeting of SAFA at Dhaka, Bangladesh on May 8, 2009.



MoU WITH DJIBOUTI

CA. Uttam Prakash Agarwal, President, ICAI, Dr. Hassan Houssein Souraya, Dean of the Faculty of Law, Economics and Management of the University of Djibouti, and Mr. Mohamed Idris Saban, Consul General, Consulate of the Republic of Djibouti, Mumbai on the occasion of Signing of Memorandum of Understanding between ICAI and University of Djibouti, Republic of Djibouti for building up accountancy curriculum and related infrastructure at Republic of Djibouti, on "Africa Day Celebration 2009" jointly with Indo-African Chambers of Commerce & Industry organised in Mumbai on May 18, 2009.



AHMEDNAGAR

CA. Uttam Prakash Agarwal, President, ICAI laying the foundation stone of ICAI Bhawan, Ahmednagar on May 3, 2009 along with CA. Jaydeep N. Shah, Central Council Member; CA. Bal Kishan Rathi, Vice-Chairman, WIRC; CA. Mohan Barmecha Sampatnal, Chairman, Ahmednagar Branch and other dignitaries.



AMRAVATI

CA. Uttam Prakash Agarwal, President, ICAI inaugurating the ITT Lab at Amravati Branch on May 1, 2009 along with CA. Jaydeep N. Shah, Central Council Member, CA. Hukmichand B. Heda, Chairman, Amravati Branch and other dignitaries



NASHIK

CA. Uttam Prakash Agarwal, President, ICAI at the inauguration ceremony of branch building construction of Nashik Branch on May 12, 2009. CA. Jaydeep Narendra Shah, Central Council Member, CA. B. C. Jain, Chairman, WIRC, CA. Yogesh C. Katariya, Chairman, Nashik Branch are also seen in the photograph.

CPE
18 Hrs.



The Institute of Chartered Accountants of India
presents

ICAI Diamond Jubilee International Conference

"Winds of Challenges – Global Strategies for Accounting Profession"

3rd – 5th July, 2009, Hotel Jaypee Palace, Agra, India



Fatehpur Sikri



Taj view from Yamuna River



Agra Fort



Sikandra

About Agra and the Conference

Agra is a city on the banks of the Yamuna River in the northern state of Uttar Pradesh, India. Agra, a feather in the cap of "Incredible India", also possesses the most precious jewel in the country's crown, the "Taj Mahal". It showcases the vibrant local culture with all the archaeological marvels like Agra Fort and Fatehpur Sikri which are the part of our rich heritage. This splendidly beautiful city and a major tourist destination would be the host city for this International Conference.

ICAI is celebrating its Diamond Jubilee this year and coinciding with its celebrations, the Institute would be hosting International Conference on the theme '**Winds of Challenges – Global Strategies for Accounting Profession**' on July 3 – 5, 2009 at Hotel Jaypee Palace, Agra.

As the world veritably transits to being 'Global Village'; the accounting profession as an integral instrumentality, in this process of transition has witnessed a paradigm change in its contributory role in every sphere of the transformation; financial reporting being the core. The shift in the business philosophies due to dawn of a new trade order further emphasizes a broadened role for the accountancy professionals as strategy formulators and facilitators. Moving to such role of a value creator, the Institute has endeavoured to imbibe the best practices globally and has been playing the role of an enabler by

getting its 150,000 strong membership base to acclimatise themselves with such practices. What classically holds out for the accountancy profession is the universal lexicon which is a common thread for accountants across the globe. One sees the emergence of shift to convergence in technical standards globally and this International Conference eloquently epitomizes the same.

Our world today is of Internet links, global networking, dissolving business frontiers and shrinking distances, and the whole world now is just one globe; newer ideas and knowledge at our doorstep; globalisation is the reality of today and a new world is fast emerging. In this scenario, Accountants should acquire requisite knowledge and skills, on one hand, and organisational and operational strength, on the other, in order to be globally competeable.

This Conference will dwell on the topical issues related to Governance, Financial Engineering, Regulatory Compliance, Value Creation, Corporate Social Responsibility and the like. The International Conference would be congregation of renowned experts in the area of accounting, auditing and management from IFAC, IASB and other international bodies including leaders from Trade and Industry in India expected to do the honours at the Conference.



President's Message

The Institute has organised this mega international Conference, to provide a forum to equip its members and overseas delegates with the emerging trends globally, where they could discuss and debate with the best of resources and update themselves with world trends.

CA. Uttam Prakash Agarwal
President & Conference Chairman



Vice-President's Message

Accounting Profession is faced with several accounting and reporting issues at present. The same needs to be addressed with a view to bring greater transparency and credibility to the financial statements and reporting. It would lead to better corporate governance and promotion of stakeholders.

CA. Amarjit Chopra
Vice-President &
Conference Vice-Chairman



Conference Convener's Message

Given the profile of the International Conference and the range of issues to be debated, it would be an opportune occasion for the membership to enrich their professional knowledge.

CA. Anuj Goyal
Central Council Member &
Conference Convener



attractions CULTURAL & BOLLYWOOD EXTRAVAGANZA

Kalakriti, Fatehabad Road, Agra, at 7 p.m. onwards
followed by dinner



3rd July 2009
Indian cultural heritage theme
4th July 2009
Bollywood theme

Arrangements would be made for sight seeing on all days for accompanying spouse/children.



The morning of **5th July, 2009** i.e. last day of the International Conference would witness the Agra Go Green Run, a mega initiative to integrate Chartered Accountants and students with people from all walks of life, who have concern for protecting the environment. Over 5000 people will run together to show that it is not about winning, its all about uniting for a greener tomorrow. We invite you to chase a dream and run for this noble endeavour.

The run would be from Hotel Jaypee Palace, Agra at 6.30 a.m. to Hotel Taj Khema, Agra.

Programme Schedule

DAY 1 (Friday, July 3rd, 2009)

Breakfast and Registration (9.00 a.m.)

Inaugural Session

Technical Sessions (11.00 a.m. to 5.30 p.m.)

Global Competitiveness: Impact of Convergence of Accounting Standards

- Transition to IFRS: Managing Expectations / Meeting Today's Challenges
- Moving Towards Complete Convergence to IFRS

Lunch Break (1 p.m.)

Governance Mandate: Professional Mindset

- A Perspective on Convergence of Auditing Standards
- Role of Accountant – Corporate Governance Beyond Statutory Framework
- Keynote Address(es)**
- Insurance Sector: Sunrise Industry for CAs
- Meeting Global Business Competition, World's Best Practices

Professional Opportunities Beyond Frontiers

- By ICAI Overseas Chapters Chairmen

Cultural Extravaganza on the Indian Cultural Heritage Theme (7.00 p.m. onwards at Kalakriti, Fatehabad Road, Agra)

Dinner: 9.00 p.m. Onwards

Day 3 (Sunday, July 5th, 2009)

Go Green Run (6.30 a.m. from Hotel Jaypee Palace to Hotel Taj Khema, Agra)

Breakfast: 9.00 a.m.

Technical Sessions (9.30 a.m. to 4.00 p.m.)

Special Session: CEOs: Meeting Governance Mandate through Entrepreneurial Vision

Special Session: Environmental Accounting Strategy for Competitive Advantage

Carbon Credit and Business Finance

- Accounting and Taxation Issues

Lunch Break (1 p.m.)

Value Creation: Challenges & Opportunities of Capital Market, Banking and Insurance Sector

- Changing Dimensions of Tax Regime in India
- Capital Market Reforms and Stakeholders Promotion – An Accountant's Perspective
- Maintaining Resilience to Risk and Shock

Special Address

- Landscaping Accountancy Profession in New Trade Order
- Role of Public Sector in National Development

Valedictory Session (4.00 p.m. to 5.00 p.m.)

Professionalism as a Tool to Sustainability/Achieving Millennium Development Goals through Sustainable Development

Day 2 (Saturday, July 4th, 2009)

Breakfast: 9.00 a.m.

Technical Sessions (9.30 a.m. to 5.30 p.m.)

Key Note Address

- Bridging the Expectation Gap: Changing Dimensions of an Accountant's Role

Special Address

- Reforms in Government Accounting: Issues and Perspective

Emerging Paradigm for Profession

- XBRL: Future of Financial Business
- Challenges Before the Profession

Lunch Break (1 p.m.)

SAFA Panel Discussion: Synergy through Harmonisation for Moving Ahead in Knowledge Era Global Imperatives: Development Context

- Creating Professional Opportunities Through Partnership in Economic Development

Challenges and New Approaches

- Contemporary Issues in International Taxation
- Financial Market Crisis – Learning Lessons

Cultural Extravaganza on Bollywood Theme (7.00 p.m. onwards at Kalakriti, Fatehabad Road, Agra)

Dinner: 9.00 p.m. Onwards



Eminent Speakers Include:

- **Sir David Tweedie**, Chairman, International Accounting Standards Board
- **Dr. Arnold Shilder**, Chairman, International Auditing and Assurance Standards Board
- **Mr. Ernie Almonte**, President, American Institute of Certified Public Accountants
- **Mr. Graham Meyer**, CEO, ICA Australia
- **Mr. Atul Kumar Rai**, CEO & MD, IFCI Ltd.
- **CA. (Dr.) M Ramadoss**, CMD, Oriental Insurance Co. Ltd.
- **Mr. M. D. Mallya**, CMD, Bank of Baroda
- **CA. Mohandas Pai**, Executive Director, Infosys Ltd
- **Mr. Rajendra Prasad**, President & CFO, SRF Ltd.
- **Prof. Narendra Jadhav**, Vice-Chancellor, Pune University
- **CA. (Dr.) Girish Ahuja**, Renowned Tax Expert
- **CA. Narendra P. Sarda**, Past President, ICAI
- **Mr. Asad Ali Shah**, President, ICA Pakistan
- **Mr. Nasiruddin Ahmed**, President, ICA, Bangladesh
- **Mr. Tanka Prasad Paneru**, President, ICA, Nepal
- **Mr. Nishan Fernando**, President, ICA Sri Lanka

Sponsorship Details

I. Diamond Sponsor: Rs. 25,00,000

- Providing an exclusive stall fully furnished (15 sq.m.) outside the conference premises, allowing you to showcase your products to the participants.
- Covering your organization's name in the full-page advertisement of our institute to be released in a leading newspaper.
- Acknowledgement as "Diamond Sponsor" on event website.
- Complimentary passes for the cultural event.
- Full-page ad in Souvenir to be issued on the occasion.
- Conference Kit containing bag, writing pad will be carrying the name & logo of your company.
- Display of Banners at the Cultural Events coinciding with the International Conference.

II. Gold Sponsor: Rs. 15,00,000

- Providing an exclusive stall fully furnished (10 sq.m.) outside the conference premises, allowing you to showcase your products to the participants.
- 8 Complimentary passes for the cultural event.
- Half-page ad in Souvenir to be issued on the occasion.
- Acknowledgement as "Gold Sponsor" on event website for the whole Diamond Jubilee Year.
- Display of Banners at the Cultural Events coinciding with the International Conference.

III. Emerald Sponsor: Rs. 10,00,000

- Providing an exclusive stall fully furnished (6 sq.m.) outside the conference premises, allowing you to showcase your products to the participants.

- 5 Complimentary passes for the cultural events coinciding the international Conference.
- Quarter-page ad in Souvenir to be issued on the occasion.
- Acknowledgement as "Emerald Sponsor" on event website.

IV. Silver Sponsor: Rs. 5,00,000

- Listed in the Souvenir to be issued on the occasion.
- Acknowledgement as an "Silver Sponsor" on event website.
- Quarter-page ad in Souvenir to be issued on the occasion.
- 3 Complimentary passes for the cultural events coinciding the international Conference.

V. Other Schedule of Sponsorships

- Dinner Rs. 8,00,000
- Banquet Rs. 12,00,000
- Conference Lunch (3) (3-5 July, 2009) Rs. 7,50,000 each
- Tea-Coffee Plaza (3) (3-5 July, 2009) Rs. 1,50,000 each
- Bollywood Cultural Evening Rs. 12,00,000
- Delegate Kit Rs. 15,00,000
- Stall Executive Rs. 1,00,000/day
- Stall Economy Rs. 50,000/ day

VI. Souvenir

- Back Cover Page Rs. 2,50,000
- Front Side Cover Page Rs. 1,50,000
- Back Side Cover Page Rs. 1,50,000
- Full Colour Page Rs. 25,000

Delegate Fees

- **Members/Students** Rs. 2750
- **Non Members** Rs. 4000
- **Accompanying Spouse/Children above 5 yrs** Rs. 2250
- **Foreign Delegates** US \$ 125

On the spot Registration

- **Members** Rs. 3500
- **Foreign Delegates** US \$ 150

Registration fee for delegates include: Delegate Kit, Entitlement to CPE Hrs. for ICAI Members, Inaugural Function, Technical Sessions, Trade Exhibitions, Lunch, Dinner and Cultural Extravaganza.

Hotel Details

For hotel details at Agra, please visit the webpage, www.icaionline.org/icaionlineinternationalconference/main.html. Hotel rates (including taxes) per person per night on twin sharing basis (including breakfast) are given below. For booking at any of these hotels please remit the necessary amount to us. For further details please contact at 09897057757, 09412259954, 09760016002/ brijeshvermaca@gmail.com; jmcca@rediffmail.com

Hotels	Star Rating	Address	Distance from Venue in Km	E-mail	Phone No. [+91]	Tariff [INR] on Twin Sharing
Hotel Jaypee Palace	**** dx	Fatehabad Road, Agra	Conf. Venue	reservations.jpa@jaypeehotels.com	0562-2330800-15	2750
Hotel Mansingh Palace	***	Fatehabad Road, Agra	2.50	lalsingh.agra@mansinghotels.com	0562-2331771-78	1575
Hotel Utkarsh Vilas	***	Fatehabad Road, Agra	1.00	sales@utkarshvilas.com	0562-2232971	1250
Hotel Welcome Heritage Grand Imperial	***	M G Road, Agra	4.00	rahul@hotelgrandimperial.com	9311055588	1250
Hotel Amar	***	Fatehabad Road, Agra	2.50	reservation@hotelamar.com	0562-2331884-88	1100
Hotel Howard Park Plaza	***	Fatehabad Road, Agra	2.50	hppagra@sarovarhotels.com	0562-4001871-73	1000
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Hotel Kiran Deep	**	Mall Road, Agra	5.00	hotelkirandeep_01@rediffmail.com	0562-3290365	475

For Further Details and Registration

For registration and further details, please visit International Conference web page at <http://www.icaionline.org/icaionlineinternationalconference/main.html>
Write to : Diamond Jubilee Committee Secretariat
The Institute of Chartered Accountants of India
ICAI Bhawan, Indraprastha Marg, New Delhi – 110 002
Email: ic@icai.org; ic@icai.in; djc@icai.in
Phone: 011-3011 0542, 3011 0487
Fax: 011-3011 0591

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Sanjay Place, Agra - 282002
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<http://www.icaionline.org/ccm.html?progid=28&makepay=1>

LEGAL DECISIONS¹

DIRECT TAXES



Section 4 of the Income-tax Act, 1961 - Mutual Concern – Charge of tax

Principle of mutuality is applicable to a situation where income of mutual concern is contributions received from its contributors and expenses incurred from such contributions; in case of mutual concern, excess of income over expenditure is not amenable to tax

Yum Restaurants (Marketing) Private Limited vs. Commissioner of Income Tax (DEL) April 1, 2009

The assessee was wholly owned subsidiary of YRIPL. It was being set up to carry out and economise the cost of advertising and promotion by catering to the specific needs of its franchisees in order to enable them to concentrate on restaurant operations and management. The assessee-company, as well as, the franchisees entered into tripartite agreements. Under the agreement the assessee-company received contributions from YRIPL and its franchisees in order to carry on co-operative advertising. There was a surplus of Rs. 44.44 lakhs arisen on account of advertisement contributions received from the holding company of the assessee-company which remained un-expended. However, the gross total income had been declared as 'nil'. The Assessing Officer brought to tax a sum of Rs. 44.44 rejecting the claim that it was a mutual concern.

The Delhi High Court held that principle of mutuality is applicable to a situation where the income of the

mutual concern is the contributions received from its contributors. The expenses incurred by the mutual concerns are incurred from such contributions and hence on the principle that no man can do business with himself, the excess of income over expenditure is not amenable to tax.

In the present case the authorities below had returned a finding of fact that the fund had contributors which do not benefit from the advertisement, marketing and promotional activities. Further, the principle of mutuality is applicable to those entities whose activities are not tinged with commercial purpose.

In the present case the parent company i.e., YRIPL which had also contributed to the brand fund was, under the agreement, under no obligation to do so. The contributions made by YRIPL were at its own discretion. Thus, it was quite clear that the principle of mutuality would not be applicable to the present case and, hence, the impugned surplus amount of income over expenditure was taxable in the hands of the assessee subsidiary.

Section 37 of the Income-tax Act, 1961 – Business expenditure

Sur-tax payable pursuant to Companies (Profits) Sur-tax Act, 1964 is not an admissible deduction in computing total income

Ingersoll-Rand (India) Limited, Bombay vs. Commissioner of Income Tax, Bombay (BOM), April 4, 2009

The question arose as to whether sur-tax payable pursuant to Companies (Profits) Sur-tax Act, 1964 was not an admissible deduction in computing the total income of the assessee.

The Mumbai High Court held that issue is no longer res integra as question is covered by the judgment of

the Supreme Court in SmithKline and French (India) Ltd. & Ors. vs. Commissioner of Income Tax 291 ITR 581. Accordingly, and thus the question was answered against the assessee.

Section 37 of the Income-tax Act, 1961 - Business expenditure

Deduction under Section 15 of Payment of Bonus Act, 1965 is not an accrued liability but only a provision to meet a future liability, if any; it is, therefore, not certain nor is it capable of being ascertained with reasonable certainty and it is a contingent liability and hence, was not allowable as a deduction from total income of year in which it was paid

Ingersoll-Rand (India) Limited, Bombay vs. Commissioner of Income Tax, Bombay (BOM), April 4, 2009

The question was as to whether the liability under section 15 of Payment of Bonus Act, 1965 is not allowable as a deduction in computing the total income of the assessee for the year under reference.

The Mumbai High Court held that the amount is merely a reserve fund which the Payment of Bonus Act, 1965 mandates. After the expiry of four succeeding accounting years if the amount is not utilised the assessee is free to make use of the amount. The amount to be adjusted for the subsequent year, therefore, depends on the shortfall which cannot be anticipated with reasonable certainty. The amount is not deducted in the hands of the assessee unless it is utilised and, hence, deduction claimed is not an accrued liability but only a provision under section 15(1) of Payment of Bonus Act, 1965 to meet a future liability, if any. It is, therefore, not certain nor is it capable of being ascertained with reasonable certainty and it is a contingent liability. Thus, the question is answered against the assessee.

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

Edited by Mr. Susanta K. Sahu, Secretary, Committee on Economic and Commercial Laws

Section 37 of the Income-tax Act, 1961 – Business expenditure

For an expenditure to be permitted as deduction under Section 37(1) twin conditions required to be fulfilled are that expenditure in issue should not be of a capital nature and it should have been expended wholly for purposes of business; expression 'for the purposes of business' has been held to mean an expenditure which is voluntary in nature and commercially expedient

Yum Restaurants (India) Private Limited vs. Commissioner of Income Tax (DEL), April 1, 2009

The assessee-company created a wholly owned subsidiary, YRMPL to carry on a 'co-operative advertising' on the behalf of its franchisees and franchisees of the assessee-company. Under the tripartite agreement for the purpose of advertisement, marketing and promotional activities Rs. 1.15 crores had been contributed by the assessee-company to YRMPL. A sum of Rs. 44.44 lakhs was unspent which was shown in the books of YRMPL as current liabilities. That amount was disallowed by the revenue in hands of the assessee.

The Delhi High Court held that the assessee-company under the tripartite agreement, was under no obligation whatsoever to contribute any money to YRMPL. The point to be noted was that what the assessee-company in law could not have claimed directly, that is, by making a provision for advertising expenditure it could not be allowed to claim an amount as an expense merely on account of the fact that it had set up an intermediary in the form of a wholly owned subsidiary. As rightly held by the authorities below, it could not be so.

For any expenditure to be permitted as deduction under Section 37(1) the twin conditions which are required to be fulfilled are that the expenditure in issue should not be of a capital nature, and that it should have been expended wholly for the purposes of business. Expression 'for the purposes of business' in Section 37 has been held to mean an expenditure which is voluntary in nature and commercially expedient and in the present case the Tribunal

had returned a finding of fact that the assessee-company had not been able to prove that the contributions to the subsidiary were made in the course of business or on account of commercial expediency. Hence, no deduction was permissible.

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

Proceedings under section 147 cannot impinge upon items which have no connection or relation with items of income and/or expenditure which form basis of a notice under section 148(1)

Jay Bharat Maruti Limited vs. Commissioner of Income Tax (DEL), April 20, 2009

Proceedings under section 147 cannot impinge upon items which have no connection or relation with items of income and/or expenditure which form basis of a notice under section 148(1).

Where items referred to in the Assessing Officer's notice had no relation with the reasons recorded, the Delhi High Court held that there assessment order would be bad in law or stand vitiated in law and was to be set aside.

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

A credit balance in MODVAT account and its consequent debit in Profit & Loss account could never ever have formed a basis for reason to believe that assessee's income had escaped assessment

Jay Bharat Maruti Limited vs. Commissioner of Income Tax (DEL), April 20, 2009

The assessee's return was processed under Section 143(1)(a) and a refund intimation was granted. Later on, the Assessing Officer formed a belief that the assessee's income in respect of which it was assessable to tax, had escaped assessment and accordingly a notice under section 148 was issued to the assessee. The assessee contended that bare perusal of reasons disclosed

would show that a credit balance in MODVAT account and its consequent debit in Profit & Loss account could never ever have formed a basis for reason to believe that assessee's income had escaped assessment.

The Delhi High Court held that if Assessing Officer has cause or justification to know or suppose that income had escaped assessment, it can be said to have 'reason to believe' that income had escaped assessment. No reasonable person could have come to a conclusion that there was relevant material available with the Assessing Officer to have reason to believe that the assessee's income chargeable to tax had escaped assessment only by virtue of fact that the assessee had charged to its profit and loss account the credit balance available in its MODVAT account.

Section 164 of the Income-tax Act, 1961 – Trust - Charge of tax where shares of beneficiaries unknown

In the case of assessment of trust, trustees could not be assessed for tax if the beneficiaries and their shares are determinate and, consequently, provisions of Section 164 cannot be attracted in assessment of trustees

Commissioner of Income Tax, Coimbatore vs. P. Sekar Trust, Pollachi and Another (MAD), April 15, 2009

The assessee was a trust created on 01.04.1986. The Trust was created for the benefit of seven beneficiaries. The beneficiaries filed returns admitting 10% income distributed to them in their individual returns. The Assessing Officer framed the assessment under Section 164 treating the trustees as the representative assessee in respect of 90% of the accumulated income.

The Madras High Court held that in order to attract Section 164(1), the beneficiaries on whose benefit such income or such part thereof is receivable, are indeterminate and unknown. In the instant case the beneficiaries were five in number for the relevant period and the respective share of each beneficiary was in different percentage as stated in the deed itself. From 01.04.1989 onwards the beneficiaries

were seven in number and their shares in the income was equal. The shares in respect of 6th and 7th beneficiaries were equal in the status of individual till the date of their marriage and separately in the status of the individual and Hindu Undivided Family consisting of themselves and their respective wives from the date of marriage. According to a clause of the deed as and when two beneficiaries would get married, their spouses would automatically become beneficiaries along with the other continuing beneficiaries in the said accounting year and subsequent accounting years, and would equally divide the beneficial interest in income of the aforesaid beneficiaries. Likewise, as and when any child or children would be born to the said married beneficiaries the child or children so born would automatically become a beneficiary/beneficiaries along with the other continuing beneficiaries in the said accounting year and subsequent accounting years and equally divide the beneficial interest in income of the aforesaid beneficiaries. From the above, it was clear that the shares of the beneficiaries was equal and as and when the two stated beneficiaries get married, they become HUF and on the birth of child/children, it or they would also become the beneficiaries. With the increase of numbers, the share of each person got reduced. So, the share income was determinate. The intention of the author of the trust cannot be said to be uncertain. So long as the trust deed gives the details of the beneficiaries and the description of the person who is to be benefitted, the beneficiaries cannot be said to be uncertain, merely because wife/children cannot be known until the marriage and begetting of children by the stated beneficiaries. The deed also provided that in the event of death of a beneficiary what should be done.

Having regard to the terms of the trust deed, which clearly prescribed the beneficiaries and the shares they are entitled to and other terms relevant to the share of interest in the corpus on determination or termination of the trust, section 164 would not be attracted.

Section 206C of the Income-tax Act, 1961 – TCS - Alcoholic liquor, forest produce, etc

Where an assessee who was responsible for collecting tax, was prevented from collecting it because of interim stay granted by High Court, he cannot be made liable under section 206C(6)

Satpuda Tapi Parisar, Sahakari Sakhar Karkhana Limited vs. Commissioner of Income-Tax, Nashik and Others, (MUM), April 13, 2009

The petitioner was a Co-operative Sugar Factory and also a manufacturer of country liquor. Section 206-C was substituted by the Finance Act, 1992. The effect of the Section was that the seller of alcoholic liquor and other goods described in the schedule had to collect from the buyer a sum equal to the percentages set out in the Tables. The constitutional validity of the Section was challenged and the Court granted interim relief restraining the seller from collecting the amount. The question involved in this case was as to whether section 206C would be attracted in case of the petitioner-seller.

The Mumbai High Court held that the disability disappeared on the stay being vacated by this Court. Thus, for the period when the stay was in operation as the petitioner was prevented from collecting the tax it could not be said that he would be liable under sub-section (6) of Section 206C. A duty was cast on the petitioner by operation of law. The petitioner could not discharge that duty by virtue of an order of this Court. The question, therefore, of calling on him to pay the amount which he was disabled to collect would be illegal. If the petitioner had collected the tax, it would have been in contempt of this Court. Even though it could be said that considering the provisions of Section 206C a duty had been cast on persons like the petitioner to collect the tax, by virtue of the interim relief he could not collect the tax for the relevant period. Section 206C would, therefore, not be attracted.

INDIRECT TAXES



Custom & Excise

Central Excise Act, 1944, read with Article 141 of Constitution of India, 1950 – Validity of Board Circulars

Circulars of Board cannot prevail over law laid down by Apex Court

Commissioner of Central Excise, Mumbai vs. Hindoostan Spinning and Wvg. M. Limited and Another (Supreme Court), April 16, 2009

The Apex Court in *CCE v. Ratan Melting & Wire Industries* [2008] 13 SCC 1 has held that Circulars and instructions issued by Board are no doubt binding in law on authorities under respective statutes, but when the Supreme Court or High Court declares law on question arising for consideration, it would not be appropriate for the Court to direct that circular should be given effect to and not view expressed in a decision of the Supreme Court or High Court. Moreover, to lay emphasis on circular would mean that valuable right of challenge would be denied to the assessee and there would be no scope for adjudication by the Supreme Court or High Court.

Headings 33.06 and 3003.31 of Central Excise Tariff Act, 1985 – Cosmetic/toiletry preparation

Common parlance test continues to be one of the determinative tests for classification of a product whether medicament or cosmetic; a product being tooth powder and there being no change in nature, character and uses of said product, it has to be held to be a cosmetic/toiletry preparation, and not medicament

Commissioner of Central Excise, Nagpur vs. Baidyanath Ayurved Bhawan Limited (Supreme Court), April 13, 2009

The primary object of the Excise Act is to raise revenue for which

various products are differently classified in the New Tariff Act. Resort should, in the circumstances, be had to popular meaning and understanding attached to such products by those using the product and not to be had to the scientific and technical meaning of the terms and expressions used. The approach of the consumer or user towards the product, thus, assumes significance. What is important to be seen is how the consumer looks at a product and what is his perception in respect of such product. The user's understanding is a strong factor in determination of classification of the products. Merely because a tooth powder is manufactured exclusively in accordance with the formulae described in Ayurveda Sar Sangrah, which is authoritative text on Ayurvedic system of treatment and is notified in the First Schedule to the Drugs and Cosmetics Act, 1940 and the said product is sold under the name 'Dant Manjan Lal' which is the name specified for the said product in Ayurveda Sar Sangrah, it cannot be said that the common parlance test is not applicable. Such a contention is based on misplaced assumption that Chapter Sub-heading 3003.31 by itself provides the definition of Ayurvedic Medicine and there is no requirement to look beyond.

Impugned product 'DML' was a powder compounded with Geru, Peepull, Sonth, Kali Mirch, Tambakuh, Clove Oil, Camphor, Peppermint, Babul Chhal, Tumber Beej. While respondent contended that the product DML was a medicament under Chapter Sub-heading 3003.31 the stand of the Department was that the said product was tooth powder i.e., cosmetic/toiletry preparation classifiable under Chapter Heading 33.06.

The Supreme Court held that common parlance test which is one of the well recognized tests to determine whether the product is classifiable as medicament or cosmetic and that has been consistently followed by the Supreme Court; it is so with regard to this very product. It also overlooks the well-settled legal position that

without a change in the nature or a change in the use of the product and in the absence of a statutory definition, the product will not change its character. The product DML remains the same in its composition, character and uses. Sub-heading 3003.31 does not define Ayurvedic Medicine and, therefore, there cannot be enough justification for changing the classification of the product DML which has not been held to be Ayurvedic Medicine by the Supreme Court. DML is a tooth powder which has not been held to be Ayurvedic Medicine in common parlance. There being no change in the nature, character and uses of DML, it has to be held to be a tooth powder. Impugned product used routinely for dental hygiene and hence classifiable under heading 33.06 and not exempted under Notification No. 62/78 – CE. Section 3(a) of the Drugs and Cosmetics Act, 1940 defines 'Ayurvedic, Siddha or Unani Drug' but that definition is not necessary to be imported in New Tariff Act. The definition of one statute having different object, purpose and scheme cannot be applied mechanically to another statute. Therefore, the product DML in nature, character and uses remains tooth powder.

Sales Tax/VAT

Section 16(2) of Tamil Nadu General Sales Tax, 1959

Where assessee-dealer purchased goods and availed second sale exemption on basis of Form XX Delivery Note issued by Department to selling dealer whose registration was found valid, assessee could be said to have discharged burden of proof by showing that earlier sale was a taxable sale and tax was really payable by seller

State of Tamil Nadu, Deputy Commissioner, Coimbatore vs. Tvl. Sri Alaggar Traders (MAD) April 17, 2009.

The assessee, dealer in Iron and Steel was originally assessed. On inspection of the business premises of the assessee it was found that during the relevant year, there was a purchase of C.I. Scraps. It was the revenue's case that dealer was not

available at the given address. The revenue alleged that assessee produced the sale bills of non-existing dealer and obtained second sales exemption in respect of the entire turnover. The assessing officer levied the penalty.

The Madras High Court held that though the dealer did not file any A1 monthly returns for relevant years, the Assessing Officer had not taken any steps to trace out this seller, but treated him as a bill trader and consequently assessed the present assessee, which was contrary to the decision in NATIONAL IRON TRADERS VS. STATE OF TAMIL NADU (1997) 106 STC 42. The Tribunal affirmed the order of the AAC by holding that issuance of Form-XX Delivery Note by Department itself was evident that the selling dealer carried on the business and its identity was also known to the department. Further the said selling dealer who happened to be the first seller was a registered dealer, whose Registration Certificate was found to be valid for the relevant year. Hence, the assessee had discharged the burden of proof by showing that the earlier sale was a taxable sale and the tax is really payable by the seller. Therefore, the assessee was not liable to pay tax.

Section 9(2), read with 60(1) (b) of Rajasthan Value Add Tax Act, 2003 – Bar against collection of tax when not payable

Where exemption notification was prone to two different interpretations, it was foremost duty of State to declare method for carrying out exemption scheme; in absence of such clear cut policy, petitioner cannot be blamed for following one interpretation and thereby collecting 12.5% tax from dealers and distributors while depositing only 6.25% with State.

Hindustan Coca Cola Beverages Private Limited and Another vs. State of Rajasthan and Others (RAJ), April 2, 2009

In order to encourage industrialisation of Rajasthan, the State Government issued a notification

under Rajasthan Sales Tax Act, 1994. The petitioner No. 1 was granted exemption benefit for a new unit, which was proposed to be established in the backward area. Since the method for implementing for Exemption Scheme under the VAT Act was absolutely unclear, the petitioner repeatedly prayed for clarification. Later on, the CTO issued a notice to the petitioner informing that the petitioner was entitled to collect the tax only at the rate of 6.25%, and not at the rate of 12.5%. Since it was collecting the tax at the rate of 12.5%, but depositing the VAT tax @ 6.25%, this amounted to evasion of tax.

The Rajasthan High Court held that the notification dated 29-4-2006 clearly stated that "dealer shall be eligible to charge and collect the tax in excess of percentage of exemption from tax liability granted to him". In one view of the matter, the petitioner was justified in collecting 12.5% and in depositing 6.25% with state exchequer, and in retaining 6.25% to itself. According to other view the petitioner was required to pay only 6.25% and 6.25% was exempted; therefore he was to collect merely 6.25% from the dealer and the distributors. In such circumstances, he was not entitled to the remaining 6.25% from the dealer and distributors. Since the same sentence was prone to two different interpretations, the notification dated 29-4-2006 was not happily worded and had led to legal confusion. The confusion is further aggravated by the silence of the State. The State was yet to declare, whether "the remission model" or "the refund model" was applicable in the State of Rajasthan.

It was the foremost duty of the State to declare the method for carrying out the exemption scheme. In absence of such clear cut policy, the petitioner cannot be blamed for having collected 12.5% tax and for having deposited only 6.25% with the State.

OTHER ACTS



Arbitration Act

Section 9 of the Arbitration and Conciliation Act, 1996 – Interim measures by Court

Merely by choosing place of arbitration, contracting parties cannot confer jurisdiction on such court over property which is situated outside court's jurisdiction

Pacific Greens Infracon Private Limited vs. Senior Builders Limited, (DEL) April 15, 2009

The respondent entered into a collaboration agreement with a real estate developer for development and construction of a multi-storey commercial building in Gurgaon. The respondent was to receive 60% of the built up commercial area. The respondent entered into a Joint Venture Agreement with the petitioner. In respect of its rights over 60% area, and the petitioner was to get right of selling for around 50,000 sq. ft. unsold space within the said 60% share and, in turn, the petitioner was to infuse funds to the tune of around Rs. 15 crore. The petitioner had paid around Rs. 1.5 crore. The petitioner had booked part of the space with India bulls and an amount of Rs. 60 lakhs was paid by India bulls to the respondent. Later on the respondent terminated the Joint Venture Agreement. By this application under Section 9 of the Arbitration & Conciliation Act, 1996, the petitioner prayed to the Delhi Court that the Court should restrain respondent from selling, transferring, disposing of or alienating or creating any third party interest in a Mall. The issue of jurisdiction raised by the respondent was that since the property in question was situated outside the jurisdiction of the High

Courts of either of Delhi, Mumbai Kolkata, or Chennai as stipulated for resolution of dispute in the arbitration clause of the agreement between the parties, suit before the Delhi High Court was not maintainable.

The Delhi High Court held that under the Arbitration Act, 1940, the parties are at liberty to choose as to who will be the Arbitrator to adjudicate the disputes for them, what will be the place of arbitration. There is no restriction on the parties in choosing these two factors i.e. Arbitrator and the place of arbitration and the parties can even choose what will be the law applicable. If one party is the Indian Party and the other is the foreign party, the parties can choose whether the Indian law will be applicable or the foreign law will be applicable. But the parties cannot by mutual consent confer jurisdiction on a Court which otherwise does not have jurisdiction. Merely because the parties have chosen the place of arbitration as Mumbai, Chennai, Delhi or Kolkata, it would not mean that the Courts at Mumbai, Chennai, Delhi or Kolkata would have jurisdiction in respect of application filed under Section 9. In order to decide an application under Section 9, the Court where application is made must have jurisdiction taking into account the subject matter of the application. Section 2(1)(e), read with Section 9 makes it clear that in order to have jurisdiction to decide an application under Section 9, the Court entertaining the application should be the Court which has power to entertain the suit on the facts as mentioned in the application under Section 9, and the Court is competent to give relief in a suit. In the present case, the petitioner wanted this Court to give relief to the petitioner in respect of immovable property in Gurgaon. However, this Court would, in fact, had no territorial jurisdiction since the subject matter of the suit was immovable property and this immovable property was situated

outside the jurisdiction of this Court.

Banking Laws

Sections 30 read with Section 29 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 – Appeal against order of Recovery Officer

There is an express bar of jurisdiction of Civil Court in entertaining civil suit, as highlighted in scheme of Act itself and there is a separate machinery to take care of grievances under RD Act and IT Act; where no excess of authority is highlighted, Civil Court right in entertaining suit.

Kinnariben Shantilal Patel, Canada, Through General Power of Attorney, Apurva Prafullabhai Patel, Nandurbar vs. Rajmal Premchand Surana, Jalgaon, (MUM) April 13, 2009

The Bank initiated recovery proceedings against the principal borrower and guarantors. The claim was decreed, excluding the appellant. Since the decretal amount was not paid, recovery proceedings were initiated. The Recovery Officer, based on the orders of the Tribunal, took requisite steps and a property was subjected to attachment in which the appellant had her share. The appellant felt aggrieved by the orders of the Recovery Officer. She contended that the bar created by any Statute does not operate in instituting civil suit and resorting to remedies available under the Civil Court's jurisdiction. The suit was dismissed on ground of availability of alternate remedies under RD Act and Income-tax Act and Rules thereunder.

The Mumbai High Court held that the plaintiff/appellant had remedies u/s. 30 of RD Act. Such remedies, the plaintiff could have exhausted which apparently had not been done. The provisions in RD Act are mandatory, which have overriding effect on other statute. Apart from RD Act, rules 60 & 61 under Second and Third Schedules to the Income-tax Act, 1961. The Income Tax (Certificate Proceedings) Rules, 1962, which is applicable by virtue of s.

29 of the RD Act, deals with making application to set aside sale of immovable property on deposit or application to set aside sale of immovable property on ground of non service of notice or irregularity can well be adjudicated upon by Recovery Officer as the Rules so contemplated. It is not the defaulter alone, but any person, whose interests are affected by the sale, can agitate the issue. This umbrella provided to any person, brings the rights, remedies available to the plaintiff which could have been exhausted and not so done. The plaintiff/appellant exhausted none of the remedies. There was an express bar of jurisdiction of the Court, as highlighted in the scheme of the Act itself. The aggrieved person had remedy before the Tribunal or Appellate Tribunal where the record could well be scanned and discussed. Since there was a machinery to take care of plaintiff's grievance, and no excess of authority was highlighted, the Civil Court had rightly refused to entertain the suit.

Companies Act

Section 100 of the Companies Act, 1956 – Reduction of share capital

Even where effect of sanctioning special resolution is that a class of shareholders will be extinguished, sanction could be granted if such shareholders themselves voted in favour of such reduction after being satisfied with amount paid to them

Sandvik Asia Limited vs. Bharat Kumar Padamsi and Others, (MUM) April 4, 2009

The Company proposed a resolution for reduction of paid-up equity share capital. The Special Resolution was passed by the company at its extra-ordinary general meeting for reduction of its share capital. The company petition was filed under Section 100 of the Companies Act, 1956 seeking sanction of the court. The effect of sanctioning the special resolution was that a class of shareholders namely the non-

promoters shareholders would be extinguished. The Single Judge declined to grant sanction to the resolution.

The Mumbai High Court held that Section 100 authorises the company limited by shares having a share capital, if so authorised by its Articles of Association by special resolution to reduce its shares capital in any way, and further condition is such resolution is sanctioned by the Court. In the present case, it was nobody's case that the special resolution passed by the company was invalid or had not been passed by following the procedure laid down by the Companies Act, 1956. It was also nobody's case that in the Articles of Association of the Company there was no provision authorising the company to reduce its share capital. It was also nobody's case that the amount that was being offered to the non-promoters share holders was not just or fair. The only objection raised was that the scheme for the reduction of share capital proposed by the special resolution wipes out a class of shareholders namely the non-promoter shareholders and this, according to the objectors, was unfair and inequitable.

In the present case, 95.54% share capital of the company was held by the promoters; balance 4.46% was held by non-promoters. In the special general body meeting the special resolution was passed by the majority of 99.95% of the votes polled by the equity shareholders present at the voting. It means that only 0.05% of the votes polled by the equity shareholders present and voting were against the special resolution. Once it was established that non-promoter shareholders were being paid fair value of their shares and at no point of time it was even suggested by them that the amount that was being paid was in any way less. Where the overwhelming majority of the non-promoters shareholders having voted in favour of the resolution, the Court was not justified in withholding its sanction to the resolution.

DISCIPLINARY CASE

Summary of a disciplinary case - Council of the Institute of Chartered Accountants of India vs. A. L. Ghael¹ (Chartered Accountant Reference No. 2 of 1991) decided on 31-05-2005 by the High Court of Gujarat under Section 21(6) of the Chartered Accountants Act, 1949.

Facts of the case:

The Chief Commissioner (Administration) and C.I.T., Gujarat-I, (hereinafter referred to as the "Complainant") filed a complaint against Shri A. L. Ghael, Chartered Accountant, Surat (hereinafter referred to as the "Respondent") under Section 21 of the Chartered Accountants Act, 1949 (hereinafter referred to as the 'Act') to the Institute of Chartered Accountants of India (hereinafter referred to as the 'Institute') alleging, *inter alia*, that under Section 132 of the Income-tax Act, 1961, a search was carried out in the office premises of the Respondent from where 15 bogus certificates purported to have been issued by a bank to the effect that the bank was maintaining a non-resident external savings bank account, as well as 13 blank acknowledgements of income-tax returns affixed with the seal of I.T.O., Circle I, Surat and receipts under the seal of the Department were seized. In his statement which was recorded under Section 132(4), the Respondent had admitted that he was in possession of those certificates, the fact which was denied by him earlier in the interrogation under Section 131. Thus the Respondent had tried to hide the fact of the possession of bogus bank certificates of gifts from NRE account kept ready by him. Further investigations revealed, beyond any doubt, the personal involvement of the Respondent in furtherance of the racket. Regarding the finding of 13 blank acknowledgements slips (ITNS 189), though the Respondent had admitted that they were found in his possession, but his replies were non-committal and evasive. Although the obvious purpose of obtaining such acknowledgements could be for antedating any return required to be filed and that was done with the connivance of

Income-tax officials, the Respondent could not plead innocence or ignorance on this account. In the above circumstances, the Respondent had acted contrary to a conduct, befitting a chartered accountant and committed professional misconduct.

The Council of the Institute *prima facie* opined that the respondent was guilty of professional and/or other misconduct and referred the case to the Disciplinary Committee for enquiry.

The Disciplinary Committee on perusal of the documents on records, after recording of evidence and hearing of the submissions made by the Parties came to the conclusion that the respondent acted contrary to the conduct befitting a Chartered Accountant and committed other misconduct for which he is liable under Section 22 read with Section 21 of the Chartered Accountants Act. The Council on consideration of the report of the Disciplinary Committee, the written representations of the parties and the oral submissions made by the Complainant's authorised representative found that the Respondent was guilty of "other misconduct" for both the charges against him under Section 21 read with Section 22 of the Chartered Accountants Act, 1949.

The Council recommended to the High Court that the name of the respondent be removed from the Register of Members for a period of six months. As required under Section 21(5) of the Act, the matter was referred to the Gujarat High Court with the recommendations of the Council.

The Judgment of the Division Bench of the High Court of Gujarat at Ahmedabad comprising of Hon'ble Mr. Justice A.R.Dave and Hon'ble Mr. Justice K.A.Pujis summarized below:

Decision of the Hon'ble Court:

The Hon'ble Court was in agreement with the opinion given by the Council to the effect that the name of the respondent should be removed from the Register of members for a period of six months and observed that it cannot be doubted that the behaviour of the respondent throughout was fishy, which would persuade anyone to believe that there was misconduct or misbehaviour on the part of the respondent.

The Hon'ble Court also observed that so far as the bogus certificates of the bank with regard to Non Resident External Savings Bank Account were concerned, it was clear that even after knowing the fact from the Manager of the Bank that the certificates were bogus, the respondent did not give copies of the bogus certificates to the bank manager, though he demanded the same. The Court further observed that even they forgot that the respondent is a member of a noble profession, even a layman ought to have cooperated with the bank authority upon knowing the fact that the certificates were bogus and even a man with ordinary prudence would understand that upon knowing the nature and genuineness of the certificates, the bank authority would be inclined to take some action to find out the real culprit and in that process, as a good citizen even a layman would handover copies of the bogus certificates to the bank authority. The respondent did not give even a single copy of the bank certificate to the bank manager even after knowing the fact that the certificates, which were in his possession, were bogus. If the bank manager or the police authorities were informed, the person behind the fraud would have been booked. Unfortunately, the respon-

¹ For full text of the Judgment please see Institute's publication viz. Disciplinary Case Vol.VIII, Part I, p. 1171 or visit Editorial Board page on the ICAI website at the link http://www.icai.org/post.html?post_id=967&c_id=59

dent did not cooperate with the authorities. Thus, there appeared to be guilty mind behind his behaviour and conduct, as observed by the Hon'ble Supreme Court in the case of *V.C. Rangadurai vs. D. Gopalan*. There need not be direct evidence in such disciplinary proceedings because the nature of proceedings is not the same as it is in a criminal case. Looking to the observations made by the Hon'ble Supreme Court, the Court was of the opinion that the respondent can be held to be guilty of "other misconduct".

As regards the second charge the Hon'ble Court was of the view that, the respondent cannot be ignorant with regard to what was happening in his office. Except him, nobody in the office might be interested in doing something, which was to be patently bad and illegal. Possibly, an effort was to be made to see that the returns, which were to be filed later on, were to be antedated by procuring blank acknowledgements of income-tax returns, on which seal of the

concerned Officer were put. The Court observed that, this was a very serious thing, as late filing of return would result into payment of interest and imposition of fine and only for avoiding the same, the respondent must have procured such blank acknowledgements. Such a conduct of the respondent would not only result into loss to the revenue but that would also be a fraud on public. A Chartered Accountant can never be expected to be a party to such a thing. Even if a tax payer does such a thing, the revenue would frown upon him. In the instant case, a person who is a party to such a fraud also happens to be a person belonging to a professional body which commands very high respect not only in the eyes of people at large but also in the eyes of highly placed revenue Officers. Except the respondent and the concerned client for whose benefit such an act of procurement of bogus certificates was undertaken, no other person would be interested in doing so and, therefore, the Court endorsed

the view of the Council to the effect that this was nothing but "other misconduct" on the part of the respondent. The Court was of the view that the present proceedings are not criminal proceedings, where benefit of doubt to a great extent can be given to the respondent and was in agreement with the view expressed by the Council that there was "other misconduct" on the part of the respondent. The Court observed that there was no reason to brush aside the report submitted by the Council and the quantum of punishment proposed to be inflicted upon the respondent by the Council is just and proper.

On overall consideration of the matter, the Hon'ble High Court accepted the finding of the Council that the respondent was guilty of professional misconduct in terms of Section 21 read with Section 22 of the said Act and ordered that the name of respondent be removed from the Register of Members for a period of six months. ■

CIRCULARS/NOTIFICATIONS

DIRECT TAXES

I. Notifications

1. Notification No. 37/2009 [F.No.142/01/2009-TPL], dated April 21, 2009



The Central Board of Direct Taxes, through Notification No. 10/2009 dated 19.01.09 notified the Income-tax (Third Amendment) Rules, 2009 which shall come into force from 1.4.2009. This notification inserted "new commercial vehicles acquired on or after the 1.01.2009 but before the 1.04.2009 and put to use before 1.04.2009 for the purposes of business or profession" under the head MACHINERY AND PLANT, which would be eligible for depreciation at the rate of 50 per cent

Subsequently, the Central Board of Direct Taxes, has, through this notification notified that the benefit of enhanced depreciation on commercial vehicles be extended up to 30th September, 2009 to the effect that the commercial vehicles acquired on or after 1st January, 2009 and put to use before the 1st October, 2009 will be eligible for depreciation at the rate of 50 per cent.

The complete text of the said notification can be downloaded from the link below:

<http://law.incometaxindia.gov.in/Taxman/NDit/DisplayPage/dpage1.aspx?md=31>

II. Press Release

1. Press Release No.402/92/2006-MC (11 of 2009) dated May 11, 2009

The Central Board of Direct Taxes has decided to defer the implementation of Notification No. 31/2009 dated 25.3.2009 amending or substituting Rules 30, 31, 31A and 31AA of the Income Tax Rules, 1962. The amended/substituted Rules will now come into effect on 1st July, 2009 instead of 1st April, 2009.

Tax deductors/collectors may continue to deposit TDS/TCS tax and file TDS/TCS returns as per the pre-amended provisions in the interim period.

The complete text of the said Press release can be downloaded from the link below:

http://www.incometaxindia.gov.in/arcl/ve/CBDTPressRelease_12052009_1.df

(Contributed by the Direct Taxes Committee of the ICAI)

INDIRECT TAXES CUSTOMS

Notification:

www.cbec.gov.in

1. Notification No. 36/2009 Cus. dated April 17, 2009



has further amended notification no. 21/2002 – Cus. dated 01.03.2002 to add two more items in the exemption list viz. Raw sugar and Refined or white sugar. With effect from 2nd August, 2009, duty of customs leviable under First Schedule shall be charged at nil rate and no additional duty leviable under section 3(1) of the Customs Tariff Act, shall be charged on the aforesaid items subject to conditions specified in the said notification.

FEMA

1. RBI/2008-09/438 A. P. (DIR. Series) Circular No.62 dated April 20, 2009



External Commercial Borrowings Policy – Liberalisation Issue of Guarantee for operating lease

As per Circular No. 24 dated March 1, 2002 and A. P. (DIR Series) Circular No. 01 dated July 11, 2008, AD Category – I banks were permitted to allow payment of lease rentals, opening of letters of credit towards security deposit, etc. in respect of import of aircraft/aircraft engine/ helicopter on operating lease and AD Category – I banks were allowed to convey 'no objection' for creation of charge on immovable assets, financial securities and issue of corporate or personal guarantees.

As a further measure of rationalization, it has been decided to allow AD Category – I banks to convey 'no objection' for issue of corporate guarantee in favour of the overseas lessor, for operating lease in respect of import of aircraft/aircraft engine/ helicopter after obtaining –

- (i) Board Resolution for issue of corporate guarantee from the company issuing such guarantees, specifying names of the officials authorised to execute such guarantees on behalf of the company.
- (ii) Ensuring that the period of such corporate guarantee is coterminus with the lease period.

2. RBI/2008-09/447 A. P. (DIR Series) Circular No. 63 dated April 22, 2009

FDI in India - Transfer of Shares/ Preference Shares/Convertible Debentures by way of Sale - Modified Reporting Mechanism Ref: A. P. (DIR Series) Circular No. 16 dated October 4, 2004

In case of transfer of shares by way of sale from a resident to a non-resident/non-resident Indian and vice versa, the transferee/his duly appointed agent is required to approach the investee company to record the transfer in their books along with the certificate in Form FC-TRS from the designated AD branch that the remittances have been received by the transferor/ payment has been made by the transferee.

The designated AD branch is also required to submit two copies of the form FC-TRS received from their constituents/customers together with the statement of inflows/outflows on account of remittances received/ made in connection with transfer of shares, by way of sale, to IBD/FED or the nodal office designated for the purpose by the AD Category – I bank, which in turn submits a consolidated monthly statement in respect of all the transactions reported by the branches to the Reserve Bank.

In order to capture the details of investment received by way of transfer, the Form FC-TRS has been revised (format in Annex I of this circular). Accordingly, the proforma for reporting of inflows/outflows on account of remittances received/ made in connection with the transfer of equity instruments by way of sale, submitted by IBD/FED/nodal branch of the AD Category – I bank to the Reserve Bank has also been modified (format in Annex III of this circular).

The sale consideration in respect of equity instruments purchased by a person resident outside India, remitted into India through normal banking channels, shall be subjected to a KYC check (format in Annex II) by the remittance receiving AD Category – I bank at the time of receipt of funds. In case, the remittance receiving AD Category – I bank is different from the AD Category – I bank handling the transfer transaction, the KYC check should be carried out by the remittance receiving bank and the KYC

report be submitted by the customer to the AD Category – I bank carrying out the transaction along with the form FC-TRS.

Further, in order to ensure that the form FC-TRS is submitted within a reasonable timeframe, it has been decided that henceforth, the **Form FC-TRS should be submitted to the AD Category – I bank, within 60 days from the date of receipt of the amount of consideration. The onus of submission of the Form FC-TRS within the given timeframe would be on the transferor / transferee, resident in India.**

In case of transfer of equity instruments where the non-resident acquirer proposes deferment of payment of the amount of consideration, prior approval of the Reserve Bank would be required, as hitherto. Further, in case approval is granted for a transaction, the same should be reported in form FC-TRS, duly certified by the AD Category – I bank, within 60 days from the date of receipt of the full and final amount of consideration.

3. RBI/2008-09/460 A.P. (DIR Series) Circular No. 64 dated April 28, 2009

External Commercial Borrowings (ECB) Policy – Liberalisation

Ref: A. P. (DIR Series) Circular No. 46 dated January 2, 2009

As per the above referred circular it was decided to dispense with the requirement of all-in-cost ceilings on ECB, under the approval route, until June 30, 2009.

As per this circular, this time limit has been extended to December 31, 2009 due to the continuing pressure on credit spreads in the international markets. This relaxation will be reviewed in December 2009.

The modifications to the ECB guidelines shall come into force with immediate effect. All other aspects of ECB policy remain unchanged.

4. RBI/2008-09/461 A. P. (DIR Series) Circular No 65 dated April 28, 2009

Buyback/Prepayment of Foreign Currency Convertible Bonds (FCCBs)

Ref: A.P.(DIR Series) Circular No. 39 dated December 8, 2008 and A. P. (DIR Series) Circular No. 58 dated March 13, 2009.

As per current situation Indian companies are permitted to buyback FCCBs out of their internal accruals, under the approval route up to a total amount of US \$ 50 million of the redemption value per company, subject to a minimum discount of 25 per cent on the book value.

As per this circular it has been decided to increase the total amount of permissible buyback of FCCBs, out of internal accruals, from US \$ 50 million of the redemption value per company to US \$ 100 million, under the approval route by linking the higher amount of buyback to larger discounts. Accordingly, Indian companies may henceforth be permitted to buyback FCCBs up to US \$ 100 million of the redemption value per company, out of internal accruals, with the prior approval of the Reserve Bank, subject to the conditions as mentioned in the circular.

All other terms and conditions stipulated in A. P. (DIR Series) Circular No. 39 dated December 8, 2008 will continue to be applicable.

5. RBI/2008-09/462 A. P. (DIR Series) Circular No. 66 dated April 28, 2009

Loans to Non-Residents/third party against security of Non Resident (External) Rupee Accounts [NR (E) RA/ Foreign Currency Non Resident (Bank) Accounts [FCNR(B)]-Deposits

As per Notification No. FEMA 5 / 2000-RB dated May 3, 2000, and A. P. (DIR Series) Circular No. 29 dated January 31, 2007, banks were prohibited from granting fresh loans or renewing existing loans in excess of Rs. 20 lakh against NR(E)RA and FCNR(B) deposits either to the depositors or third parties. The banks were also advised not to undertake artificial slicing of the loan amount to circumvent the ceiling.

This existing cap of Rs. 20 lakh has been enhanced to Rs. 100 lakh as per this circular. The banks are also advised not to undertake artificial slicing of the loan amount to circumvent the aforesaid ceiling.

(For full text of the above circulars one may refer www.rbi.org.in)

(Contributed by CA. Manoj Shah and CA HineshDoshi)

CORPORATE LAWS

1. Certification under SEBI Associated Persons Regulations

www.sebi.gov.in

The SEBI has issued Notification No. LAD/NRO/GN/2009-10/04/163097 dtd. 13.05.2009 under regulation 3 of SEBI (Certification of Associated Persons in the Securities Markets) Regulations, 2007 providing that the required certification for approved users and sales personnel of trading members of the Currency Derivatives Segment of recognized stock exchanges for the purpose of regulation 16L(2) of the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations, 1992 shall be the Series-I: Currency Derivatives Certification Examination (Series-I: CD), as specified by the National Institute of Securities Markets. Hence, a trading member of the Currency Derivatives Segment of a recognised stock exchange shall ensure that all its approved users and sales personnel obtain 'Series-I: CD' certification, as specified above, by August 10, 2009.



2. Simplified Listing Agreement for Debt Securities

www.sebi.gov.in

The SEBI has issued Circular No. SEBI/IMD/BOND/1/2009/11/05 dated 11.05.2009 under the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 which provide for a simplified regulatory framework for issuance and listing of non-convertible debt securities by any issuer company, public sector undertaking or statutory corporation. To further rationalise the disclosure norms for listing of debt issuances, a simplified Listing Agreement for debt securities is now put in place, and applicable with immediate effect, whereby:

- Where the equity of an issuer is listed, and such an issuer seeks listing of debt securities (whether by way of a public issue or a private placement), minimal incremental disclosures related to the debt security issuance would be sufficient, since large amount of information is already in public domain and material developments are disclosed under the equity Listing Agreement on a nearly continuous basis.
- Where the equity of an issuer is not listed, and such an issuer seeks listing of debt securities (whether issued by way of a public issue or a private placement), detailed disclosures, fewer than those made under the equity Listing Agreement, would need to be made.

For further details, the conditionalities, the listing agreement for debt securities and annexures to the listing agreement, the above, mentioned link may be referred.

3. Amendment to SEBI portfolio managers regulations

www.sebi.gov.in

The SEBI has issued Circular No. IMD/PMS/2/2009/11/05 dtd. 11.05.2009 clarifying in regard to the compliance with Regulation 16(8) of SEBI (Portfolio Managers) Regulations, 1993 of furnishing the compliance report to SEBI lest penal action is taken by SEBI. It is now decided that those portfolio managers who have not complied with the requirement of Regulation 16(8) of the SEBI (Portfolio Managers) Regulations, 2008 by the deadline of May 10, 2009, shall immediately stop undertaking new clients for portfolio management services till the time they become fully compliant with the requirements and shall submit a monthly progress report in regard to the status of their

compliance. Thereafter, the portfolio managers will require to ensure that the client securities which are held in a pool account as on May 11, 2009 shall be frozen with respect to any further transactions. Selling of securities, though, from such pool account shall be permitted; transfer of securities from such pool account to respective client's account shall also be permitted and No fresh purchases on behalf of such clients can be made.

4. Amendment to the equity listing agreement

www.sebi.gov.in

The SEBI has issued Circular No. SEBI/ CFD/ DIL/LA/ 1/2009/24/04 dtd. 24.04.2009 amending the equity listing agreement to be entered into by the stock exchange(s) with capital issuing companies whereby clause (5A) is inserted providing for uniform procedure for dealing with unclaimed shares, reducing the notice period for the timeline for corporate actions like dividend, bonus etc, for all scripts whether in demat or physical, whether in F&O segment or not from present 7 working days to 2 working days, uniformity in declaring dividends on per share basis only (new clause 20A inserted) and providing for additional format for disclosures of voting rights pattern in the company for each class of shares.

5. IRDA disclosure requirements in financial statements

www.irda.gov.in

The Insurance Regulatory Development Authority (IRDA) has issued Circular No. 005-IRDA-F&A-CIR-MAY-09 dtd. 07.05.2009 providing that apart from the disclosure requirements specified in the IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002, all insurers are required to provide details of various penal actions taken by various Government authorities from the financial year 2008-09 onwards as per the format given in the Circular which is required to be duly certified by the statutory auditor of the insurer and in view of the advanced stage of finalization of accounts by the insurers, these disclosures for 2008-09 may be made to the Authority through a separate filing. It may, however, be ensured that this information is incorporated in annual report w.e.f. 2009-10 onwards.

(One may refer to the link given with the circulars for further details and full text).

(Contributed by CA. Jayesh Thakur)

Accounting for maintenance spares supplied free of cost along with the main equipment

The following is the opinion given by the Expert Advisory Committee of the Institute in response to a query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. A company is a leading engineering product company in public sector under the Ministry of Defence catering to the vital sectors of the economy, such as, infrastructure, surface transportation, mining and defence. As per the querist, with a turnover of Rs. 2601.79 crore for the financial year 2006-07, the company is market leader in earthmoving and mining equipments and consistently making profits right from its inception. For the financial year 2006-07, the company earned a profit before tax of Rs. 316.04 crore registering a growth of 10.73% over previous year. The company is a fast growing engineering product company with export presence in as many as 42 countries spanning over Asia, Africa, and South American countries. For the financial year 2006-07, the export turnover was Rs. 110.73 crore and, according to the querist, it is expected to increase manifold in the future.

2. The company has three manufacturing units located at Kolar Gold Fields (KGF), Bangalore and Mysore. It has marketing and service centres spread all over India. The KGF unit manufactures dozers, excavators, loaders, walking draglines, rope shovels and sophisticated aggregates catering to the needs of mining and defence sectors. The Bangalore unit manufactures rail coaches, EMU's wagons, overhead inspection vehicles for Indian Railways and also logistics vehicles (tatra variants), mechanised pontoon bridges, ground support system for the integrated guided missiles for use by the Ministry of Defence. In addition, Bangalore unit is manufacturing for the first time in India, metro rail coaches under licence from a company of Korea. The Mysore unit manufactures highly sophisticated dumpers, graders, aircraft towing

tractors, the weapon loading systems and high powered internal combustion engines. All these products are highly technology intensive and call for an array of manufacturing technologies.

3. The querist has stated that one of the usual terms of sale is that the price of the equipment includes certain specified quantity of maintenance spares supplied free of cost. In other words, the company agrees to supply certain spares free of cost, i.e., without charging anything in excess of the agreed price of the equipment, purely as a marketing strategy.

4. The querist has illustrated the accounting treatment being followed by the company with the help of the accounting entries as follows:

(i) Debit: Sundry Debtors/
Customers
Credit: Sales Account –
Equipment (value of
equipment + value of
spares to be supplied
free of cost)
Credit: Sales Tax

(ii) The value of spares supplied/to be supplied free of cost as per the terms of the customer order is intimated through the issuance of a credit note, a copy of which is marked to the concerned sales office located at various states. The accounting entry passed is as follows:

(a) Debit: Sales Account
(Equipment) – To the
extent of the value of
free spares
Debit: Depot Sales Tax
Account – Prorata
Credit: Deposit – Customer
Account

(b) Thus, the equipment sold is recorded at a net value, i.e., value as per customer order as reduced by the value of free spares.

(iii) The free spares may be supplied either from the production units located at Karnataka or from the concerned sales office(s) located at various places in India. To the extent the free spares are supplied from Karnataka, i.e., in case of interstate sale, the accounting entry passed is as follows:

Debit: Deposit – Customer
Account
Credit: Sales Account –
Spare Parts
Credit: Sales Tax

To the extent free spares are supplied from the sales offices, i.e., intrastate sales, the accounting entry passed is as follows:

Debit: Deposit – Customer
Account
Credit: Sales Account – Spare
Parts
Credit: Sales Tax at the
appropriate rate as
per the statute of the
concerned State

Thus, in the view of the querist, with the passing of the above accounting entries, the total sale value as per the customer order is restored.

5. According to the querist, this is done purely to reflect correctly the value of spare parts sold to customers (either at a price or free of charge or as a part of equipment), as the company has a strategic business unit for spare parts. Also, in the view of the querist, by doing this, the company is not violating Accounting Standard (AS) 9, 'Revenue Recognition', in any manner whatsoever. As per the querist, this method enables the company to fix the price of the equipment as per the market dynamics.

6. The querist has further stated that the statutory auditors of

the company are of the opinion that raising invoice separately for spare parts supplied free of cost and accounting thereof by reducing the value of the equipment (to the extent of the value of spares supplied free of cost) is not in order.

B. Query

7. The querist has sought the opinion of the Expert Advisory Committee as to whether the accounting for sale of equipment duly reducing the value of free supply of spares and accounting as sale the value of spares at the time of supply is in line with Accounting Standard (AS) 9, 'Revenue Recognition'.

C. Points considered by the Committee

8. The Committee notes that the basic issue raised in the query relates to whether or not the accounting of maintenance spares supplied free of cost by reducing the value of equipment (to the extent of the value of the spares) and recording the sale of spares at the time of supply thereof is in order. The Committee has, therefore, restricted its opinion to this issue and has not touched upon any other issue arising from the Facts of the Case, such as, the accounting and valuation of inventories of maintenance spares, accounting for sales tax, basis of measurement of the amount at which revenue from sale of spares should be booked, etc. Further, the opinion expressed by the Committee is purely from accounting point of view and the Committee has not gone into legal interpretation of various enactments, such as those relating to sales tax, etc.

9. The Committee notes on the perusal of the query that the entries passed by the company are not clear in respect of the values at which the entries are passed. Accordingly, the understanding of the Committee in this regard has been illustrated with the help of the following entries:

(a) Assuming the value of sales order of equipment is Rs. 100, inclusive of the value of spares to be supplied along with the equipment Rs. 10; ignoring the

effect of sales tax, the entry passed by the company is:

Sundry			
Debtors A/c	Dr.	100	
To Sales A/c			
(Equipment)		100	
(b) For issuing credit note to the concerned sales office:			
Sales A/c			
(Equipment)	Dr.	10	
To Deposit –			
Customer A/c		10	
(With passing of this entry, the equipment sold is recorded at the net value, i.e., value as per customer order as reduced by the value of free spares)			
(c) At the time of supply of free spares from the concerned sales office:			
Deposit –			
Customer A/c	Dr.	10	
To Sales A/c			
(Spare parts)		10	
(With the passing of this entry, the total sales value as per the customer order is restored)			

10. The Committee notes from the Facts of the Case that though the company, in the instant case, is supplying spares free of cost, since the spares have a value which otherwise would have been recovered had these spares not been supplied under the agreement of selling of main equipment, in substance, in the view of the Committee, the company is selling two products under one composite selling arrangement. The Committee is, therefore, of the view that principles of revenue recognition, as enunciated in AS 9, should be applied separately to each element of the composite arrangement with a view to recognise revenue. In this context, the Committee notes paragraphs 6.1, 10 and 11 of AS 9, which provide as follows:

“6.1 A key criterion for determining when to recognise revenue from a transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration. The transfer of property in goods, in most cases, results in or coincides with the transfer of significant risks and rewards of

ownership to the buyer. However, there may be situations where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership. Revenue in such situations is recognised at the time of transfer of significant risks and rewards of ownership to the buyer. Such cases may arise where delivery has been delayed through the fault of either the buyer or the seller and the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault. Further, sometimes the parties may agree that the risk will pass at a time different from the time when ownership passes.”

“10. Revenue from sales or service transactions should be recognised when the requirements as to performance set out in paragraphs 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed. 11. In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

- (i) **the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and**
- (ii) **no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.”**

11. The Committee further notes from paragraph 4(iii) above that free spares may be supplied either from the production units located at Karnataka or from the concerned sales offices located at various places. Thus, there can be a time lag between

the recognition of revenue on account of sale of equipment and that for spares in case significant risks and rewards in respect thereof are transferred to the buyer on different dates, e.g., significant risks and rewards in respect of spares are transferred at the time of delivery thereof to the buyer whereas those of equipment are transferred at the time of the delivery of equipment which might have taken place at an earlier date. In such a situation, passing of a separate entry for spares would be justified.

12. The Committee notes from the above-reproduced paragraphs of AS 9 that the Standard requires recognition of revenue when the significant risks and rewards of ownership in respect of the goods have been transferred to the buyer. Thus, the Committee is of the view that in case the significant risks and rewards in respect of spares are transferred at a time different from the time of transfer of the risks and rewards of the concerned equipment, the revenue in respect of that

equipment should not be recognised at a gross amount, inclusive of value of spares. The revenue in respect of spares should be separately recognised at the time of transfer of significant risks and rewards of ownership of the spares. Therefore, it is not appropriate to first pass the entry for sale of equipment at the gross amount and then to pass a reversal entry for recognising revenue from spares.

D. Opinion

13. On the basis of the above, the Committee is of the opinion that the accounting for sale of equipment duly reducing the value of free supply of spares would be in line with AS 9 provided significant risks and rewards of ownership in respect of free spares are transferred at the time of the delivery of spares to the buyer. However, separate entries should be passed for (a) booking recognition of revenue from sale of equipment net of the amount related to revenue from spares when the risks and rewards of ownership of the

equipment are transferred and (b) booking recognition of revenue from spares when the risks and rewards of ownership of spares are transferred.

1. The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.

2. The Opinion is based on the facts supplied and in the specific circumstances of the querist.

3. The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in twenty five volumes. These volumes are also available in the form of a CD, viz., CD of Compendium of Opinions with user friendly features. These are available for sale at the Institute's office at New Delhi and its Regional Council offices at Mumbai, Chennai, Kolkata and Kanpur.

4. Recent opinions of the Committee are available on the website of the Institute at URL: http://www.icai.org/category.html?c_id=146

IFRS Financial Statements Presentation — Present and Future



The presentation aspects of financial statements are gaining more and more importance. A uniform presentation of financial statements over the years for the same entity and across entities for the same industry makes the financial statements comparable and more relevant to the users of financial statements by providing a feedback and predictive value. In India, Schedule VI to the Companies Act, Accounting Standards (AS) 1, “*Disclosure of Accounting Policies*” and AS 3 “*Cash Flow Statements*” deal with aspects of presentation of components of a complete set of financial statements. A draft of revised Schedule VI has been issued which is in line with requirements of IFRS as existed before the revision of IAS 1 in September 2007. This article discusses and explores the concept of IFRS financial statements presentation in present and future perspective.



CA. Manish Iyer

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

Under International Financial Reporting Standards (IFRS), IAS 1, “*Presentation of Financial Statements*” and IAS 7, “*Statement of Cash Flows*”, deal with aspects of presentation of components of a complete set of financial statements. A draft of revised Schedule VI has been issued which is in line with requirements of IFRS as existed before the revision of IAS 1 in September 2007. Recently, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) have in a joint project on Financial Statement Presentation issued a Discussion Paper on Financial Statement Presentation in which an entirely new presentation model has been proposed. It is heartening to note that the top level classification proposed in the Discussion Paper is more in line with the present Part I of Schedule VI. This article discusses the requirements of IAS 1 and IAS 7 in brief as they existed before revision, as they are at present, as they are

proposed to be in the Discussion Paper on Financial Statement Presentation and where thought fit, with the requirements in the present Schedule VI and Draft of revised Schedule VI.

Why is Presentation Important

To know why presentation is important, we should know what the objective of financial reporting is. The Framework for the Preparation and Presentation of Financial Statements as issued by Institute of Chartered Accountants of India states that the objective of financial statements is to provide information to a wide range of users to help them make economic decisions. The users of financial statements as envisaged in the Framework are investors, employees, lenders, suppliers and other trade creditors, customers, government and their agencies and public at large. Financial statements that are issued to such a wide range of users are called general purpose financial statements. However, under IFRS the users of a general purpose financial report are limited. The Exposure Draft on an Improved Conceptual Framework to Financial Reporting states that the object of general purpose financial reporting is to provide financial information about the reporting entity to its present and potential equity investors, lenders and other creditors to help them take decisions in their capacity as capital providers. IAS 1 defines General Purpose Financial Statements as intended for those who are not in a position to demand tailored reports from the entity. Thus, the only source of financial information for such users is the entity's financial statements. Financial statements to be relevant to such users should provide feedback value and predictive value. The users gather these values from each individual item, subtotal or other parts of a financial statement differently. Thus, the way the financial statements are presented governs the way these values are obtained. Also, the way the financial statements are to be presented governs the way the information is collected and summarised by entities.

Components of Complete Set of Financial Statements

What constitutes a complete set of financial statements differs as per IFRS and as per Indian GAAP. Till its revision in September 2007, IAS 1 stated the following to be a complete set of financial statements (Comparisons with Indian GAAP are stated in brackets, where they differ):

1. Balance Sheet.
2. Income Statement (Profit and Loss Account).
3. Statement of Recognised Income and Expense or Statement of Changes in Equity (Profit and Loss Appropriation Account and Reserves and Surplus Schedule to the Balance Sheet).
4. Cash Flow Statements.
5. Notes.

In September 2007, IAS 1 was revised and was brought in line with US GAAP. As per the revised IAS 1, the following are the components of a complete set of financial statements:

Financial statements to be relevant to users should provide feedback value and predictive value. The users gather these values from each individual item, subtotal or other parts of a financial statement differently. Thus, the way the financial statements are presented governs the way these values are obtained. Also, the way the financial statements are to be presented governs the way the information is collected and summarised by entities.



1. Statement of Financial Position.
2. Statement of Comprehensive Income or a separate Income Statement showing components of Profit or Loss and Statement of Comprehensive Income showing components of other comprehensive income.
3. Statement of Cash Flows.
4. Statement of Changes in Equity.
5. Notes.
6. Statement of Financial Position as of the beginning of the earliest comparative period presented when an entity, during the reporting period –
 - a. changes its accounting policy; or
 - b. rectifies a prior period error; or
 - c. reclassifies items.

Thus, the statement of recognised income and expense was removed and items stated in those statements were to be reported as other comprehensive income. As the presentation is new for IFRS, IAS 1 gives an option to entities to present a separate income statement as before and a separate statement of comprehensive income. The sixth component is a new component required to be presented only if any of the above three conditions exist. However, the Discussion Paper on Financial Statements Presentation issued by IASB and FASB eliminates this additional sixth component. Also, the option of presenting a separate income statement and a separate statement of comprehensive income has been eliminated. Entities would have to present a combined statement of comprehensive income. These revisions require revisions to Draft of revised Schedule VI.

It would be interesting to note the definition of "Financial Statement" in the Companies Bill, 2008. Clause 2(zp) of The Companies Bill, 2008 defines "Financial Statement" as under:

- (i) Balance sheet as at the end of the financial year
- (ii) A profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year
- (iii) Cash flow Statement for the financial year; and
- (iv) Any explanatory note attached to, or forming part of, any document referred to in sub-clause (i) or (ii).

Thus, the Companies Bill, 2008 does not identify Statement of Changes in Equity as a separate component of financial statements. Also, the fourth component "Explanatory Notes" is said to relate to only balance sheet and profit and loss account and not to cash flow statement. We would analyse the presentation aspects of each of the components separately.

Statement of Financial Position

In September 2007, IAS 1 was revised and the title of Balance Sheet was changed to Statement of Financial Position. IAS 1 specifies that all assets and liabilities be classified into current and non-current or on the basis of liquidity on the face of the Statement of Financial Position. It also says whatever method of classification is opted for, an entity has to disclose separately the amount expected to be recovered or settled after more than twelve months of the reporting date.

A current asset is one that is:

1. Expected to be realised, or sold or consumed in the entity's normal operating cycle.
2. Held primarily for trading.
3. Expected to be realised within twelve months after the reporting period.
4. Unrestricted cash and cash equivalents.

A current liability is one that is:

1. Expected to be settled in its normal operating cycle.
2. Held primarily for trading.
3. Expected to be settled within twelve months after the reporting period.
4. Not having an option to defer its settlement for at least twelve months after the reporting period.

IAS 1 requires each financial statement component to be clearly identified. It requires the following information to be displayed prominently and repetitively:

1. Name of the reporting entity.
2. Name of the reporting entity in the previous period, if changed.
3. Whether the financial statements are individual financial statements or consolidated financial statements.
4. The Balance Sheet date.
5. The currency in which the financial statements have been presented.
6. The level of rounding off.



To present a cohesive set of financial statements, the Discussion Paper on Financial Statement Presentation jointly issued by IASB and FASB requires an entity to align the line items, their descriptions and the order in which information is presented in the statements of financial position, comprehensive income and cash flows. It has been proposed to distinguish the financing activities from business activities in all the statements of financial position, comprehensive income and cash flows.

IAS 1 does not prescribe any slabs for rounding off. IAS 1 specifies minimum line items to be shown on the face of the Statement of Financial Position. Further, sub-classifications and disaggregations may be provided either on the face or in the notes. An illustrative format of the Statement of Financial Position is given below (Minimum line items specified by IAS 1 are denoted as (M)):

X Ltd. Group –Balance Sheet as at 31st March, 2008 (in lakhs of Rs.)

	Note	2008	2007
ASSETS:			
Non-Current Assets:			
Property, Plant and Equipment (M)			
Other Intangible Assets (M)			
Investments in Associates (M)			
Investment Property (M)			
Biological Assets (M)			
Financial Assets (M)			
Total Non-Current Assets			
Current Assets:			
Inventories (M)			
Trade receivables (M)			
Cash and cash equivalents (M)			
Total Current Assets			
Total Assets			
LIABILITIES:			
Non-Current Liabilities:			
Long term borrowings			
Deferred tax liabilities (M)			
Long-term Provisions (M)			
Total Non-Current Liabilities			
Current Liabilities:			
Trade and other payables (M)			
Short-term borrowings			
Current portion of long term borrowings			
Current Tax Payable (M)			
Short term Provisions (M)			
Total Current Liabilities			
Total Liabilities			
EQUITY:			
Issued capital and reserves attributable to equity holders of the entity (M)			
Ordinary Shares			
Other Components of Equity			
Non-Controlling Interests (M)			
Total Equity			
Total Equity and Liabilities			

Other Minimum Line items:

- The total of assets classified as held for sale and assets included in disposal groups classified as held for sale.
- Liabilities included in disposal groups classified as held for sale.

Disclosures for share capital such as number of shares authorised, issued, paid-up, nominal value per share, the rights, preferences and restrictions attaching to each class of shares, shares reserved for issue under options, shares in the entity held by the entity or by its subsidiaries or associates, nature and purpose of each reserve and a reconciliation of the number of shares outstanding at the beginning and at the end of the period may be made on the face or in the notes or in the statement of changes in equity. Presentation of deferred tax assets and liabilities as current asset or current liability is prohibited. The above format is proposed to be changed completely in the Discussion Paper on Financial Statements Presentation issued jointly by IASB and FASB.

Statement of Comprehensive Income

In September 2007, IAS 1 was revised and the income statement and the statement of recognised income and expense were combined to make it a statement of comprehensive income. However, to allow time to get familiar with the new presentation, an option has been given to entities to present a separate income statement and a separate statement of comprehensive income. The Statement of Comprehensive Income begins with Profit after Tax and further adjusted for after tax effects of Actuarial gains and losses, effective portion of cash flow hedges, revaluation gains and losses, remeasurement of available for sale financial assets, etc. A further option is given to present the tax effect and reclassification effect of individual line items of comprehensive income either on the face or in the notes. An entity is required to classify its expenses in either function of expense or nature of expense format either on the face or in the notes. Disclosure of any item of income or expense as extraordinary is prohibited. Like in the case of Statement of Financial Position, IAS 1 specifies the minimum line items to be specified on the face of the income statement. Thus, many options are provided for presentation of Income Statement and these options tend to reduce comparability. The new presentation model proposes to remove all these options which

are discussed later. The Draft of Revised Schedule VI requires function of expense method to be followed. Below is given the format



In September 2007, IAS 1 was revised and the income statement and the statement of recognised income and expense were combined to make it a statement of comprehensive income. However, to allow time to get familiar with the new presentation, an option has been given to entities to present a separate income statement and a separate statement of comprehensive income.

of function of expense method of presentation (Source: Rotork Plc. Annual Report 2007)

	Notes	2007 £ 000	2006 £ 000
Revenue	2	235,688	206,709
Cost of sales		(127,748)	(115,603)
Gross profit		107,408	91,106
Other income	4	227	98
Distribution costs		(2,954)	(2,287)
Administrative expenses		(49,811)	(43,735)
Other expenses	5	(15)	(93)
Operating profit	2	55,387	45,089
Financial income	7	6,607	5,568
Financial expenses	7	(4,741)	(4,596)
Profit before tax	8	57,253	46,061
Income tax expense	9	(17,957)	(14,728)
Profit for the year		39,296 Pence	31,333 Pence
Basic earnings per share	17	45.6	36.4
Diluted earnings per share	17	45.2	36.1

In the next column is given the format of other comprehensive income items. The items are similar to what was reported in Statement of Recognised Income and Expense (Source: Ricardo Plc. Annual Report 2007: Statement of Recognised Income and Expense converted to Statement of Comprehensive Income):

	Notes	Group		Company	
		2007 £ m	2006 £ m	2007 £ m	2006 £ m
Profit for the year		15.1	12.2	5.8	15.3
Currency translation differences on net investment in foreign operations		(1.5)	(0.2)	(1.1)	-
Fair value gain/(loss on net investment hedges)		0.4	(0.4)	0.4	(0.4)
Actuarial gains on the defined benefit pension scheme		2.5	4.7	2.5	4.7
Total Comprehensive Income for the Period		16.5	16.3	7.6	19.6
Attributable to:					
Owners of the Parent		16.4	16.2	7.6	19.6
Non-controlling Interests		0.1	0.1	-	-

Statement of Changes in Equity

Statement of Changes in Equity is basically a statement showing reconciliation of opening and closing balance of each component of equity separately showing each movement therein. This information is given in the Schedule of Reserves and Surplus to the Balance Sheet as per Part I of Schedule VI to the Companies Act.

Statement of Cash Flows

IAS 7 deals with the presentation aspects of Statement of Cash Flows. In India, AS 3 deals with cash flow statement presentation. IAS 7 and AS 3 are mostly similar except that IAS 7 is flexible when it comes to presentation of interest expense and dividend cash outflows and require more disclosures in case of acquisition or disposal of subsidiar-



ies. Both the standards require cash flows to be classified into operating, investing and financing activities. Both the standards provide an option to present cash flows from operating activities using either a direct method or an indirect method. Though both the standards including SFAS 95 in US GAAP prefer direct method, most entities follow an indirect method of presentation.

Proposed Presentation Model

The Discussion Paper on Financial Statement Presentation (DP) jointly issued by IASB and FASB proposes a totally new presentation model. The new model has been proposed in view of the criticism of the existing presentation, as under:

1. Information presented in different components of a set of financial statements is not cohesive. It is difficult to analyse an entity's performance independently of its capital structure. For this, the financial statement should distinguish its financing activities from its business activities. For example, the statement of cash flows requires cash flows to be classified into operating, investing and financing whereas neither the statement of financial position nor the statement of comprehensive income provides such classifications. Thus, it becomes difficult for a user to compare operating earnings with operating cash flows. The Exposure Draft on an Improved Conceptual Framework issued by IASB and FASB jointly identifies verifiability as one the enhancing qualitative characteristics. However, today's presentation lacks this quality.
2. Information presented is too much aggregated and there is no uniformity in disaggregation. For example, it becomes difficult for an analyst who wants to judge the trend in Operating Earnings between entities in an industry as the level of aggregation/disaggregation reported by those entities is not similar and, therefore, the extent of adjustments required to be made also differ. This reduces comparability.
3. Too many alternative presentations are permitted which reduces comparability.
4. It is difficult to analyse the changes in assets and liabilities reported in income statement into accruals, cash flow and fair value remeasurements thereby reducing relevance of financial statement.

In view of the above criticisms the Discussion Paper proposes to establish the following as the objectives of financial statement presentation:

1. **Cohesiveness:** The information should be presented in financial statements in a manner that portrays a cohesive financial picture of an entity's activities.
2. **Disaggregation:** The information should be presented in financial statements in a manner that disaggregates information so that it is useful in assessing the amount, timing and certainty of an entity's future cash flows.
3. **Liquidity and financial flexibility:** Helps users to assess an entity's ability to meet its financial commitments as they become due and to invest in business opportunities.

To present a cohesive set of financial statements, the Discussion Paper on Financial Statement Presentation jointly issued by IASB and FASB requires an entity to align the line items, their descriptions and the order in which information is

The statement of financial position seeks to separate its assets and liabilities into business and financing sections. Income taxes have been kept as a separate section as it is sometimes difficult to allocate the income tax expense to the various categories. A separate section for discontinued operations is to ensure that profit or loss from continuing operations is not mixed with discontinuing operations profit or loss. Equity is presented as a separate section.



presented in the statements of financial position, comprehensive income and cash flows. It has been proposed to distinguish the financing activities from business activities in all the statements of financial position, comprehensive income and cash flows. The table on the next page summarises the new classification scheme proposed.

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business	Business	Business
<ul style="list-style-type: none"> • Operating Assets and Liabilities <ul style="list-style-type: none"> • Long Term • Short Term • Investing Assets and Liabilities <ul style="list-style-type: none"> • Long Term • Short Term 	<ul style="list-style-type: none"> • Operating Income and Expenses • Investing Income and Expenses 	<ul style="list-style-type: none"> • Operating cash flows • Investing cash flows
Financing	Financing	Financing
<ul style="list-style-type: none"> • Financing Assets <ul style="list-style-type: none"> • Long Term • Short Term • Financing Liabilities <ul style="list-style-type: none"> • Long Term • Short Term 	<ul style="list-style-type: none"> • Financing asset income • Financing liability expense <p>Profit/ (Loss) from continuing operations before tax and other comprehensive income</p>	<ul style="list-style-type: none"> • Financing asset cash flows • Financing liability cash flows
Income Taxes	Income taxes on continuing operations	Income Taxes
<ul style="list-style-type: none"> • Current Tax Assets and Liabilities <ul style="list-style-type: none"> • Long Term • Short Term • Deferred Tax Asset and Liabilities <ul style="list-style-type: none"> • Long Term • Short Term 	<ul style="list-style-type: none"> • Income tax expense 	
	Net Profit/ (Loss) from continuing operation	
Discontinued Operations	Discontinued Operations	Discontinued Operations
	<ul style="list-style-type: none"> • Profit/ (Loss) from discontinued operations • (Tax expense)/ Benefit • Net Profit/ (Loss) from discontinued operations 	
	Net Profit/ (Loss)	
	Other comprehensive income, net of tax	
	Total Comprehensive Income	
Equity		Equity

The proposed model thus seeks to achieve cohesiveness at the line item level. The hierarchy of classification is sections, categories, sub-categories and individual line items.



Statement of Financial Position

The statement of financial position seeks to separate its assets and liabilities into business and financing sections. Income taxes have been kept as a separate section as it is sometimes difficult to allocate the income tax expense to the various categories. A separate section for discontinued operations is to ensure that profit or loss from continuing operations is not mixed with discontinuing operations profit or loss. Equity is presented as a separate section as no item of income or expense reported in statement of comprehensive income pertains to equity. The business section has been defined as including those assets and liabilities that management views as part of its continuing business activities and changes in those assets and liabilities such as assets and liabilities related to transactions with customers, suppliers and employees. The categorization of assets and liabilities into operating and investing under business section is based on the principle of core and non-core activities. The proposed model adopts a management approach to classification. The classification of assets and liabilities into operating, investing and financing categories should reflect how the entity uses those assets and liabilities in its reportable segments. It should be noted that the definition of segment as per AS 17, "Segment Reporting" significantly differs from the definition as per IFRS 8, "Operating Segments". AS 17 identifies segments on the basis of significantly differing risks and rewards whereas IFRS 8 identifies a segment as a group of assets and liabilities from which it may earn revenues and incur expenses, the performance of which is regularly assessed by the Chief Operating Decision Maker and for which financial information is available separately. All assets and liabilities including deferred tax assets and liabilities, except those assets and liabilities related to discontinued operations, are to be classified into short-term and long-term unless a presentation based on liquidity is more relevant. If an entity presents assets and liabilities on liquidity, it should present it either in increasing or decreasing order. Presently assets under Schedule VI are classified in increasing order of liquidity from top to bottom. An asset or

liability is short-term if either its contractual maturity or its expected date of realization or settlement is within one year of the reporting date. Thus, an asset or liability classified as current need not necessarily be a short-term asset or short-term liability. This is because an asset or liability is classified as current on the basis of operating cycle. Even if operating cycles are longer than one year of the reporting date, the asset or liability is classified as current asset or current liability. However, as per DP, the asset or liability would be classified as long-term asset or long-term liability. Though the classification of assets and liabilities is no more on



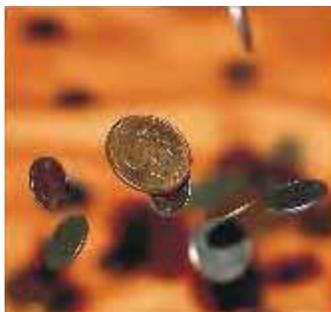
The new presentation model is a welcome step. The new presentation model falls in line with presentation specified in Part I of Schedule VI as far as the separate presentation of business and financing activities is concerned. However, the proposed presentation model relies on management approach to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment. This may reduce comparability.

the basis of operating cycle, it is proposed that all entities having an operating cycle longer than one year should describe its operating cycle in the notes. Further, all entities are required to disclose the contractual maturities of all its long-term assets and those entities presenting classification of assets and liabilities in order of liquidity are required to disclose the contractual maturities of its short-term assets also. Cash is required to be presented under one category only. Cash equivalents should be separated from cash and classified as investing or financing assets. This is different from the present practice of reporting cash and cash equivalents in one line item. All similar assets and liabilities that are measured on different bases should be presented on separate lines in the Statement of Financial Position. For example, the Draft of Revised Schedule VI specifies Non-current investments as a separate line item on the face of the Balance Sheet. The disaggregation for this line item is presented in a separate schedule as Investment Property, Investment in Government

Securities, and other investments. The bases of measurement for Investment Property and Investment in Government Securities differ and, therefore, should be presented in separate line on the face of the Balance Sheet.

Statement of Comprehensive Income

The Discussion Paper proposes to remove the option of presenting a separate income statement and a separate statement of comprehensive income by requiring all entities to present all items of income and expense under one statement of comprehensive income showing profit or loss for the year and total comprehensive income for the year separately. The profit or loss for the year is classified into income or expense / profit or loss from continuing operations and profit or loss from discontinued operations. Expenses are required to be classified on function of expense method. Within a function, the expense is to be disaggregated specifying its nature. The classification of income and expenses into operating, investing and financing should be based on the classification of related assets and liabilities.



operating assets, the purchases and sales of fixed asset would be classified as operating cash flow. The proposed model specifies all statements of cash flows to be presented in direct method only.

Also, cash equivalents are to be separated from cash. Thus, this would result in larger number of receipts and payments being reported. Further, the Discussion Paper requires an entity to disclose all relevant information about the significant non-cash activities. There is no consensus on presenting cash flows from business combinations. Two methods are proposed:

1. Allocation method whereby the cash flows are allocated to various categories on the basis of the categorization of assets and liabilities.
2. Classified in a separate section or category

Reconciliation Schedule

The Discussion Paper introduces a new component. Though it is termed as a reconciliation schedule to be presented in notes, it is in effect a separate component. The schedule reconciles cash flows to comprehensive income. Further, the schedule disaggregates comprehensive income into the following components:

1. Cash received or paid other than in transactions with owners.
2. Accruals other than remeasurements.
3. Recurring remeasurements.
4. Non-recurring remeasurements.

Below is given the proposed format of the reconciliation schedule.

XYZ Ltd.

Reconciliation of Consolidated Cash Flows to Consolidated Comprehensive Income for the year ended 31st March 20X0 (Rs. lakhs)

Caption in Statement of Cash Flows	Changes in assets and liabilities excluding transactions with owners				Statement of comprehensive Income	
	Not from remeasurements		From remeasurement		Comprehensive Income (Rs.)	Caption in Statement of Comprehensive Income (Rs.)
	Cash flows (Rs.)	Accruals, allocations and others (Rs.)	Recurring valuation adjustments (Rs.)	All other (Rs.)		

The Discussion Paper proposes two alternative models:

1. Statement of financial position reconciliation

XYZ Ltd.

Reconciliation of Statement of Financial Position March 31, 20X0 – March 31, 20X1 (Rs. lakhs)

Caption in Statement of Financial Position	March 31, 20X0 balance (Rs.)	Cash Flows (Rs.)	Caption in Cash Flow Statements	Changes in Assets and Liabilities			Statement of Comprehensive Income		Non Cash / Non Income (Rs.)	March 31, 20x1 balance (Rs.)
				Not from re-measurements	From remeasurements					
				Accruals, allocations & others (Rs.)	Recurring fair value changes	All others (Rs.)	Comprehensive Income (Rs.)	Caption in Statement of Comprehensive Income		

2. Comprehensive income matrix

XYZ Ltd.

Statement of comprehensive Income Matrix for the year ended 31, March, 20X0 (Rs. lakhs)

Statement of comprehensive Income		Changes in Assets and Liabilities excluding transactions with owners			
Caption in Statement of Comprehensive Income	Comprehensive Income (Rs.)	Not from remeasurements		From remeasurements	
		Cash Flows (Rs.)	Accruals, allocations and others (Rs.)	Recurring valuation adjustments (Rs.)	All others (Rs.)

Comments on the New Presentation Model

Following are the author's comments on the New Presentation Model proposed in Discussion Paper:

1. The new presentation model is a welcome step. The new presentation model falls in line with presentation specified in Part I of Schedule VI as far as the separate presentation of business and financing activities is concerned.
2. The Statement of Financial Position includes a section heading "Business". The definition of business in IFRS 3, "Business Combinations" includes financial assets and liabilities. Thus, if the section heading of business is pursued with, there would be different meanings of business in International Financial Reporting Standards.

Also, the word business is subject to many interpretations. Moreover, to show a separate section for Income Taxes by not including it in business may suggest that the Income Tax assets and liabilities are not related to business. However, there is a constraint for including income taxes under business as the cohesiveness of financial statements at the line item level would not be maintained. Hence, instead of "Bus-iness", the section may be named by some other word(s) such as "Application of Funds". The Statement of Financial Position includes a section called equity. Equity is one of the elements of statement of financial position. All other elements of statement of financial position are stated within section and, therefore, equity should be stated within

section. Hence, instead of “Equity”, the section may be named as “Owner sources of funds”. The section named “Financing” may

be renamed to “Non-Owner sources of funds”. The presentation of financial statements may be as given below:

3. Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Application of Funds for Operations <ul style="list-style-type: none"> • Operating Assets <ul style="list-style-type: none"> • Long-Term • Short-Term • Operating Liabilities <ul style="list-style-type: none"> • Long-Term • Short-Term • Total Operating Assets and Liabilities 	Application of Funds for Operations <ul style="list-style-type: none"> • Operating Income • Operating Expense • Total Operating Income and Expense 	Cash Flows for Application of Funds for Operations <ul style="list-style-type: none"> • Operating Asset <ul style="list-style-type: none"> • Long-Term • Short-Term • Operating Liability <ul style="list-style-type: none"> • Long-Term • Short-Term Total Cash Flows for Application of Funds for Operations
Application of Funds for Investments <ul style="list-style-type: none"> • Investing Assets <ul style="list-style-type: none"> • Long-Term • Short-Term • Investing Liabilities <ul style="list-style-type: none"> • Long-Term • Short-Term • Total Investing Assets and Liabilities 	Application of Funds for Investments <ul style="list-style-type: none"> • Investment Income • Investment Expense • Total Investment Income and Expense 	Cash Flows for Application of Funds for Investments <ul style="list-style-type: none"> • Investing Asset <ul style="list-style-type: none"> • Long-Term • Short-Term • Investing Liability <ul style="list-style-type: none"> • Long-Term • Short-Term Total Cash Flows for application of Funds for Investments
Non-Owner Source of Funds <ul style="list-style-type: none"> • Financing Asset <ul style="list-style-type: none"> • Long-Term • Short-Term • Financing Liability <ul style="list-style-type: none"> • Long-Term • Short-Term Total Non-Owner Sources of Funds	Non-Owner Sources of Funds <ul style="list-style-type: none"> • Financing Income • Financing Expense 	Cash Flows from Non-Owner Sources of Funds <ul style="list-style-type: none"> • Financing Asset <ul style="list-style-type: none"> • Long-Term • Short-Term • Financing Liability <ul style="list-style-type: none"> • Long-Term • Short-Term Total Cash Flows from Non-Owner Sources of Funds
	Profit/(Loss) from continuing operations before tax and other comprehensive income	
Application of Funds for Income Taxes <ul style="list-style-type: none"> • Current Tax Asset <ul style="list-style-type: none"> • Long-Term • Short-Term • Current Tax Liability <ul style="list-style-type: none"> • Long-Term • Short-Term • Deferred Tax Asset <ul style="list-style-type: none"> • Long-Term • Short-Term 	Application of Funds for Income Taxes on continuing operations <ul style="list-style-type: none"> • Income tax expense 	Cash Flows for Application of Funds for Income Taxes <ul style="list-style-type: none"> • Current Tax Asset <ul style="list-style-type: none"> • Long-Term • Short-Term • Current Tax Liability <ul style="list-style-type: none"> • Long-Term • Short-Term Total Cash Flows for Application of Funds for Income Taxes

<ul style="list-style-type: none"> • Deferred Tax Liabilities • Long-Term • Short-Term Total Income Tax Assets and Liabilities		
	Net Profit/ (Loss) from continuing operation	
Application of Funds for Discontinued Operation <ul style="list-style-type: none"> • Operating Asset • Operating Liability • Investing Asset • Investing Liability • Total Assets and Liabilities under Discontinued Operations 	Application of Funds for Discontinued Operations <ul style="list-style-type: none"> • Profit/(Loss) from discontinued operations • (Tax expense)/Benefit • Net Profit/(Loss) from discontinued operations 	Cash Flows for Application of Funds for Discontinued Operations
Total Application of Funds accruing to owners	Net Profit/ (Loss)	Total Cash Flows for Application of Funds accruing to owner
	Other comprehensive income, net of tax	
	Total Comprehensive Income	
Owner Sources of Funds <ul style="list-style-type: none"> • Ordinary Share Capital • Other Components of Equity Total Owner Sources of Funds		Cash Flows from Owner Sources of Funds <ul style="list-style-type: none"> • Ordinary Share Capital • Other components of Equity Total Cash Flows from Owner Sources of Funds
		Net Increase/Decrease in Cash during the Reporting Period
		Balance of Cash as at the beginning of the Reporting Period
		Balance of Cash as at the end of the Reporting Period

It may be noted that instead of "Business", the phrase "Application of Funds" provides more clarity. The above model shows perfect cohesiveness between Statement of Financial Position, Statement of Comprehensive Income and Statement of Cash Flows. The above model is based on the following relationship among elements of equity as stated in the Framework: Assets – Liabilities including non-owner sources of funds = Equity being owner sources of funds.

4. The proposed presentation model relies on management approach to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment. This may reduce comparability. Also, managements tend to change the use of an

asset or liability.

5. The cash flows on account of business combination should be allocated on the basis of the relative fair values of assets and liabilities in a business combination. The disclosures in IAS 7 with regard to Business Combination would provide sufficient details needed for the same.

6. The reconciliation schedule reconciling cash flows to statement of comprehensive income may be made mandatory and the reconciliation of statement of financial position be made recommendatory in addition to the schedule reconciling cash flows to comprehensive income.

7. The Framework recognises cost-benefit criterion as one of the constraints to quality financial statements. Thus, the Boards have to consider this element before prescribing the new model. ■

Purchase Price Allocation



CA. Gurudutt N. Joishy

The author is a member of the Institute.

*He can be reached at
gurudutt.joishy@icai.org*

Mergers and acquisitions accounting is one of the key areas which requires the underlying fair values to surface in financial reporting. Mergers and acquisitions could be accounted either under *pooling of interest* method or *purchase* method. Purchase Price Allocation (PPA) exercise has to be carried out for accounting a business combination under purchase method. Business combination accounting requires examination of intricate technical and case specific issues. A PPA involves both valuation and accounting, encompassing a vast body of accounting literature and valuation aspects. PPA is an emerging area full of opportunities for valuation professionals familiar with accounting. The article provides an overview of PPA with particular reference to US GAAP and IFRS.

Historical cost convention requires an asset to be accounted at its original price and this is one of the basic accounting principles. Measurement of monetary cost is the objective rather than deriving a value estimate. However, passage of time erodes the economic relevance of cost. Financial accounting statements based on historical cost may not be useful in assessing the performance based on the economic value of the capital employed in a business. In certain respects, accounting is hesitantly moving away from historical cost conventions, which has been its bedrock, towards fair value reporting. Mergers and acquisitions accounting is one of the key areas which requires the underlying fair values to surface in financial reporting.

Mergers and acquisitions could be accounted either under *pooling of interest* method or *purchase* method. *Pooling of interest* allows the assets and liabilities of the newly acquired company to be included at their book value. The difference between the consideration paid for the business and their book value are to be adjusted

from the acquirer's equity. Under the *purchase* method of accounting for a merger or combination, an entity is considered to have purchased the business. If the price paid for the acquired entity exceeds the market value of the acquired firm's assets, the difference is recorded as goodwill in the acquiring firm's balance sheet. In contrast to *Pooling of interest* method, which is purely accounting based on historical cost, *purchase* method, by considering the fair values, attempts to set out the economic rationale of a business combination in the acquirer's books.

The Indian GAAP under *Accounting Standard 14- Accounting for Amalgamations* allows a business combination to be accounted under the *pooling of interest* method. US GAAP requires business combination after 30th June 2001 to be accounted under *purchase* method while under the International Financial Reporting Standards ('IFRS') any business combination on or after 31st March 2004 is to be accounted under the *purchase* method. The accounting rules are codified in FAS Statement No. 141 (revised 2007), Business Combinations ('FAS 141(R)'), and in IFRS 3 (revised 2008), Business Combinations ('IFRS 3R').

Purchase Price Allocation ('PPA') exercise has to be carried out for accounting a business combination under *purchase* method. Business combination accounting requires examination of intricate technical and case specific issues such as whether the acquisition is of a business or of assets, definition of control, allocation of goodwill to reporting units, classification of assets, etc. A PPA involves both valuation and accounting, encompassing a vast body of accounting literature and valuation aspects.

Even though the accounting bodies are striving to harmonise US GAAP and IFRS, there are differences in treatment of certain elements of business combination accounting under the standards. The ensuing paragraphs attempt to draw a broad non-technical outline of a PPA with reference to US GAAP and IFRS. Technical literature specific to the accounting

regime should be relied upon for the minutiae to be dealt with in an engagement.

Scoping and Conducting a PPA

As on the acquisition date, the acquirer needs to recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. The identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree is to be measured at their acquisition-date fair values. Income taxes, indemnification assets, employee benefits, reacquired rights, share based payment awards, assets held for sale are the few exceptions to the fair valuation rule. A PPA is done necessarily after the transaction has been consummated and thus the justification of the consideration paid or the enterprise value ascribed is outside the scope of this exercise.

The acquisition date is the date on which the acquirer obtains control of the acquiree, which is generally the closing date. However, if control of the acquiree transfers to the acquirer through a written agreement, the acquisition date can be before or after the closing date. All pertinent facts and circumstances surrounding a business combination should be considered in assessing as to when the acquirer has obtained control of the acquiree. [FAS 141(R).11; IFRS 3R.9].

A PPA may be carried out internally by the internal management team of the acquirer. However, given the complexity and detailing required, rarely an internal management team is equipped to carry out a PPA and, therefore, PPA engagements usually involve external consultants to provide comfort to the auditors and external agencies including tax authorities.

An external consultant may take up the entire PPA engagement. The responsibility assumed by the external consultant in such situations is very high, particularly since the assets to be accounted in acquirer books may include self generated assets (not recorded earlier) that

A PPA may be carried out internally by the internal management team of the acquirer. However, given the complexity and detailing required, rarely an internal management team is equipped to carry out a PPA and, therefore, PPA engagements usually involve external consultants to provide comfort to the auditors and external agencies including tax authorities.





Goodwill is an integral element of a business and presence of goodwill is an indication that the transaction is a business acquisition. An entity is more than the sum of its parts benefiting on interplay between intangibles and tangible assets and the resultant value also forms part of goodwill. In case the amount is in deficit, a bargain purchase may have occurred and this economic gain would need to be recognized as part of acquirer's earnings.

meet the recognition criteria. An acquirer with a deep understanding of the business is better equipped to identify the assets and in many cases would have involved technical experts across functional departments. In addition, the acquirer would also have carried out pre-acquisition due diligences to permit ready identification of the assets and liabilities.

As an alternate to a full scope PPA, valuation of specified intangibles and tangible assets of the business could be assigned to external consultants. In practical situations, even though the external valuer may not formally accept responsibility for comprehensive identification of the assets, the acquirer management would involve both the external valuer and auditor to identify the assets and initiate the exercise. This arrangement effectively exploits the in-depth knowledge of the specific transaction with the acquirer and also brings to bear independent perspective and technical expertise of an external consultant. Valuation of tangible assets is usually handled by a technical valuer with expertise in plant and machinery, land and building while intangible assets are valued by consultants with expertise in financial and accounting theory.

Elements of a PPA

Goodwill determination is the culminating point in a PPA. Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised [FAS 141(R).3(j); IFRS 3R.Appendix A].

Goodwill results when the aggregate of (a) consideration at acquisition-date fair value (b) fair value of any non-controlling interest, and (c) fair value of equity interest in acquiree held previously exceed net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. The amount of goodwill recognised is also impacted by measurement differences resulting from certain

assets and liabilities not being recorded at fair value (e.g., income taxes, employee benefits). Goodwill and 'Indefinite – Lived Intangible assets' are not amortised but tested for impairment while tangible and intangible assets are generally amortised. Thus, recognition and valuations in an acquisition impact acquirer's prospective profitability reporting.

Goodwill is an integral element of a business and presence of goodwill is an indication that the transaction is a business acquisition. An entity is more than the sum of its parts benefiting on interplay between intangibles and tangible assets and the resultant value also forms part of goodwill. In case the amount is in deficit, a bargain purchase may have occurred and this economic gain would need to be recognized as part of acquirer's earnings. There are no free lunches and the bargain purchases are quite rare.

Consideration transferred is the sum of the acquisition-date fair values of the assets transferred, the liabilities incurred by the acquirer to the former owners of the acquiree, and the equity interests issued by the acquirer (except for the measurement of share-based payment awards). Consideration transferred is generally to be measured at fair values. Examples of consideration transferred include cash, other assets, contingent consideration, a subsidiary or a business of the acquirer transferred to the seller, common or preferred equity instruments, options, warrants, and member interests of mutual entities [FAS 141(R).39; IFRS 3R.37].

Legal agreements need to be studied carefully to determine the consideration. Acquisition costs, which include fees to investment bankers, lawyers, accountants in connection with the acquisition need to be expensed out and should not be considered part of the business combination.

The term 'Asset' is defined as the "*probable* future economic benefits *controlled* by the firm that can be *reliably* measured" and may be either *tangible* or *intangible*. *Tangible assets* are those which have a

physical form e.g. building, plant and machinery etc. *Intangible assets* do not have a physical form/ financial embodiment but are expected to provide future benefits for e.g. human capital, technology.

Tangible assets such as land, building, plant and machinery and current assets such as receivables, cash and bank balances are assets. A business generally would have generated intangible assets not recorded in the books and assets accounted at historical cost which are not represented at the current value and many a time key drivers for the acquisition. Identification of intangible assets not recorded earlier requires deep understanding of the business and its drivers.

Understanding the enterprise valuation of the acquiree is the starting point of a PPA. Discussions with the acquirer management, who knows the basis for the consideration, is possibly the best source for identifying the assets that need to be valued. This could be supplemented by the pre-bid valuation report setting out the key value contributors of a business. Other sources of information could be the presentation made by the acquirer management to its board, which would explain the acquisition rationale for justifying the consideration, due-diligence reports, etc. Business purchase agreements usually set out the key agreements that are to be novated, transferred and usually describe the assets in detail and can be used as a source to identify the assets.

FAS 141(R) deals with recognition and other criteria in respect of intangible assets while under IFRS, issues relating to intangible assets are dealt with in IFRS 3(R). In determining whether an intangible asset is to be separately recognized from goodwill, it needs to be evaluated whether the asset meets the below mentioned criteria and those that meet either of these criteria are considered identifiable and are separately recognised at fair value on the acquisition date:

Contractual-Legal Criterion: The intangible asset arises from contractual or other legal rights (regardless of whether those rights are transferable or separable from the acquired business or from other rights and obligations).

Separability Criterion: The intangible asset is capable of being separated or divided from the acquired business and sold,



transferred, licensed, ren-tened, or exchanged. An intangible asset that the acquirer would be able to sell, license, or otherwise exchange for something of value meets the 'separability' criterion, even if the acquirer does not intend to sell, license, or otherwise exchange it. If an intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually, it can still be considered separable if it can be sold, transferred, licensed, rented, or exchanged in combination with a related contract, asset, or liability. However, there cannot be restrictions on the transfer, sale, or exchange of the asset.

Trademark, non-competition agreements, customer contracts, non-contractual customer relationships, patents, unpatented technology and copyrights are illustrative examples of intangible assets to be recognised. Certain intangible assets do not typically meet either of the identifiable criteria and, therefore, would not be recognised as separate intangible assets from goodwill. Examples include customer base or unidentifiable "walk-up" customers, non-contractual customer relationships that are not separable, customer service capability, presence in geographic locations or markets, specially trained employees and assembled workforce.

Useful life and its determination is vital to an intangible asset and many factors, including legal life, obsolescence and expected use of the asset, would need to be factored in for determining the same. An asset would usually be amortised over its useful life. A class of intangible assets called 'Indefinite – Lived Intangible Assets' are those which have useful life for the entity and are not limited by legal, regulatory, contractual, competitive, economic or other factors. The term indefinite, however, does not mean infinite. Indefinite-lived intangible assets should be reassessed at each reporting period to determine whether events or circumstances continue to support an indefinite useful life. [*FAS 142 – Goodwill and Other Intangible*

Fair value is not the investment value, which may include buyer specific synergies, book value which is the historical cost, value in use that may include benefits due to interplay between intangibles, or liquidation value where there is a compulsion to sell. Measurement of value based on an entity's intended exploitation of asset (under utilisation of asset, including acquirer specific synergies) is explicitly prohibited.

Assets; IAS 38 – Intangible Assets].

Liabilities include debts and other obligations which need to be recorded at their respective fair values. IAS 32 – *Financial Instruments* defines a financial liability as (i) contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or liabilities with another entity under conditions that are potentially unfavourable to the entity; or (ii) a contract that will or may be settled in its own equity instruments that could be a non-derivative for which an entity is or may be obliged to deliver a variable number of its own equity shares or derivative that will or may be settled other than by exchange of a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

A loss [onerous] contract occurs if the unavoidable costs of meeting the obligations under a contract exceed the expected future economic benefits to be received [FAS 141(R).A79; IFRS 3R.B52]. A loss [onerous] contract should be recognised as a liability at fair value if the contract is a loss [onerous] contract to the acquiree at the acquisition date.

Valuation Techniques

In valuing an asset or a liability the concept of value to be applied is the *Fair Value* which is the “price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.” (*FAS 157- Fair Value Measurements*). There are fine differences in the IFRS 3-R definition which may not be material in most cases and, therefore, have not been elaborated here. It is necessary that the market participants transact purely on economic considerations and are independent, knowledgeable and informed.

Fair value is not the investment value which may include buyer specific synergies, book value

which is the historical cost, value in use which may include benefits due to interplay between intangibles, or liquidation value where there is a compulsion to sell. *Measurement of value based on an entity's intended exploitation of asset (under utilisation of asset, including acquirer specific synergies) is explicitly prohibited.*

In the fair value hierarchy, primacy is accorded to the quoted prices (unadjusted) in active markets for identical assets or liabilities, which is considered a Level 1 input. Level 2 inputs are quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in non-active markets, inputs other than quoted prices, and market-corroborated inputs, adjusted as appropriate for differences. Level 1 and Level 2 inputs are observable while Level 3 inputs are the entities' own assumptions on the asset/liability and not observable. Such assumptions need to be supported/reflected in the market.

The valuation techniques employed to determine the fair value are:

Market Approach:

This approach involves comparing the relevant asset parameters with the parameters of a similar asset to derive the value from the transaction price. Parameters could include multiples based on profits, sales, number of units, etc. Prices in a transparent and liquid market are considered more reliable indicators of value compared to values derived from subjective projections.

Income Approach:

Income approach technique attempts at measuring the future benefits from ownership of the asset and involves valuation based on expected cash flows/income streams the subject intangible is expected to generate. This approach typically is applied using the discounted cash flow ('DCF') method, which requires (i) estimating future cash



Tangible assets are usually multipurpose, used across industries, with high possibility of substitution. Land value is based on the market price. Building is valued considering the cost of construction and items of plant and machinery could be valued based on vendor quotations and the remainder life realizable value, which is derived on the basis of the useful life and adjusting for wear and tear, years in use and such other technical factors. Replacement cost may be more appropriate in case of such assets.

flows for projected horizon (ii) estimating the terminal value, if appropriate; and (iii) discounting the cash flows to present value at a rate of return that considers the relative risk of the cash flows. Income approach rests on the premise that an asset is worth what it can earn. Multi-period excess earnings method and relief-from-royalty method are applications of income approach.



PPA is the base to incorporate the opening balance sheet of the acquired entity. In view of its significance a PPA reports needs to be clear and transparent dealing with among others - acquisition rationale, crystallization of consideration, process of identification of assets and liabilities. Target business market overview is useful as a guidance on identification of key business drivers apart from giving an insight of the valuer's perspective on the exercise.

Cost Approach:

The concept of replacement as an indicator of fair value is based on the principle of substitution and based on the premise that a market participant would pay no more for an asset than the amount necessary to replace the asset.

Application of Valuation Techniques

Tangible assets are usually multipurpose, used across industries, with high possibility of substitution. Land value is based on the market price. Building is valued considering the cost of construction and items of plant and machinery could be valued based on vendor quotations and the remainder life realizable value, which is derived on the basis of the useful life and adjusting for wear and tear, years in use and such other technical factors. Replacement cost may be more appropriate in case of such assets. In case of large projects requiring substantial time for commissioning, appropriate preoperative expenses are normally factored into the replacement cost.

Intangible assets assume strategic importance due to uniqueness. Most intangibles are industry specific and their value cannot be realized unless they reside in a going concern. The value of an intangible asset in most cases can be partially attributed to its interplay with tangible assets and other intangible assets. In knowledge-based businesses, the enterprise value is attributable largely to the intangibles and the leading asset contributing/expected to contribute significantly to the cash flows of the acquired business is likely to be an intangible asset.

Cost approach is not appropriate for valuing intangibles in most cases, since intangible assets are subject to high degree of failures with the probability of success not captured in the 'cost' of subject asset in isolation. The future income streams

diverge significantly from the historical cost of the successful intangible.

While intangibles are valuable because of exclusivity and strategic importance, these attributes contribute to illiquidity and pose a valuation challenge as information on such assets is invariably limited with rarely any comparable transactions in similar assets. Market approach, though ideal, may be rendered inapplicable as a primary method in most cases. Income approach would need to be employed as a primary approach in valuing intangible assets, particularly the leading asset to synchronise with going concern assumption of a business and its value as the present value of the expected earnings/cash flows. The cash flow projections for this purpose are not expected to include any acquirer specific synergies. Apart from other assumptions in the projections, useful life of the asset is to be closely examined. Deteriorating cash flows would be inconsistent with the assumption that the subject asset is an indefinite-lived intangible asset. In respect of contracts, as a broad principle, the value has to be arrived by comparing contracted price with reference to the prevailing market price.

Broadly, any debt is fair valued considering the contracted interest rate, maturity duration with reference to the prevailing market rate for similar duration with reference to the rating of the borrower. Liabilities are fair valued based on transfer concept under US GAAP while it is the settlement concept applicable in IFRS. Thus, the value of a liability is market-based under US GAAP in contrast to liability under IFRS which is entity-specific.

In most of the cases, given the nature of leading intangible asset, projections for asset on a standalone basis may have to be derived from the projections of the entire business after adjusting for the charges of other assets which contribute to the

cash flows of the business. The contributory asset charges are to be adjusted as if the owner of the intangible would have to rent or lease all other assets enabling the owner to generate the projected cash flows. Thus, such charges would consider the principal component and the interest component. For example, in case plant and machinery is a contributing asset, the charge is its operational lease rent and not just the depreciation.

Market based inputs have primacy in a valuation. However, defining the relevant market to be considered for obtaining the valuation metrics is a daunting task. Issues the valuer needs to reckon with before considering international multiples are - Is it relevant to consider valuation metrics of companies operating in other geographies with different growth pattern and future potential?, Are the regulatory regimes the same? Another related problem is that market participants for intangible assets comprise largely the strategic players with differing estimates of private values of assets. The transaction price would have an element of strategic premium and isolating the standalone value in such cases is difficult.

In many cases assets may be tax amortisable and the benefit would be equivalent of the present value of the tax benefit over which the amortisation benefit can be claimed. The DCF value without this benefit is to be grossed up for the tax amortization benefit ('TAB') by applying the appropriate step-up factor. This factor is the function of the tax rate, time duration and the discount rate. TAB is to be considered irrespective of whether the transaction results in a new tax base or not and is independent of the deal structure. A share purchase may not result in a tax base as opposed to a slump sale. However, in both the cases, TAB is necessarily to be considered and the logic in support of this treatment is that an asset is considered on a stand-alone basis. TAB is not added to the market value as it is assumed that the market price is after this benefit and in case of cost approach the difference between the cost and present value of the tax benefit is usually not adjusted.

Discount rate determination is critical to a valuation process. This rate is used to discount

the cash flows so as to reflect the risks associated with the asset. Weighted average cost of capital ('WACC'), considering the equity cost of capital and the cost of debt, is appropriate for an enterprise. The enterprise WACC relates to a portfolio of assets with varying risk profiles and return expectations attached to the same and thus carry different discount rates. In valuing individual assets, this aspect needs to be considered though the enterprise WACC may be considered as a guidepost. To illustrate – intangibles are riskier compared to tangibles, a non-contractual relationship has higher risks than that of a binding contractual relationship implying the discount rate is higher for the former; a multipurpose asset such as land would have a lower discounting rate compared to a discount rate for customised equipment with high technological obsolescence.

Valuation is an iterative process and the results under the income approach based on cash flow projections need to be tested with reference to the value outcome based on market parameters. The implied value of intangibles of listed companies (based on traded price of equity) that have comparable intangibles as a leading asset could be derived and used only as a broad cross check as market prices of small lots do not include control premium.

A valuation exercise is incomplete without overall checks. The value attributable to the identified tangible and intangible assets as a percentage of the enterprise value is an important check. In case the residual goodwill value is very high, the valuer may need to revisit the process of identification of assets to ensure that there are no omissions and also examine the valuations attributed to the assets. The discount rates for the individual assets need to be reconciled with that of the composite business after weighing in the value outcomes.

One of the key advantages of purchase accounting is the transparency in reporting an acquisition to the stakeholders. The economics of the transaction and its rationale is articulated by combining accounting and valuation. This benefit is eroded in case the PPA exercise is motivated by other considerations. Educating the client in these circumstances becomes important as PPA impacts financial statements for many years into the future.





Issues

PPA is the base to incorporate the opening balance sheet of the acquired entity. In view of its significance, a PPA report needs to be clear and transparent dealing with among others - acquisition rationale, crystallization of consideration, process of identification of assets and liabilities. Target business market overview is useful as a guidance on identification of key business drivers apart from giving an insight of the valuer's perspective on the exercise. The assumptions underlying the projections, such as income-streams, useful life and contributory asset charges, need to be spelt out very clearly particularly because valuation is a subjective exercise, especially for intangibles. In the absence of the aforementioned information, the auditor cannot derive overall comfort on the reasonableness of the acquisition accounting, which involves subjective fair value estimates. In many cases, the consultant does not spell in the report the degree of responsibility assumed – is it a full-fledged PPA or is the responsibility of valuing only the specified assets? Unfortunately the quality of reporting is quite inconsistent in India and it might take some time before it evolves to an acceptable standard.

Lack of clarity on the definition of the asset that is valued is particularly acute in case of intangible assets. One of the important dimensions of intangible assets is that they are legal rights and these need to be examined in forming a value perspective. Many valuation reports do not explicitly address this aspect. Valuation adjustment for contributory asset charges is totally omitted at times or may not be considered at the market price. TAB adjustment is often not carried out. The discount rates are not calibrated considering the risk / return profile of the individual assets. 'Replacement cost' is arrived taking into account the notional profit foregone for the time

duration taken to construct an asset without testing if the market prices include this element.

The independent consultant who has compiled the report is answerable to the client which is the acquirer company and may not be inclined to act upon the comments that an auditor may have unless the client prevails upon him to do so. The client is usually not disposed to revisit a completed exercise. A report that is not transparent may not be acceptable to statutory authorities. Unless details of useful life, cash flows considered in each of the years are spelt out it would be difficult to amortise the assets accurately.

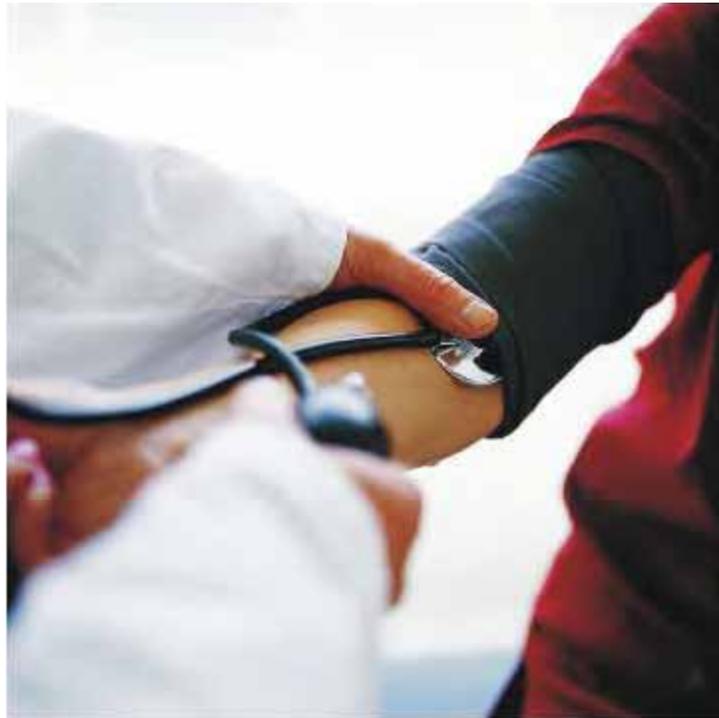
Many a time the valuation reports are used as a back-up for claiming tax depreciation. Under the domestic tax laws, intangibles assets that meet the criteria for claiming tax benefit is quite narrow and goodwill is not tax deductible which might tempt the acquirer to stretch the description of intangibles to meet the tax deductibility requirement. If tax considerations are irrelevant, as in a share purchase, the value assigned to amortizable assets could be lower to reduce amortization charge. Thus the residual goodwill, as a percentage of the enterprise value could be quite large, so much so that at times the auditor is compelled to examine the acquisition rationale.

In theory, it is possible that the fair value under the US GAAP and IFRS may be different from cost as defined under the domestic tax laws for claiming tax benefit. In practice, however, the same exercise and values are used for both tax and financial reporting purposes. It might be useful and necessary to involve the auditor at the PPA initiation stage to ensure clarity on the issues and scope of the exercise.

One of the key advantages of purchase accounting is the transparency in reporting an acquisition to the stakeholders. The economics of the transaction and its rationale is articulated by combining accounting and valuation. ■

No Fringe Benefit Tax Payable on Medical Reimbursement

CBDT Circular 8/2005 dated 29th August 2005, while answering Question 69, has mentioned that medical reimbursement up to Rs. 15000 is chargeable to tax as fringe benefit in the hands of employer. The article analyses this and related CBDT circulars and other similar issues, and puts forward the viewpoint that no fringe benefit tax is payable by the employer on medical reimbursement facility provided to employees.



CA. Tushar Gandhi

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

With Introduction of Fringe Benefit Tax in the Finance Bill 2005, the employer is now liable to pay the tax in respect of certain fringe benefits. These fringe benefits were taxable as perquisites are no longer taxable in the hands of employees. For this, the Rules for valuation of perquisite have been amended vide notification no. 68/2005, whereby following Rules of valuation of perquisite have been withdrawn.

- 1 - Rule 2 for valuation of motor car.
- 2 - Rule 3 relating to valuation of travelling, free meal, credit card, club facility, etc.

Mutual Exclusion Between Perquisite and Fringe Benefit Tax

Clause (VI) of section 17(2) has been amended by Finance Act 2005 which is read as 'the value of any other fringe benefit and amenity (excluding the fringe benefit chargeable to tax under Chapter XII – H) as may be prescribed.' Prior to this amendment Clause VI was read as 'the value of any other fringe benefit or amenity as may be prescribed'.

Thus this clause has been amended to provide that only those fringe benefits and amenities shall be included in the perquisite chargeable to tax in the hands of employee which are not chargeable to tax as fringe benefit tax in the hands of employer. It means that those fringe benefits and amenities on which tax is



Facility or amenity, which is chargeable as perquisite in the hands of employees, cannot be taxed as fringe benefit in the hands of employer in view of sub section (3) of section 115WB. Similarly facility or amenity chargeable as fringe benefit in the hands of employer cannot be taxed as perquisite in the hands of employees in view of amended clause (VI) of sub section (2) of section 17 of the Act.

payable by the employer as fringe benefit tax shall not be included as perquisite in the hands of employee.

Sub-section (3) of section 115WB is read as 'for the purpose of sub section (1) the privilege, service, facility or amenity does not include perquisite in respect of which tax is paid or payable by employee'. Thus, any facility or amenity chargeable to tax as perquisite in the hands of employee cannot be taxed as fringe benefit tax in the hands of employer.

In this way there is mutual exclusion between the two. If the facility or amenity is chargeable to tax as perquisite in the hands of employee, the same cannot be taxed as fringe benefit in the hands of employer in view of sub section (3) of section 115WB. Similarly, if the facility or amenity is chargeable to tax as fringe benefit in the hands of employer, the same cannot be taxed as perquisite in the hands of employees in view of amended clause (VI) of sub section (2) of section 17.

Facility or amenity, which is chargeable as perquisite in the hands of employees, cannot be taxed as fringe benefit in the hands of employer in view of sub section (3) of section 115WB. Similarly, facility or amenity chargeable as fringe benefit in the hands of employer cannot be taxed as perquisite in the hands of employees in view of amended clause (VI) of sub section (2) of section 17 of the Act.

Taxation of Medical Facility Provided by Employer to Employee

Medical facility is chargeable to tax as perquisite in the hands of employee as per proviso to clause (VI) of sub section 2 of section 17 of the Act. Clause (V) of the above proviso has provided that the medical reimbursement in excess of Rs. 15000 is chargeable to tax in the hands of employee as perquisite.

However, CBDT Circular 8/2005 dated 29th August, 2005, while answering Question 69, has mentioned that medical reimbursement up to Rs. 15000 is chargeable to tax as fringe benefit in the hands of employer. The text of Question 69 of the above circular is as follows:

'Whether medical reimbursement up to Rs. 15000 (exempt in the hands of the employees) and medical reimbursement over Rs. 15000 (taxed as perquisite in the hands of the employee) is liable to FBT?

69. At present, if any sum is paid by the employer for expenditure actually incurred by the employee for medical treatment in an unapproved hospital and it exceeds Rs. 15,000 during the year, such sum is salary as defined in clause (1) of section 17 of the Income-tax Act and liable to income-tax in the hands of the employee. There is no change in this position. Since such sum is taxable in the hands of the employee, the same is not liable to FBT.

However, if any sum is paid by the employer for expenditure actually incurred by the employee for medical treatment in an unapproved hospital and it does not exceed Rs. 15,000 during the year, such sum does not fall within the meaning of salary as defined in clause (1) of section 17 of the Income-tax Act and not liable to income-tax in the hands of the employee. There is no change in this position. Since such sum is not taxable in the hands of the employee, the same is liable to FBT.'

Thus, the above circular provides that medical reimbursement up to Rs. 15000 is chargeable to tax as fringe benefit tax in the hands of employer and as per proviso to clause (VI) of sub section 2 of section 17 the medical reimbursement above Rs. 15000 is chargeable as perquisite in the hands of employee. Is this right that some part of the same facility is chargeable to tax as fringe benefit tax in the hands of employer and remaining part is chargeable to tax as perquisite in the hands of employee?

Tax on the facility or amenity received by the employees from employer is to be paid by employees. Fringe benefit tax is on obligation of employees borne by employer. If there would not be fringe benefit tax, employees would not be required to pay tax on medical reimbursement up to Rs. 15000.

Approach Towards Taxability of Facility, Privilege, Amenity or Benefit

The first stage is to check whether the facility or amenity is chargeable to tax as perquisite as per sub section (2) of section 17 of the Act because in the

clause (VI) of section 17(2) it has been provided as 'the value of -----as may be prescribed'. Thus, if the chargeability of facility or amenity has not been precised in section 17(2), the same facility or amenity cannot be charged to tax as perquisite. Then one is required to check whether that facility or amenity is chargeable as fringe benefit tax as per section 115WB (1).

The second stage is to include the same facility or amenity in the taxable income of employee as perquisite or in the hands of employer as fringe benefit after considering the exemption given in the Act.

Thus, the facility or amenity provided by the employer to employee will be either taxed as perquisite in the hands of employee or fringe benefit tax in the hands of employer. Therefore, it is incorrect to charge some part of the facility as fringe benefit in the hands of employer and remaining part of the same facility in the hands of employee as perquisite.

Contradictory CBDT Circular

CBDT circular 8/2008 is contradictory to the provision of sub section (3) of section 115WB because as per the proviso to the clause (VI) of sub section 2 of section 17 of the Act, medical facility is chargeable to tax as perquisite in the hands of employee. Therefore, the same cannot be taxed as fringe benefit in the hands of employer [section 115(3)].

Applicability of CBDT Circular

The circular cannot override provisions of the Act. Section 119 has empowered CBDT to issue orders, instructions or directions for the 'proper administration' of the Act. Such an order, instruction or direction cannot override the provisions of the Act. This was pronounced in the case of *Kerala Financial Corporation vs. CIT* [1994] 210 ITR 129 (SC).

Medical reimbursement is chargeable as perquisite in the hands of employee as per clause (v) of the proviso to the clause (VI) of sub section (2) of section 17 of the Act. While including the same in the taxable income of employee, exemption of Rs. 15000



Medical facility is chargeable to tax as perquisite in the hands of employee as per proviso to clause (VI) of sub section 2 of section 17 of the Act. Clause (V) of the above proviso has provided that the medical reimbursement in excess of Rs. 15000 is chargeable to tax in the hands of employee as perquisite.

is given. Thus, an exemption of Rs. 15000 is given in the Act. The CBDT circular (No 8/2005) has mentioned that payment of fringe benefit tax on medical reimbursement of Rs. 15000 is amounting to amending the provision of the Act, which is passed in Parliament. Thus, this CBDT circular directing authority to charge medical reimbursement up to Rs. 15000 as fringe benefit in the hands of employer is *ultra virus*.

Binding nature of circulars - CBDT circular is binding on revenue even though the circular is deviation from the provision of the Act. - *Ellerman Lines Ltd vs. CIT* [1971] 82 ITR 913 (SC). However CBDT circular is not binding on Appellate Authority or Tribunal or Court or Assessee - *CIT vs. Hero Cycles (P.) Ltd.* [1997] 94 Taxman 271/228 ITR 463 (SC).

Fringe Benefit Tax an Obligation of Employee

Privilege, service, benefit or amenity is received by the employees from employer. Therefore, tax on these facilities or amenities is to be paid by employee. Fringe benefit tax is an obligation of the employee borne by employer. So, if there would not be fringe benefit tax, employees would not be required to pay tax on medical reimbursement up to Rs. 15000.

Thus, payment of fringe benefit tax by the employer on medical reimbursement is amounting to double taxation.

Conclusion

It would be better if CBDT issues another circular amending the above circular to provide that no fringe benefit tax is payable by the employer on medical reimbursement of Rs. 15000. To sum up, no fringe benefit tax is payable by the employer on medical reimbursement facility provided to employees.

Tax on the facility or amenity received by the employees from employer is to be paid by employees. Fringe benefit tax is an obligation of employees borne by employer. If there would not be fringe benefit tax, employees would not be required to pay tax on medical reimbursement up to Rs. 15000.

The Fiction of Deemed Dividend – An Insight



The concept of deemed dividend under the Income-tax Act, 1961 is not new. The provision of deemed dividend is an effective tool utilised by the revenue authorities to reprimand shareholders having substantial controlling interest who benefit directly or indirectly from closely-held companies. To determine whether a benefit has been derived as per the provisions of deemed dividend, tax authorities may not be hesitant to pierce corporate veil to establish disparity for genuine shareholders being deprived of dividend distribution. The revenue authorities would utilise this measure only after being convinced of a skilful evasion of tax by distributing retained profits in the form of loans / advances to preferred substantial owners of the company. With the revenue authorities getting fairly equipped, taxation on deemed dividend is a first step to safeguard interest of legitimate shareholders.



CA. Shailendra Sharma

The author is a member of the Institute.

He can be reached at

shailendra.shashikant.sharma@icai.org

Understanding Deemed Dividend

The provisions of Companies Act, 1956 ('Companies Act') permits declaration and distribution of profits in the proportion of share capital held as per the guidelines laid down for distribution of dividend to its shareholder as on record date. Under the Income-tax Act, 1961 ('the Act'), dividend received by a shareholder is exempt under Sections 10(33) / (34) of the Act. However, in order to avoid loss of revenue, Section 115O was enacted which makes a company liable to pay additional Dividend Distribution Tax ('DDT') at 16.995 per cent on distribution of dividend.

Section 2(22) of the Act in all has 5 clauses (a), (b), (c), (d) and (e), which detail methods for distributions and payments of dividend to the company's shareholders. A company can distribute profit, including accumulated profit / income to its shareholders in the prescribed manner and such distribution is called declaration of dividend. Clauses (a), (b), (c)

In India, taxation of dividend has undergone amendment in recent times under the Income-tax Act, 1961. Effective from 1-6-1997, the scheme of taxing dividend has been modified and has been made diverse from the earlier provision. However, there has been no amendment in taxation scheme of deemed dividend under Section 2(22)(e) of the Act and such dividends are governed by the old scheme of taxation.



and (d) comprise distributions through cash which entail release of assets or creation of liabilities, while clause (e) entails payments through loans or advances attracting deemed dividend under common parlance understood and dealt with in this article.

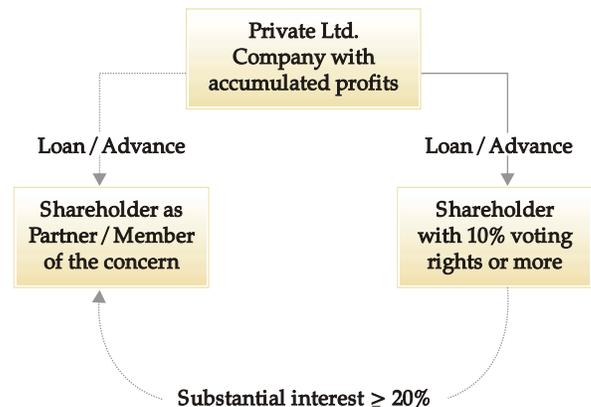
Presently, closely-held (private) companies with accumulated profits are vesting substantial voting power in the hands of promoters who intend to distribute accumulated profits as dividends to the shareholders. With this, declaration of dividends is entirely within discretion of the promoter. In order to safeguard the interest of shareholders, the legislature realised that though funds are available with private company in the form of profits, the controlling promoter may not distribute profits as dividends to the shareholders but, in turn, may opt to part with profits by way of loan to its shareholders thus avoiding payment of tax on distributed profits. The main intention for enacting Section 2(22)(e) of the Act was to counter this mechanism of distribution.

In India, taxation of dividend has undergone amendment in recent times under the Act. Effective from 1-6-1997, the scheme of taxing dividend has been modified and made diverse from the earlier provision. However, there has been no amendment in taxation scheme of deemed dividend under Section 2(22)(e) of the Act and such dividends are governed by the old scheme of taxation. Tax on deemed dividend is paid by the recipient and the paying company does not bear dividend tax but would be liable to deduct tax at source from such loans / advances and pay the same to the Government.

The introduction of provisions under deemed dividend was with an intent to impose a check on closely held companies for advancing loans / advances, to shareholders substantially interested, from its accumulated profits instead of paying dividend. The provision would be applicable only in respect of private companies, and apply only when the company advances money to its

shareholder holding at least 10 per cent voting power in the company or to entities where the shareholder has substantial interest (as defined from time to time) and not to any other shareholder or other person, subject to company's accumulated surplus. Furthermore, the provision is not applicable to company engaged substantially in the business of money lending and the money is advanced to such shareholders in the ordinary course of its money lending business.

A diagram illustrating the deemed dividend scenario is depicted below:



Issues Related to Deemed Dividend

Dividend versus deemed dividend:

The applicability of deemed dividend to companies in which general public is not substantially interested has led to immense litigation and this has resulted in the tax authority succeeding in taxing all such loans and advances as deemed dividends. When dividends were exempt from tax in the hands of recipients, question arose whether such exemption was available in respect of deemed dividend under Section 2(22)(e) of the Act. Recently, this matter has been considered by the Income Tax Appellate Tribunal ('ITAT') Mumbai Bench in the case of *Kalyan M. Gupta vs. JCIT 293 ITR 249 [2007] (Bombay)*.

In this case, the assessee was a shareholder with more than 10 per cent interest in a private company who received a loan from the company

outstanding as on March 31, 1998. After hearing the assessee, the Income-tax Officer ('ITO') added the loan amount as deemed dividend assessable under Section 2(22)(e). It was contended that the amount was in the nature of temporary borrowings as loan or advances. When the argument was not accepted, it was prayed by the assessee that provisions of exempting dividend under Section 10 should be given effect.

The principle that applies to dividend income should also apply to deemed dividend under Section 2(22)(e) of the Act. The Bench examined Sections 115O, 115P and 115Q in Chapter XIID of the Act and referred to the Explanation given in this Chapter: *"For the purposes of this Chapter, the expression "dividend" shall have the same meaning as is given to "dividend" in clause (22) of Section 2 but shall not include sub-clause (e) thereof"*.

Thus, loans or advances to substantial shareholder is treated as deemed dividend under Section 2(22)(e). The Explanation under Chapter XIID stipulates that the expression 'dividends' shall not include this form of dividends comprising loans and advances. Hence, deemed dividend referred to in Section 2(22)(e) has been excluded from the ambit of Chapter XIID. Tax is not levied on the company with regard to deemed dividend under Section 115O. Consequently, exemption provided under Section 10 is not applicable to "deemed dividend" referred to in Section 2(22)(e).

The ITAT viewed that on deemed dividend, since the company is not liable to pay additional tax under Section 115O of the Act, such dividend is not referred to in Section 115O. The background of Section 115O provides for levy of additional tax on companies and exemption in the hands of shareholders simultaneously. When tax under Section 115O was withdrawn, exemption under Section 10(33) was also withdrawn. Therefore, Section 115O is a special provision and manner of collecting tax on distribution of income.

Overall there is no cascading effect of dividend tax on the company and its shareholders together. For this reason also, it can be viewed that



distribution of profit which does not require payment of DDT by the company is not intended to be exempted. Provisions of the old Section 10 (33) and new Section 10(34) read as "Any income by way of dividends referred to in Section 115O". This clearly shows that dividend referred in Section 115O where the company has paid DDT is exempt.

In light of the above decision, a view could be taken that only such dividend which has suffered DDT payment by the company on distribution would be subject to exemption under Section 10 (33)/10 (34) at relevant times. As deemed dividend under Section 2(22) (e) is not included in the Explanation of dividend for the purpose of Chapter XIID including Section 115O, it is not a dividend referred to in section 115O, and hence the company is not liable to pay DDT but deemed dividend is included in the income of the shareholder.

Taxability of deemed dividend in the hands of shareholder/borrowing concern

An issue arises that in whose hands deemed dividend should be taxable. A school of thought prevails that, loan / advance paid is taxable as deemed dividend in the hands of the borrowing concern. This premise is based on the rationale that under relevant provisions of Section 2(22)(e), it is the 'payment' made to the related concern regarded as deemed dividend. The Hyderabad ITAT in the case of *Hyderabad Chemical Products vs. ITO 72 ITD 323 [1998] (Hyderabad)* taxed the borrowing concern for deemed dividend.

In fact, the Central Board of Direct Taxes in Circular No. 495 dated September 22, 1987 provides explanatory notes on introducing the provisions of deemed dividend in the Act, highlighting that such loan is taxable as deemed dividend in the hands of the borrowing concern. In the light of the Board's circular, revenue authority is prone to take a stand that such deemed

A view could be taken that only such dividend which has suffered DDT payment by the company on distribution would be subject to exemption under Section 10 (33) / 10 (34) at relevant times. As deemed dividend under Section 2(22) (e) is not included in the explanation of dividend for the purpose of Chapter XIID including Section 115O, it is not a dividend referred to in section 115O, and hence the company is not liable to pay DDT but deemed dividend is included in the income of the shareholder.

dividend should be taxed in the hands of the borrowing concern and not in the hands of the shareholder.

However, defending the above argument another school of thought believes that loan or advance ought to be taxed

as deemed dividend in the hands of the shareholder and not the borrowing concern. This view finds its support from established principles laid down by multiple judicial pronouncements in the case of *Madura Coats Private Limited* 274 ITR 609 [2005] by Authority for Advance Ruling ('AAR'), *Rameshwarlal Sanwmal vs. CIT* 122 ITR 1 [1979] (Supreme Court) and a recent Special Bench decision by the Mumbai ITAT in the case of *ACIT vs. Bhaumik Colour Pvt. Ltd.* (ITA No. 5030/Mum/04) dated 19th November, 2008 where dividend income is linked to shareholding.

The legislative intent behind introducing such a deeming provision was to plug loopholes where the shareholders controlled closely held companies and evaded payment of tax by retaining profits in the company and subsequently providing loans or advances either to preferred shareholders or to a concern in which they have substantial interest, instead of distributing dividends. Dividend is generally a return or income on the investment for the shareholders. However, taxation of deemed dividend in the hands of the borrowing concern and not shareholder leads to an irregular situation, due to non-holding of shares by the borrowing concern in the company.

The Special Bench relied on the decision of *CIT vs. C. P. Sarathy Mudaliar* 83 ITR 170 [1972] (Supreme Court), where the company advanced loan to a Hindu Undivided Family ('HUF') who was the beneficial owner of shares in the company. However, the shares were registered in the name of individual Karta of the HUF. The apex court held that HUF was only a beneficial shareholder and not a registered shareholder, hence was outside the scope of Section 2(6A)(e) of the Income-tax Act, 1922 – corresponding provision to Section 2(22)(e) of the Act.

The quasi judicial authority laid down following conditions to be satisfied in order to consider such payments as deemed dividend:



To sum up, the expression "Accumulated Profits" means profits in commercial sense. The expression includes profits arrived out of commercial expedience including general reserve but not normal depreciation or provision for taxation and dividends. "Accumulated Profits" do not necessarily mean reserves and other profits as disclosed in the company's balance sheet.

- a) There must be a payment to a person by a company;
- b) A person must be a shareholder of the payee company being registered and beneficial owner of share holding more than 10 per cent of the voting power in the company; and
- c) The person referred in paragraph a) above must also be:
 - i. a member or partner in the concern;
 - ii. hold substantial interest in the concern, i.e. he must at any time during the previous year, be beneficially entitled to 20 per cent income. In case such a concern is a company, he must be the owner of shares holding more than 20 percent of the voting power.

In the case of *ACIT vs. Bhaumik Colour Pvt. Ltd.* the conditions b) and c) above were not fulfilled as the shares were held in legal and registered capacity but not as beneficial owner. Furthermore, the shares were held for and on behalf of the beneficiaries of the trust who were different individuals. It was concluded that shareholders were not the ultimate beneficial owner of the shares. The Special Bench followed ratio of the decision in the case of *CIT vs. Hotel Hilltop* 217 CTR 527 [2008] (Rajasthan), which held that deemed dividend under Section 2(22)(e) can be assessed only in the hands of person who is a shareholder of the lender company and not in the hands of any other person other than a shareholder.

Amidst all the controversies, the expression 'such shareholder' referred to in Section 2(22)(e) would mean both a registered and beneficial shareholder. If a person is a registered shareholder but not a beneficial shareholder then the provisions of Section 2(22)(e) will not apply. Thus, judicial authority after due analysis held that the objective of tax provisions on deemed dividend was to tax dividend income in the hands of shareholders and not the non-shareholders.

On review of the available judicial pronouncements, the courts are of the opinion that securities premium is not a taxable income in the hands of the company, since it is not an accumulated profit so it cannot be used to pay dividend. Further, even if loan is given to a substantially interested person, and the company has utilized securities premium as a means to finance, it cannot be said that there is tax avoidance because the company has adopted method of giving loan instead of giving dividend to its shareholder.



Determining shareholders benefit and accumulated profits

The legislature realised the intention of introducing provisions under deemed dividend for companies promoting distribution of profits through a device by way of loan to its preferred shareholders and averse payment of DDT on distribution of accumulated profits.

The beneficial argument of deemed dividend is contended by the Apex Court in the case of *CIT vs. Mukundray. K. Shah* 290 ITR 433 [2007] (Supreme Court). In this case the assessee was a shareholder in a private company, which paid an amount to two firms, in which the assessee was a partner. During search proceedings conducted on the assessee under Section 132 of the Act by the department, apart from cash and jewellery a diary belonging to the assessee was seized which indicated investment by the assessee in RBI Relief Bonds.

The ITO found that bonds were purchased from financial assistance by the firm. In the books of the firm it was shown to have received loans from the company in which the assessee had considerable voting power. Based on the evidence of diary and cash flow statement, the ITO assessed the sum invested in bonds as deemed dividend in the hands of the assessee under Section 2(22)(e) of the Act.

The ITAT ruled in favour of the revenue attracting provision of Section 2(22)(e), but the High Court reversed the decision of Appellate Tribunal. The Apex Court held that the revenue was right in invoking provisions of Chapter XIVB of the Act. The assessment order originated on account of a search process under Section 132(1), in which the diary was found. The diary enabled the ITO to enquire about the cash flow statement which resulted in detection of the undisclosed income. The undisclosed income was in



the nature of deemed dividend and did not arise from any scrutiny proceedings, tax evasion, information received from external agency, etc.

Payment made by the company through its two firms was for the benefit of the assessee. Further, the funds were not used for repayment of loan but were utilized for purchase of bonds by the assessee. In the event of amalgamation of the company, the accounts of two firms were merged. Therefore, the reserve was taken on the basis of the merged accounts.

The question of fact was whether payments made by the company were for the benefit of the assessee (shareholder). In fact ITAT ruled that the payments, though routed through the two firms, were for the benefit of the assessee. Relying on the decision of *CIT vs. L. Alagusundaram Chettiar* 109 ITR 508 [1976] (Madras), the Madras High Court held that the word "payment" in Section 2(22)(e) means an act of paying. Therefore, in that case it was held that payment by the company (though indirect) was for the benefit of the assessee, and was assessable as deemed dividend in the hands of the shareholder.

This judge held that the basic test to be applied in such case is not whether the loan given is a benefit but whether payment by the company was for the benefit of the shareholder. Applying the ratio in the case of *Mukundray K. Shah*, the Supreme Court held that ITAT was right to view that examination of the cash flow statement and payment by the company to the firms was for benefit of the shareholder which enabled the shareholder to buy RBI Relief Bonds in the financial year.

The firms were merely a channel used by the shareholder for its benefit. During the block assessment it was discovered that in addition to the shareholder holding substantial



voting power in the Company (exceeding 10 per cent), he was also a director of the company having substantial interest in the firm. It was also observed that timing of loan by the company to the firm, instant withdrawal of funds by the assessee (shareholder) and investment thereafter in bonds had close nexus.

Thus, two factors co-related for establishing deemed dividend under Section 2(22)(e) are:

- whether payment is a loan; and
- whether on the date of payment there is accumulated profit.

Hence, in the case of Mukundray K. Shah, the Supreme Court held that High Court ought not have disturbed the fact finding arrived by the ITAT.

To sum up, the expression "accumulated profits" means profits in commercial sense. The expression includes profits arrived out of commercial expedience including general reserve but not normal depreciation or provision for taxation and dividends. "Accumulated profits" do not necessarily mean reserves and other profits as disclosed in the company's balance sheet. In every case, depreciation calculated at the income-tax rates should be deducted in computing "accumulated profits" even if lower depreciation has been provided for in the accounts.

Deemed dividend out of securities premium

An issue arises whether securities premium was considered to be part of accumulated profits under reserve and surplus or profits available for distribution. Perhaps the myth was clarified when it was clarified by the courts that securities premium is not in nature of 'profit' or 'gain', and, therefore, it cannot be regarded as accumulated profit. Therefore, irrespective of any liberalisation, which the Companies Act may provide on its use through memorandum or articles of association, securities premium cannot be regarded as 'profit' or 'gain' when it is received as 'accumulated profit' or 'accumulated surplus'.

In the decision in a case *DCIT vs. MAIPO India Limited ITA No. 2266 (Delhi)*, the ITAT relied on the provisions of the Companies Act, pursuant to which securities premium cannot be utilized for

payment of dividend and it can be used only for permitted purposes. Utilisation of securities premium for any other purpose is considered as reduction of capital and provisions for share reduction are applicable.

In the instant case, the assessee held 40 per cent shares of another company 'G Limited', therefore, the assessee was a shareholder having substantial interest within the meaning of Section 2(22) of the Act. The assessee received an amount in the nature of advance from G Limited which was repaid partially. The ITO included the balance amount repaid as deemed dividend in the hands of the assessee under Section 2(22)(e) of the Act. The assessee's contention was that the entire reserve and surplus in the books of G Limited consisted of securities premium being capital receipt which cannot be distributed as dividend.

The revenue refuted assessee's contention and took a view that in Section 2(22) clause (e), the words 'whether capitalised or not' is not evident, on comparing with the earlier clauses of the Section where these words were part of the relevant Section and, therefore, it was immaterial that the reserve and surplus consisted of capital receipt by way of securities premium or not.

On further appeal, the Commissioner of Income-tax (Appeals) 'CIT (A)', accepted the claim of the assessee and held that reserves and surplus account of G Limited comprised securities premium and profit and loss account. Accordingly, the addition of the amount representing profit and loss account sustained and the balance was deleted. The revenue being aggrieved preferred an appeal before the ITAT.

Significant observations of the ITAT were:

- a. There was a sum as reserves in the books of G Limited by way of securities premium collected by the company.
- b. As per Section 78(1) of the Companies Act, premium received shall be transferred to a separate account 'securities premium account', which provides for the reduction of share capital of the company or for applying as if securities premium account was paid-up share

- capital of the company.
- c. Section 78(2) provides five purposes for which securities premium account may be applied without attracting consequence of share capital reduction:
- i. issue and pay off fully paid bonus shares to its members;
 - ii. to write-off preliminary expenses of the company;
 - iii. to write-off expenses of issue of shares or debentures or underwriting commission paid or discount allowed on such issues;
 - iv. to pay premium on the redemption of redeemable shares or debentures issued by the company;
 - v. purchase of its own shares or other specified securities in terms of Section 77A.

The ITAT viewed that when there is a statutory restriction on distribution of securities premium account as dividend and utilization for certain events, provisions of Section 2(22)(e) cannot apply. Not only is there a prohibition on distribution of the securities premium as dividend, there is also an

- Development rebate debited to profit and loss account and taken to reserve would amount to accumulated profits.
- 2 *CIT vs. Urmila Ramesh 230 ITR 422[1998] (Supreme Court)*, the amount distributed on liquidation of company was treated as accumulated profits and assessable as "deemed dividend" under Section 2(22)(e) of the Act. The courts held that amount received was not assessable because the liquidator sold assets for less than their purchase price. "Profits" are to be actual profits calculated on commercial principles. Hence amount taxed under Section 41(2) in the hands of the company did not represent "accumulated profits" for the purpose of Section 2(22) of the Act.
 - 3 *CIT vs. Allahabad Bank Ltd. AIR 1969 Supreme Court 1058*, securities premium account is to be included in the paid-up capital for the purpose of computing rebate if maintained as a separate account. If within reserves it is an identifiable separate account, the securities premium will qualify for inclusion in the paid-up capital for

Where the shareholder, having business of his own, was transacting with the company and the account of the assessee in the company showed a debit balance, it is clarified that the said debit balance would amount to a loan from the company to the assessee by *CIT vs. Jamnadas Khimji Kothari 92 ITR 105 [1973] (Bombay)*. However, all credit sales of goods do not amount to a loan transaction.



obligation to treat the same as part of share capital of the company. It is evident that under Section 78(1) of the Companies Act, any payment out of securities premium account, except for purposes authorised by sub-section (2), will be treated as reduction of share capital.

The constraint of utilizing securities premium for deemed dividend is derived from the following judgments:

- 1 *P.K. Badiani vs. CIT 105 ITR 642 [1976] (Supreme Court)*, the term "accumulated profits" should be construed in commercial sense and not as assessable / taxable profits liable to tax.

computing reduction in rebate for super-tax.

On review of the available judicial pronouncements, the courts are of the opinion that securities premium is not a taxable income in the hands of the company, since it is not an accumulated profit so it cannot be used to pay dividend. Further, even if loan is given to a substantially interested person, and the company has utilized securities premium as a means to finance, it cannot be said that there is tax avoidance because the Company has adopted method of giving loan instead of giving dividend to its shareholder.



Other Issues

Payment in cash or in kind: Clauses (a),(b),(c) and (d) of Section 2(22) has word "distribution" while clause (e) has word "payment" which means that amount may have been disbursed to two or more shareholders and not necessarily be distributed to all the shareholders. Thus would this imply whether goods as loan will be subject to deemed dividend? The doubt has been clarified in the case of *M.D. Jindal vs. CIT 28 Taxman 509 [1986] (Calcutta)* wherein it was held that Section 2(22)(e) is applicable even if a loan is given in kind. Thus a loan of goods or other assets will also be covered by this clause and it is not necessary that the loan or advance must be given in cash only.

Debit balance/ Book Debts: In case of a current account which shows a debit balance of the shareholder in company's books, it need not partake the character of a loan. In order to attract the provisions of Section 2(22)(e), the important consideration is that there should be loan/advance by the company to its shareholder. Every payment by a company to its shareholder may not be termed as loan/advance.

If, at the time when payment is made, the company is already a debtor of the shareholder, the payment would merely be a repayment by the company towards its already existing debt unless paid in excess of the debt. If a shareholder has existing current account with the company, each case would have to be considered on merits, as it may or may not be construed as loan. In such case debit balance of shareholders with the company cannot be taken to represent an advance/loan by the company; nor the amount at the end of previous year be alone taken as loan - *CIT vs. P.K. Badiani 76 ITR 369 (Bombay)*.

Where the shareholder, having business of his own, was transacting with the company and the account of the assessee in the company showed a debit balance, it is clarified that the said debit balance would amount to a loan from the company to the assessee by *CIT vs. Jamnadas Khimji Kothari 92 ITR 105 [1973] (Bombay)*. However, all credit sales of goods do not amount to a loan transaction.

Loan repaid before the year end:

In the case of *Tarulata Shyam vs. CIT 108 ITR 345 [1977] (Supreme Court)*, the apex court clarified that under Section 2(22) the liability to tax attracts to any amount taken as loan by the shareholder from a controlled company to the extent it possesses accumulated profits when the loan is borrowed and it is immaterial whether the loan is repaid before the year end. Hence, even if a loan is repaid before end of the previous year, Section 2(22)(e) will be attracted.

Inclusion of capital gains in accumulated profits: Capital gains include the expression 'accumulated profits' except capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956. In any case, capital gains which are not taxable cannot form part of accumulated profits. Thus any distribution out of such non-taxable accumulated profits cannot be treated as taxable deemed dividend in *CIT vs. Mangesh J. Sanzgiri, 119 ITR 962 [1979] (Bombay)*. Thus, capital gains arising out of sale of agricultural land which is exempt would not form part of the accumulated profits for the purpose of deemed dividend.

Quantum of dividend: The court in the case of *CIT vs. Mayur Madhukant Mehta 85 ITR 230 [1972] (Gujarat)* held that Section 2(22)(e) does not restrict deemed dividend to the proportion of accumulated profits corresponding to the assessee's shareholding in the share capital of the company. If a loan is given by the company to a shareholder who owns 25 per cent of share capital, the entire amount of accumulated profits to the extent of loan (and not to the extent of 25 per cent of accumulated profits) will be treated as dividend confirmed by *CIT vs. Arati Debi 111 ITR 277 [1978] (Calcutta)*.



Maxim of Interpretation

Rule of interpretation is a conclusion because of its greatest dignity, most certain authority and universally approved character. It is said to be a proposition of all men confessed and granted without argument or discourse. One must keep in mind that although manifestly absurd, unjust results could never be intended by the legislature even if the language is plain. Since language is at best an imperfect medium to express human thought, so, the attempt should always be to discover the ideas behind the language. Every statute shall be construed fairly and reasonably. The article explores this concept.



CA. Ravi Holani

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

Every maxim, because of being based on experimentation or on probability cannot possibly comprehend all conceivable situations at any rate in one measure, in any event at one time – *Stewart Dry Good Co. vs. Lewis* 294 US 550; *Adar vs. State of Kerala* (1974) 34 STC 73 (SC), [well settled norms or guiding principles] So, before applying it, social, economical and political purposes must always be taken into consideration – *S.P. Gupta vs. President of India*, AIR 1982 SC 149.

Interpretation of a statute means introduction of elements that are necessarily extrinsic to the words in the statute. Since a statute is an edict of the legislature (*Vishnu Pratap Sugar Works (Pvt. Ltd.) vs. Chief Inspector of Stamp, U.P.*, AIR 1968 SC 102), the term “interpretation” refers to the process of discovery of ideas behind the same. Salmond in “Jurisprudence” 11th edition at page 152 expressed that “by interpretation or construction is meant the process by which the courts seek to ascertain the meaning of the legislature through the medium of authoritative forms in which it is expressed”.

A word is employed with some object or situation assigned a technical name referent, but it is not a scientific symbol, so any word may refer to different allusion in different context even at same point of time, so as to avoid a miscommunication or misunderstanding, and to find out the ideas is the essence for an interpretation.

Since the process of interpretation of a statute being an exercise in the ascertainment of meaning, everything which is logically relevant, should be admissible as Lord Reid has said in *Black-Clawson International Ltd. vs. Papier Werke Waldhof Achaffenburg AG* (1975 AC 591):

"We often say that we are looking for the intention of Parliament, but that is not quite accurate. We are seeking the meaning of the words which Parliament used. We are seeking not what Parliament meant but the true meaning of what they said."

[See also *Cross Statutory Interpretation – 2nd Edition* – Page 200-30]

The phrase "interpretation" means process of ascertaining the ideas of a given text to avoid any inconvenient and absurd construction. It is a method by which the meaning of an expression is ascertained. The term "construction" includes not only ascertaining the sense and meaning (i.e. ideas) of the subject but also its effect and consequences.



A rule of construction is one which governs the effect of the ascertained intentions to point out what the court should do in the absence of express or implied intention, while a rule of interpretation is one which directs to ascertain the ideas of the given text. In other words, a rule of interpretation points out the ideas, the term "construction" refers to its effect and consequences.

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Though the word "interpretation and construction" are used interchangeably, in the very full sense of the word "construction", the judges have set themselves to frame the law as they would like to have it – *CWT vs. Smt. Hashmatunnisa Begum* AIR 1989 SC 1024.

In a conventional language, the interpreter must put himself in place of those who were passing the Act, i.e. the members of the Parliament.

A word on interpretation, vicissitudes of time and necessities of history contribute to changes of philosophical attitudes, concepts, ideas and ideals and, with them, the meaning of words and phrases and the language itself. The philosophy and the language of the law are no exception. Words and phrases take colour and character from the context and the time and speak differently in different contexts and times. And, it is worthwhile remembering that words and phrases have not only a meaning but also a content, a living content which breaths and so, expands and contracts – *Municipal Corporation of Delhi vs. Mohammad Yasin* 1983 AIR 617 (SC); 1983 (3) SCC 229.

The question of interpretation involves determining the meaning of a text contained in one or more documents. There are two units of enquiry in statutory interpretation - the statutory text and the intention of the Parliament and the judge must seek to harmonise the two [see *Gross's Statutory Interpretation – 2nd Edition* at page 21]. This, however, is not correct. According to the tradition of the Indian law, primacy is to be given to the text in which the intention of the law given has been expressed. Cross refer to Blackstone's

observations that the fairest and the most rational method to interpret the will of the law maker is by exploring his intentions at the time when the law was made, by signs the most natural and probable. And these signs are either the words, the context, the subject matter, the effect and the consequences, or the spirit and the reason of law – *CCE vs. Parle Exports (P) Ltd* (1989)/SCC 345. In India, contextual interpretation is normally adopted rather than a reference to dictionaries – *Gramophone Company of India Ltd vs. Birendre Bahadur Pandey* 1984 AIR (SC) 667, 1984 (2) SCC 534.

The task of interpretation of an enactment is not a mechanical task. It is more than a mere

reading of a mathematical formula, because few words possess the precision of mathematical symbols. It is an attempt to discover the intention of the legislature from the language used by it and it must always be remembered that language is at best an imperfect medium for expression of human thought.

The assumption that “a word has one meaning and one only”

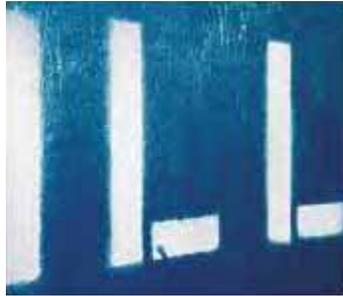
is not admitted in normal circumstances because of different senses even the etymological meaning of many words has become absolute and becoming a new colour and more modern meaning not only common but technical meaning also due to fast changing environment and civilization. The primary general sense of a word gets ramified into different senses later, so it is required to search different uses and application of the word and the act of ascertaining what intention the writer inferred to convey to the reader by it, is called an interpretation of a document.

When in a statute, same words have been employed in different parts of the same section or statute, the presumption about the same sense throughout in such statute [*Bhogilal Chunnilal Pandya vs. State of Bombay*, AIR 1959 SC 356, *Raghubans Narain Singh vs. Uttar Pradesh Government*, AIR 1967 SC 465] **is a weak one** – *Shamrao Vishnu Parulekar vs. District Magistrate, Thanai*, AIR 1957 SC 23, *Aswini Kumar Ghose vs. Arabinda Bose*, AIR 1952 SC 369; *Payne (Inspector of Taxes) vs. Barratt Developments (Luton) Ltd.* (1985)1 All ER 257 (HL) **which is readily displaced by the context.** In other words, the context must be similar– *Farrell vs. Alexander* (1976)2 ALL ER 721 (HL).

In other words, even when the same word is used at different places in the same clause of the same section, it is not a rule of thumb that it bears the same meaning at each place, the real meaning shall depend on the context of its use – *Anand Nivas (P) Ltd. vs. Anandji Kalyanji's Pedhi*, AIR 1965 SC 414.

It is well-settled law that each word, phrase or sentence must be construed in the reference for which the same has been employed. In other words, the process of interpretation depends on

the text and context. No principle of interpretation requires a statutory provision to be broken down to the words which constitute it and then often



Interpretation must depend on the text and the context. They are the basis of interpretation. One may well say if the text is the texture, context is what gives the colour. Neither can be ignored. Both are important. That interpretation is best which makes the textual representation match the contextual. A statute is best interpreted when we know why it was enacted.

defining each word individually and weld them together to arrive at the meaning of a phrase. Words take their colour from the context in which they are used – *S.A. Venkatraman vs. UOI*, AIR 1954 SC 376.

An understanding of the general sense of the words employed cannot prevail where the scheme of the statute of the instrument considered as a whole clearly conveys a somewhat different shade of meaning. It is not always a safe way to construe a statute or a contract by dividing it by a process of etymological dissection and after separating words from their context to give each word some particular definition given by lexicographers and then to reconstruct the instrument forming the basis of those definitions. What particular meaning should be attached to words and phrases in a given instrument is usually to be gathered from the context, the nature of the subject matter, the purpose of the intention of the author and the effect of giving to them one or the other permissible meaning on the object to be achieved. Words are after all used merely as a vehicle to convey the ideas of the speaker or the writer and the words have naturally, therefore, to be so construed as to fit in with the idea which emerges on a consideration of entire context. Each word is but a symbol which may stand for one or a number of objects. The context, in which a word conveying different shades of meanings is used, is of importance in determining the precise sense which fits in with the context as intended to be conveyed by the author – *Dy. Chief Controller of I & E. New Delhi vs. K.T. Kosalram* 1999 (110) ELT 366 (SC).

Interpretation must depend on the text and the context. They are the bases of interpretation. One may well say if the text is the texture, context is

what gives the colour. Neither can be ignored. Both are important. That interpretation is best which makes the textual representation match the contextual. A statute is best interpreted when we know why it was enacted. With this knowledge, the statute must be read, first as a whole and then section by section, clause by clause, phrase by phrase and word by word. If a statute is looked at in the context of its enactment, with the glasses of the statute-maker, provided by such context, its scheme, the sections, clauses, phrases and words may take colour and appear different than when the statute is looked at without the glasses provided by the context. With those glasses we must look at the Act as a whole and discover what each section, each clause, each phrase and each word is meant and designed to say as to fit into the scheme of the entire Act. No part of a statute and no word of a statute can be construed in isolation. Statutes have to be construed so that every word has a place and every thing is in its place - *Reserve Bank of India vs. Peerless General Finance and Investment Co. Ltd*, AIR 1987 SC 1023.

The observation of Lord Russel of Killowen in *Attorney General vs. Carlton Bank* (1889) 2Q.B.158 is, "I see no reason why special cannons of constructions should be applied to any Parliament and I know of no authority for saying that a taxing Act is to be construed differently from any other Act. The duty of the Court is in my opinion in all case the same. Whether the Act to be construed relates to taxation or to any other subject, namely, to give effect to the intention of the legislature, as that intention is to be gathered from the language employed having regard to the context in connection with which it is employed..... Courts have to give effect to what legislature has said".

When a provision can be interpreted in more than one way, the interpretation which validates rather than one which may invalidate, may prevail, but it may be decided by the intention of the legislature because the legislature is presumed not to have intended an excess of its own

jurisdiction, but it applies only where two views are reasonably possible under the statutory language. However, at the time of proper construction, if the words used in a statute by the legislature are in a particular way, then it cannot be read in another way.

Unless there is any ambiguity, there is no need to look somewhere else to discover the ideas behind the language. In other words, it is a literal rule that the intentions of the legislature should be gathered from words, which are employed. However, where such literal interpretation leads to some absurdity or inconsistency with the rest of the statute, the word only to the extent of avoiding absurdity and inconsistency could be modified. This rule is known as golden rule of interpretation. However, where there is an ambiguity in the language itself, then by applying mischief rule, the ideas behind the same could be found through external and internal sources. It is only when the words used are ambiguous that they would stand to be examined and construed in the light of surrounding circumstances, constitutional principles and practices – *CIT vs. Sodra Devi* (1957) 32 ITR 615 (SC).

Ordinarily and naturally meaning of words has to be given effect as legislature is deemed to intend and mean what it says – However, in case of ambiguity in language, reference may be made to legislative intent and object to resolve it - *ITC. Ltd. vs. CCE 2004* (171) ELT – 433 (SC). Words of clear and unambiguous statute have to be given effect and a meaning contrary to that could not be given based on general principles of construction – *Gurav Distributors (P) Ltd. vs. CCE 2004* (170) ELT 513 (SC). Merely on the basis of penal consequences, literal interpretation could not be denied – *Tata Consultancy Service vs. State of AP*, 2004 (178) ELT – 22 (SC).

It is well settled law that words in the statute must, *prima facie*, be given their ordinary meaning where the grammatical construction is clear and manifest and without doubt, that construction ought to prevail unless there are some strong and obvious reasons to the contrary. Nothing has been shown to warrant that literal construction should not be given effect to – *Chandra Varkar S. R. Rao vs. Asha Lata* (1986) 4 SCC 447.



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It is well settled law that merely because a law causes hardship, it cannot be interpreted in a manner so as to defeat its object. It is also to be remembered that the courts are not concerned with the legislative policy or with the result, whether injurious or otherwise, by giving effect to the language used nor it is the function of the court where the meaning is clear not to give effect to it merely because it would lead to some hardship.

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It is well settled law that the court must ascertain the intention of the legislature by directing its attention not merely to the clauses to be construed but to the entire statute. It must compare the clause with the other parts of the law, and the setting in which the clause to be interpreted, occurs – *State of W.B. vs. UOI*, AIR 1963 SC 1241.

It is well settled that in construing the provisions of statute, the court should be slow to adopt a construction which tends to make any parts of the statute meaningless or ineffective. Thus, an attempt must always be made to reconcile the relevant provisions so as to advance the remedy intended by the statute. *Board of Muslim Wakfs, Rajasthan vs. Radha Kishan*, AIR 1979 SC 289.

It is well settled law that any word employed in a statute is not superfluous or redundant – *Grasim Industries Ltd. vs. CCE 2002* (141) ELT 593 (SC). In matters of interpretation one should not concentrate too much on one word and pay too little attention to other words. No provision in the statute and no word in any section can be construed in isolation. Any part or any word of a statute shall not be construed in isolation. Statutes have to be construed so that every word has a place and everything is in its place – *Reserve Bank of India vs. Peerless General Finance and Investment Co. Ltd.* AIR 1987 SC 1023. Every word employed has its own relevance, so, the provision must be perused as a whole and then construed accordingly. A statute is trite and hence must be read as a whole – *ITW Signode India Ltd vs. CCE 2003* (158) ELT – 403 (SC). Each word, phrase or sentence is to be considered in the light of general purpose and object of the statute itself – *Poppatlal Shah vs. State of Madras*, AIR 1953 SC 274. No

principle of interpretation requires a statutory provision to be broken down to the words which constitute it and then after defining each word individually weld them together to arrive at the meaning of a phrase – *Jasbir Singh vs. Vipin Kumar Jaggi 2001* (132) ELT 529 (SC). The court cannot approach the enactment with a view to pick holes or to search defects of drafting which make its working impossible – *British Airways PLC vs. UOI 2002* (139) ELT – 6(SC). Any addition or amendment of words is not permissible and they must be construed as they stand, if reasonably possible – *ITC vs. CCE 2004* (174) ELT – 433 (SC). The court should not overzealously search for ambiguities or obscurities – *Tata Consultancy Services vs. State of AP 2004* (178) ELT – 22 (SC). An interpretation that imputes tautology to the legislature shall not be admitted – *State of Bihar vs. Hira Lal Kejriwal 1960* AIR 47 (SC).

Every provision and every word must be looked at generally and in the context in which it is used. It is said that every statute is an edict of the legislature. The elementary principle of interpreting any word while considering a statute is to gather *sententia legis* of the legislature. Where the words are clear and there is no obscurity, and there is no ambiguity and the intention of the legislature is clearly conveyed, there is no scope for the court to take upon itself the task of amending or alternating the statutory provisions. Wherever the language is clear the intention of the legislature is to be gathered from the language used. While doing so what has been said in the statute as also what has not been said has to be noted. The construction which requires for its support addition or substitution of words which results in rejection of words has to be avoided. As stated by the Privy Council in *Crawford vs. Spooner* [(1846) 6 Moore PC 1] “we cannot aid the Legislature's defective phrasing of an Act, we cannot add or mend and, by construction make up deficiencies which are left there”.

In case of an ordinary word there should be no attempt to substitute or paraphrase of general

application. Attention should be confined to what is necessary for deciding the particular case. This principle is too well settled and reference to few decisions of this Court would suffice. [See: *Gwalior Rayons Silk Mfg. (Wvg.) Co. Ltd. vs. Custodian of Vested Forests, Palghat and Anr.* (AIR 1990 SC 1747), *Union of India and Anr. vs. Dekoi Nandon Aggarwal* (AIR 1992 SC 96), *Institute of Chartered Accountants of India vs. Price Waterhouse and Anr.* (1997 (6) SCC 312) and *Harbhajan Singh vs. Press Council of India and Ors.* (JT 2002 (3) SC 21)]. However, where expressions employed in a part lucidly express a clear and unambiguous meaning, it is not required to introduce another part of the statute for the purpose of controlling or diminishing the efficacy of the previous part – *Warburton vs. Loveland*, (1832) 2D & C 480. But in case of conflict, to ascertain the legislative intentions, all the constitutional parts of a statute are to be taken together and each word, phrase or sentence is to be considered in the light of general purpose and object of the Act itself – *Ashwani Kumar Ghosh vs. Arvindra Bose*, AIR 1952 SC 369. And in case of conflict or inconsistency, attempt shall be made to reconcile them [*State of Bihar vs. Hira Lal Kejriwal* AIR 1960 SC 47], if reasonably possible to do so and to avoid repugnancy – *Madanlal Fakirchand Dudhediya vs. Shree Changdeo Sugar Mills Ltd.*, AIR 1962 SC 1543. A head-on clash must be avoided – *Raj Krushna Bose vs. Binod Kanungo*, AIR 1954 SC 202. But if two parts are repugnant, the last must prevail – *K. M. Nanavati vs. State of Bombay*, AIR 1961 SC 112.

The principle – “*Exvisceribus Actus*” indicates that a statute must be read as a whole but not in piecemeal. The intention of the legislature must be found by a reading of the statute as a whole and in its context [*Doy Pack Systems Pot Ltd vs. UOI*, AIR 1988 SC 782], which is derived from the context-exual scheme – *Hindustan Aluminium Corpn. Ltd vs. State of U.P.*, AIR 1981 SC 1649.

While interpreting the law, setting of the words placed is also relevant, but it does not mean that a word which conveys a clean meaning, still a different interpretation or meaning, should be given merely because of the setting – *Bank of India vs. Vijay Transport* 1988 AIR 151 (SC), 1988 SCC. SUPPL. 47.



Where the plain literal interpretation of a statutory provision produces manifestly absurd and unjust results which could never have been intended by the legislature, the court may modify the language used by the legislature or even do some violence to it, so as to achieve the obvious intention of the legislature and produce a rational construction

It is well settled law that merely because a law causes hardship, it cannot be interpreted in a manner so as to defeat its object. It is also to be remembered that the courts are not concerned with the legislative policy or with the result, whether injurious or otherwise, by giving effect to the language used nor it is the function of the court where the meaning is clear not to give effect to it merely because it would lead to some hardship. It is the duty imposed on the courts in interpreting a particular provision of law to ascertain the meaning and intention of the legislature and in doing so, it should presume that the provision was designed to effectuate a particular object or to meet a particular requirement – *Firm Amarnath Bashesar Dass vs. Tek Chand* (1972) 1 SCC 893; *Easland Combines vs. CCE*, 2003 (152) ELT 39 (SC).

In taxation measure the legislature enjoys wider latitude and its dispensations are based on an interpretation of the diverse economic, social and policy considerations. The cardinal principle of statutory interpretation is that if the meaning of the statutory interpretation is plain, then the court must apply it regardless of the results. It is well settled law that if the language of a statute is clear and unambiguous and if two interpretations are not reasonably possible, it would be wrong to discard the plain meaning of the words used in order to meet a possible injustice – *CIT vs. TVS Sundram Iyengar & Sons (P) Ltd* (1975) 101 ITR 784 (SC). Where the language is plain and unambiguous, it must be applied as it stands.

It is a settled proposition of laws that the provisions of a taxation statute have to be construed strictly. Statutory rules should be construed in such a manner as to further the object or scheme of which they are the part and not to hamper. The primary and foremost task of a court in interpreting a statute is to ascertain the intention of the legislature, actual or imputed. Having

ascertained the intention, the court must then strive to so interpret the statute as to promote or advance the object and the purpose of the enactment. For this purpose, where necessary, the court may even depart from the rule that plain words should be interpreted according to their plain meaning. There need be no meek submission to the plainness of the language. To avoid patent injustice, anomaly or absurdity or to avoid invalidation of law, the court would be well justified in departing from the so-called golden rule of construction so as to give effect to the object and purpose of the enactment by supplementing the written word, if necessary – *Girdharlal And Sons vs. Balbir Nath Mathur*, A.I.R. 1986 S.C. 1099.

If the intention of the legislature is clear and beyond doubt, then the fact that the provision could have been more artistically drafted, cannot be a ground to treat any part of the provision as otiose – *CWT vs. Kripa Shankar Dayashankar Worah* (1971) 81 ITR 763 (SC). The Supreme Court has held that a construction which defeats the very object sought to be achieved by the legislature, must, if possible, be avoided – *CIT Vs Teja Singh* (1959) 35 ITR 408 (SC). Where the plain literal interpretation of a statutory provision produces manifestly absurd and unjust results, which could never have been intended by the legislature, the court may modify the language used by the legislature or even do some violence to it, so as to achieve the obvious intention of the legislature and produce a rational construction – *K.P. Varghese vs. ITO (1981) 131 ITR 597 (SC)*.

An enactment being the will of the legislature, the permanent rule of interpretation is that a statute should be interpreted according to the intention of the persons who made it. If the legislature willfully omits to incorporate something of an analogous law in a subsequent statute or even if there is a case of omission in a statute, the language of which is otherwise plain and unambiguous, the court is not

competent to supply the omission by engrafting on it or introducing in it, under the guise of interpretation by analogy or implication, something that it thinks by analogy or implication, and something that it thinks to be a general principle of justice and equity.

It is well settled rule of interpretation, hallowed by time and sanctified by authority that the meaning of an ordinary word is to be found not so much in strict etymological propriety of the language, nor even in popular use, as in the subject or occasion on which it is used and the object which is intended to be attained. *Santa Singh vs. State of Punjab*. AIR 1976 SC 2386.

It is well settled law that where the legislature clearly declares its intent in the scheme and language of a statute, it is the duty of the court to give full effect of the same without scanning its wisdom or policy, and without engrafting, adding or implying anything which is congenial to or consistent with such expressed intent of the law giver, more so, if the statute is a taxing statute – *CST vs. Parson Tools & Plants* (1975) 35 STC 413 (SC). A *casus omissus* could not be supplied by the court, except in the case of clear necessity and when reason for it is found in the four corners of the statute itself – *CIT vs. National Taj Traders* (1980) 121 ITR 535 (SC). For example, in the case of *CIT Vs James Anderson* (1964) 54 ITR 345 (SC), it was held that if the legislature has failed to set up a procedure to assess an income, courts cannot supply it. It should not be readily inferred, but supplied only in the case of clear necessity and when reason for it is found in the Act itself – *CIT vs. National Taj Traders* (1980) 121 ITR 535 (SC).

A statute must be construed according to its plain language and neither should anything be added nor subtracted unless there are adequate grounds to justify the inference that the legislature clearly so intended *Assessing Authority-Cum-Excise and Taxation Officer, Gurgaon vs. East India Cotton Mfg. Co. Ltd., Faridabad*, AIR 1981 SC 1610.

It is well settled that reading down tax provision in a way affecting parties adversely by imposing levy whereas statute never applied to them is impermissible especially for those parties

Though the benefit of an ambiguity in a taxing provision must go to the subject and the taxing provision must receive a strict construction, “that is not the same thing as saying that a taxing provision should not receive a reasonable construction.” If the subject falls separately within the letter of the law he must be taxed, howsoever inequitable the consequences may appear to the judicial mind.



not before the court – *Punjab Dairy Development Board vs. Cephammlk Specialities Ltd.*- 2004 (175) ELT – 3 (SC).

And to ascertain the meaning of doubtful terms, there are two rules – one is *Noscitur A Sociis* which stipulates that the interpretation should be ascertained by reference to word associated with it while another is *Ejusdem Generis* which lays down that where there is a category, class or genus, words of a general nature shall be construed according to such class, category or genus. In case of *Ajay Gandhi vs. B. Singh*, 2004 (167) ELT – 257 (SC), it was held that for constructing statutory provision scheme of the Act, the actual practice may be taken into consideration. Factors to be taken into consideration are length for which it was followed, nature of rights and property affected by it, the injustice resulting from its departure and approval it has received in judicial decision or in legislations.

In a taxing statute, one has to look at what is clearly said. There is no room for any amendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.

One must have regard to the letter of the law and not to the spirit of the law. One must know that the subject cannot be taxed by inference or analogy and that in a taxing statute there is no governing principle to look at and one has simply to go on the Act itself to see whether the claimed is that which the statute imposes. While construing taxing Acts, it is not the function of the court to give to the words used a strained and unnatural meaning and that the subject can be taxed only if the revenue satisfies the court that the case falls strictly within the provision of the law.

If the statute contains the lacuna or a loophole, it is not the function of the court to plug it by a strained construction in reference to the supposed intention of the legislature. The legislature must then step in to resolve the ambiguity and so long as it does not do so, the tax payer will get the benefit of that ambiguity. But, equally, courts ought not to be astute to hunt out ambiguities by an unnatural construction of a taxing section. Whether the statute, even a taxing statute, contains an ambiguity has to be determined by applying normal rules of construction for interpretation of statutes. As observed by Lord Cairns in *Pryce vs.*

Mommonthshire Canal and Rly. Cos., (1879) 4 AC 197 cases which have decided that Taxing Acts are to be construed with strictness and that no payment is to be exacted from the subject which is not clearly and unequivocally required by Act of Parliament to be made, probable meant little more than this, that, in as much as there was not any prior liability in a subject to pay any particular tax, nor any antecedent relationship between the tax payer and the taxing authority, no reasoning founded upon any supposed relationship of the tax payer and taxing authority could be brought to bear upon the construction of the Act and, therefore, the tax payer had a right to stand upon a literal construction of the words used, whatever might be the consequences - *Murarilal Mahabir Prasad vs. B. R. Vad* 1976 AIR – 313 (SC); 1975 (2) SCC 736.

Though the benefit of an ambiguity in a taxing provision must go to the subject and the taxing provision must receive a strict construction, “that is not the same thing as saying that a taxing provision should not receive a reasonable construction” – *CWT vs. Kripashankar* – A 971 AIR 2463 SC. If the subject falls separately within the letter of the law he must be taxed, howsoever inequitable the consequences may appear to the judicial mind. If the Revenue seeking to tax cannot bring the subject within the letter of law, the subject is free no matter that such a construction may cause serious prejudice to the Revenue. In other words, though what is called equitable construction may be admissible in relation to other statutes or other provisions of a taxing statute, such a construction is not admissible in the interpretation of a charging or taxing provision of a taxing statute. Speaking for the court in *C.I.T. Madras vs. Ajax Products Ltd.*, (1965) 1 SCR 700 at page 706 = (AIR) 1965 SC1358 at page 1362) Subba Rao J., after citing a passage from the judgment of Rowlatt J. in the Cape Brandy case said: “To put it in other words, the subject is not to be taxed unless the charging provision clearly imposes the obligation”.

So far as the taxability is concerned, the subject is not to be taxed without clear words for that purpose, according to the natural construction of its words – *St. Aubyn vs. A.G.* (1951) 2 ALL ER 473 (HL). There is no room for any intendment, there is no equity about a tax, there is no presumption as to tax, nothing is to be read in, nothing is to be implied – *Canadian Eagle Oil Co. Ltd. vs. R* (1945) 2 ALL ER 499 (HL); *Tarulata vs. CIT*, AIR 1977 SC

1802 [1977- (108) ITR 345 (SC)]. Fiscal matters are not built upon any theory of taxation-*CC vs. Top Ten Promotions* (1969) 3 ALL ER 39 (HL). To interact charging section, if law is certain, strange meaning should not be given to it – *Tata Consultancy Service vs. State Of AP* 2004 (178) ELT – 22(SC).

In other words, the maxim is that in construing fiscal statutes to determine tax liability or penal consequences, one must have regard to the strict letter of the law and not merely to the spirit of the law – *A.VS Fernandez vs. State of Kerala*, AIR 1957 SC 657, *Murarilal vs. B.R.Vad*, AIR 1976 SC 313. A subject cannot be charged even if it falls within the spirit of law. A subject cannot be charged unless the language of statute clearly imposes the obligation and if once the person ought to be taxed comes within the letter of law, he must be taxed, however, great the hardship may appear to the judicial mind – *Russel vs. Scott* (1948) AC 422; *D. Migator Goldsmith vs. IRC* (1953) AC 347.

It is well settled law that while construing the law reasonably, if there are two views i.e. there is a doubt, it must be interpreted strictly, but if the results are different, it depends upon the nature of the provision and the context. For example, where there are two views i.e. doubt about the imposition or measurement of the levy, the benefit shall be given to the assessee – *CIT vs. Naga Hills Tea Co. Ltd.*, AIR 1973 SC 2524; *CIT vs. Shahzada Nanda & Sons* (1966) 60 ITR 392 (SC). The rule is similar in case of imposition of penal consequences – *CIT vs. Vegetable Products Ltd.* (1973) 88 ITR 192 (SC); *CCE vs. Orient Fabrics Pvt. Ltd.* 2003 (158) ELT – 545(SC).

It is well known assumption that if the interpretation of a fiscal statute is open to doubt, the construction beneficial to the assessee shall prevail, which is not a rule of thumb. In other words, for example, exemption being a freedom from liability, tax or duty, unlike charging provision, has to be tested at different touchstone.

In fact, an exemption provision is like an exception and on normal principle of construction or interpretation of statutes, it is construed strictly either because of legislative intention or on economic justification of inequitable burden or progressive approach of fiscal provisions intended to augment state revenue. But once exception or exemption becomes applicable, no rule or principle requires it to be construed strictly. Truly speaking, liberal and strict construction of an exemption provision is to be invoked at different

stages of interpreting it. When the question is whether a subject falls in the notification or in the exemption clause then it being in nature of exception is to be construed strictly and against the subject but once ambiguity or doubt about applicability is lifted and the subject falls in the notification then full play should be given to it and then it calls for a wider and liberal construction – *UOI vs. Wood Papers Ltd.* 1990 (47) ELT 500 (SC).

It is reiterated that procedural part of the exemption notification shall not be construed strictly. There are conditions and conditions. Some may be substantive, mandatory and based on considerations of policy and some others may merely belong to the area of procedure. It will be erroneous to attach equal importance to the non-observance of all conditions irrespective of the purposes they were intended to serve. A distinction between the provisions of statute which are of substantive character and were built-in with certain specific objectives of policy on the one hand and those, which are merely procedural and technical in their nature on the other, must be kept clearly distinguished – *Mangalore Chemicals & Fertilizers Ltd. vs. Dy. Commissioner* 1991 (55) ELT 437 (SC).

The rules are meant to promote the cause of justice and not *vice versa*, so the same should be construed reasonably having regard to the language employed therein – *H.M.M. Ltd. vs. CCE* 1996 (87) ELT 593 (SC). If there is no doubt or ambiguity, it need not be construed strictly – *S.G. Glass Works Pvt. Ltd. vs. CCE* 1994 (74) ELT 775 (SC). However, purpose and policy decision behind the notification should not be defeated by giving it some meaning other than what is clearly and plainly flowing from it – *CCE vs. Himalayan Coop. Milk Product Union Ltd* 2000 (122) ELT 327 (SC). Similarly, where liberal interpretation about a procedural condition is likely to facilitate commission of fraud and introduce administrative inconvenience [*Indian Aluminium Co. Ltd. vs Thane Municipal Corporation* 1991 (55) ELT 454 (SC)] or procedural condition is being a substantive one, the same could not be construed liberally.

The principal that a fiscal statute has to be strictly construed, is also subject to an exception that the rule of strict construction does not apply to a provision which merely lays down the machinery provision for the calculation or procedure for the collection of the tax which requires the construction that makes the mach-

inery workable – *Gursahai Saigal vs. CIT* 1963 (3) SCR 893. Another exception is if two constructions are possible and a strict construction would lead to an absurd result then the construction which is keeping with the object of the statutory provision or in keeping with equity could be accepted – *CIT vs. J. H. Gotla*, 1985 (4) SCC 343. The Supreme Court has expressed as follows:-

“..... if strict literal construction tends to an absurd result i.e. result not intended to be subserved by the object of the legislation found in the manner indicated before, and if another construction is possible apart from strict literal construction then that construction should be preferred to the strict literal construction. Though equity and taxation are often strangers, attempts should be made that these do not mean always so and if a construction results in equity rather than in injustice, then such construction should be preferred to the literal construction”.

While the levy in our country has the status of a constitutional concept, the point of collection is located where the statute declares it will be. The measure adopted cannot be identified with the nature of the tax. The measure employed for assessing tax must not be confused with the nature of the tax. While the levy of a tax is defined by its nature, the measure of the tax may be assessed by its own standard. While the nature of levy may indicate the nature of the tax, it does not necessarily determine it. Hence, the legislature, while enacting a measure to serve as a standard for assessing the levy need not contour it along the lines while spelling out the character of the levy itself.

So far as the machinery provisions are concerned, a declaration of the levy is the starting point. If there is a taxability imposed under the terms of the taxing statute, then follows the provisions in regard to the assessment of such liability. If there is no taxability to tax, there cannot be any assessment either – *A. V. Fernandez vs. State of Kerala* 1957 AIR 657 SC.

In case of amendment, meaning prior to amendment cannot be given as that would negate statutory provisions. Pre-amendment position, when not changed by carving out any specific exclusions has to be given effect to – *State of UP vs. UOI* 2004 (170) ELT- 385 (SC). If a Section of an Act is substituted by new section and thus, the legislature wants to depart from the earlier position, it would have to do so in express words – *Gaurav Distributors (P) Ltd. vs. CCE* 2004 (170) ELT –

513 (SC), when not disturbed while amending a statute indicates that legislature did not want to depart from that construction. Rewriting of statute is the function of legislature and court cannot do so while interpreting statutes – *Tata Consultancy Service vs. State of AP* – 2004 (178) ELT – 22 (SC).

It is well settled that the words employed in a statute shall be perused in the context of such enactment, and in case of any ambiguity, the attempt should be to resolve by construing the statute as a whole. For this, the sources such as preamble, definitions, exceptions, explanations, fictions, deeming provisions, provisos, punctuation, saving clauses, *non obstante* clause, rules of language, scheme of the statute, etc. are known as internal aids.

However, where the statute is not exhaustive or its language is ambiguous, uncertain, doubtful, clouded or susceptible because of having several meanings or shades of meaning, the external sources prevail to ascertain the ideas. And to resolve the ambiguity, service of many external aids may be put to use, which include dictionaries, earlier legislations, history of the legislation, Parliamentary proceedings and foreign decisions, etc. However, such external aids may be employed rarely for limited purposes only. The priority would always be for the internal sources.

And at last, it must always be kept in mind that though manifestly absurd, unjust results could never be intended by the legislature even if its language is plain. Since language is at best an imperfect medium to express human thought, so, the attempt should always be to discover the ideas behind the language; so, it is not a mechanical task. Every statute shall be construed fairly and reasonably. Since a statute is neither a literary text nor a divine revelation, its effect is, therefore, neither an expression laid on immutable overtones nor a permanent creation of infallible wisdom. It is a statement of situation or rather a group of possible events within a situation and as such it is essentially “ambiguous”, the ideas behind the same are revolutionary because of fast changing social, economic and political environment i.e. evolution of civilization. There shall be no rigidity as regards to its propositions and principles which may not be relevant now because of fast movement of ideologies, values and systems. What is relevant is that the interpretation and its effect must be suited to the needs of the society in the given circumstances. It is an essence for construction. ■

The Sub-Prime Mortgage Crisis: Impact on Asia

The recent mayhem in the global financial markets has been somewhat unprecedented in economic history. Although there are several factors that have brought the world to the doorstep of financial doom, the main cause is said to be the US sub-prime loans.

In fact, the cascading effects of the sub-prime meltdown have traveled deep into financial markets, causing substantial turmoil and uncertainty in global economy and emerging Asia. However, it remains uncertain whether we have seen the worst of the global financial turbulence or if there are more shocks in store. Another bout of global financial volatility could reverse inflows and make financing more difficult for sovereign and corporate borrowers in Asia. This article attempts to comprehend the macro impact of sub-prime crisis on some leading countries of Asia.



Dr. Malayendu Saha

*The author is Professor, Department of Commerce,
University of Calcutta.
He can be reached at
m_saha2@rediffmail.com*



The chain of events in the last few months has gone something like this: collapse of Bear Sterns and Lehman Brothers, the biggest ever US bankruptcy, the takeover of Merrill Lynch by Bank of America, apprehensions that the world's largest life insurance company AIG, Fannie Mae and Freddie Mac, Washington Mutual, Wachovia – and more are now on the brink, bankrupt or sold or bought by the US Government. Even an icon like Goldman Sachs is now undergoing public loss of confidence. The root cause, however, for all these is very simple to understand. Banks and Wall Street firms have made trillions of dollars in loans they should not have given – chiefly sub-prime home mortgage loans. Now they are endeavouring to write off the losses and some of them no longer have enough capital to get by. Complicating the matters are the securities in the derivative markets, debt markets, hedge funds and the housing market that have proved almost

impossible to get a grip on. As borrowers defaulted on their mortgages, the panic spread, paralysing parts of the financial system and threatening to undermine the global economy.

The sub-prime crisis has, however, resulted in increased uncertainty about the outlook for emerging Asia. First, it remains uncertain whether the world has already experienced the worst of the global financial turbulence or if there are more shocks in store. The region's apparently small exposure to sub-prime mortgages and structured products more generally has helped moderate the impact of the crisis on Asia. But another bout of global financial volatility could have significant spillovers for the region. It could result either in reversing capital inflows or making financing more difficult for a number of sovereign and corporate borrowers. But perhaps the main risk to the region arises from the sharp slowdown in the US and the Euro area, because of the persistent US housing doldrums and associated global financial problems. Despite a view that Asia has "delinked" from the US and other industrialized countries, the truth is that the region remains significantly dependent on exports to the rest of the world.

What is Sub-Prime?

Sub-prime loan is a type of loan that is offered at a rate above the prime rate to individuals who do not qualify for prime rate loans. Quite often, sub-prime borrowers are often turned away from traditional lenders because of their low credit ratings or other factors that suggest that they have a reasonable chance of defaulting on the debt repayment. These loans tend to have a higher interest rate than the prime rate offered on traditional loans. The additional percentage points of interest often translate to tens of thousands of dollars worth of additional interest payments over the life of a longer-term loan. Borrowers with very poor or insufficient creditworthiness are able to obtain mortgages far in excess of what they should have been able to, for houses that are far beyond their means. In addition, these sub-prime mortgages are frequently granted to borrowers with limited or no credit history at variable interest rates, characterized by very low initial "teaser" rates, which would be sharply adjusted up-wards after the initial period – typically after two years. However, getting a sub-prime loan could still be a

Sub-prime Mess



good idea if the loan is meant to pay off a higher interest debt (such as credit card debt) and the borrower has no other means for payment. The specific amount of interest charged on a sub-prime loan is not set in stone. Different lenders may not value a borrower's risk in the



The reasons for the sub-prime crisis are varied and complex. Understanding and managing the ripple effect through the world-wide economy poses a critical challenge for governments, businesses and investors. The crisis can be attributed to a number of factors, such as the inability of homeowners to make the mortgage payments, poor judgement by the borrower and/or the lender and mortgage incentives such as “teaser” interest rates that later rise significantly. Further, declining home prices have made refinancing more difficult.

same manner. This means that a sub-prime loan borrower has an opportunity to save some additional money by shopping around. Sub-prime loans are dicey as they are given to people with unstable incomes or low credit worthiness. These individuals are not financially sound enough to be given a loan when judged under the strict standards that should normally be followed by a bank or lending institution.

Over the last few years, the US financial system had experienced substantial excess liquidity, which created huge surges in the valuations for home prices in the country. As interest rates fell due to excess liquidity, house prices rose rapidly. This was attributable to declining interest rates that saw their lowest levels in the last 20 years. Banks lowered lending standards, allowing “sub-prime” borrowers to obtain home mortgages on increasingly favourable and imprudent terms. This, coupled with the emergent practice of selling these mortgages to other financial institutions, in packaged products known as Collateralised Debt Obligations (CDOs), enabled the lending banks immediately to take such mortgage loans off their balance sheets. This increased the banks' propensity to make such loans on increasingly liberal and imprudent terms. As house prices rose, borrowers' equity in the properties grew and they were able to sell their homes and book profits. They borrowed against their increased equity in the properties and used such secondary mortgages to engage in increased consumer spending. This further created a vicious cycle, resulting in very high consumer spending and fuelling global growth. However, as interest rates started to rise in the US due to inflation concerns, this cycle came to an end and the demand for

houses started to decline. This resulted in sharp falls in home prices and as a result, many owners/borrowers became unable to service their mortgage loans. The excess liquidity slowly dried up and the levels of equity extraction available from home purchases came down — leaving less money for consumer spending. This is now causing problems for the US economy in the form of foreclosures, job losses, loss of consumer confidence and reduced consumer spending and the fears of a slowdown, if not outright recession. This is what has become known as the Sub-prime Crisis.

The Sub-Prime Loan Virus

There is nothing inherently wrong or reckless about lending to borrowers with lower incomes and lower credit scores. But prudence dictates that in making sub-prime loans, lenders must control the risks by more closely evaluating the borrower, setting higher standards for collateral, and charging rates commensurate with the greater risks. Too often, however, standards were steadily loosened in recent sub-prime and “Alt-A” (whose risks are between prime and sub-prime) lending. Instead, many sub-prime mortgages were “ninja” loans— standing for no income, no job, and no assets. To make matters worse, many of these mortgages were issued with initially low “teaser” interest rates or with other terms, such as interest-only or negative amortization payment options, to make them seem more affordable to borrowers. This allowed borrowers to get larger mortgages, but created greater future payments for households when the teaser rate expired or principal repayments began. The rationale for such risky lending was that house prices were

appreciating rapidly and had not fallen nationally in the United States since the 1930s. Therefore, any potential repayment problems would be substantially mitigated, if not eliminated, by higher market prices for the underlying collateral. If the borrower failed to repay on schedule, the home's increase in value would facilitate a refinancing or, in the event of foreclosure, would cover the loan and accrued interest and penalties.

Under the assumption that house prices would continue increasing and loan-to-value ratios would always be falling, little could go wrong.

The process of transforming home loans into securities (in which the income and principal payments are passed through a trust to investors) also added to the problems. Due diligence from investors did not increase enough to compensate for this greater information burden. Instead, investors increased their reliance on the assessments of credit rating agencies. Although these agencies have a long and well-known track record, rating bonds, sub-prime residential mortgage-backed securities (MBSs) and CDOs were new and more complex. CDOs are structured credit securities backed by pools of securities, loans, or credit derivatives whose cash flows are divided into segments, called tranches, with different repayment and return characteristics. However, as the poor quality of the loans became more apparent and securities were downgraded, tranches soon began to fall in value together. More



problems occurred when the securities were distributed and traded. The vulnerability of leveraged, or thinly capitalized, investment positions and the illiquidity of many structured credit markets were exposed when trading was disrupted in a host of other markets — subprime-linked MBSs, CDOs, asset-backed commercial paper (ABCP), and credit derivatives (Dodd, 2007). High degrees of leverage, in which investors

borrowed heavily or used derivatives to increase returns to capital, made investment strategies vulnerable to large market price movements. But such a strategy, which relied on markets remaining liquid, failed when markets rapidly became illiquid. It is a challenge to any financial market when trading becomes

one-sided— with everyone trying to sell or to buy. But some markets have proved to be more reliably liquid than others. U.S. stock exchanges remained liquid even during the crash of 1987 and the bear market that followed the dot-com boom earlier this decade. As volatility in MBSs and credit markets increased, the riskiness of making markets and maintaining an inventory of the securities also rose. That reduced the willingness of dealers to offer market liquidity to those seeking to trade.

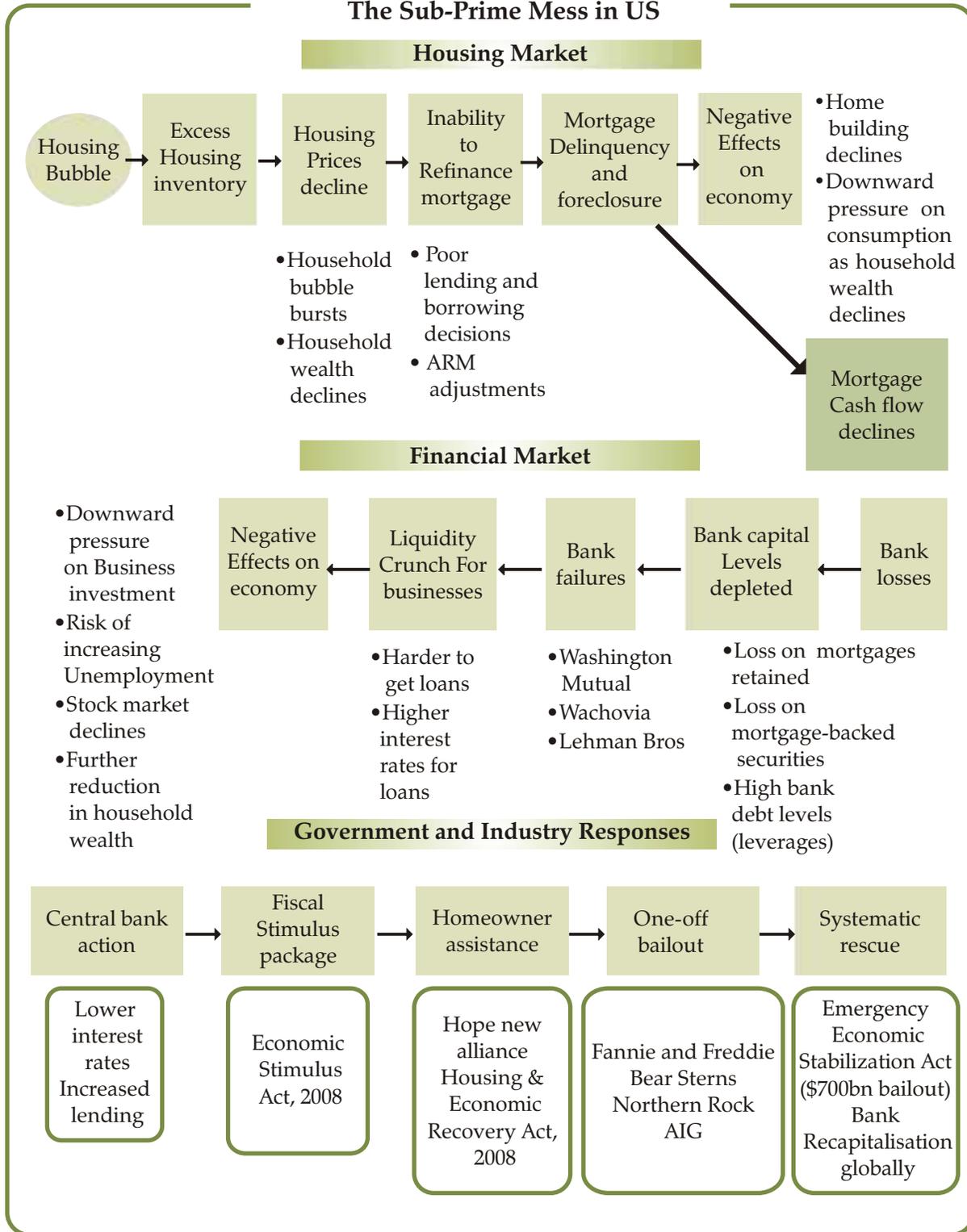
Causes of the Crisis

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The Sub-Prime Mess in US



critical challenge for governments, businesses and investors. The crisis can be attributed to a number of factors, such as the inability of homeowners to make the mortgage payments, poor judgement by

the borrower and/or the lender and mortgage incentives such as “teaser” interest rates that later rise significantly. Further, declining home prices have made refinancing more difficult. As a result of

innovations in securitization, risk related to the inability of the homeowners to meet mortgage payments have been distributed broadly, with a series of consequential impacts. Some of the causes of crisis are:

1. Unsound banking practices:

The root cause of the sub-prime mortgage crisis is the unsound credit practices that emerged in the US market. Fake certification, violation of sound credit practices, personal loans and overdue credit cards are the factors that have led to this kind of financial crisis throughout the world.

2. Uncontrolled derivatives market: Derivatives are financial instruments, which can spread the default risk attached to loans. Indiscriminate use of such derivatives can lead to havoc as in US. Derivatives lead to such a chain reaction that it becomes nearly impossible to quantify the risk of exposure to bad loans and advances subsequently.

3. Reckless investments: Prudent investments abroad should be the order of the day. Reckless investment in the derivatives market abroad by banks and financial institutions has resulted in this crisis. In the recent crisis, BNP Paribas of France and Macquarie Bank of Australia have been affected because of such overseas investments.

4. Complex risks: Traditionally, the risk of default is assumed by the bank originating the loan. However, due to innovations in securitization, credit risk is frequently transferred to third party

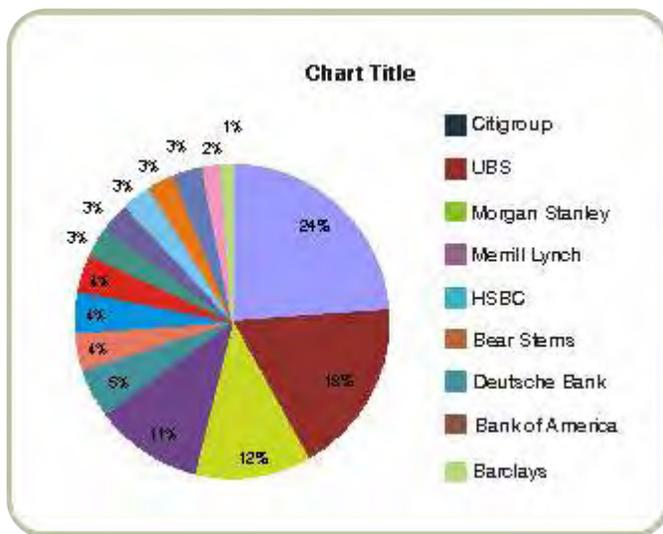
investors. The rights to mortgage payments have been repackaged into a variety of complex investment vehicles, viz., MBS or CDOs. MBS and CDO asset valuation is complex and related “fair value” or “mark to market” accounting is subject to wide interpretation. There is some debate regarding whether fair value accounting should be suspended or modified temporarily, as large write-downs of difficult to value MBS and CDO assets may have exacerbated the crisis.

Global Impact

The sub-prime crisis in the US, following the collapse of the housing sector boom, has sent ripples through the economies of many countries. During the high demand period for housing loans in the US, when the real estate sector was booming, people with a bad credit history, and a higher chance of defaulting on their payments, were provided loans at higher-than-normal interest rates (sub-prime rates). A decline in economic activity in the US resulted in lower disposable incomes and hence a decline in demand. Simultaneously there was a rise in supply due to repayments and foreclosures arising out of a higher interest rate. This triggered the sub-prime crisis. Over the past year, the world has been hit by the heat of the US sub-prime crisis. It was initially thought by some that other major world economies would not be significantly affected.

Losses by Leading Banks Due to the Crisis

Table: 1



Name of the Bank	Losses (in \$ billion)
Citigroup	18.0
UBS	13.5
Morgan Stanley	9.4
Merrill Lynch	8.0
HSBC	3.4
Bear Sterns	3.2
Deutsche Bank	3.2
Bank of America	3.0
Barclays	2.6
Royal Bank of Scotland	2.6
IKB	2.6
Societe Generale	2.0
Freddie Mac	2.0
Wachovia	1.1
Credit Suisse	1.0

However, the crisis is quickly assuming bigger and bigger proportions, affecting major economies worldwide both directly and indirectly. Some experts feel that this crisis could match or even outmatch the economic devastation of the great depression. Such sectors as stock markets and bank investment funds have been affected worldwide, especially in European and Asian countries. The central banks of many countries on these continents have taken evasive action to prevent credit crises that could lead to economic recession.

The sub-prime crisis has also had a contagion effect and this resulted into huge write-offs by banks business in the US as well as the UK, where housing prices during last five years have also risen very rapidly, creating a potential effect such as in the US. This is expected to have global effects since the US consumer demand amounts to more than 40 per cent of the total OECD demand, and to 18 per cent of world demand. Similar to the Asian financial crisis approximately ten years ago, the current events triggered by the US sub-prime market has sent global markets and currencies into a tailspin. Indications are that, fundamentally, the global economy has firm foundations, although there is still the possibility that the turmoil may have some long-term impact due to the domino effect of reduced economic activity in the world's largest economy, the US. The IMF has forecast that Japan, Euro region and the UK economies will all contract next year.

Given the dominance of US financial markets in other developed and developing economies, the sub-prime mortgage market crisis affected markets and institutions all over the globe. In July 2007, when the sub-prime crisis hit, the global stock markets and the main Dow Jones stock index lost 4.2 per cent in five sessions — its worst weekly



decline in five years and the fall continued in next few months as well. London's main FTSE 100 stock index closed down 1.2 per cent with French and German markets also declining. French bank BNP Paribas suspended three investment funds worth €2 billion citing problems in the US sub-prime mortgage sector. The Dutch bank NIBC announced losses of €137 million from asset-backed securities in the first half of last year. The European Central Bank (ECB) pumped €95 billion into the European banking market to allay fears about a sub-prime credit crunch. In the event of a dramatic tightening of credit, some of the sources of capital like Foreign Institutional Investors, Foreign Direct Investment and External Commercial Borrowing, could dry up.

Portfolio inflows by FIIs could reverse rapidly in the event of a flight to safety, exerting pressure on share prices, said the Economist Intelligence Unit (EIU) report on the impact of US subprime mortgage crisis on global economy. The European economy is scarcely likely to be able to decouple completely from the US economy on a permanent basis. The reason is that ongoing globalisation and the increasing use of information and communication technologies have resulted in

Table: 2





closer transatlantic links in external trade and financial markets than in the 1980s. The growth slump in the US could restrain growth in the Euro area by roughly one-half of a percentage point, with the effect being reinforced by the strong Euro and stubbornly high oil prices. Against this backdrop, the study expects Euro-area growth to slow in the current year, from 2.7% to merely 1.6%, and continue at a similarly moderate pace in 2009.

Impact on Asian Countries

Shanta Devarajan, World Bank Chief Economist for the South Asian Region, has commented that the current sub-prime mortgage crisis in the United States will not seriously impact South Asia region and rather it would be mild because of the structure of the region's trade and financial flows, and partly because of compensating effects. He attributed three factors that worked well for the region: 1) lack of exposure to US mortgage securities, 2) availability of liquidity in domestic markets and 3) the possibility that lower capital inflows could help countries such as India with macroeconomic management. Given the overall lack of access to credit, and the relatively high cost of registering and enforcing a mortgage lien, emerging market banks have been slow to move down market with mortgages. Mortgage lending is typically less than 20 per cent

of GDP in emerging markets, while it ranges between 40 and 100 per cent of GDP in developed countries.

The emerging Asia's economies have been among the most dynamic in the world in the last decade. In recent times, the region has accounted for almost half of global economic growth. Much of this success stems from broad reform measures initiated by these countries during the last ten years. These have led to healthier financial and corporate sectors and more robust macro-economic policy across the region. During the last year the region has experienced unexpected economic growth. China and India have led the way, with growth rates in the first half of the year of 11.5% and 9.25% respectively. The trend has been positive for other Asian countries too. However, the sub-prime crisis has increased uncertainty about the outlook for the global economy and emerging Asia. IMF staff estimates that a 1 percentage point decline in US economic growth could reduce growth in emerging Asia, through lower exports, by up to 0.4 percentage points. The region's apparently small exposure to sub-prime mortgages and structured products more generally has helped moderate the impact of the crisis on Asia. The fallout from the Bear Sterns collapse confirms the global character of the crisis that is centred in the US and points to deepening problems ahead for all the major economies in Asia. The impact of the crisis in some of the leading countries in the region is discussed below:

China

All eyes are on China, which since the 1997-98 Asian financial crisis, has been the prime mover of economic growth, providing markets for raw materials, parts, and, in the case of Japan, capital goods. Some commentators have speculated that China, and, to a lesser extent, India, will not be affected much by the US crisis and could even pull

Despite Indian government's best efforts to insulate Indian economy from catching the Wall Street cold, the contagion finally spread to these shores in recent times in a rather rude manner. In India, the rise in the value of the Rupee versus the US Dollar is expected to damage exports. Indian companies involved in mortgage processing for the US have faced a decline in work orders. Already, export orders for the textile sector have fallen significantly and large job losses are being reported.





The US sub-prime residential mortgage crisis is having a profound impact on Japanese financial institutions, prompting them to revise down their group earnings estimates for fiscal 2007 that ended in March 2008. The global financial market turmoil induced by the sub-prime crisis led to plunges in the prices of stocks and securitized products that are not directly linked to the sub-prime loans, making the Japanese financial institutions to incur massive investment losses. Some commentators argue that Japan is already in recession.

the world economy out of recession. However, another belief which is fast gaining credence is that any slowdown of exports to the US would affect China's economic growth, leading to rising unemployment and social instability. Reports show that China needs to create 10 million jobs a year for the next five years. Like other countries throughout the region, China is being hit by soaring prices for oil, food and other commodities. Inflation in China is officially at 8.7 per cent, an 11-year high and almost double the Beijing's official target of 4.4 per cent. Further, squeezing Chinese manufacturers and rising commodity prices are fuelling popular discontent and unrest. Sharp falls in China's financial stocks in recent times also reflect concerns about underlying weaknesses in the country's financial system. In Hong Kong, the Industrial & Commercial Bank of China, the world's largest bank by market value, fell 5.5 per cent and the Bank of China, the nation's third largest, dropped 4.5 per cent recently. China faces the prospect of a slowdown in exports not only to the US but also Europe and Japan. The European Central Bank recently projected growth across Europe of just 1.7 per cent, but even this figure may be optimistic.

Malaysia

The Malaysian government's growth target of 6 to 6.5 percent could be at risk if the US sub-prime mortgage crisis deepens and creates a steep fall in external demand, economists say. Weaker outlook for the advanced economies is likely to slow export growth (for emerging Asian economies). Slower demand for Asian exports, and electronic goods in particular, and the possibility of further global financial market turbulence are particular downside concerns. Malaysian export growth is highly dependent on demand from the US but the outlook for the world's largest economy does not look good, as chances are that the sub-prime

upheaval is likely to get worse. The latest trade figures show that Malaysian exports to the US have reduced by 12 per cent from last year, suggesting that the slowdown in the US has already filtered down.

India

Despite Indian government's best efforts to insulate the Indian economy from catching the Wall Street cold, the contagion finally spread to these shores in recent times in a rather rude manner. Such was the impact of the detritus of the crumbling US financial system that it finally wreaked havoc on the Indian stock markets, forcing policy-makers to take urgent steps to try and stop further haemorrhage of the Indian rupee and equities. The Sensex had shed more than 45 per cent from its peak in January in recent past. Another headache for policymakers was the double-digit inflation. The tight money supply and a high tax regime put in place over last one year were largely dictated by rising concerns about inflation. Investments through various offshore tax havens, especially Mauritius, through participatory notes (PNs), were widely suspected to be misused for tax evasion and money laundering. It was also believed that a good portion of the investments, coming through the PN route, was made by NRIs through equity market operations.



Despite the fall in the price of crude oil, the weakening of the rupee has more than cancelled out the likely advantage. India's balance of payments position has deteriorated too, with the April-June quarter last year registering a surplus of a mere US\$2.4 billion as against \$25 billion in the January-March quarter. Happily, the foreign exchange reserves at over \$252.46 billion (as on April 17, 2009) provide the RBI a good cushion to stop the further depreciation of the rupee. In India, the rise in the value of the Rupee versus the US Dollar is expected to damage exports. Indian companies involved in mortgage processing for the US have faced a decline in work orders. Already, export orders for the textile sector have fallen significantly, and large job losses are being reported.

The other side of the coin is that contraction in the US would lead to less demand for imported goods, impacting imports. There is the argument that the Indian economy is sufficiently decoupled from the rest of the world and that there is robust domestic demand and employment creation – this would cushion the economy from external shocks. The sub-prime crisis offers such an opportunity and, in the coming months, one is likely to see enhanced explanations of how the Indian economy has been affected. India is relatively less exposed to the US sub-prime mortgage crisis that has sent global stock markets into a tizzy. But if the crisis does continue and causes a general economic downturn, India will be affected to a greater extent. The biggest worry then would be of a slowdown in the economy.

Indonesia

The argument that the economies in Asia, particularly the Indonesian economy, are decoupled from the US economy is not true. The Indonesian financial market is very much influenced by the US financial crisis, albeit indirectly. The Indonesian capital market has gone down around 35 per cent since the beginning of the year, the Rupiah value is depreciating and the

bond price is under strong pressure, as portfolio investors have been leaving Indonesia. It is true that growth has been relatively high at 6.4 per cent for the second half of the last year, but growth could be threatened by a further decline of commodity prices. The decline in commodity prices on one side hurts the capital market and it could reduce export revenue and thereby reduce growth. So far, despite the sharp declines in share prices of commodity companies, their balance sheets remain strong. If commodity prices decline sharply, this would also affect domestic banks as their exposure in corporate credit is primarily to commodity-related companies. This decline in



Proponents of the idea that Asia can keep growing even if the U.S slows, cite growing intra-Asian trade as evidence that the U.S now matters less. But they overlook the fact that much of this intra-regional trade is in parts and components assembled into final goods in China are sold to the United States. What is needed to be carefully pondered over is that if the U.S. economy enters a recession and Asian growth slows, what should governments and central banks do?

commodity prices could help to ease inflation pressures. However, this needs to be kept in perspective given these uncertain conditions. The positive scenario is that by the end of the year things might be sorted out. If this is the case, the Indonesian economy would reap the benefit for its financial market in general. If, on the other hand, things in the US become worse with more financial institutions falling and if the measures taken by the US authorities are not effective, the Indonesian economy could also be hard hit. It seems there is not much that can be done by the Indonesian monetary and fiscal authorities as the economy is very open to the global economy. If monetary and fiscal authorities can manage inflation well, investors will not be too worried about the Indonesian economy.

Hong Kong

Given its strong economic integration with China, despite external challenges including volatility in the financial markets and continued high energy prices, the Hong Kong economy has remained resilient with real gross domestic product expanding moderately by 6.4% in 2007

and by 5.8% year-on-year in the first half of 2008. Nevertheless, the second quarter GDP figure suggests that the headwinds from slowing growth in the major industrial economies plus lingering financial market turbulence increasingly pose a drag on the local economy. A moderation in consumption is also increasingly apparent; it slipped for the third consecutive quarter to 3.1% year-on-year in 2008's second quarter from a 7.9% rate at the end of March. Consumption was also restrained by a volatile stock market, rising inflation and expectation of slower payroll growth. The economic outlook, however, looked uncertain if the sub-prime housing mortgages crisis snowballs and results in a severe economic downturn in North America and Europe. Weakening exports could be the biggest threat to Hong Kong's economic expansion. Export growth in last year's second quarter nearly halved as compared to growth in the preceding quarter as a global slowdown and a more expensive Chinese Yuan curtailed demand for China-made goods shipped through Hong Kong. The unemployment figure is a lagging indicator. Employers have become more cautious about hiring, according to a survey published last month by the recruitment company. Despite all this, there is reason to remain cautiously optimistic about Hong Kong's prospects for the rest of 2009.

Japan

The U.S. sub-prime residential mortgage crisis is having a profound impact on Japanese financial institutions, prompting them to revise down their group earnings estimates for fiscal 2007 that ended in March 2008. Previously, Japanese financial institutions were believed to be immune from the meltdown in the U.S. sub-prime mortgage market due to their relatively limited exposure to sub-prime-linked securitized products. But the global

financial market turmoil induced by the sub-prime crisis led to plunges in the prices of stocks and securitized products that are not directly linked to the sub-prime loans, making the Japanese financial institutions to incur massive investment losses. Among the mega banks, Mizuho Financial Group Inc., Chuo Mitsui Trust Holdings Inc., have reduced their group net profit forecast due to losses from stock investments. Other major banks like Bank of Ikeda, Nanto Bank, Fukuoka Financial Group Inc. and Takinogawa Shinkin Bank are expected to book losses.

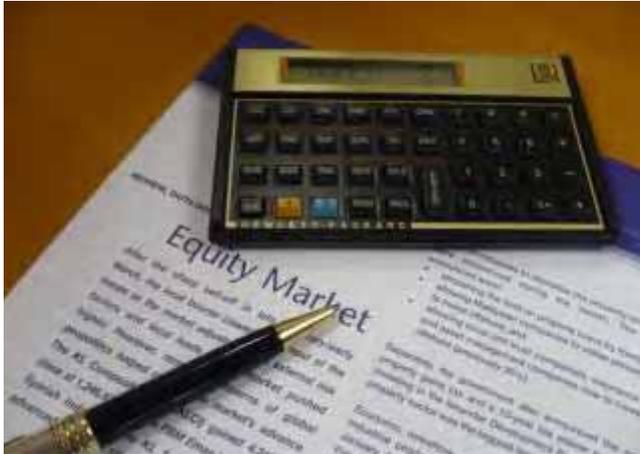
Some commentators argue that Japan is already in recession. Shares in Japanese manufacturing corporations, namely Toyota, Honda, Sony, Canon dropped sharply. Exporters are deeply concerned about the rising value of the Yen against the US dollar. Very recently, the currency slid past the 100 yen to the dollar, for the first time in 12 years. Sony has admitted that it loses \$62 million in operating profits for every 1 yen rise against the dollar. The share market reaction in recent times also pointed to deeper concerns about the Japanese banking system. Among the victims were the Tokyo-based Shinsei Bank, Mitsubishi UFJ and the Sumitomo Mitsui Financial Group, the second-largest bank by market value. The Shinsei Bank admitted last week that it had a US\$318 million exposure to the US sub-prime crisis and expected an extra US\$100 million loss in American mortgage-related markdowns in the last quarter of 2008. However, it was opined that these losses could be revised down "if the situation changes."

Conclusion

Asia's exports to the United States are simply too important. Proponents of the idea that Asia can keep growing even if the U.S. slows, cite growing intra-Asian trade as evidence that the U.S. no



The outlook for emerging Asia remains positive but the economic environment will, as always, present a number of policy challenges. First, policymakers need to be ready to respond to a slowdown in the global economy with a more accommodative monetary policy. Second, the volatile global environment has raised uncertainty regarding capital flows to the region. Countries will need to continue to be pragmatic and allow for greater exchange rate flexibility to create a two-way risk in foreign currency markets and promote a rebalancing of growth where necessary.



matters less. But they overlook the fact that much of this intra-regional trade is in parts and components, assembled into final goods in China are sold to the United States. If the U.S. economy enters a recession and Asian growth slows, what should governments and central banks do? In particular, what is the role for the regional cooperation that Asian leaders have been working to encourage? Efforts to stabilize intra-regional currencies would not be appropriate because different Asian economies will be affected differently. Singapore, Taiwan and Malaysia depend mostly on the U.S. market, so they will need relatively large interest rate cuts and currency depreciations to make up for lost exports. In contrast, other economies that depend less on exports to the U.S. will want to see their interest rates and exchange rates adjust by less. If a U.S. recession causes Asian growth to slow, then Asian governments are also going to want to cut taxes in order to stimulate domestic demand. The Chinese government, for its part, will want to boost public spending. But each Asian government will hesitate to go first. They face a free-rider problem, since some of the benefits from increased demand will spill over to neighboring countries in the form of increased exports.

In Asia, the impact of these spillovers will be felt, it is expected, at a time when the region is facing fragility and imbalances resulting from trade and financial policies and strategies pursued in recent years, including credit, asset and investment bubbles and excessive reliance on foreign markets. However, economic fundamentals in the region are generally strong enough to allow a positive response to trade

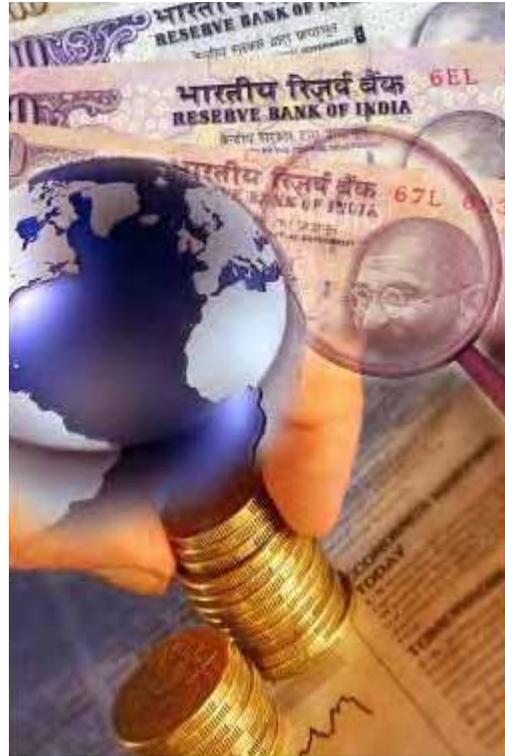
shocks from contraction of markets abroad and swings in exchange rates. Countries with weak fiscal and current account positions look somewhat vulnerable to a sudden stop and reversal of capital flows, but this is not likely to occur. On balance, therefore, Asian developing countries can be expected to continue with rapid, albeit somewhat reduced, growth provided that they undertake counter-cyclical and structural measures needed to address domestic fragility and imbalances and counter the adverse effects of external shocks from the sub-prime crisis.

In addition, cooperation is needed to prevent Asia from having its own sub-prime crisis. The crisis in the United States resulted from inadequate regulation of financial markets. U.S. regulation was loosened to win back business that had migrated to London. Singapore, Hong Kong, Shanghai, Tokyo and Seoul are now competing to see who will be the dominant Asian financial center. This creates a similar pressure for competitive deregulation. Asian governments and central banks need to cooperate to ensure that this does not result in a race to the bottom.

Overall, then, the outlook for emerging Asia remains positive, but the economic environment will, as always, present a number of policy challenges. First, policymakers need to be ready to respond to a slowdown in the global economy with a more accommodative monetary policy. Second, the volatile global environment has raised uncertainty regarding capital flows to the region. Countries will need to continue to be pragmatic and allow for greater exchange rate flexibility to create a two-way risk in foreign currency markets and promote a rebalancing of growth where necessary. This is pertinent in China, where the current account surplus has continued to grow and the currency remains considerably undervalued relative to medium-term fundamentals. Finally, the sub-prime crisis, while so far largely skirting the region, will provide a number of lessons for Asia, as its financial systems become more sophisticated. This is likely to include the need for enhanced financial supervision. At the same time, countries will also likely need to strengthen reporting and disclosure requirements and pricing and provisioning rules to deal effectively with complex financial products, and the cascading system of risks they imply.

Future Trend and Challenges in Indian Banking: A Fresh Look

The Reserve Bank of India (RBI) had made it compulsory that Basel II be implemented by March 2009 by all scheduled commercial banks without any exception. Indian market will be opened for foreign banks this year. Maintenance of adequate capital adequacy ratio (CAR) for managing credit, market and operational risks has become mandatory. Due to this step, competition is likely to increase in the market which may lead to large scale consolidation among various banks for ensuring their survival and sustainable growth. This article makes an attempt to focus on future trend and challenges in Indian banking system especially from the angle of Basel II implementation.



Chanchal Chatterjee

*The author is Lecturer in Finance and Accounts,
St. Xavier's College, Kolkata.
He can be reached at
chanchal_chatterjee2007@yahoo.co.in*

In the era of ever changing global business environment, a healthy as well as well balanced banking system is considered to be quite essential for any economy striving for growth and prosperity in the world of modern finance. The Indian banking system has witnessed numerous reforms and changes over the past two decades. Indian banks have enlarged their business portfolios not only in the domestic market but also in the global competitive market and “mass banking” rather than “class banking” has become the focus of banking. The development of information technology has transformed the banking system from “personalized banking” to “technological banking”. The Reserve Bank of India (RBI) has ensured the implementation of Basel II Accord which has been accepted by over 100 nations, including India. Basel II Accord has mainly emphasized on the maintenance of capital adequacy ratio (CAR) which represents the ratio of capital funds (i.e. net worth or

own funds) to risk weighted assets. As per Basel II, banks are required to maintain a CAR of 12 per cent as against 9 per cent in Basel I. As per the financial guidelines issued by the RBI during April 2007, all commercial banks operating in India were asked to follow standardized approach for credit risk, market risk and operational risk which are perceived to be most significant for banking operations. Keeping pace with the global best practices, foreign banks having presence in India and Indian banks having operational presence outside the country have already taken positive steps for implementing Basel II with effect from March 31, 2008. All other commercial banks (except local area banks and regional rural banks) were expected to implement Basel II by March 31, 2009 without any exception. The shift from Basel I to Basel II has brought Indian banking system to the door step of global competitive market in the realm of finance. In this, backdrop, this article seeks to

highlight some important and sensitive aspects which are expected to emerge in near future in Indian banking industry.

In order to meet the ever increasing capital needs, (which is expected to be around 65 per cent more than the present level of capital base) keeping pace with the Basel II accord, Indian banking system may have to resort to the strategy of entering both domestic as well as international capital market and enlarge its portfolio in these markets.



Capital Adequacy

Proper adherence of capital adequacy is presumed to be the most vital aspect with relevance to financial crisis in banking and finance sector. The higher the CAR, the stronger is the security and safety against bankruptcy and lower is the risk of financial crisis. A fact which is worth mentioning is that a majority of scheduled commercial banks (SCBs) in India have reported a CAR (%) of more than 12 per cent as prescribed in Basel II. The transformation of Basel I into Basel II has presented a new challenge to the Indian banking system. It is noteworthy that the average CAR for the SCBs improved dramatically from just 2 per cent in 1997 to 13.08 per cent on March 31, 2008. As per the RBI report, the Indian banking system needs to increase its capital base from the present level of Rs. 2,96,191 crore to Rs. 8,64,935 crore by March, 2012. This fact would become much clearer from the Table 1

Table: 1

Capital Needs			
			(Rs. in Crore)
	Projected Risk weighted assets	Projected capital requirement	Projected Tier -I capital requirement
Commercial Banks			
2008	3,397,383	305,764	152,882
2009	4,239,008	381,511	190,755
2010	5,061,643	455,548	227,774
2011	6,041,344	543,721	271,860
2012	7,207,788	648,701	324,350
Public Sector Banks			
2008	2,212,938	199,164	99,582
2009	2,761,143	248,503	124,251
2010	3,296,979	296,728	148,364
2011	3,935,122	354,161	177,080
2012	4,694,903	422,541	122,271

Source RBI

In order to meet the ever increasing capital needs, (which is expected to be around 65 per cent more than the present level of capital base) keeping pace with the Basel II accord, Indian banking system may have to resort to the strategy of entering into both domestic as well as international capital market and enlarge its portfolio in these markets. However, Public Sector Banks (PSBs) may have to face difficulties in raising capital from the capital market since the government holding in such banks cannot be reduced below 51 per cent and that is why many industry experts are in support of reducing such government control in state-owned banks to around 33 per cent.

Managing Credit, Market and Operational Risks

Credit Risk: Managing credit risk has assumed great importance with the implementation of Basel II norms. Indian banks need to adopt standardized approach for credit risk management, and for that, credit ratings of recognized and well renowned agencies will have to be used for assigning risk weights. Table 2 shows the risk weights provided by RBI:

Domestic Rating Agencies	AAA	AA	A	BBB	BB& Below	Unrated
Risk Weight	20%	30%	50%	100%	150%	100%

Source RBI

For utilization of standardized approach for credit risk management, banks are now required to obtain the loan portfolios rated by recognized External Credit Assessment Institutions (ECAI). Thus, for managing credit risk, Indian banks are expected to resort to different models and strategies like credit derivatives, third party software for computing capital requirements for credit risk and sector - specific models for different categories of loans, etc. Various advanced modules used for estimating the probability defaults (PD) and exposure at default (EAD) may also be applied.

Market Risk: Market risk arising out of changes in market prices is another important area to be heeded to. Since banks are already involved with this aspect of Basel I, such requirement is not new to banks. Whatsoever, implementing advance

approaches for ascertaining capital requirement for market risk seems to be very much relevant as well as important aspect.

Operational Risk: Another thrust area covered in Basel II is the capital requirement for managing operational risk which is defined as a kind of risk of incurring loss arising out of improper or faulty internal process, people and systems. Suitable models and approaches should be applied for managing this kind of risk. Management of operational risk has assumed much importance in the present context of global financial slowdown for ensuring the financial and economic viability of banking and financial institutions. Perceiving, measuring and managing this kind of risk is considered to be a matter of primary concern. Lehman Brothers, the fourth largest investment bank in the USA, has recently gone bankrupt and its failure to manage the operational risk in the present context was a major reason behind its bankruptcy. Methods suggested by new capital adequacy framework for calculating operational risk such as Basic Indicator Approach (BIA), The Standardized Approach (TSA), Advanced Measurement Approach (AMA) etc. may be used for this purpose.

With regard to Basel II implementation, the existence as well as proper utilization of Effective Internal Capital Adequacy Assessment Process (ICCAP) is presumed to be important with an aim to capture and manage all kinds of relevant risks. A proper monitoring is also essential.

Large Scale Consolidation

The Reserve Bank of India (RBI), in its "road map" for the banking industry, has revealed that the Indian market will be opened for international



banks in 2009. This may facilitate the emergence of a large number of foreign banks in India and such foreign banks are expected to tap the huge potentials with their strong capital bases, updated as well as modern IT based infrastructural facilities and customer – centric approaches. Such forthcoming competition is expected to raise some critical issues such as management of credit, market and operational risks, effective leadership and decision making procedure, attractive HR policies for retaining global talents etc. Moreover, banks which do not comply with the Basel II norms, will have to merge with other larger banks, as a result of which, large scale mergers and acquisitions (M&As) may become very much evident in the days to come. Consolidation in banking industry is expected to emerge as a key word. Initiatives have already been taken by policy makers for eliminating inherent legal constraints in the process of consolidation. Several branches of State Bank group may shortly be a part of SBI and that synergy is expected to uplift the SBI into one among global giants in banking industry.

Innovative Product Portfolio for Future Success

In the realm of global competitive market, the banking system needs to introduce some new as well as innovative products to ensure long term survival, existence and sustainable growth. A few of them are explained below:

(1) Global Portfolio Management: Subject to regulatory compliance, Indian companies have a prosperous avenue to enter into and invest in international capital market through international

mutual funds, derivative instruments and other instruments like currency swaps, lending-borrowing functions in expanding Euro market etc. By ensuring the global network for international portfolio management, banks may play a vital role in that perspective since, without the presence of a global banker, this cannot be actualized.

(2) Transactions of Derivative Instruments: Investment in various kinds of derivative instruments like futures, options, swaps, credit derivatives, currency derivatives etc. has become widely popular in the world of finance and investment. Derivative instruments have

enormous use for hedging of risks in the market and for risk management. Recently, the National Stock Exchange (NSE) has launched the system for trading currency derivatives for managing foreign currency risks since August 29, 2008. Moreover, by incorporating financial derivatives along with ordinary stocks in the portfolio, the modern portfolio management can facilitate creating synthetic

portfolio depending upon market situations (bull market or bear market) and undertaking appropriate strategies (Short position or Long position) with response to the market changes. Banks can play a crucial role in ensuring and facilitating such kind of dynamic investments.

(3) Investments Abroad: In the present corporate scenario, many Indian companies having strong financial base are attempting to enter the global market in the mode of takeover, cross-border acquisition, joint ventureship etc. For instance, Tata Steel has acquired Corus. Such kind of acquisitions involve transactions of billions of



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The phased implementation of Basel accords (Basel I and Basel II) has posed a stiff challenge before the Indian banking system. Indian banks are presumed to be highly vulnerable in respect of their sizes in the emerging scenario of global financial landscape. The cost of conducting business is quite high in India compared to other nations. India, where cost of intermediation is 5.1 per cent, is lagging behind some other countries like Thailand (4%), China (3%), USA (2.9%), Singapore (2.4%), etc.

dollars. The existence of an active global banking partner is presumed to be essential for such global corporate actions.

(4) Project Finance: Another thrust area in the banking and finance sector is attachment of banks and financial institutions with project finance, which includes the dual role of banks in respect of providing financial support as well as sharing of operational risk of an enterprise. For execution of various large global projects, project finance has emerged as a new avenue where banks have very crucial role to play.

In addition, banks may think of other new and innovative product portfolios like currency swaps, use of structured products that have emerged in the field of financial economics, execution of trans-national as well as multinational capital budgeting, etc.

Conclusion

The phased implementation of Basel accords (Basel I and Basel II) has posed a stiff challenge



before the Indian banking system. Indian banks are presumed to be highly vulnerable in respect of their sizes in the emerging scenario of global financial

landscape. The cost of conducting business is quite high in India compared to other nations. In India the cost of intermediation is 5.1 per cent, which is higher than many other countries like Thailand (4%), China (3%), USA (2.9%), Singapore (2.4%), etc. However, consolidation is expected to happen on a large scale in India, due to the mandatory implementation of Basel II in 2009. The entry of large number of strong foreign banks may throw a tough challenge in this sector for Indian banks and strategic decisions, implementation of modern as well as updated IT based infrastructure, customer-oriented approach, management of all types of material risks, introduction of innovative banking products- all are expected to assume tremendous importance for banks if they are ensure their long run existence, survival and sustainable growth. For economic and strategic reasons, foreign banks are expected not to enter rural and semi-urban areas at least for the time being. Hence, Indian banks can play a crucial role to tap the untapped portion of the population which is still outside the banking network and thereby ensuring their sustainable long-term growth and exploitation of potential. Financial inclusion, micro finance etc. are also important aspects to be addressed. It is also noteworthy that the retention of talented and skilled manpower will be a great challenge for the nationalized banks. Foreign banks, with their strong financial strength, are likely to capture the talented segment of manpower for ensuring their success. The global financial Tsunami is expected to blow over after a certain period and the development of the financial sector is likely to re-emerge in the world of finance. Keeping the entire scenario in mind, Indian banks need to prepare themselves from multidimensional angles like strategic decisions, risk management, overall business operation, etc.

How to Move to Next Orbit of Professional Practice



With the role of Chartered Accountants as auditors getting more and more critical and demanding, it is high time to have a rethink on the outlook and approach of accountancy profession. It is also time to re-analyse rising expectations of society from Chartered Accountants. All those who sign balance sheets as auditors need to understand that professional risk has now reached a new level. Society now wants much more than a traditional audit report. Time has come to move to next orbit of professional practice. The article puts the issue in future perspective.



CA. Praveen Kumar

*The author is member of the Institute.
He can be reached at
praveen.kumar@icai.org*

With the role of Chartered Accountants as auditors getting more and more critical and demanding, it is high time to have a fresh look at the outlook and approach of the accountancy profession and re-analyse rising expectations of the society from the Chartered Accountants.

Whenever a fraud is detected in the corporate world, questions are raised about the role and integrity of the auditors. As such, it appears to be high time to have a relook on the role and responsibility of auditors, who are generally understood to be watchdogs of economic world.

Now, all of us professionals who take up the job of auditing and each one of us who signs a balance sheet as auditor, need to understand that risk has now reached a different level. Today,

society demands much more than traditional audit report. The time has come to move to the next orbit of professional practice. I would like to discuss some of the essentials about professional practice of a chartered accountant in the times to come.

Let us look at some hard hitting facts. Last year not even ten per cent of newly qualified CAs opted for certificate of practice. Ask anyone who is doing CA course about his or her aspiration. The obvious answer is that after qualifying there will be a good opportunity in the industry. Very few courageous ones want to struggle for some time to set up own practice. But that was not so always. About a decade ago, quite a lot of CAs dreamt of starting their own practice.

Today I see a lot of scope in practice. If some one can establish his/her own practice and survive in these times, he/she will be a happy person when direction of the global markets become north. It is time to prepare and work according to the world's best practices. Before discussing importance of having a clear vision, there is a need to understand the challenges in the realm of professional practice, of course, besides global recession.

Challenges

The first challenge before the profession is to meet the growing expectations of the society at large, which generally places a lot of trust on the financial statements signed by Chartered Accountants as the auditors. But not to forget, sometimes the aggrieved society forgets about the limitations of the auditor.

Second, you need to satisfy the client. Besides audits, you also cater to client as consultant or outsourcing agents. He hires you to know the best way to control cost, do tax planning or do business within the ambit of regulators framework.

If you are a practising CA and had tried to hire a qualified person, you would understand what this next challenge is. Hiring and keeping qualified staff is one of the greatest tests and challenges of your professional career. Of course, the student who qualifies, would like to have best of the jobs in the market, with nice environment and lot of things to learn. So better put things in perspective and understand this difficulty.

Keeping pace with rapid 'Technical Updates' is another challenge. We need to remain on our toes on this front. E filing, shifting focus on IFRS and changing laws require continuous study and timely updation.

Vision

Many philosophers and thinkers have emphasised the importance of 'Dreaming Big'. A practising CA should also have a vision for future of his practice. The ultimate objective should be very clear in the mind. Specialisation and Professionalism may sound little theoretical, but any practice based on sound principles will have much better standing. It is important to translate that vision into numbers with realistic estimates.

Different Hats

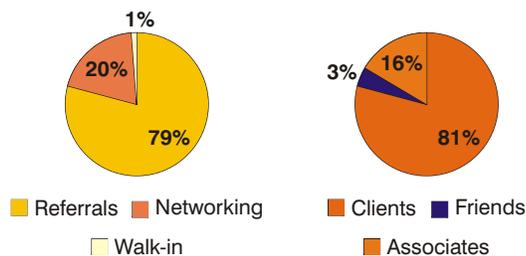
To run the practice in the future, you will have to manage it professionally. The time has come for even small practices to start putting value to the time. Various activities might be broken into functions of an office. Idea is to delegate the function and fix the responsibilities. Following is an example of division of the activities of a practice.

1. Growth
2. Client Servicing
3. Communication
4. Technical Update
5. Administration
6. Finance
7. IT / EDP
8. Human Resource

Please note that all the functions mentioned above are equally important. These are not in order or sequence. Though it might be seen broadly that first four are dealing with the external world and last four are inside functions of the practice. Let me discuss these functions one by one.

Growth

The time has come when you will need to make efforts to make practice grow. Recently, a survey was carried out to ascertain flow of business to a small CA practice. Result was that about 79 per cent of the business comes from referrals, 20 per cent comes from the networking and 1 per cent of the business comes from 'walk in clients'. And in the referrals, 81% of the business flows with reference of clients and 16 per cent flows in with referral of associates.



Client Servicing

We have seen that client is the most important factor in CA practice. In order to serve the client better, we need to understand our own strength. Even though the firm might be carrying out all activities, broadly one of the following areas may

be its core strength.

1. Assurance
2. Compliance
3. Business Advisory
4. Others



TABLE - 1

Client	Activity	October	Nov	Dec	Jan	Feb	March	Remark	Responsibility	Executive
	Accounts	Review	Review	Review	Review	Review	Review			
	TDS	Review	Review	Review	Review	Review	Review			
		Deposit by 7th	Deposit by 7th	Deposit by 7th	Deposit by 7th	Deposit by 7th	Deposit by 7th			
		Return Submit				Return Submit				
	Salary Structuring		Review			Review				
	FBT	Review				Review		Review		
		Deposit by 15th				Deposit by 15th		Deposit by 15th		
ROC	Annual Return Submit									

It is important to identify the strength and start focusing on developing that area. The time has come for the specialisation. If you have been assigned to carry out function of support to clients in regulatory compliances, a control chart can be prepared. An example is given in Table 1 above.

Communication

No words can explain the importance of effective communication. Be it communicating scope of work, writing reports, sending message to staff or remaining on the radar of your prospective clients, it ultimately boils down to how effective was your communication. In the office, there may be a person or a group of people, who takes care of communication internally as well as externally.

Technical Update

To share my experience, we generally have 'Friday Morning Class' in our office. Each Friday, the office starts 45 minutes earlier and either a guest, specialist in a subject or manager / partner takes a session on latest topics. There are also technical sessions among specific groups on upcoming issues. The ICAI too monitors this aspect of upgrading our knowledge by implementing CPE hour mechanism. New courses are being launched every now and then. Our country has never seen

such a seriousness and enthusiasm about enhancing technical knowledge in the past. There is a wonderful opportunity to become a specialist.

Administration

Administration is backbone of any organisation. The whole cosmos moves according to some rules. A professional firm cannot survive without good systems and processes. Be it monitoring time of coming to office or dress code, drafting letter or managing files, claiming expenses or minuting the meetings of staff or partners, defining rules and systems in writing is of utmost importance. Once systems start running the office, you will have time to think about growth and specialisation. Practical test is – How much time it takes to search a document paper or a file? If it is more than three minutes, you need to do something about it.

Finance

Finance function is generally critical one and managed directly by the owner. I am not trying to

convince you about delegating cheque signing authority. Rather I would like to highlight importance of putting value to the time and set priorities right. If you can monitor how much time has been spent on a client and you know value of that time, it will be easy to ask for proper fees from client. You will know when to walk away and what is the limit for accepting an assignment. A sample of time sheet, which is based on 15 days reporting, is given in Table -2.

The time may be divided into chargeable and non chargeable hours. Excel sheets are being used, which are easy to understand and easy to adopt. You may change the format according to your requirement.

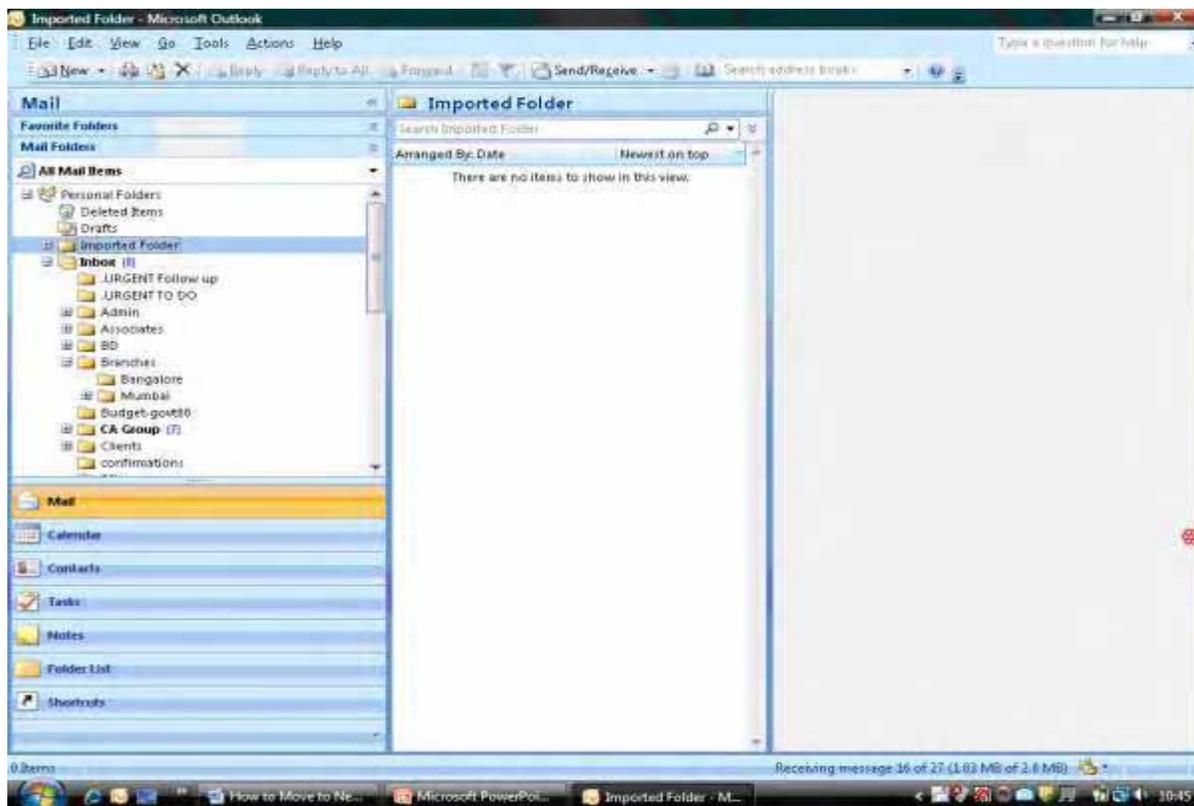
EDP

Now-a-days professional practice is highly dependent on IT. Maximum compliance requires

TABLE - 2

technical knowledge and use of technology, be it ROC or Income Tax. Traditional ways of paper filing etc. have lived their lives. Apply same test here. Try and find a mail. If it takes more than one minute, you need improvement. One example on how to manage your files is given in Table -3

TABLE - 3



The first challenge before the profession is to meet the growing expectations of society at large, which generally places a lot of trust on the financial statements signed by Chartered Accountants as Auditors. Second challenge is to satisfy the clients by providing value-added services. Hiring and keeping qualified staff and keeping pace with rapid technical updates are some other big challenges faced by the profession.



More clusters in your inbox create more confusion and time is wasted in searching and taking action. The rule of the game is, 'When you first time see a mail, take action then and there'. Either delete it, reply, forward to staff for action or shift to respective folder. Have separate folders for separate mails.

Human Resource

You might have prepared HR Manuals for your clients. Create one for your firm also, if not yet done. Define rules and policies. Staff will need that clarity. Transparency is the key factor for future. Even if it is a proprietorship firm,

satisfied and encouraged staff will always bring more business for you. Besides others, exit interview is a great tool to understand if there is scope of improvement in the office systems and to understand the need of the hour.

Conclusion

Despite all that is happening around us, if we can focus on building a professional practice keeping in mind future of profession, we are surely going to enjoy the next boom, which is inevitable. Remember the words of a very famous saying "Each difficult situation is an opportunity for those who see it."

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Young CAs have proved CAs are not prone to recession¹

The Committee for Members in Industry (CMII) of the Institute has successfully organised one more round of Campus Placement Programme during March-April 2009 at sixteen centres viz. Ahmedabad, Chandigarh, Coimbatore, Ernakulam, Hyderabad, Indore, Jaipur, Kanpur, Nagpur, Pune, Surat, Bangalore, Chennai, Kolkata, Mumbai and New Delhi for those candidates who have qualified in November 2008 examination. In all 3,842 candidates had the opportunity to avail this service. The bio-data of these professionals were classified centre-wise and they were given an opportunity to meet 95 interview boards of 54 organisations at sixteen centres.

Executive Summary of the Campus Placement Programme

1. Highest salary offered for International posting in the Campus Placement Programme is Rs. 23.00 lacs per annum.
2. Highest salary offered for domestic posting in the Campus Placement Programme is Rs. 9 lacs per annum.
3. Around 508 jobs were offered to the candidates who participated in Campus Placement Programme.
4. The average salary offered to the candidates is about Rs. 6.06 lacs per annum.
5. 54 companies have participated during the Campus Placement Programme.
6. 95 Interview Panels have participated during the Campus Placement Programme.
7. Financial Services (29.62%) is amongst the highest recruiter of all sectors, but sectors like Banking (20.00%), Oil & Gas Refining (11.90%), Engineering Procurement and Construction (8.10%), are also the major recruiters.
8. The Committee for Members in Industry brought out new publication "Handbook for newly qualified Chartered Accountants" to

enable the candidates to prepare for their Interviews.

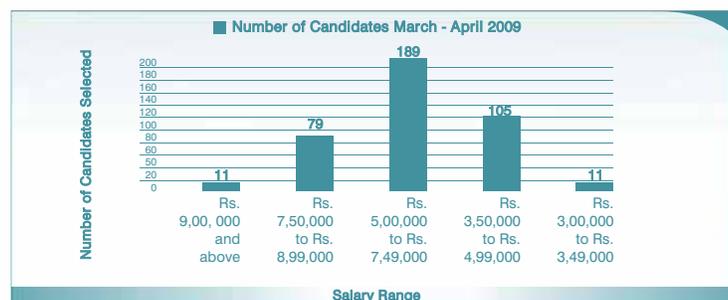
9. The Committee organised Orientation Programme for candidates to sharpen their soft skills and give updates on the Technical side.

We got heterogeneous recruiting entities both from abroad and India representing wide range of industries and sectors both from public and private. When institutions of international repute are finding it very hard to attract companies to their campuses to place their handful students, ICAI has proved itself as an important destination to recruit entry level finance, audit and compliance executives.

Trends in Salary Packages

In the March-April 2009 Campus Placement Programme the maximum salary offered to five candidates were Rs. 23.00 lacs per annum for International posting. For Indian posting the maximum salary offered to six candidates were Rs. 9 lacs per annum.

The average salary works out to be about Rs. 6.06 lacs per annum. Major details are as below:



¹ An executive summary on the Campus Placement Programme for newly qualified Chartered Accountants conducted by CMII during March-April, 2009. Comments are welcome at placements@icai.org particularly on further penetration of the Campus Placement System.

Top Five Recruiters during the March-April 2009 Campus Interviews

S.No.	Company Name	Selected
1	Jaypee Capital Services Ltd.	64
2	IOCL	40
3	SBI	34
4	Genpact	28
5	SIDBI	18
5.2	Power Grid Corporation Ltd.	18

Spreading Wings: There were 8 new entities who joined the Campus Placement Programme for the first time

S.No.	Company Name
1.	Amar Ujala Publications Limited
2.	Cairn India Ltd.
3.	DBOI Global Services
4.	Indian Railway Catering and Tourism Corporation Ltd.
5.	Krishak Bharati Co-operative Limited
6.	Power Grid Corporation of India Ltd.
7.	Sony India Software Centre
8.	Tehri Hydro Development Corporation Ltd.

For further details kindly visit <http://www.cmii.icai.org>

Top Ten Remunerations offered during the March-April, 2009 Campus Interviews

S.No.	Company Name	Remuneration Offered (Rs. in lacs P.A.)
1	Tolaram Corporation Private Limited	2300000 (International Posting)
2	SEBI	900000
3	Power Grid Corporation of India Ltd.	850000
4	Nestle India Ltd.	800000
5	Jaypee Capital Services Ltd.	750000
6	ONGC	750000
7	BPCL	720000
8	Rural Electrification Corporation Ltd.	700000
9.1	IOCL	668000
9.2	Credit Suisse India Pvt. Ltd.	650000
10	PWC	632500

Feedback from the candidates

Appreciation	Criticisms	Suggestions
<p>My heartiest thanks to CMII for conducting the Campus even in such meltdown environment. CA. Vipin Gupta, DEL-189¹ A vote of thanks to the entire team of CMII for successful arrangement of PPT and Orientation Programme. CA. Amardeep Kaur, DEL-642 The effort made by the members of CMII is really nice and commendable. Although the slowdown in the economy has somewhat affected the placement short listings, but nonetheless the efforts of CA. Vijay Kumar Gupta are quite generous. CA. Aman Ajmani, DEL-260 Everything was very well arranged & properly coordinated CA. Shubham Agarwal, IND-123 Very meticulously arrangement no need of more improvement but maintain the same spirit for the years to come. CA. G. Sravanthi, HYD-66</p>	<p>There should be one extra session on how can we participate in the activities of Institute or how can we serve the Institute on individual basis. CA. Vikrant Kumar, DEL-346 More Programmes should be held giving individual attention to freshly qualified CA (like Pilot Workshop at Delhi) at least 1-2 months in advance of Campus Placement Programme. CA. Alok Gulati DEL-541 The orientation should be more candidates oriented and not just revolving around some persons attending the programme like just praising somebody and just conducting. It should give more insight to participants that what they have to do in this crisis where more companies have not come for the campus, what the candidates not selected have to do, how they can get off-campus etc. need to be dealt. Also, the short listings should have been completed much earlier by companies and not till last minute, more private companies should have come, by that more people will get more placements. CA. Tejomurtula Ravi Kiran, CHE-376</p>	<p>Orientation should be conducted at least 15 days before the placement programme. CA. N. V. S. Koteswararao, HYD-73 Conduct orientation two or three days before interviews, so we shall get time to prepare interviews and able to apply the suggestions as given in orientation. CA. Jaya Gupta, KPR-6 There should be gap between orientation and interview so that we focus more on Interview concepts. CA. Koushma Charthanya Vunnam, HYD-158 Companies must give some more information about the job profile. Attendance should not be mandatory, boring session should be avoided, cultural program must be there. CA. Mamta Kwatra, Del-1032 Fees for participation for companies to be reduced so that more companies can participate 2) many companies revised shortlisting in last moment which created lots of problem for outsider participants 3) orientation program should be more practical rather than theoretical (plain vanilla speeches). CA. Akanksha Jain, BLR-32</p>

¹ DEL... denotes candidate appeared from Delhi Campus Interview centre. Similarly IND, PNE, HYD, KPR, MUM, CAL, CHE, BLR, JPR means Indore, Pune, Hyderabad, Kanpur, Mumbai, Kolkata, Chennai, Bangalore, Jaipur

»» 2.5 Lakh Jobs Back, Claims Government

A government study has thrown up a surprising finding – employment has revived in the last two months. The Ministry of Labour and Employment said that jobs had grown by 2.5 lakh by March 2009. Conducted in mid-April, the findings of the survey were withheld till now because of the Election Commission's Code of Conduct. The survey covered 3,192 units in 10 states. It visited key sectors like textile manufacturing, powerloom/handloom, IT and BPOs, automobiles, leather, metals, gems and jewellery, which contribute an estimated 60% of India's Gross Domestic Product, and over 16 million formal jobs. The survey did not study the informal sector, which employs an estimated 85% of India's workforce.

<http://www.hindustantimes.com/>

»» Economists Feel Revival Still a Couple of Quarters Away

Economists feel that recovery in industrial output and economic growth would happen towards the end of 2009. An economist, Robert Prior-Wandesforde, was of the opinion that there were a number of reasons to be positive about India's growth prospects. Individually, none of the factors might be hugely powerful, but collectively they have the capability to drive a recovery which would gain momentum in 2010. Economists Tanvee Gupta and Chetan Ahya said that they expected industrial production to start recovering gradually from June-July 2008 and achieve a growth of 6-7 per cent by March 2010.

<http://www.hindustantimes.com/>

»» No Service Tax on Renting Premises for Business: HC

Companies cannot be subjected to service tax for renting premises to run their businesses, the Delhi High Court has ruled while disposing of petitions filed by some retailers against a government directive. The court struck down Centre's notification, by which renting of immovable property for use in the course of business was brought within the ambit of service tax. "We hold that law does not in terms entail that renting out of immovable property for use in the course of furtherance of business or commerce would by itself constitute a taxable service and be eligible to service tax," Justice B D Ahmed said. The court passed the order on a number of petitions filed by corporate houses in retail sector, including Shopper's Stop, Lifestyle International and Fun Multiplex, challenging Finance Ministry's notification issued in 2007 by which rent was made taxable.

<http://cainindia.org>

»» India's Approach to Financial Sector Reforms Gradual: RBI

In the light of global financial meltdown, India's approach to financial sector reforms has been gradual, consistent and constant, Reserve Bank of India's Deputy Governor Rakesh Mohan said, adding that risks cannot be taken in a low-income country. The Central bank's tight monetary policies had helped in warding off the impact of a severe global recession in India, when the country witnessed huge capital outflows.

<http://economictimes.indiatimes.com>

»» India's National Election a Big Economic Stimulus Engine

India's month-long nationwide election, the world's largest exercise in democracy, could also be regarded as a big economic stimulus engine. Candidates and parties spent \$3 billion on everything, including transportation, advertising, celebrity endorsements and cash bribes over the course of the campaign, according to economists and political analysts. In comparison, the last United States presidential campaign cost an estimated \$2.4 billion. The campaign has plumped earnings at television stations, advertising agencies, florists, airlines, car companies and gas stations. It has added to the business for sweets manufacturers, priests and astrologers. Air travel and advertising make up the biggest expenses. Air time for television ads in particular has risen nearly 1,500 per cent since the last election as a result of the proliferation of televisions into the rural hinterlands. Many of the 400 million cellphone owners in India could hardly go a day without receiving messages of campaigns.

<http://www.nytimes.com>

»» India's Investment Promotion Very Weak: World Bank

A new World Bank group report suggests the website and inquiry handling by the Indian government's investment-promotion agency is very weak. The Global Investment Promotion Benchmarking 2009 report gives the rating to the Department of Industrial Policy and Promotion under India's Commerce Ministry in an appendix of its consolidated results without providing details. The report finds that over 70 per cent of government investment-promotion intermediaries miss out on investment and job-creating opportunities by failing to provide accurate and timely information to potential investors. The report shows that professional facilitation efforts do pay off. The Austrian Business Agency emerged as number one worldwide, based on the report's rankings. Middle-income countries are showing immense progress in competing for mobile investment, particularly Brazil, Botswana, Colombia, Lithuania and Turkey. Lower-income countries like Honduras and Sri Lanka offer strong facilitation services.

<http://economictimes.indiatimes.com/>

»» **Government Bailouts Bring International Public Sector Accounting Standards to the Forefront**

Robert L. Bunting, President of the International Federation of Accountants (IFAC), has said that convergence and implementation of international standards is needed to rebuild and sustain the global financial system. The IFAC is expediting the development of standards and guidance on key issues, such as going concern, fair value, financial instruments, and corporate governance. He has pointed out that Government bailouts of the financial and automotive industries are also resulting in calls for greater accountability and transparency on the part of governments, and governments can achieve this by adopting International Public Sector Accounting Standards (IPSASs).

<http://www.ifac.org/>

»» **IFAC's IPSASB Proposes New Guidance to Strengthen Financial Reporting by Governments**

The International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) is expanding its guidance in two significant areas: accounting for intangible assets and entity combinations. It has published two new exposure drafts (EDs)-ED 40, *Intangible Assets* and ED 41, *Entity Combinations from Exchange Transactions*, which propose important new guidance for professional accountants working in government and other public sector entities. The issuance of the exposure drafts is part of the IPSASB's global convergence programme that will substantially converge International Public Sector Accounting Standards (IPSASs) with International Financial Reporting Standards (IFRSs) approved on December 31, 2008. The project is scheduled for completion by December 31, 2009.

<http://www.ifac.org/>

»» **IFAC Releases 2009 Handbook of International Standards on Auditing and Quality Control**

The International Federation of Accountants (IFAC) has released the 2009 *Handbook of International Standards on Auditing and Quality Control*. The handbook can be downloaded free of charge from the IFAC online bookstore (www.ifac.org/store). The handbook brings together all the International Standards on Auditing and the International Standard on Quality Control that have been redrafted by the International Auditing and Assurance Standards Board (IAASB) to improve their clarity. It also includes a Glossary of Terms and the *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*. These become effective on December 15, 2009. This handbook replaces Part II of the 2008 *Handbook of International Standards on Auditing, Assurance, and Ethics Pronouncements*. Part I of the 2008 *Handbook of International Auditing, Assurance, and Ethics Pronouncements* will remain in effect during 2009.

http://www.ifac.org

»» **IASB sets out timetable for IAS 39 replacement**

The International Accounting Standards Board (IASB) has set out a detailed six-month timetable for publishing a proposal to replace its existing financial instruments standard, IAS 39 *Financial Instruments: Recognition and Measurement*. The IASB also announced the results of its 30-day accelerated consultation on the Staff Positions (FSPs) on fair value measurement and impairment published recently by the US Financial Accounting Standards Board (FASB). The IASB's comprehensive project on financial instruments responds directly to and is consistent with the recommendations and timetable set out by the Group of 20 (G20) nations at their meeting last month. The IASB will work jointly with the FASB to pursue the objective of a globally accepted replacement of the requirements on accounting for financial instruments. The guidance on fair value measurement issued by the FASB is consistent with existing guidance on IFRSs. The IASB will work with the FASB as part of its comprehensive project to ensure global consistency in impairment approaches.

<http://www.iasb.org/>

»» **US Relaxes Fair Value Rules**

The US standard-setter has relaxed fair value accounting rules for bank assets in a move that allows them to ignore market prices where the market for those assets is judged to be illiquid or distressed. In a bid to reduce pressure on banks carrying toxic assets on their balance sheets, the Financial Accounting Standards Board also voted to allow banks to book smaller losses on impaired assets that are listed for sale. US markets reacted strongly, welcoming FASB's decision. The cheer spread to the UK, where the FTSE 100 rose 4.3 per cent to 4,125 in the first time it has closed above 4,000 for more than a month. However, the move is likely to alarm investors who have argued that relaxing fair value accounting rules will make company accounts less transparent, and possibly misleading. Together, US banks hold trillions of dollars of mortgage-related assets, which have not been traded for 18 months

<http://www.accountancyage.com/news/>

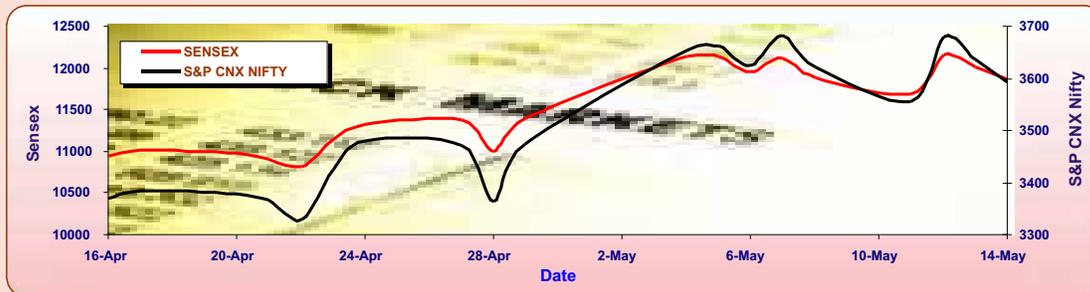
Economic Indicators



Indian Rupee vs. Major Foreign Currencies (April 16, 2009 to May 15, 2009)



Stock Markets



Selected Indicators

Item	Unit/Base	2008	2009					
		May 2	Mar. 27	Apr. 3	Apr. 10	Apr. 17	Apr. 24	May 1
Cash Reserve Ratio	per cent	7.75	5.00	5.00	5.00	5.00	5.00	5.00
Bank Rate	Per cent per annum	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Prime Lending Rate	Per cent per annum	12.25 - 12.75	11.50 - 12.50	11.50 - 12.50	11.50 - 12.25	11.50 - 12.25	11.50 - 12.25	11.50 - 12.25
Deposit Rate	Per cent per annum	7.50 - 9.00	7.75 - 8.75	7.00 - 8.50	7.00 - 8.50	7.00 - 8.50	7.00 - 8.50	6.50 - 8.50
Call Money Rate (Low/High)	Per cent per annum	4.75/7.50	2.25/5.00	2.30/5.75	1.25/4.00	1.50/3.75	1.75/4.30	1.20/3.40

Note: Readers are Invited to contribute write-ups or any relevant and interesting piece of information for this feature at eboard@icai.org.

Enhancing Audit Quality

Non-Compliance with Reporting Obligations observed by the FRRB

With a view to apprise the members of the Institute and others concerned about the major non-compliances observed during the review, the Financial Reporting Review Board compiles such non-compliances from time to time and publishes the same in the Journal of the Institute. Continuing the same practice, following are the some of the common non-compliances observed by the Board during review of general-purpose financial statements of certain enterprises and auditors' reports thereon:

Accounting Standards

AS 1, Disclosure of Accounting Policies

1. Some enterprises report significant amounts of income earned by way of interest, royalties, and dividend. However, they do not disclose their accounting policy adopted for reporting the same. This is not as per the requirement of paragraph 24 of Accounting Standard (AS) 1, *Disclosure of Accounting Policies*, which requires that 'All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed'.

AS 2, Valuation of Inventories

2. Paragraph 26 of the AS 2, *Valuation of Inventories*, dealing with disclosure requires that the financial statements should disclose:

- the accounting policies adopted in measuring inventories, including the cost formula used; and
- the total carrying amount of inventories and its classification appropriate to the enterprise.

In contravention to AS 2, some enterprises do not disclose the method of valuation of inventories i.e. whether FIFO/ LIFO or other method in their accounting policy on Inventories. Other enterprises simply state that the value of inventory is determined by using FIFO or Specific

Identification method as applicable. The usage of term 'as applicable' is not correct. Such general statement on the method of valuation seems to be ambiguous. The enterprise should specifically state the method of valuation for each class of inventory viz. raw material and components, work in progress, finished goods, stores and spares, and loose tools.

AS 9, Revenue Recognition

3. Accounting Standards Interpretation (ASI) 14, *Disclosure of Revenue from Sales Transactions* (Re. AS 9, Revenue Recognition), requires that the amount of turnover should be disclosed in the following manner on the face of the statement of profit and loss:

Turnover (Gross)	xx
Less: Excise Duty	xx
Turnover (Net)	xx

Some enterprises disclose sales (net of excise duty) on the face of the profit and loss account and the amount of excise duty is shown as deduction from sales in the Schedule to the profit and loss account, which is contrary to the Accounting Standards Interpretation (ASI) 14.

AS 13, Accounting for Investments

4. The balance sheet of certain enterprises shows the Investments as part of their assets and classifies the same as per the requirements of Schedule VI of the Companies Act, 1956. However, they do not disclose any accounting policy regarding the Investments, which is not as per the requirements of AS 1 and AS 13. It may be mentioned that as per paragraph 24 of AS 1, *Disclosure of Accounting Policy*, 'All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed'. Further, as per clause (a) of paragraph 35 of AS 13, *Accounting for Investments*, along with other disclosure an enterprise is also required to state the accounting policy adopted for determination of

carrying amount of both the long-term investments as well as current investments.

5. Some enterprises in their balance sheet classify the Investments as per the requirements of Schedule VI of the Companies Act, 1956 but do not classify these Investments as per the requirement of clause (b) and clause (e) of paragraph 35 of AS 13, *Accounting for Investments*, either in the Schedule 'Investments' or in the notes. It is not as per the requirement of AS 13. It may be noted that as per paragraph 35(b) and 35(e), an enterprise should disclose current investments and long term investments distinctly in its financial statements and the aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments, respectively.

AS 19, Leases

6. Some enterprises, while complying with the requirements of paragraph 22 of AS 19, *Leases*, disclose the information required by clause (a) to (e) of paragraph 22 of AS 19, however, they do not disclose general description of the lessee's significant arrangements as required by paragraph 22 (f) of AS 19. It may be mentioned that the disclosure requirement under clause (f) is also an important requirement and therefore the lessee should disclose, amongst the other disclosures of paragraph 22, a general descriptions of the lessee's significant arrangements including, but not limited to, the following:

- a. the basis on which contingent rent payment are determined;
- b. the existence and terms of renewal of purchase options and escalation clauses: and
- c. restrictions imposed by lease arrangements, such as those concerning dividends, additional debts, and further leasing.

(to be continued...)



ACCOUNTANT'S BROWSER

“PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE”

Index of some useful articles taken from Periodicals/Newspapers received during April - May 2009 for the reference of Faculty/Students & Members of the Institute.

1. ACCOUNTING

Accounting for Financial Instruments & Derivatives, Part-2 by Raghu Iyer. *BCAJ*, April 2009, pp. 9-16.

Are Financial Statements Meaningful Under Exchange Rate Fluctuations?: Financial Analysis by J.P. Nance & R.A. Roemmich. *Journal of Financial Management & Analysis*, Vol. 21/2, 2008, pp. 65-74.

Financial Reporting by Private Enterprises: Part – 2 by Stephen Spector. *CGA Magazine*, March-April 2009, pp. 36-37.

GAPs in GAAP – AS-7 Percentage of Completion Accounting Based on an Output Measure by Dolphy D'Souza. *BCAJ*, April-2009, p.75.

IAS 16, Property, Plant & Equipment A Closer Look by K.S. Muthupandian. *The Management Accountant*, April 2009, pp. 281-285.

Implications of IFRS on Accounting for Mergers & Acquisitions by Santosh N. by *The Management Accountant*, April 2009, pp. 304-305+309. Observations on Measuring the Differences Between Domestic Accounting Standards & IAS by Christopher W. Nobes. *J. Account. Public Policy*, Vol. 28, 2009, pp. 148-153.

2. AUDITING

Bank Audits: Crash Investigators by James Essinger. *Accountancy*, April 2009, pp.28-30.

Effective Functioning of Audit Committee at this Time of Global Crisis by R. Balakrishnan. *Chartered Secretary*, April 2009, pp.435-439.

Mandatory Audit Firm Rotation: Fresh Look Versus Poor Knowledge by Tong Lu & K. Sivaramakrishnan. *J. Account. Public Policy*, Vol. 28, 2009, pp. 71-91.

Public Audit: A Powerful Instrument Turned Blunt by Meeta Rajivlochan. *Eco. & Pol. Weekly*, April 18, 2009, pp. 31-32.

The Satyam Story: Many Questions & A Few Answers by James E. Post etc. *Vikalpa*, Jan.-March 2009, pp. 69-88.

Work Culture Audit: A Breakthrough for Educational Institutions

by Ram Prahlad Choudhary. *PR Communication Age*, April 2009, pp.13-15.

3. ECONOMICS

India- Managing the Impact of Global Financial Crisis by D. Subbarao. *RBI Bulletin*, April 2009, pp. 529-536.

Impact of Globalization on Small Scale Industry (SSI) by Gautam Bandyopadhyay etc. *The Management Accountant*, April 2009, pp. 268-273.

Productivity & Unit Labour Cost in Indian Manufacturing: A Comparative Perspective by Abdul Azeer Erumban. *Eco. & Pol. Weekly*, April 11, 2009, pp. 39-48.

4. INVESTMENT

Anti-Competitive Effect of Mergers, Amalgamation & Takeover by Bharat Budholia. *CLC*, Vol. IV, 2009, pp.141-151.

Impact of Globalization in Indian Financial Markets with Special Reference to Indian Banking Industry: A Meta Analysis by A.S. Pandey. *Synergy: ITS Journal of IT & Management*, Vol. 7/1, pp. 81-105.

Securities Laws: Mandatory Disclosure of Pledged Shares by Promoters by Kaushik Mukherjee. *SEBI & Corporate Laws*, April 13-19, 2009, pp. 38-42.

Securities Laws: Most Convenient Way of Raising Finance & Improving the Debt Equity Ratio by Kaushik Mukherjee. *SEBI & Corporate Laws*, April 6-12, 2009, pp.1-14.

Shareholder Activism – A Necessity to Prevent Corporate Frauds by Kanika Sanwal & Shreevidhya K.R. *CLA*, Vol.89, 2009, pp.79-86.

5. LAW

Corporate Criminal Liability & Liability of Directors for Company's offences? – Part II by K.R. Chandratra, *CLC*, Vol. IV, 2009, pp. 125-128.

Inconclusive Provisions on Depreciation in the Companies Act by M.L. Bhakta. *CLA*, Vol.89, 2009, pp.69-78.

Rajaratnam's Corner Power of Precedents by S. Rajaratnam. *Consolidated Commercial Digest*, 01.05.2009, pp.3-5.

6. MANAGEMENT

Ethics in Corporate Social Responsibility- A Positive Approach by Renny Corera. *Chartered Secretary*, April 2009, pp. 425-426.

Recession Survival Guide by Peter Steidl. *Intheblack*, April 2009, pp.38-41.

Reinstating the Self-help Group Perspective in Microfinance by R. Vijay Kumar. *Eco. & Pol. Weekly*, April 11, 2009, pp. 68-69.

Risk Management – Case Study by Vishnu Kanhere. *BCAJ*, April 2009, pp. 77-79.

Service Tax Liability of Charitably-run Educational Institutions – The Controversy by V. Sundararajan. *Consolidated Commercial Digest*, 01.05.2009, pp. 6-8

Target Costing—An Effective Tool to Target Business by Mukesh Chauhan & Shivani Gupta. *The Management Accountant*, April 2009, pp.296-303.

7. TAXATION & FINANCE

Changes in TDS Credit & Remittance Provisions by V.K. Subramani. *Corporate Professionals Today*, April 16-30, 2009, pp.787-790.

E-Commerce & Taxation by Dayana M.K. *CAPJ*, April (ist), 2009, pp. 33-46.

Goodwill as an Intangible Asset is Eligible for Depreciation? by T. N. Pandey. *Chartered Secretary*, April 2009, pp. 430-432.

Merger of Business Tax into VAT in China by Xiaoqiang Yang. *International Vat Monitor*, March-April 2009, pp.120-123.

Run up to Elections – Contributions to Political Parties (Allowances Under the Companies & Income-Tax Laws) by T.N. Pandey. *Corporate Professionals Today*, April 16-30, 2009, pp.794-804.

Transfer Pricing – An International Taxation Issue Concerning the Balance of Interest Between the Tax Payer & Tax Administrator by Sayantan Gupta. *Company Law Journal*, Vol. 2, 2009, pp. 40-59.

Waiver of Commercial Loan – A Benefit Without any Tax Hazard by Minu Agarwal. *CTR*, April, 2nd, 2009, pp. 109-114.

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

Women Steering Group - The Voice of Women CAs

The world celebrated International Women's Day on 8th March, a day dedicated to the political, economic and social achievements of global women. In India too, women have come a long way. With the transition from pastoral society to contemporary information and global society, the role of women in the country too has changed drastically. The role of a typical *Grihani* (house wife) who catered to all the needs of the households, including the rearing and upbringing of children in various sub-roles of daughter, daughter-in-law, wife, mother, aunt etc. has been played quite efficiently by the Indian women. However, the continuity of changes in socio-economic and psycho-cultural aspects of human living has influenced the role of Indian women.

With the process of Industrialization, Modernization and Globalization showing its deep impact on the human society all over the world, the role and responsibilities of women has attained new definition and perspective. Further, this has also led to addition of responsibilities and has widened the role of women who now also shares the financial responsibilities. Today, women are playing leading roles in every sector and every sphere of life, be it politics, service, finance or even entrepreneurship. This accomplishment has come after a long period of struggle. However, much remains to be done.

In the words of Robert Kennedy, *"Each time a (human being) stands up for an ideal, or acts to improve the lot of others, or strikes out against injustice (he/she) sends forth a tiny ripple of hope, and crossing each other from a million different centres of energy and daring, these ripples build a current that can sweep down the mightiest walls of oppression and resistance"*.

The same applies to the Women Steering Group (WSG) of the Institute of Chartered Accountants of India.

Women Steering Group came into existence in the Diamond Jubilee Year of the ICAI. This group was formed by the thoughtful and visionary President of ICAI, CA. Uttam Prakash Agarwal marking the International Women's Day this year. Women Steering Group has been conceptualized to provide a platform within ICAI to act as the voice of women in the account-

ing profession. It is a group devoted exclusively to the support and professional development of women Chartered Accountants and students.

The vision of ICAI to launch WSG is brought out very clearly in its Mission Statement which flows as follows:

"The Women Steering Group of the Institute of Chartered Accountants of India (WSG of the ICAI) is a wing of ICAI which is dedicated to serving women Chartered Accountants and female students aspiring to be the members of the ICAI. The WSG will provide a supportive environment and valuable resources for female members and students to achieve their personal and professional goals through various opportunities including leadership, networking and education."

To accomplish the mission, WSG offers in-depth support in four important areas:

- 1) Increase Professional and Public Awareness about the Indian Women Chartered Accountants.
- 2) Facilitate a national network of individuals and organizations to encourage networking and mentoring of women members.
- 3) Provide opportunities for professional growth.
- 4) Advocate professional parity.

WSG have a significant duty to be successful. If we say that out of an estimated total of 1,50,000 CAs in our country, we only have 15% women CAs, and out of 4,50,000 students' base, we have nearly 40% women student base, then the road ahead demands absolute focus, determination and the strengthening of the WSG as a vehicle to promote the accounting profession amongst women in particular.

The WSG is bound to act as spur to the growing number of women to embark on an accountancy career with the following objectives:

- **Awareness:** To create an awareness of the profession and provide support to aspirant and qualified Women Chartered Accountants.
- **Enabling Environment:** To achieve the outputs related to raising community demand for quality professional services through women empowerment.
- **Capacity Building and Mobilization:** To mobilize women group and build their capacity to act as change agents in the community by creating and

- maintaining a database with profiles of Women CAs.
- **Sustainability:** To ensure sustainability of the process of women empowerment.
- **Woman Development [Knowledge, Aptitude and Skill – Role Strengthening]:** To enhance level of understanding and maturity of women in respect of their role in social system and to recognize the achievements of Women Chartered Accountants.
- **Facilitate:** To facilitate the advancement of Women CA's involvement in broad aspects of business at all levels and to facilitate the appointment of suitable Women CAs to key positions as strategic decision makers.
- **Support:** To align with and support organizations with similar objectives in advancing aspirant Chartered Accountants and to conduct support programs for qualified Women CAs through mentoring, information sharing and workshops.

To achieve the above stated objectives and to inspire and motivate female Chartered Accountants and students to realize their full leadership potential, WSG is organizing professional, educational and networking events, including its first major initiative which is a conference titled "Women in Accountancy Profession" on 29th June at India Habitat Center, New Delhi. The detailed information in respect to the same is available at www.icai.org

As we are all aware that the corporate world is very overwhelming and overpowering, it has the ability of

changing one's values and beliefs, and destroying the loving and caring nature women have. WSG encourages all women professionals to participate in this young democracy, where the emphasis lies to realize who we are — women, feminine, accomplished, professional, helpful and effective.

Women Steering Group aims to act as a Voice of women professionals to bring them in the mainstream, nurture the talent of young CA students and other women members of the Institute by providing them necessary guidance, leadership and networking skills to ensure their progress.

As is famously said,

*Your own words are the bricks and mortar
of the dreams you want to realize.*

*Your words are the greatest power you have.
The words you choose and their use establish the life you
experience.*

In this journey that WSG has commenced, the group seeks support of the entire fraternity of Women CAs and students to work towards their capacity building and to position them as competent, capable, collaborative partners in all facets of professional and allied activities. For all other details in respect to this Group one can visit www.icai.org or can e-mail their ideas, suggestions at wsg@icai.org

Announcement from Public Finance Committee



The Committee on Public Finance constituted by *The Institute of Chartered Accountants of India* requires faculty to deliberate in Meetings and Seminars on various economic issues i.e. Outcome Budget, Accrual Accounting, Deficit Financing, Fiscal and Revenue Deficit, Public Finance and Debt Management.

The Committee also invites authors, researchers and faculty having interest to contribute articles in different areas of Public Finance. Published articles will be suitably rewarded.

Those desirous may please contact at the following address :-

The Chairman, Committee on Public Finance
The Institute of Chartered Accountants of India
ICAI Bhawan, Indraprastha Marg, New Delhi – 110 002
Mobile No. : 098300 22848

Email : subodhka@yahoo.com; subodhka@gmail.com; pfc@icai.in

CORRIGENDUM

Readers are hereby informed that the email ID of the author of the article titled 'Chartered Accountancy and Bharathanatyam', published on May 2009 issue of *The Chartered Accountant* journal, is subhashini.giridhar@icai.org and not what has been printed in her article. The typographical error is regretted.

Important Council Decisions – Transfer of Articles

[Repeat of the Announcement hosted on website on 27-03-2009]

The following decisions taken by the Council of the Institute are brought into force immediately for compliance by the Students/ Members concerned. It is advised that required compliance be made by the concerned students / members. It may please be noted that non-compliance will be viewed seriously and proceeded against accordingly.

- a) The coaching classes shall not continue after 9.30 a.m. or start before 5.30 p.m. so as to enable the articled/audit assistants to concentrate wholly on practical training.
- b) Members of the Institute who are engaged in coaching be advised not to undertake coaching between 9.30 a.m. and 5.30 p.m.
- c) An articled assistant should undergo practical training in accordance with the guidelines of the Institute between 10.30 a.m. and 5.30 p.m. During the period an articled assistant shall not be permitted to attend colleges/other institutions for graduation or any other course.
- d) Every articled/audit assistant shall submit once in a year a specific declaration duly countersigned by the Principal to the effect that he is regularly attending training and his college hours do not clash with his articles timings and that no coaching is undertaken by him between 9.30 a.m. and 5.30 p.m. on any working day. In the event of breach of this guidelines and not taking permission as required, the articles already undergone shall be derecognised for such period as the Institute may decide.
- e) Every articled/audit assistant shall be required to maintain mandatorily the Work Diary in the Form to be prescribed by the Board of Studies.
- f) The Institute to call for at random training report along with attendance record and stipend details and also Work Diary maintained by articled/audit assistant from any member/ firm in respect of any articled assistant at any point of time during the period of practical training for verification.
- g) In case an articled assistant is found not undergoing articles in the manner prescribed he shall be debarred from appearing in the exam up to 3 consecutive exams besides cancellation of such period of articles. The concerned member who allowed such an articled assistant be subject to punitive action besides withdrawing either partly or fully his eligibility to train articled assistant. In Peer Review the Reviewer be required to verify whether training is imparted to the articled assistant in the manner prescribed.
- h) No request for termination of articles is entertained from any articled assistant in general and more particularly during the first six months and also during the last twelve months of articles except as provided in the Regulations and as specified herein below:
 - i. No request of an articled assistant for termination (transfer) of articleship shall be considered unless his/her working parent(s) is/are transferred from the city/place where the articled assistant is receiving training to another city and a copy of transfer order/proof is submitted to the principal in proof thereof. On such termination the articled assistant concerned shall join articles training in and around the place of posting of his/her parent(s) and shall not re-register articles in the same city or within 50 Kms radius of the city where he/she has undergone articles prior to such termination.
 - ii. If the articled assistant is not able to serve the articleship for specified genuine medical reasons thereby opting to discontinue the CA course for a period of at least three months, the termination of articles be permitted, provided that the medical grounds are such that warrant termination of Articleship.
 - iii. In the event of misconduct involving moral turpitude, gross negligence or unsatisfactory performance of the articled assistant, his articles shall be liable to be terminated by his principal besides being cancelled or extended for such period as may be decided by the Institute. Board of Studies to decide and enumerate the acts constituting misconduct.
 - iv. Termination of articles be permitted on such other justified circumstances as may be deemed genuine by the Council.
In the event of termination, his articles shall not be registered in the same city.
- i) While forwarding the Form No. 109 the principal shall state specifically the clause (the relevant clause mentioned above) under which the articles have been terminated.

Secretary, ICAI

27th March, 2009

Certificate Course on Valuation at Delhi & Mumbai Centres



A certificate course on valuation was launched by the Corporate Laws Committee in compliance of the decision of the Council of the Institute of the Chartered Accountants of India. In the light of the emerging diversities & complexities in valuation jobs, the course has been designed to empower the members to be the leaders in the global service market. The course is targeted at the members and the students who have cleared their CA. Final examinations.

Course Objective & Thrust Area

The objective of the course is to enable the members to gain acumen, deeper understanding & expertise on valuation job. Apart from comprehensive theoretical aspects, this course, first of its kind in India, will sharpen the knowledge and excellence of the members through multiple case studies across the industry and service sector in Valuation, Strategic Financial Management and CrossBorder transactions, etc.

Achievements

The First batch of the course has already been conducted and 167 participants out of 172 have successfully qualified. Looking at the overwhelming response of the members, the Second Batch for the course at Delhi & Mumbai Centres will start from the first week of June, 2009. Registrations for the second batch of the course are ongoing and will be on the first come first serve basis.

Course Duration

The total duration of the course is 300 hours as follows;

- | | |
|--------------------------------|-------------|
| 1. Self study | : 200 hours |
| 2. Classroom teaching | : 50 hours |
| 3. Preparation of case studies | : 50 hours |

The classes of the course will be schedule on alternative Saturdays & Sundays.

Course Fees

Rs. 25,000/- per delegate only, payable online or by DD/Pay order drawn in favour of the Secretary, ICAI, payable at Delhi.

Further details & Registration Form Links

All relevant details of the course and registration form have been hosted on the website of the Institute at www.icai.org/post.html?post_id=219. The filled up form along with requisite fee can be sent to the following address;

The Secretary,
Corporate Laws Committee, 4th Floor, Legal Section, P.B. No. 7100, Indraprastha Marg, The Institute of the Chartered Accountants of India New Delhi-110 002

Locations

Delhi & Mumbai

The dates and the Venues for both the Centres will be announced shortly.

Further Assistance

National Course Director

CA. Vinod Jain, FCA
Chairman, Corporate Laws Committee
E-mail: vinodjainca@gmail.com

Course Technical Director

CA. Avineesh Matta
Mobile: 09811052264
E-mail: matta@ava-ca.com

Course Co-ordinator

Sh. S. K. Garg
Secretary, Corporate Laws Committee
Mobile: 09350852388
E-mail: skgarg@icai.in

CPE Requirement and Guidance for Checking CPE Hours (Structured/Unstructured) independently in PC

The underlying principle for making CPE hours requirement mandatory was to ensure the systematic maintenance, implementation and broadening of knowledge and skills, and the development of personal qualities necessary for executing professional and technical duties throughout the individual's working life.

With that endeavour, the CPE Committee categorized the members based on their COP status/residential address/age and devised norms in the form of Structured/Unstructured Learning Activities with a mission to ensure compliance of CPE hours voluntarily by all the members of ICAI, to keep pace with the IFAC recommendations/requirements.

Now members can view/check their CPE credit hours (Calendar year wise) on the site www.cpeicai.org, maintained internally by the EDP Section, at the member login (not POU Login) for which they need to insert Six (6) digit membership number (add zero (0), if required) and password would be that (6) digit membership number prefixed with the letters (cpe)

Comments/suggestions/clarifications, if any, may please be sent to the CPEC Secretariat at madhu@icai.in with cc. to bansal@icai.in/ghosh@icai.in.

Requirement for 2008

20 hours (Structured) for COP holders below 60 years of age; 10 hours (Structured/Unstructured) for COP holders above 60 years of age and for non-COP holders below 60 years of age as well as for members residing abroad (whether holding COP or not); 5 hours (Structured/Unstructured) for non-COP holders above 60 years of age.

Chairman
Continuing Professional Education Committee



Multipurpose Empanelment Form 2009-10

Respected Professional Colleagues,
Multipurpose Empanelment Form for the year 2009-10 has already been hosted on www.meficai.org. **Last date of submission of form is 15th June 2009.** Members are advised to fill MEF well in advance to avoid last minute rush. In case, an applicant faces any problem in accessing, operating or submission of MEF, complaint may be lodged by accessing [complaint-box link available on http://www.meficai.org/complaints/complaint_enrt_y_enter.jsp](http://www.meficai.org/complaints/complaint_enrt_y_enter.jsp). A hard copy of the Declaration duly signed by all partners/ proprietor/ member

practising in individual name accompanied by a print of the e-mail acknowledging submission of MEF must be sent to ICAI by courier/speed post/hand delivery at
Director, PD Directorate,
The Institute of Chartered Accountants of India,
ICAI Bhawan, P. B. No. 7100, Indraprastha Marg,
New Delhi – 110 002 in an envelope superscribed with the words "DECLARATION FOR MEF 2009-10" so as to reach on or before 30th June, 2009.

Chairman,
Professional Development Committee



Announcement regarding working hours of the Articled Assistants

[Repeat of the Announcement hosted on the website on 29-03-2008]

The Council has considered the issue regarding the working hours of the articled assistants. The Council is of the view that the article training is an important part of the CA curriculum and the same needs to be carried out in accordance with the scheme framed by the ICAI in this behalf. Accordingly, to clarify the doubts being raised by various quarters about the working hours of the articled assistants and for pursuing graduation/ other course, the Council decided to issue the following directions:-

1. The articled assistants should undergo practical training in accordance with the Chartered Accountants Regulations, 1988 as explained hereinafter.
 - i. The working hours for the articled assistants shall be 35 hours in a week excluding the lunch break.
 - ii. The office hours of the Principal for providing article training to the articled assistants shall not be generally before 9.00 a.m. or after 7.00 p.m.
 - iii. The normal working hours for the articled assistants shall not start after 11.00 a.m. or end before 5.00 p.m.
 - iv. The working hours for the articled assistants should not exceed 35 hours in a week excluding the lunch break and normally an articled assistant be required to work during the normal working hours fixed for articled assistants.
 - v. In case of the exigencies of work with the Principal, an articled assistant may be required to work beyond his/her normal working hours. However, under such circumstances, the aggregate number of working hours shall not exceed 45 hours per week. The requirement to work beyond 35 hours in a week should not be a practice but only in exceptional circumstances. Further, where the articled assistant is required to work beyond normal working hours, and aggregate of such hours exceed 35 hours per week, he/she shall be entitled to compensatory leave calculated with reference to number of completed working hours, over and above, 35 hours per week.
 - vi. The facility of allowing flexible office hours stands withdrawn.
2. During the working hours, the articled assistant is not permitted to attend college/other institutions for pursuing any course including



graduation. Accordingly, college timings of such course should not be such (after taking into account the time required to commute) which clashes with the normal working hours of the article training.

3. To ensure that the working hours do not clash with the graduation or any other course, if any pursued by the article assistant, each articled assistant registered on or after 1st April, 2008 shall now be required to obtain specific permission from the ICAI for pursuing graduation or other course as permitted under the Chartered Accountants Regulation by submitting Form No.112, within one month from the date of joining the college or course to the ICAI.
4. The articled assistant presently registered and undergoing graduation or any other course and who have not obtained specific permission shall be required to obtain the specific permission from the ICAI by submitting Form No. 112 within six months of issue of these guidelines i.e. by 30th September, 2008. However those students who have already obtained the specific permission by submitting Form No. 112, need not obtain it again and the permission so granted shall continue to be valid.
5. The Certificate in Form No. 112 indicating college timings etc. shall be counter-signed by the concerned Principal of the college with the seal and stamp of the College and also indicating the telephone number/s and full address of the College.
6. In case a student does not comply with the above requirements or violates any of the above guidelines, his/her articleship period shall not be recognised.
7. In this connection, attention is invited to the Regulations 65 and 66 read with Regulation 60 of the Chartered Accountants Regulations, 1988 which provide as under:-

Regulation 60: Working hours of an Articled Clerk

“Subject to such directions as may be issued by the Council, the working hours of an articled clerk shall be 35 hours per week to be regulated by the Principal from time to time”.

Regulation 65: Articled clerk not to engage in any other occupation

“Without the previous permission of the Council, obtained on application made in the *approved form, no articled clerk shall, during the period of his service as an articled clerk, take any other course of study or training, whether academic or professional, or engage in any business or occupation.”



Regulation 66: Enquiries against articled clerk

“(1)Where a complaint or information of any misconduct or breach of Regulation 65 or breach of any of the covenants contained in the articles is received against an articled clerk from his principal or any other person, the President

or the Vice-President as the Executive Committee may decide from time to time, may cause an investigation to be made.

- (2) The Executive Committee may, on a consideration of the report of the investigation and after giving the articled clerk an opportunity of being heard, make any of the following orders, namely;–
 - i. direct that the papers be filed and the complaint be dismissed, if the Executive Committee finds that the articled clerk is not guilty of any misconduct of breach of Regulation 65 or breach of any of the covenants contained in the articles; or
 - ii. if the articled clerk is found guilty, reprimand the articled clerk or cancel the registration of articles or direct that any period already served under such articles shall not be reckoned as service for the purpose of the period of practical training specified in Regulation 50.
- (3)The articled clerk, the registration of whose articles has been cancelled under this regulation, shall not, except with the permission of the Executive Committee be retained or taken as an articled clerk or audit clerk by any member”.

Invitation of Comments for Trade Policy Reviews at WTO

Surveillance of national trade policies is a fundamentally important activity running throughout the work of the WTO. At the centre of this work is the Trade Policy Review Mechanism (TPRM). The reviews take place in the Trade Policy Review Body which is actually the WTO General Council — comprising the WTO's full membership — operating under special rules and procedures. The objectives of the TPRM include facilitating the smooth functioning of the multilateral trading system by enhancing the transparency of Members' trade policies. Trade Policy review of the following countries shall be due during the current year:-

New Zealand	Morocco	Guyana	Zambia
South African Customs Union		Chile	
Maldives	Niger/Senegal	El Salvador	
Georgia			

The Members are requested to inform us of any policy measures taken by any country, as aforesaid, that may inhibit or hamper access of Indian services in the Accountancy sector to its markets so that the same could be taken up with the Government of India which could take up the issue at the TPR meetings at the WTO. May please also let us know your concerns in respect of the Accountancy services for the aforesaid countries at ctlwto@icai.org



Chairman,
Committee on Trade Laws and WTO

ENHANCED PROFESSIONAL DEVELOPMENT PORTAL

www.pdicai.org

- ▶▶ The Professional Development Committee has enhanced and upgraded the PD portal, www.pdicai.org, with a view to provide timely and necessary information on practice development and professional opportunities to the members. In its four years of existence the PD portal has proved to be a great success and is very popular amongst the members with almost 47,000 registered members as on date.
- ▶▶ The Institute of Chartered Accountants of India has launched the PD Portal which aims to be a 'one stop knowledge source' for a member, containing an easy and coherent route to all the online information and services relevant to their profession and the economy as a whole.
- ▶▶ The portal meets a growing requirement of the easy access to the wealth of information available with various print and electronic media saving the precious time of the members. This information is researched and filtered by a team of professional Chartered Accountants so that relevance of the information is assured.
- ▶▶ To make the PD portal more and more useful and interactive, we monitor the various sections of the portal and the news articles which members are reading on regular basis. This gives us a broad view of the preferences and usage patterns of our members. We use this information to improve our website design, content and primarily to give our members a better browsing experience.
- ▶▶ Based on the various suggestions of the members and the usage statistics, we have introduced many new sections and have added more functionalities to our most frequented and interactive section Member's Forum. We have added new sections like Bills and a Blog where members can post their views on the various news.
- ▶▶ The portal aims to link the members through a common platform where they can express their professional concerns and discuss the same with fellow members across the world.
- ▶▶ The PD portal consists of the following categories classified under different heads from a professional's perspective.

1. Commercial

- RBI
- SEBI
- DTAA
- Finance Bill(s)
- Financial Newspaper Headlines
- Others important news

2. Central Laws

- Direct Tax
- Indirect Tax
- Corporate Laws
- Other Relevant Laws

The amendment in acts and changes in rules, new circulars and notifications with press notes issued in by the Government Agencies are pertaining to the above will be hosted.

3. State Laws

- Local Sales Tax / VAT
- Octroi
- Excise Rules
- Other State specific laws

4. Professional Opportunities

- Tenders
- Seminars/Special Events
- Current Significant Topics

5. Professional Forum

- The portal will also offer an **Online Professional Forum** wherein the users can submit their queries which are replied by fellow professionals.



Your suggestions are invited for the improvement of this portal. You can send the same to CA. Anuj Goyal, Chairman, Professional Development Committee at anujgoyal@icai.org and anujgoel28@sify.com or send your views to PDC Secretariat at pdc@icai.org

Information Systems Audit (ISA) Course Assessment Test, June 2009

To be Published in Part III Section 4 of The Gazette of India
Notification

5th May, 2009

No.13-CA(EXAM)/ISA/J/2009:- In pursuance of Rule 7 of Schedule 'F' to Regulation 204 of the Chartered Accountants Regulations, 1988 (as amended vide Notification No. 1-CA(7)/59/2001 dated 28th September 2001), the Council of the Institute of Chartered Accountants of India is

pleased to notify that the Information Systems Audit (ISA) Course Assessment Test will be held on **20th June, 2009 from 10.30 a.m. to 2.30 p.m.** at the following centres provided that sufficient number of candidates offer themselves to appear from each centre as detailed below.

1	Agra	10	Chandigarh	19	Jaipur	28	Pune
2	Ahmedabad	11	Chennai	20	Jalgaon	29	Raipur
3	Aurangabad	12	Dehradun	21	Kanpur	30	Rajkot
4	Bangalore	13	Delhi	22	Kolkata	31	Salem
5	Bareilly	14	Durg	23	Lucknow	32	Surat
6	Bhilwara	15	Ernakulam	24	Ludhiana	33	Vadodara
7	Bhopal	16	Ghaziabad	25	Mumbai	34	Varanasi
8	Bhubaneswar	17	Goa	26	Nagpur		
9	Bikaner	18	Hyderabad	27	Nashik		

The Council reserves the right to withdraw any centre at any stage without assigning any reason. The above Test is open only to eligible Members of the Institute who are already registered with the Institute for the said course. The fees payable for the above Assessment Test is Rs. 1000/-.

Payment of fees for the Assessment Test should be made only by Demand Draft. The Demand Draft may be of any Scheduled Bank and should be drawn in favour of "The Secretary, The Institute of Chartered Accountants of India, payable at New Delhi" only. Application together with the prescribed fee be sent so as to reach the Additional Secretary (Exams) at New Delhi on or before **3rd June 2009**.

Applications for admission to the Assessment Test is required to be made in the prescribed form which may be obtained from the Additional Secretary (Exams), The Institute of Chartered Accountants of India, ICAI Bhawan, Indraprastha

Marg, New Delhi – 110 002 on payment of Rs. 100/- per application form.

The forms are also available in the Regional and Branch Offices of the Institute and can be obtained upon cash payment on or from 13th May, 2009. Alternatively, the format of application form can be downloaded from the website of the Institute viz. www.icai.org and the cost of the application form of Rs. 100/- can be added to the Assessment Test fee of Rs. 1000/- and the Demand Draft for Rs. 1100/- has to be sent. The last date for receipt of duly filled in application forms is 3rd June, 2009. The application together with the prescribed fee should be sent by Speed Post/Registered Post to the Additional Secretary (Exams), New Delhi. The applications received after 3rd June 2009 will not be entertained under any circumstances.



(G. Somasekhar)
Additional Secretary (Exams)

CPE
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2 Days Extensive Seminar on “Private Equity”

Organised by: Committee on Financial Markets and Investors' Protection
Jointly with Committee for Members in Industry
Hosted by: Bangalore Branch of SIRC of ICAI

Objective	Private Equity categorized under the umbrella of alternative instruments of finance is a class of asset that is complementary to the stock and bond portfolios. In India, the PE is gradually becoming popular in the capital market and to understand the PE characteristics and how best to approach the construction and implementation of a PE portfolio, the Seminar on PE has been designed taking into account the role CA professionals.	
Date & Time	26 th June 2009 and 27 th June 2009: 09:00 a.m. to 06:00 p.m.	
Venue	Hotel Le Meridian, Bangalore	
Programme Structure	Day 1	Day 2
	Inaugural Session	
	Technical Sessions	Technical Sessions
	<ul style="list-style-type: none"> • Private Equity: A Bird's Eye view on Contemporary Indian Scenario • Preparation of Business Plan – Key to Success • Investment Process, Term Sheet and Due Diligence – the Heart of a Private Equity Transaction • Valuation of Private Equity Deals 	<ul style="list-style-type: none"> • Private equity- The Deal closure- The Fine Art • Fund Manager's Perspective to the Private Equity Deal • Role of Chartered Accountants in Adding Value & assisting Company in unlocking their potential • Corporate Story telling Session: Experiences of Corporates in undertaking Private Equity Deals • Panel Discussion: PE: interface between funds and Stakeholders
	Special Technical Session	
	International Financing Alternatives	
Resource Persons	Nationally renowned speakers	
Fees	Rs. 2,500/- for members Rs. 3,000/- for non-members Rs. 2,000/- for students of ICAI Cheque (local)/draft in favour of “Secretary ICAI” payable at Bangalore.	
Seminar Chairman	Contact Details CA. C.S. Nanda, Chairman – CFM & IP of ICAI Mob.: 09811130985, Email: csnanda@gmail.com CA Vijay Kumar Gupta, Chairman – Committee for Members in Industry of ICAI Mob.: 09810050029, Email: chairmanmii@icai.org	
Seminar Director	CA. K Raghu, Central Council Member of ICAI and Chairman, IT Committee of ICAI and Chairman, PRB of ICAI Mob.: 09341219091, Email: kraghu9999@gmail.com; kraghu@kraghu.com	
Seminar Co-ordinators	CA. C.S Srinivas, Chairman, Bangalore Branch of SIRC of ICAI, Mob.: 09845063387, Email: dcobangalore@icai.org	
For Registration and further details, please contact	Bangalore Branch of SIRC of ICAI 'ICAI Bhawan', 16/O, Millers Tank Bed Area, Bangalore - 560 052. Ph.: 080- 30563500, Email: bangalore@icai.org	

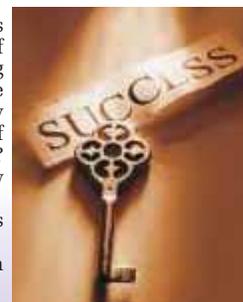
ICAI NEWS

Send Us Your Inspiring Success Stories

As part of multi-pronged activities to mark the ICAI Diamond Jubilee year, the Editorial Board has decided to publish extra-ordinary success stories of Chartered Accountants in various walks of professional life in the Institute's journal *The Chartered Accountant*. Do you think there is something remarkable about your achievements in professional life that the others should know? If yes, write down that glorious story and send that to us. You may ask yourself: What did I do to create my professional success? What inspired me in this mission? How did I not deviate despite the presence of blockages and distractions in my way? How did I overcome my weaknesses and work on my strength? How, my achievements helped the organization/other professionals/society at large? and Finally, how my CA qualification laid the foundation of my success?

The objective of the write-up to should be to motivate all our students, members, other readers as well as those who wish to join chartered accountant fraternity.

We look forward to receiving your submissions. Send your write-up along with your photograph to eboard@icai.org / journal.ca@gmail.com for consideration of the Editorial Board.



CPE
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HRS

National Information Technology Conference Technology Summit 2009

June 12th - 13th, 2009 (Friday & Saturday) at Bangalore

Organised by: Committee on Information Technology, ICAI
Hosted by: Bangalore Branch of SIRC of ICAI
Venue: Hotel Le-Meridian, Bangalore

Day 1	Theme	Faculty/Speaker
	Inaugural Address	
1.	Technology Shaping the Audit Profession	
2.	ERP- Implementation Opportunities for CAs.	CA. Piyush Jain, Delhi
3.	IS Audit - Using ISACA Standards, Guidelines and Procedures	CA. Ravi Muthukrishnan, Bangalore
4.	Audit Tools and Software for Practising CAs	CA. Neeraj Kapasi, Bangalore
Day 2	Theme	Faculty/Speaker
5.	KPO - Setting up, Operation for Payroll, Accounting and Tax Returns	CA. L.S. Ram, Bangalore
6.	XBRL - Extensible Business Reporting Language - ICAI Roadmap for XBRL jurisdiction	CA. S Swaminathan, Mumbai
7.	Forensic Accounting and Fraud Detection	CA. Chetan Dalal, Mumbai
8.	New Professional Opportunities in IT Arena- Success Stories	CA. Anand Prakash Jangid, Bangalore
9.	Valedictory Session followed by Networking	

Registration is on First-Cum-First-Serve basis on receipt of application with **Fee of Rs. 2,500/- for members, Rs 3,000/- for non-members and Rs 2,000/- for students by 6th June, 2009** per delegate by DD/ Pay-Order/ Cheque drawn in favour of “**Bangalore Branch of SIRC of ICAI**” payable at Bangalore and to be sent to “Bangalore Branch of SIRC of ICAI, 16/0, Millers Tank Bed Area, Bangalore-560 052.

For further/ updated details and clarifications see www.icai-bangalore.org or www.icai.org or contact bangalore@icai.org Ph. 080-3056 3500, Secretary, IT Committee Ph. 011-3021 0619/621 and E-mail: cit@icai.in.

Conference Chairman CA. K. Raghu, Chairman, IT Committee, Email: kraghu9999@gmail.com, Mob.: 093412 19091

Conference Director CA.Srinivas C S, Chairman, Bangalore Branch, Email: cothas@yukthiconsulting.com, Mob.: 98450 63387

Conference Coordinators CA. Vinay Mruthyunjaya, Co-opted Member, IT Committee Email: vinay@vkca.com, Mob.: 9972567575
CA. T. R. Venkatesh Babu Secretary, Bangalore Branch, dfvb_99@yahoo.com Mob.: 9845031028

Chief Financial Officers/Chief Executive Officers Meets

Organised by Committee for Members in Industry of ICAI

Discussion Sessions	First Technical Session: (06:30 PM to 07:30 PM) Independent Directors and Audit Committee- Role in the current scenario Second Technical Session: (07:30 PM to 08.30 PM) Issues in adopting IFRSs					
Programme Chairman	CA. Vijay Kumar Gupta, Chairman, CMII, 9810050029 Email: chairmancmii@icai.org					
Time	From 06:30 PM to 08:30 PM					
Date	7 th June, 2009	21 st June, 2009	14 th June, 2009	31 st May, 2009	28 th June, 2009	11 th July, 2009
Hosted by	New Delhi, NIRC of ICAI	Chennai, SIRC of ICAI	Bangalore, SIRC of ICAI	Mumbai, WIRC of ICAI	Kolkata, EIRC of ICAI	Jaipur Branch of CIRC of ICAI
Programme Director(s)	CA. Harinderjit Singh, FCA Mob: +91 98 101 87341 Email: harinderjit.singh@in.pwc.com; hsingh@icai.org	CA. V. Murali, FCA, Mob: +91 98410 40010, 93810 46 952, Email: victorgrace@vsnl.com/murli@icai.org	CA. K. Raghu, FCA, Mob: +91 93412 19091, Email: kraghu9999@gmail.com	CA. Sanjeev Maheshwari, FCA, Mob: +91 98211 19043 / 93211 19043 Email: sanjeev@gmjca.com, mudra@vsnl.com	CA. K. P. Khandelwal, FCA, Mob: +98300 30216 Email: elwalyahoo.com	CA. Vijay Kumar Garg, Mob: 094140 41872, 093145 03871
Programme Co-ordinator	CA. Bhagwan Das Gupta, Chairman, NIRC of ICAI, bdguptaca@hotmail.com, bdguptaca@gmail.com Mob.: 98111 52662	CA. M. Devaraj Reddy, Chairman of SIRC, Mob: 93999 35799, Email: devarajareddy@yahoo.com	CA. C.S Srinivas, Chairman of Bangalore Branch, Mob.: 98450 63387, Office: (80) 30563500, Email: bangalore@icai.org	CA. B. C. Jain, Chairman, WIRC of ICAI, Email: jainbc@icai.org, Mob.: 098211 17813	CA. Suvendu Chunder, Chairman EIRC of ICAI, Email: schunder@hotmail.com, Mob.: 98300 86986	CA. Dhruv Kumar Agrawal, Chairman of CIRC, Mob.: 98104 25103, Email: dhruvkum@yahoo.com
Official Co-ordinator (For registration)	Dr. T Paramashivan, Secretary, CMII	CA. Bhavani Mahesh Kumar, Sr. Deputy Director	Shri. T. V. Srinivasan, Sr. Asst. Secretary	CA. B. Muralidharan, Deputy Secretary	CA. Atis Basu, Sr. Deputy Secretary	CA. Sanjay Kumar Goyal, Asst. Secretary
Phone No.	+ 91 (11) 3011 0491,	+ 91 (44) 3989 3989	+ 91 (80) 3056 3500	+ 91 (22) 3980 2952	+ 91 (33) 3989 3102	+ 91 (141) 3044 214
Fax No.	+ 91 (11) 3011 0583	+ 91 (44) 3021 0355	+ 91 (80) 2225 2547	+ 91 (22) 3980 2953	+ 91 (33) 3021 1145	+ 91 (141) 3044 215
Email:	tparamashivan@icai.org	sro@icai.org	dcobangalore@icai.org	bmurli@icai.org	abasu@icai.org	icaijpr@icaijpr.org, jaipur@icai.org
Contact Address (Registration for participation should be sent to Official Co-ordinators)	The Institute of Chartered Accountants of India 'ICAI BHAWAN' Indraprastha Marg, NEW DELHI - 110 002	The Institute of Chartered Accountants of India 'ICAI BHAWAN' 122, Mahatma Gandhi Road, Nungambakam, Chennai-600 034	Bangalore Branch of Southern India Regional Council, The Institute of Chartered Accountants of India 'ICAI BHAWAN' 16/0, Millers Bed Area, Bangalore -	The Institute of Chartered Accountants of India 'ICAI BHAWAN' 'Anveshak', 27, Cuffe Parade, Colaba, Mumbai - 400 005	The Institute of Chartered Accountants of India 'ICAI BHAWAN' 7, Anandilal Poddar Sarani, (Russell Street) Kolkata - 700 071	Jaipur Branch of Central India Regional Council, The Institute of Chartered Accountants of India 'ICAI BHAWAN' D-1, Industrial Area, Jhalana Doongri, Jaipur-302 004

CPE
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ICAI National Conference “Delivering Excellence – Polishing the Diamond”

Organised by: Professional Development Committee
Hosted by: Jaipur Branch of CIRC of ICAI

Date & Time	16 th -17 th June 2009 (09:00. a.m. to 06:00 p.m.)																			
Venue	B. M. Birla Auditorium, Statue Circle, Jaipur																			
Inaugural Session	Guest of Honour: CA. Uttam Prakash Agarwal, President, ICAI																			
Technical Sessions	<p>Schedule –16th June, 2009</p> <table border="0"> <tr> <td>Menace of Section 40(a)(ia). and Disallowances under section 40 of IT Act</td> <td>CA. G Ramaswamy, Member, Central Council, ICAI</td> </tr> <tr> <td>Recent changes in TDS provisions & Controversies</td> <td>CA. Girish Ahuja, Delhi</td> </tr> <tr> <td>Recent controversial issues in service tax.</td> <td>CA. Kapil Vaish</td> </tr> <tr> <td>Emerging IT challenges and opportunities</td> <td></td> </tr> </table> <p>Schedule –17th June, 2009</p> <table border="0"> <tr> <td>Recent judicial pronouncements on Direct Taxes</td> <td>CA. Sanjay Jhanwar, Jaipur</td> </tr> <tr> <td>Accounting and Taxation in Real Estate Transaction</td> <td>CA. Padam Khincha, Bangalore</td> </tr> <tr> <td>Accounting and Taxation of F&O & derivatives</td> <td>CA. P R Ramesh, Mumbai</td> </tr> <tr> <td>Implementation of Auditing Standards to SMP LLP and Networking</td> <td>CA. Rajeev Sogani, Jaipur</td> </tr> <tr> <td>In bound and out bound investment</td> <td></td> </tr> </table>		Menace of Section 40(a)(ia). and Disallowances under section 40 of IT Act	CA. G Ramaswamy, Member, Central Council, ICAI	Recent changes in TDS provisions & Controversies	CA. Girish Ahuja, Delhi	Recent controversial issues in service tax.	CA. Kapil Vaish	Emerging IT challenges and opportunities		Recent judicial pronouncements on Direct Taxes	CA. Sanjay Jhanwar, Jaipur	Accounting and Taxation in Real Estate Transaction	CA. Padam Khincha, Bangalore	Accounting and Taxation of F&O & derivatives	CA. P R Ramesh, Mumbai	Implementation of Auditing Standards to SMP LLP and Networking	CA. Rajeev Sogani, Jaipur	In bound and out bound investment	
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Spouse	Rs. 750/-	Rs. 1000/-																		
Corporate Delegate	Rs. 2000/-	Rs. 2500/-																		
<p>Cheque should be drawn in favour of “Secretary ICAI-Jaipur National Conference”, payable at Jaipur and sent to The Institute of Chartered Accountants of India “ICAI Bhawan”, D-1, Institutional Area, Jhalana Doongari, Jaipur-302004 Phone: 0141 – 3989398, 3044200/14, Fax: 0141-3044215, Mob.: 94140 77460/9314501320, Email: jaipur@icai.org</p>																				
Conference Chairman	<p>CA. Anuj Goyal, Chairman, Professional Development Committee, Mob.: 9810041371, Email: anujgoyal@icai.org; anujgoel128@sify.com</p>																			
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Conference Coordinator	<p>CA. R P Vijay, Chairman, Jaipur Branch of CIRC of ICAI, Mob.: 9414077460 Email: rpvijay@rediffmail.com</p>																			

HEALTH TIPS

Soul Food:

"Live as if you were to die tomorrow. Learn as if you were to live forever." -Mahatma Gandhi &

Why is it that I'm most aware of my body only when it's not working properly?

Contributed by CA R. S. Agrawal, Mumbai



Lime: Lime juice is very beneficial in arthritis cases.



Papaya: Papaya removes round worms from stomach. Raw papaya helps cure diabetes, cancer and kidney problems. Raw papaya juice may be taken with milk. It is also helpful in treating skin disorders. Papaya is not advisable for pregnant women.



Chillies: Chillies contain vitamin A which is powerful antioxidant that boosts the immune system



Asparagus: Asparagus contains high vitamin-K which helps to ease menstrual cramps and is also good for gastrointestinal track.



Broccoli: A substance found in broccoli may limit the damage which leads to serious lung disease, US research suggests

Pineapple: Pineapple juice is good for heart. It is also recommended in jaundice cases, anaemia, abdominal disorders and throat. It is rich source of vitamin-C and, therefore, strengthens the immune system. Pineapple juice is not advisable for pregnant women.



Strawberries: They are rich source of vitamin-C and therefore helpful in building healthy immune system



Cabbage: Cabbage juice has anti cancer properties and is effective in treating skin disorders



Rosehips: Rosehips are very rich source of vitamin-C. They have properties to regenerate the joints crippled by arthritis. They level the immune system

Disclaimer

The above information have been taken from the reliable sources, still the author is not liable for any loss or damage that may be caused directly or indirectly by the above information. A physician is always recommended for any remedy.

ICAI NEWS

Committee on Information Technology

ERP Courses on SAP FA & MA Modules & Microsoft Dynamics NAV

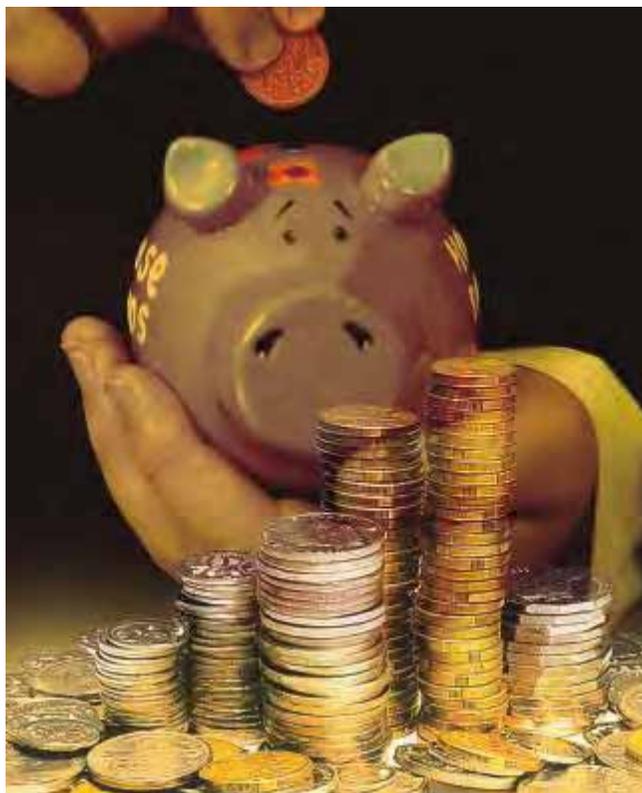
The Committee has started offering ERP Courses for members and students (final/ article ship completed) of the Institute to enable them to offer value added services in the field of ERP Consulting as Functional Consultants in the finance domain considering their rich experience in accounting/ finance/ business/ legal requirements, which are in increasing demand today. These courses are also suitable for Members in Industry where ERP applications are implemented/ being implemented. This ERP Initiative includes, training programmes on (a) **SAP FA & MA Modules**, (b) **Microsoft NAV Dynamics**. These courses

are being offered through OEM vendors giving twin benefits of convenient timing and discounted course fees.



Further details are available on the Institute website at www.icai.org under Members Courses. Please contact 011-30210619/ 621 or erp@icai.org for further details/ clarifications/ registration.

Behavioural Finance - As Investment Concept



Since the popping of the technology stock bubble in March 2000, Behavioural Finance (BF) has taken a more prominent role in the financial media and more importantly, in the minds of financial advisors globally. BF is commonly defined as the application of psychology to finance. BF is an emerging science and is very popular in stock markets across the world for investment decisions. It exploits the irrational nature of investors. This article explores this new concept.



CA. Sushma Vishnani | CA. Bhupesh Kr. Shah

*The authors are members of the Institute
They can be reached at
shah.bhupesh.kumar@icai.org*

Basic Concept of Behavioural Finance

Behavioural Finance (BF) is the study of investors' psychology while making financial decisions. Investors fall prey to their own and sometimes others' mistakes due to use of emotions in financial decision making. For many financial advisors BF is still an unfamiliar and unused subject. There are some financial advisors, however, who have taken the time to read and learn about BF and use it in practice with good results. These advisors realize that being successful is just as much about building great relationships with clients as it is about delivering investment performance. And they have observed that BF can provide tools that can help them "get inside" the head of their clients in order to build mutually beneficial relationships. Understanding how clients actually think and behave is a key ingredient in the recipe for success in

acquiring and retaining clients. As such, BF is becoming a powerful force in the financial advisory field.

BF tries to understand how people forget fundamentals and take investment decisions based on emotions. For decades, economists have argued about the rational behaviour of investors. Now psychologists are weighing in, and they are finding that human beings often do not act that way. "Psychology has a story to tell about investing, and it is different from the one economics tells," says Princeton Psychologist Daniel Kahneman. BF is the study of the influence of psychology on the behaviour of financial practitioners and the subsequent effect on markets. Research in this area is emerging from the academia and the results are being taken into account in the field of money management.

What Drives Investor Behaviour?

We would all like to think we always behave rationally while at the same time assuming that others often do not. Most financial theories are based on the idea that every one takes careful account of all available information before making investment decisions. But there is much evidence that it is not always the case. It has been proved in studies that people are ruled as much by emotion as by cold logic. While the emotions such as fear and greed often play an important role in poor decisions, there are other causes like cognitive biases and heuristics that make investors to incorrectly analyze new information about a stock or currency and thus overreact or under-react.

Finance practitioners use rules of thumb or heuristics to process data. For example, people use past performance as the best predictor for future performance and often invest in the mutual funds with the best five year track records. These rules are likely to be faulty and generally lead to poor decisions. Relying on such heuristics is called Heuristic Bias.

BF is the study of how these mental errors and emotions can cause stocks or currency to be over-valued or undervalued. BF is also a study to create investment strategies that give a winning edge over other investors.



Some Examples of Behavioural Finance in Indian markets –

(1) IPO Craze -

- The herd mentality is evident. As the positive information of excess subscription comes, more investors enter the bandwagon.
- Prices of these stocks start soaring. Alas everyone is thinking of the same thinking: I am going to sell on listing and book the profits. Can money making be so simple? Is life and the financial markets so predictable? One will see investors selling the stocks as soon as they get the allotments.
- Herd mentality will be at work with people trying to sell faster than the neighbour, thus eroding stock values at a faster rate. Only bankers and financiers, who loaned out money, will end up laughing.
- Greed thus becomes graveyard. One needs to understand that there are no shortcuts to earning money.
- The sentiment of the investors can be traced back to the overvalued Reliance Power IPO during Q4' 2007. Reliance Power IPO was oversubscribed 73 times. This was an issue from the Ambani stable, who were the most high profile sufferer. Reliance Power ended its first day on the markets at Rs. 372 against issue price of Rs.450. Millions lost money. The Sensex dropped 863 points in sympathy.

(2) IT Bubble Burst 2000 Story –

In June 1999, Perkins Bros. submitted the final manuscript of the first edition of their book, 'The Internet Bubble' to their publishers with the following concluding thesis: "The bottom line of our analysis is very simple. With very few exceptions, every one of the 133 public internet companies in the US is over-valued. Our advice to the internet investors is equally simple. If you hold any of these stocks, it is time to sell."

There weren't any takers of their recommendation at that point of time. By the time 'The

Finance practitioners use rules of thumb or heuristics to process data. For example, people use past performance as the best predictor for future performance and often invest in the mutual funds with the best five year track records. These rules are likely to be faulty and generally lead to poor decisions. Relying on such heuristics is called Heuristic Bias.



During bull phases, markets are full of momentum investing which is just another way of saying “buy high & sell higher”. Ultimately momentum investors are looking for the greater fool who will pay more for the share than they did. It is really a form of gambling. This kind of gambling makes investors particularly susceptible to torpedo stocks.

Internet Bubble’ hit the book stalls in November ‘99, the market cap of Amazon and Yahoo continued to climb, literally by billions. This continued till April 14, 2000, when Internet companies were hit by 50-70% cut in prices.

By the time, Perkins had completed the finishing touches to the second edition of their book which contains detailed story on why Internet Bubble burst and what one can do to profit now, on December 22, 2000 the total market cap of over 370 public Internet companies in US crashed by 75% in just a few months’ time period.

What went wrong?

(a) Momentum Investing:

During bull phases, markets are full of momentum investing which is just another way of saying “buy high & sell higher”. Ultimately momentum investors are looking for the greater fool who will pay more for the share than they did. It is really a form of gambling. This kind of gambling makes investors particularly susceptible to torpedo stocks – the overpriced, speculative stocks whose prospects have been heavily hyped but are primed for a disastrous plunge that could ruin any portfolio. It’s even worse when investors speculate on margin, investing with borrowed money.

(b) Over-confidence:

One of the authors’ research on investors’ behaviour found that investor, given one bit of financial data about a company felt just as confident as those investors who had also been given more detailed information of financial performance. Over-confident investors tend to trade too much and bet too heavily on particular stock or sectors.

(c) Creative Accounting:

Many companies use this to make their top line revenue numbers look much stronger than they really are. For instance, two online companies agree to run each other’s advertisements for free and then each company counts the advertisements as revenues. Instead of the greatest ever legal creation of wealth, the Internet financial bubble represented the greatest ever legal transfer of wealth from retail investors to insiders. The

insiders being of course, entrepreneurs, venture capital firm, investment banks and large institutional investors who had pulled out their capital long before the fall.

(3) Reliance – Gas discovery in 2004 – impact on prices

This episode also went on to become a glaring example of Behavioural Finance in the Indian markets.

Key Ideas in Behavioural Finance

1. Prospect Theory:

People respond differently to equivalent situations depending on whether it is presented in the context of a loss or a gain. Typically, they become considerably more distressed at the prospect of losses than they become happy by equivalent gains. This ‘loss aversion’ means that people are willing to take more risks to avoid losses than to realize gains. Even faced with sure gain, most investors are risk averse, but faced with sure loss they become risk takers.

2. Regret Theory:

It is about people’s emotional reaction to having made an error of judgment, whether buying a stock that has gone down or not buying one they considered and which has subsequently gone up. Investors may avoid selling stocks that have gone down in order to avoid the regret of having made a bad investment and the embarrassment of reporting loss. People may also find it easier to follow the crowd and buy a popular stock: if it significantly goes down, it can be rationalized as everyone else owned it. Going against conventional wisdom is harder since it raises the possibility of feeling regret if decisions prove incorrect.

3. Anchoring:

In the absence of better information, investors assume current prices are about right. This phenomenon is called Anchoring. In a bull market, for example, each new stock is ‘anchored’ by its closeness to the last record and more distant history increasingly becomes irrelevant. People tend to give too much weight to recent experience, extrapolating recent trends that are often at odds with long-run averages and probabilities.

4. Over- and under-reaction:

The consequence of investors putting too much weight on recent news at the expense of other data is market over- or under-reaction. People show over-confidence. They tend to become more optimistic when the market goes up and more pessimistic when the market goes down. Hence, prices fall too much on bad news and rise too much on good news. This can lead to extreme events at times.



and consultants, which help them in identifying the personality type of their clients. After identifying the personality type, next step is identifying the behavioural biases to which such personality types are susceptible. And the final step is suggesting investment programmes that tone down the ill effects of these biases. By profiling investors by personality type, investment consultants

can create investment programmes that mitigate individual’s behavioural biases – encouraging investors to observe their long-term investment strategies, saving them the costs of rebalancing a plan in response to unexpected market movements.

In this backdrop, we now take up a few studies conducted by finance practitioners towards practical application of BF.

(A) BITs and How to deal with each BIT –

One of the studies categorizes BITs into:-

- (I) Passive Preservers
- (ii) Friendly Followers
- (iii) Independent Individualists
- (iv) Active Accumulators

Each BIT is characterized by a certain risk tolerance level and a primary type of bias — either cognitive (driven by faulty reasoning) or emotional (driven by impulses or feelings). One of the most important concepts advisors should keep in mind as they go through this section is that the least risk-tolerant BIT and the most risk tolerant BIT are driven by *emotional* biases, while the two types in between these two extremes are mainly affected by cognitive biases. Emotional clients tend to be more difficult clients to work with. Advisors who can recognize the type of client before making investment recommendations will be much better

Applications of Behavioural Finance

If Behavioural Finance were to be helpful to the majority of financial advisors in creating better investment portfolios, the three key challenges are required to be tackled:

First, advisors needed a guidebook to teach them the basics of behavioural biases and how to diagnose them in clients.

Second, even if advisors could diagnose client biases, they needed to know what to do with that information. For example, given a certain set of behaviours, should they attempt to change behaviour of the client to match the allocation that is right for the client, or should they change the allocation to match the client’s behaviour.

Third, the industry needed a common BF language. Behavioural biases, as earlier articulated, were not user friendly because there was not a widely accepted set of terms for describing and communicating these biases to other advisors or to clients.

To understand the behavioural biases, the prerequisite is an understanding of various personality dimensions which have implications for the investors’ behaviour.

Personality Dimension	High level	Low level
1. Neuroticism	Sensitive, nervous	Secure, confident
2. Extraversion	Outgoing, energetic	Shy, withdrawn
3. Openness to experience	Inventive, curious	Cautious, conservative
4. Agreeableness	Friendly, compassionate	Competitive, outspoken
5. Conscientiousness	Efficient, organized	Easy going, carelessness

Based on above personality traits, a number of psychographic models and tests have been designed and used over the years by practitioners

prepared to deal with irrational behaviour when it arises.

Passive Preserver –

Basic type: Passive

Risk tolerance level: Low

Primary bias: Emotional

Passive preservers are, as the name implies, investors who place a great deal of emphasis on financial security and preserving wealth rather than taking risks to grow wealth. Many such investors have gained wealth through inheritance or conservatively by working in a large company. Because they have gained wealth by not risking their own capital, passive preservers may not be financially sophisticated. Some passive preservers are "worriers" in that they get obsessed with over short-term performance and are slow to make investment decisions because they dislike change. Most passive preservers are focused on family and security. Passive preserver biases tend to be emotional rather than cognitive. As age and wealth level increase, this BIT becomes more common.

Behavioural biases of passive preservers tend to be emotional, security-oriented biases such as endowment bias, loss aversion, status quo, and regret.

Advising Passive Preservers: Passive preservers are difficult to advise because they are driven mainly by emotion. Passive preservers need "big picture" advice. Passive preservers need to buy into their advisor's general philosophy first and then, once trust is gained, they take action. After a period of time, Passive preservers are likely

to become the advisor's best clients because they value greatly the advisor's professional expertise and objectivity in helping make the right investment decisions.

Friendly Follower

Basic type: Passive

Risk tolerance level: Low to medium

Primary bias: Cognitive



Friendly followers are passive investors who usually do not have their own ideas about investing. They often follow the lead of their friends and colleagues in investment decisions, and want to be in the latest, most popular investments without regard to a long-term plan. One of the key challenges of working with friendly followers is that they often overestimate their risk tolerance.

Advisors need to be careful not to suggest too many "hot" investment ideas—Friendly followers mostly want to do all of them. Friendly followers generally comply with professional advice when they get it, and they educate themselves financially. Biases of Friendly followers are cognitive: recency, hindsight, framing, cognitive dissonance, and ambiguity aversion.

Advising Friendly Followers: Advisors to friendly follower clients know that friendly followers often overestimate their risk tolerance. They also may convince themselves that they "knew it all along," which also increases risk-taking behaviour. Advisors need to handle friendly followers with care because they are likely to say yes to advice that makes sense to them. Advisors need to guide them to take a hard look at behavioural tendencies to overestimate their risk tolerance. Because friendly follower biases are mainly cognitive, education on the benefits of portfolio diversification is usually the best course of action. Advisors should challenge friendly follower clients to be introspective and provide them data-backed substantiation for recommendations. Offer education in clear, unambi-



In the absence of better information, investors assume current prices are about right. This phenomenon is called Anchoring. In a bull market, for example, each new stock is 'anchored' by its closeness to the last record and more distant history increasingly becomes an irrelevance. People tend to give too much weight to recent experience, extrapolating recent trends that are often at odds with long-run averages and probabilities.

guous ways so they have the chance to get it. If advisors take the time, this steady, educational approach will generate greater client loyalty and adherence to long-term investment plans.

Independent Individualist

Basic type: Active

Risk tolerance: Medium to high

Primary bias: Cognitive

An independent individualist is an active investor with medium-to-high risk tolerance who is strong-willed and an independent thinker.



Passive preservers are, as the name implies, investors who place a great deal of emphasis on financial security and preserving wealth rather than taking risks to grow wealth. Many such investors have gained wealth through inheritance or conservatively by working in a large company. Because they have gained wealth by not risking their own capital, passive preservers may not be financially sophisticated.

independent individualists are self-assured and "trust their gut" when making decisions. However, when they do research on their own, they may be susceptible to acting on the initial information rather than getting corroboration from other sources. Sometimes advisors find that an independent individualist client made an investment without consulting anyone. This can be problematic because due to their independent mindset, these clients maintain the view they had when they made the investment, even when market conditions change. They often enjoy investing and are comfortable taking risks, yet often resist following a financial plan. Some independent individualists view investing as a way to make money to give themselves freedom. They can be good clients because they are usually busy people, although some will not accept financial advice. Others are obsessed with trying to beat the market and may hold concentrated portfolios. Of all behavioural investor types, independent individualists are the most likely to be contrarian, which can benefit them and lead them to continue their contrarian practices. Independent individualist biases are cognitive: conservatism, availability, confirmation, representativeness and self-attribution.

Advising Independent Individualists: Independent individualists can be difficult clients to advise but they are usually grounded enough to

listen to sound advice when it is presented in a way that respects their independent mindset. As we have learnt, independent individualists are firm in their belief in themselves and their decisions but can be blind to contrary thinking. As with friendly followers, education is essential to change behaviour of Independent Individualists; their biases are predominantly cognitive. A good approach is to have regular educational discussions during client meetings. This way, the advisor does not point out unique or recent failures but rather educates regularly and can

incorporate concepts that he or she feels are appropriate for the client.

Active Accumulator

Basic type: Active

Risk tolerance: High

Primary bias: Emotional

The Active Accumulator is the most aggressive behavioural investor type. These clients are entrepreneurial and often the first generation to create wealth. They are even more strong-willed and confident than independent individualists. This behaviour can lead to overconfidence in investing activities. Left unadvised, active accumulators often have high portfolio turnover rates, putting a drag on investment performance. Active accumulators seek risk in the hope of high return and are comfortable with volatility, although they





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don't like it. Active accumulators are quick decision-makers but may chase higher risk investments than their friends. If successful, they enjoy the thrill of making a good investment. Some active accumulators can be difficult to advise because they do not usually believe in basic investment principles such as diversification and asset allocation. They are often hands-on, wanting to be heavily involved in the investment decision-making process, although some readily admit they lack investment knowledge. Biases of active accumulators are over-confidence, illusion of control, self-control, and optimism.

Advising Active Accumulators: Active accumulators are the most difficult clients to advise. They like to control or at least get deeply involved in the details of investment decision-making. They are emotionally charged and optimistic that their investments will do well, even if that optimism is irrational. Some active accumulators need to be monitored for excess spending which, when out of control, can inhibit performance of long-term portfolio. The best approach in dealing with these clients is to take control of the situation. If advisors let the active accumulator client dictate the terms of the advisory engagement, they will always be at the mercy of the client's irrational decision-making and the result will likely be an unhappy client and an unhappy advisor. Advisors need to prove to the client that they have the ability to make wise, objective, long-term decisions and can communicate these results in an effective way. Advisors who can demonstrate the ability to take control of a situation will see their active accumulator clients fall into step and be easier to advise.

(B) Correlations between personality dimensions and investor behaviour –

- Introverts have low risk tolerance *vis-à-vis* extroverts.
- Intuitive people (who don't pay heed to surrounding information) are relatively more pessimistic.

- People who think a lot before arriving at an investment decision have high risk tolerance.
- People who are more structured are realistic in their investment decision making process.
- Extrovert personalities at times behave irrationally and are overconfident in their investment decision making.
- Males have higher risk tolerance in comparison to females. Males are more likely to cut losses immediately while women are more likely to buy and hold.
- People who are spontaneous in their decision making are more risk tolerant and unrealistic.
- People with personality traits such as introvert, intuitive and structured are susceptible to behavioural biases such as pessimistic, realistic, low risk tolerant.
- People with personality traits such as extrovert, spontaneous, critical in their decision making are susceptible to behavioural biases such as overconfidence, unrealistic and high risk tolerance.

Unresolved Questions in Behavioural Finance

Some unresolved questions regarding behavioural finance include— Do age, income, previous investment outcomes, or bull and bear market backdrops influence investor biases? Are biases rooted to relatively static personality traits?



Exposure Draft Standard on Review Engagements¹ 2400 (Revised) Engagements to Review Financial Statements

Your comments on the Exposure Draft should reach us by **July 31, 2009**. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

**Secretary, Auditing and Assurance Standards Board
The Institute of Chartered Accountants of India
ICAI Bhawan, C-1, Sector-1,
NOIDA, Uttar Pradesh - 201 301.**

Comments can also be emailed at: aasb@icai.org

Standard on Review Engagements (SRE) 2400 (Revised), “Engagements to Review Financial Statements” should be read in the context of the “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services”, which sets out the application and authority of SREs.

Introduction

1. The purpose of this Standard on Review Engagements (SRE) is to establish standards and provide guidance on the practitioner's² professional responsibilities when a practitioner, who is not the auditor of an entity, undertakes an engagement to review financial statements and on the form and content of the report that the practitioner issues in connection with such a review. A practitioner, who is the auditor of the entity, engaged to perform a review of interim financial information performs such a review in accordance with SRE 2410, “Review of Interim Financial Information Performed by the Independent Auditor of the Entity”.

2. This SRE is directed towards the review of financial statements. However, it is to be applied, adapted as necessary in the circumstances, to engagements to review other historical financial information. Guidance in the Standards on Auditing (SAs) may be useful to the practitioner in applying this SRE.

Objective of a Review Engagement

3. The objective of a review of financial statements is to enable a practitioner to state whether, on the basis of procedures which do not

provide all the evidence that would be required in an audit, anything has come to the practitioner's attention that causes the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework (negative assurance).

General Principles of a Review Engagement

4. The practitioner should comply with the *Code of Ethics* issued by the Institute of Chartered Accountants of India. Ethical principles governing the practitioner's professional responsibilities are:

- (a) Independence;
- (b) Integrity;
- (c) Objectivity;
- (d) Professional competence and due care;
- (e) Confidentiality;
- (f) Professional behaviour; and
- (g) Technical standards.

5. The practitioner should conduct a review in accordance with this SRE.

6. The practitioner should plan and perform the review with an attitude of professional skepticism recognising that circumstances may exist which cause the financial statements to be materially misstated.

7. For the purpose of expressing

negative assurance in the review report, the practitioner should obtain sufficient appropriate evidence primarily through inquiry and analytical procedures to be able to draw conclusions.

Scope of a Review

8. The term “scope of a review” refers to the review procedures deemed necessary in the circumstances to achieve the objective of the review. The procedures required to conduct a review of financial statements should be determined by the auditor having regard to the requirements of this SRE, relevant professional bodies, legislation, regulation and, where appropriate, the terms of the review engagement and reporting requirements.

Moderate Assurance

9. A review engagement provides a moderate level of assurance that the information subject to review is free of material misstatement, this is expressed in the form of negative assurance.

Terms of Engagement

10. The practitioner and the client should agree on the terms of the engagement. The agreed terms would be recorded in an engagement letter

¹ Hitherto known as Auditing and Assurance Standard (AAS) 33.

² The term “practitioner” means professional accountants in public practice, i.e., a member of the Institute of Chartered Accountants of India who is in practice in terms of section 2 of the Chartered Accountants Act, 1949. The term is also used to refer to a firm of chartered accountants in public practice.

or other suitable form such as a contract.

11. An engagement letter will be of assistance in planning the review work. It is in the interests of both the practitioner and the client that the practitioner sends an engagement letter documenting the key terms of the appointment. An engagement letter confirms the practitioner's acceptance of the appointment and helps avoid misunderstanding regarding such matters as the objectives and scope of the engagement, the extent of the practitioner's responsibilities and the form of reports to be issued.

12. Matters that would be included in the engagement letter include the following:

- The objective of the service being performed.
- Management's responsibility for the financial statements.
- The scope of the review, including reference to this SRE (or relevant national standards or practices).
- Unrestricted access to whatever records, documentation and other information requested in connection with the review.
- A sample of the report expected to be rendered.
- The fact that the engagement cannot be relied upon to disclose errors, illegal acts or other irregularities, for example, fraud or defalcations that may exist.
- A statement that an audit is not being performed and that an audit opinion will not be expressed. To emphasize this point and to avoid confusion, the practitioner may also consider pointing out that a review engagement will not satisfy any statutory or third party requirements for an audit.

An example of an engagement letter for a review of financial statements appears in Appendix 1 to this SRE.

Planning

13. The practitioner should plan the work so that an effective engagement will be performed.

14. In planning a review of financial statements, the practitioner should obtain or update the knowledge of

the business including consideration of the entity's organisation, accounting systems, operating characteristics and the nature of its assets, liabilities, revenues and expenses.

15. The practitioner needs to possess an understanding of such matters and other matters relevant to the financial statements, for example, a knowledge of the entity's production and distribution methods, product lines, operating locations and related parties. The practitioner requires this understanding to be able to make relevant inquiries and to design appropriate procedures, as well as to assess the responses and other information obtained.

Work Performed by Others

16. When using work performed by another practitioner or an expert, the practitioner should be satisfied that such work is adequate for the purposes of the review.

Documentation

17. The practitioner should document matters which are important in providing evidence to support the review report, and evidence that the review was carried out in accordance with this SRE.

Procedures and Evidence

18. The practitioner should apply judgment in determining the specific nature, timing and extent of review procedures. The practitioner will be guided by such matters as the following:

- Any knowledge acquired by carrying out audits or reviews of the financial statements for prior periods.
- The practitioner's knowledge of the business including knowledge of the accounting principles and practices of the industry in which the entity operates.
- The entity's accounting systems.
- The extent to which a particular item is affected by management judgment.
- The materiality of transactions and account balances.

19. The practitioner should apply the same materiality considerations as would be applied if an audit

opinion on the financial statements were being given. Although there is a greater risk that misstatements will not be detected in a review than in an audit, the judgment as to what is material is made by reference to the information on which the practitioner is reporting and the needs of those relying on that information, not to the level of assurance provided.

20. Procedures for the review of financial statements will ordinarily include the following:

- Obtaining an understanding of the entity's business and the industry in which it operates.
- Inquiries concerning the entity's accounting principles and practices.
- Inquiries concerning the entity's procedures for recording, classifying and summarising transactions, accumulating information for disclosure in the financial statements and preparing financial statements.
- Inquiries concerning all material assertions in the financial statements.
- Analytical procedures designed to identify relationships and individual items that appear unusual. Such procedures would include:
 - ▶ Comparison of the financial statements with statements for prior periods.
 - ▶ Comparison of the financial statements with anticipated results and financial position.
 - ▶ Study of the relationships of the elements of the financial statements that would be expected to conform to a predictable pattern based on the entity's experience or industry norm.
 In applying these procedures, the practitioner would consider the types of matters that required accounting adjustments in prior periods.
- Inquiries concerning actions taken at meetings of shareholders, the board of directors, committees of the board of directors and other meetings that may affect the financial statements.
- Reading the financial statements

- to consider, on the basis of information coming to the practitioner's attention, whether the financial statements appear to conform with the basis of accounting indicated.
- Obtaining reports from other practitioners, if any and if considered necessary, who have been engaged to audit or review the financial statements of components of the entity.
 - Inquiries of persons having responsibility for financial and accounting matters concerning, for example:
 - ▶ Whether all transactions have been recorded.
 - ▶ Whether the financial statements have been prepared in accordance with the basis of accounting indicated.
 - ▶ Changes in the entity's business activities and accounting principles and practices.
 - ▶ Matters as to which questions have arisen in the course of applying the foregoing procedures.
 - ▶ Obtaining written representations from management when considered appropriate.

Appendix 2 to this SRE provides an illustrative list of procedures which are often used. The list is not exhaustive, nor is it intended that all the procedures suggested apply to every review engagement.

21. The practitioner should inquire about events subsequent to the date of the financial statements that may require adjustment of or disclosure in the financial statements. The practitioner does not have any responsibility to perform procedures to identify events occurring after the date of the review report.

22. If the practitioner has reason to believe that the information subject to review may be materially misstated, the practitioner should carry out additional or more extensive procedures as are necessary to be able to express negative assurance or to confirm

that a modified report is required.

Conclusions and Reporting

23. The review report should contain a clear written expression of negative assurance. The practitioner should review and assess the conclusions drawn from the evidence obtained as the basis for the expression of negative assurance.

24. Based on the work performed, the practitioner should assess whether any information obtained during the review indicates that the financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the applicable financial reporting framework.

25. The report on a review of financial statements describes the scope of the engagement to enable the reader to understand the nature of the work performed and make it clear that an audit was not performed and, therefore, that an audit opinion is not expressed.

26. The report on a review of financial statements should contain the following basic elements, ordinarily in the following layout:

- (a) Title³;
- (b) Addressee;
- (c) Opening or introductory paragraph including:
 - (i) Identification of the financial statements on which the review has been performed; and
 - (ii) A statement of the responsibility of the entity's management and the responsibility of the practitioner;
- (d) Scope paragraph, describing the nature of a review, including:
 - (i) A reference to this SRE applicable to review engagements, or to relevant national standards or practices;
 - (ii) A statement that a review is limited primarily to inquiries and analytical procedures; and
 - (iii) A statement that an audit has not been performed, that the

procedures undertaken provide less assurance than an audit and that an audit opinion is not expressed;

- (e) Statement of negative assurance;
- (f) Date of the report;
- (g) Place of Signature; and
- (h) Practitioner's signature and membership number assigned by the Institute of Chartered Accountants of India.

Appendices 3 and 4 to this SRE contain illustrations of review reports.

27. The review report should:

- (a) State that nothing has come to the practitioner's attention based on the review that causes the practitioner to believe the financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the applicable financial reporting framework (negative assurance); or
- (b) If matters have come to the practitioner's attention, describe those matters that impair a true and fair view (or a fair presentation, in all material respects) in accordance with the applicable financial reporting framework, including, unless impracticable, a quantification of the possible effect(s) on the financial statements, and either:
 - (i) Express a qualification of the negative assurance provided; or
 - (ii) When the effect of the matter is so material and pervasive to the financial statements that the practitioner concludes that a qualification is not adequate to disclose the misleading or incomplete nature of the financial statements, give an adverse statement that the financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the applicable financial reporting framework; or

³ It may be appropriate to use the term "independent" in the title to distinguish the practitioner's report from reports that might be issued by others, such as officers of the entity, or from the reports of other practitioners who may not have to abide by the same ethical requirements as an independent practitioner.

(c) If there has been a material scope limitation, describe the limitation and either:

(i) Express a qualification of the negative assurance provided regarding the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed; or

(ii) When the possible effect of the limitation is so significant and pervasive that the practitioner concludes that no level of assurance can be provided, not provide any assurance.

28. The practitioner should date the review report as of the date the review is completed, which includes performing procedures relating to events occurring up to the date of the report. However, since the practitioner's responsibility is to report on the financial statements as prepared and presented by management, the practitioner should not date the review report earlier than the date on which the financial statements were approved by management.

Material Modifications to ISRE 2400, "Engagements to Review Financial Statements"

Additions

1. Paragraph 26 of ISRE 2400 deals with the basic elements of the report on a review of financial statements, which also includes the Practitioner's Address. Since in India, Standard on Auditing (SA) 700 requires the auditor also to mention the "Place of Signature", i.e., name of specific location, which is ordinarily the city where the review report is signed, in his report, the requirement to mention the practitioner's address in the practitioner's report has been replaced with the requirement to mention the place of signature in the practitioner's report.

2. Paragraph 26 of ISRE 2400 deals with the basic elements of the report on a review of financial statements, which includes the Practitioner's Signature. Since in India, Standard on Auditing (SA) 700 requires the auditor also to mention the membership

number assigned by the Institute of Chartered Accountants of India along with his signature in his audit report, the requirement of mentioning the membership number assigned by the Institute of Chartered Accountants of India has been added in the paragraph 26 of SRE 2400.

Appendix 1

Example of an Engagement Letter for a Review of Financial Statements

The following letter is for use as a guide in conjunction with the consideration outlined in paragraph 10 of this SRE and will need to be varied according to individual requirements and circumstances.

To the Board of Directors (or the appropriate representative of senior management):

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will review the balance sheet of ABC Company as of March 31, 20XX, and the related profit and loss account and the cash flows for the year then ended, in accordance with the Standard on Review Engagements (SRE) 2400. We will not perform an audit of such financial statements and, accordingly, we will not express an audit opinion on them. Accordingly, we expect to report on the financial statements as follows:

(see Appendix 3 to this SRE) Responsibility for the financial statements, including adequate disclosure, is that of the management of the company. This includes the maintenance of adequate accounting records and internal controls and the selection and application of accounting policies. (As part of our review process, we will request written representations from management concerning assertions made in connection with the review.)

This letter will be effective for future years unless it is terminated, amended or superseded (if applicable). Our engagement cannot be relied

upon to disclose whether fraud or errors, or illegal acts exist. However, we will inform you of any material matters that come to our attention. Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our review of the financial statements.

XYZ & Co

Acknowledged on behalf of ABC

Company by

(signed)

.....

Name and Title

Date

Appendix 2

Illustrative Detailed Procedures that may be Performed in an Engagement to Review Financial Statements

1. The inquiry and analytical review procedures carried out in a review of financial statements are determined by the auditor's judgment. The procedures listed below are for illustrative purposes only. It is not intended that all the procedures suggested apply to every review engagement. This Appendix is not intended to serve as a program or checklist in the conduct of a review.

General

2. Discuss terms and scope of the engagement with the client and the engagement team.

3. Prepare an engagement letter setting forth the terms and scope of the engagement.

4. Obtain an understanding of the entity's business activities and the system for recording financial information and preparing financial statements.

5. Inquire whether all financial information is recorded:

(a) Completely;

(b) Promptly; and

(c) After the necessary authorisation.

6. Obtain the trial balance and determine whether it agrees with the general ledger and the financial statements.

7. Consider the results of previous audits and review engagements, including accounting adjustments required.

8. Inquire whether there have been any significant changes in the entity from the previous year (e.g., changes in ownership or changes in capital structure).
9. Inquire about the accounting policies and consider whether:
 - (a) They comply with local or national standards;
 - (b) They have been applied appropriately; and
 - (c) They have been applied consistently and, if not, consider whether disclosure has been made of any changes in the accounting policies.
10. Read the minutes of meetings of shareholders, the board of directors and other appropriate committees in order to identify matters that could be important to the review.
11. Inquire if actions taken at shareholder, board of directors or comparable meetings that affect the financial statements have been appropriately reflected therein.
12. Inquire about the existence of transactions with related parties, how such transactions have been accounted for and whether related parties have been properly disclosed.
13. Inquire about contingencies and commitments.
14. Inquire about plans to dispose of major assets or business segments.
15. Obtain the financial statements and discuss them with management.
16. Consider the adequacy of disclosure in the financial statements and their suitability as to classification and presentation.
17. Compare the results shown in the current period financial statements with those shown in financial statements for comparable prior periods and, if available, with budgets and forecasts.
18. Obtain explanations from management for any unusual fluctuations or inconsistencies in the financial statements.
19. Consider the effect of any unadjusted errors – individually and in aggregate. Bring the errors to the attention of management and determine how the unadjusted errors will influence the report on the review.
20. Consider obtaining a representation letter from management.

Cash

21. Obtain the bank reconciliations. Inquire about any old or unusual reconciling items with client personnel.
22. Inquire about transfers between cash accounts for the period before and after the review date.
23. Inquire whether there are any restrictions on cash accounts.

Receivables

24. Inquire about the accounting policies for initially recording trade receivables and determine whether any allowances are given on such transactions.
25. Obtain a schedule of receivables and determine whether the total agrees with the trial balance.
26. Obtain and consider explanations of significant variations in account balances from previous periods or from those anticipated.
27. Obtain an aged analysis of the trade receivables. Inquire about the reason for unusually large accounts, credit balances on accounts or any other unusual balances and inquire about the collectibility of receivables.
28. Discuss with management the classification of receivables, including non-current balances, net credit balances and amounts due from shareholders, directors and other related parties in the financial statements.
29. Inquire about the method for identifying “slow payment” accounts and setting allowances for doubtful accounts and consider it for reasonableness.
30. Inquire whether receivables have been pledged, factored or discounted.
31. Inquire about procedures applied to ensure that a proper cutoff of sales transactions and sales returns has been achieved.
32. Inquire whether accounts represent goods shipped on consignment and, if so, whether adjustments have been made to reverse these transactions and include the goods in inventory.
33. Inquire whether any large credits relating to revenue recorded have been issued after the balance sheet date and whether provision has been made for such amounts.

Inventories

34. Obtain the inventory list and determine whether:
 - (a) The total agrees with the balance in the trial balance; and
 - (b) The list is based on a physical count of inventory.
35. Inquire about the method for counting inventory.
36. Where a physical count was not carried out on the balance sheet date, inquire whether:
 - (a) A perpetual inventory system is used and whether periodic comparisons are made with actual quantities on hand; and
 - (b) An integrated cost system is used and whether it has produced reliable information in the past.
37. Discuss adjustments made resulting from the last physical inventory count.
38. Inquire about procedures applied to control cut-off and any inventory movements.
39. Inquire about the basis used in valuing each category of the inventory and, in particular, regarding the elimination of inter-branch profits. Inquire whether inventory is valued at the lower of cost and net realisable value.
40. Consider the consistency with which inventory valuation methods have been applied, including factors such as material, labour and overhead.
41. Compare amounts of major inventory categories with those of prior periods and with those anticipated for the current period. Inquire about major fluctuations and differences.
42. Compare inventory turnover with that in previous periods.
43. Inquire about the method used for identifying slow moving and obsolete inventory and whether such inventory has been accounted for at net realisable value.
44. Inquire whether any of the inventory has been consigned to the entity and, if so, whether adjustments have been made to exclude such goods from inventory.
45. Inquire whether any inventory is pledged, stored at other locations or on consignment to others and consider whether such transactions have been accounted for appropriately.

Investments (Including Associated Companies and Marketable Securities)

46. Obtain a schedule of the investments at the balance sheet date and determine whether it agrees with the trial balance.

47. Inquire about the accounting policy applied to investments.

48. Inquire from management about the carrying values of investments. Consider whether there are any realisation problems.

49. Consider whether there has been proper accounting for gains and losses and investment income.

50. Inquire about the classification of long-term and short-term investments.

Property and Depreciation

51. Obtain a schedule of the property indicating the cost and accumulated depreciation and determine whether it agrees with the trial balance.

52. Inquire about the accounting policy applied regarding the provision for depreciation and distinguishing between capital and maintenance items.

Consider whether the property has suffered a material, permanent impairment in value.

53. Discuss with management the additions and deletions to property accounts and accounting for gains and losses on sales or retirements. Inquire whether all such transactions have been accounted for.

54. Inquire about the consistency with which the depreciation method and rates have been applied and compare depreciation provisions with prior years.

55. Inquire whether there are any liens on the property.

56. Discuss whether lease agreements have been properly reflected in the financial statements in conformity with current accounting pronouncements.

Prepaid Expenses, Intangibles and Other Assets

57. Obtain schedules identifying the nature of these accounts and discuss with management the recoverability thereof.

58. Inquire about the basis for recording these accounts and the amortisation methods used.

59. Compare balances of related

expense accounts with those of prior periods and discuss significant variations with management.

60. Discuss the classification between long-term and short-term accounts with management.

Loans Payable

61. Obtain from management a schedule of loans payable and determine whether the total agrees with the trial balance.

62. Inquire whether there are any loans where management has not complied with the provisions of the loan agreement and, if so, inquire as to management's actions and whether appropriate adjustments have been made in the financial statements.

63. Consider the reasonableness of interest expense in relation to loan balances.

64. Inquire whether loans payable are secured.

65. Inquire whether loans payable have been classified between non-current and current.

Trade Payables

66. Inquire about the accounting policies for initially recording trade payables and whether the entity is entitled to any allowances given on such transactions.

67. Obtain and consider explanations of significant variations in account balances from previous periods or from those anticipated.

68. Obtain a schedule of trade payables and determine whether the total agrees with the trial balance.

69. Inquire whether balances are reconciled with the creditors' statements and compare with prior period balances. Compare turnover with prior periods.

70. Consider whether there could be material unrecorded liabilities.

71. Inquire whether payables to shareholders, directors and other related parties are separately disclosed.

Accrued and Contingent Liabilities

72. Obtain a schedule of the accrued liabilities and determine whether the total agrees with the trial balance.

73. Compare major balances of related expense accounts with similar accounts for prior periods.

74. Inquire about approvals for such accruals, terms of payment, com-

pliance with terms, collateral and classification.

75. Inquire about the method for determining accrued liabilities.

76. Inquire as to the nature of amounts included in contingent liabilities and commitments.

77. Inquire whether any actual or contingent liabilities exist which have not been recorded in the accounts. If so, discuss with management whether provisions need to be made in the accounts or whether disclosure should be made in the notes to the financial statements.

Income and Other Taxes

78. Inquire from management if there were any events, including disputes with taxation authorities, which could have a significant effect on the taxes payable by the entity.

79. Consider the tax expense in relation to the entity's income for the period.

80. Inquire from management as to the adequacy of the recorded deferred and current tax liabilities including provisions in respect of prior periods.

Subsequent Events

81. Obtain from management the latest interim financial statements and compare them with the financial statements being reviewed or with those for comparable periods from the preceding year.

82. Inquire about events after the balance sheet date that would have a material effect on the financial statements under review and, in particular, inquire whether:

- (a) Any substantial commitments or uncertainties have arisen subsequent to the balance sheet date;
- (b) Any significant changes in the share capital, long-term debt or working capital have occurred up to the date of inquiry; and
- (c) Any unusual adjustments have been made during the period between the balance sheet date and the date of inquiry.

Consider the need for adjustments or disclosure in the financial statements.

83. Obtain and read the minutes of meetings of shareholders, directors and appropriate committees subsequent to the balance sheet date.

Litigation

84. Inquire from management whether the entity is the subject of any legal actions threatened, pending or in process. Consider the effect thereof on the financial statements.

Equity

85. Obtain and consider a schedule of the transactions in the equity accounts, including new issues, retirements and dividends.

86. Inquire whether there are any restrictions on retained earnings or other equity accounts.

Operations

87. Compare results with those of prior periods and those expected for the current period. Discuss significant variations with management.

88. Discuss whether the recognition of major sales and expenses have taken place in the appropriate periods.

89. Consider extraordinary and unusual items.

90. Consider and discuss with management the relationship between related items in the revenue account and assess the reasonableness thereof in the context of similar relationships for prior periods and other information available to the auditor.

Appendix 3

Form of Unqualified Review Report

REVIEW REPORT TO ...

We have reviewed the accompanying balance sheet of ABC Company at March 31, 20XX, and related profit and loss account, and the cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the Standard on Review Engagements 2400. This Standard

requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the Accounting Standards⁴.

For ABC and Co.,
Chartered Accountants
.....
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation⁵)
(Membership Number)

Place of Signature

Date

Appendix 4

Examples of Review Reports Other than Unqualified

Qualification for a Departure from Accounting Standards

REVIEW REPORT TO ...

We have reviewed the accompanying balance sheet of ABC Company at March 31, 20XX, and the related profit and loss account, and the cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the Standard on Review Engagements 2400. This Standard requires that we plan and perform the review to obtain moderate assurance

as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit, and, accordingly, we do not express an audit opinion.

Management has informed us that inventory has been stated at its cost, which is in excess of its net realisable value. Management's computation, which we have reviewed, shows that inventory, if valued at the lower of cost and net realisable value as required by Accounting Standard (AS) 2, "Valuation of Inventories" issued by the Institute of Chartered Accountants of India⁶, would have been decreased by Rs. X, and net profit and reserves would have been decreased by Rs. X.

Based on our review, except for the effects of the overstatement of inventory described in the previous paragraph, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the aforesaid Accounting Standards.

For ABC and Co.,
Chartered Accountants
.....
Auditor's Signature
(Name of Member signing the Audit Report)
(Designation⁷)
(Membership Number)

Place of Signature

Date

Adverse Report for a Departure from Accounting Standards

REVIEW REPORT TO

We have reviewed the balance sheet of ABC Company as at March 31, 20XX, and the related profit and loss account, and the cash flow statement for the year then ended. These financial statements are the respon-

⁴ Accounting Standards promulgated by the Accounting Standards Board of the Institute of Chartered Accountants of India or Accounting Standards notified by the Central Government as the Companies (Accounting Standards) Rules, 2006, or the Accounting Standards for Local Bodies promulgated by the Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India, as may be applicable.

⁵ Partner or proprietor, as the case may be.

⁶ See footnote 4.

⁷ Partner or proprietor, as the case may be.

sibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the Standard on Review Engagements 2400. This Standard requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

As noted in note X, the Company has adopted the method of taking entire profits on construction contracts to the statement of profit and loss on entering into the contract. This has resulted in anticipating the profit in cases where the contracts have not even been commenced or where only a very minor part of the expenditure relating to the construction contracts has been incurred. This method of accounting is contrary to the requirements of Accounting Standard (AS) 7, "Accounting for Construction Contracts", issued by the Institute of Chartered Accountants of India⁸.

Based on our review, because of the

pervasive effect on the financial statements of the matter discussed in the preceding paragraph, the accompanying financial statements do not give a true and fair view (or are not presented fairly, in all material respects) in accordance with the aforesaid Accounting Standards.

For ABC and Co.,
Chartered Accountants

.....
Auditor's Signature
(Name of Member signing
the Audit Report)
(Designation⁹)
(Membership Number)

Place of Signature

Date

⁸ See footnote 4.

⁹ Partner or proprietor, as the case may be.

Invitation for Chartered Accountants for Sharing their Experiences

The Committee on Accounting Standards for Local Bodies of the ICAI is in the process of drafting the Status paper on 'Accounting Reforms in Local Bodies in India and Role of Chartered Accountants'.

In this regard, the Committee extends invitation to share the experiences with the Chartered Accountants who associated with the Local Bodies for accrual accounting reforms. They may share their experiences with regard to the specific issues and problems and the manner in which those are sort out at their end.

They may also share the appreciations, if any, received from the Local Bodies/Government while performing the assignment relating to accrual accounting in these bodies.



The responses may kindly be sent in writing to the Secretary, Committee on Accounting Standards for Local Bodies, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002 or by e-mail at caslb@icai.in or caslb@icai.org

Exposure Draft Standard on Auditing 700 (Revised)* Forming an Opinion and Reporting on Financial Statements

(Effective for audits of financial statements for periods beginning on or after -----)

Your comments on the Exposure Draft should reach us by **July 31, 2009**. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

**Secretary, Auditing and Assurance Standards Board
The Institute of Chartered Accountants of India
ICAI Bhawan, C-1, Sector-1, NOIDA, Uttar Pradesh - 201 301.**
Comments can also be emailed at: aasb@icai.org

Standard on Auditing (SA) 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", which sets out the authority of SAs and proposed SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"².

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibility to form an opinion on the financial statements. It also deals with the form and content of the auditor's report issued as a result of an audit of financial statements.
2. Proposed SA 705³ and Proposed SA 706⁴ deal with how the form and content of the auditor's report are affected when the auditor expresses a modified opinion or includes an Emphasis of Matter paragraph or an Other Matter paragraph in the auditor's report.
3. This SA is written in the context of a complete set of general purpose financial statements. Proposed SA 800⁵ deals with special considerations when financial statements are prepared in accordance with a special

purpose framework. Proposed SA 805⁶ deals with special considerations relevant to an audit of a single financial statement or of a specific element, account or item of a financial statement.

4. This SA promotes consistency in the auditor's report. Consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognised standards. It also helps to promote the user's understanding and to identify unusual circumstances when they occur.

Effective Date

5. This SA is effective for audits of financial statements for periods beginning on or after

Objectives

6. The objectives of the auditor are to:
- (a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
 - (b) Express clearly that opinion through a written report that also describes the basis for the opinion.

Definitions

7. For purposes of the SAs, the following terms have the meanings attributed below:
- (a) General purpose financial statements—Financial statements prepared in accordance with a general purpose framework⁷.
 - (b) General purpose framework – A financial reporting framework

* Earlier known as SA 700 (AAS 28), "The Auditor's Report on Financial Statements".

¹ Published in the July, 2007 issue of the Journal.

² Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200.

³ Proposed SA 705, "Modifications to the Opinion in the Independent Auditor's Report". The Exposure Draft of SA 705 is published elsewhere in this issue of the Journal.

⁴ Proposed SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report". The Exposure Draft of SA 706 is published elsewhere in this issue of the Journal.

⁵ The Auditing and Assurance Standards Board (AASB) has already undertaken a project to formulate the proposed SA 800 corresponding to International Standard on Auditing (ISA) 800 (Revised and Redrafted), "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks".

⁶ The Auditing and Assurance Standards Board (AASB) has already undertaken a project to formulate the proposed SA 805 corresponding to International Standard on Auditing (ISA) 805 (Revised and Redrafted), "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement".

⁷ Paragraph 3.4 of the Revised Preface to the Statements of Accounting Standards issued by the Institute of Chartered Accountants of India in 2004 states as follows:

"The term "General Purpose Financial Statements" includes balance sheet, statement of profit and loss, a cash flow statements (wherever applicable) and statements and explanatory notes which form part thereof, issued for the use of various stakeholders, Governments and their agencies and the public....."

designed to meet the common financial information needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework.

The term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

- (i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
- (ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term “compliance framework” is used to refer to a financial reporting framework that requires compliance

with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above⁸.

(c) Unmodified opinion – The opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework⁹.

8. Reference to “financial statements” in this SA means “a complete set of general purpose financial statements, including the related notes.” The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The requirements of the applicable financial reporting framework determine the form and content of the financial statements, and what constitutes a complete set of financial statements.

9. Reference to “Financial Reporting Standards” in this SA means the Accounting Standards promulgated by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) or Accounting Standards, notified by the Central Government by

publishing the same as the Companies (Accounting Standards) Rules, 2006, or the Accounting Standards for Local Bodies promulgated by the Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India, as may be applicable.

Requirements

Forming an Opinion on the Financial Statements

10. The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.^{10 & 11}

11. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:

- (a) The auditor’s conclusion, in accordance with SA 330, whether sufficient appropriate audit evidence has been obtained;¹²
- (b) The auditor’s conclusion, in accordance with SA 450, whether uncorrected misstatements are

⁸ Presently, SA 200, “Basic Principles Governing an Audit” and SA 200A, “Objective and Scope of an Audit of Financial Statements” correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing”. Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200. Paragraph 13(a) of ISA 200 states as follows:

“(a) Applicable financial reporting framework – The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

The term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

(i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

(ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term “compliance framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above”.

⁹ Paragraphs 35-36 deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework respectively.

¹⁰ Presently, SA 200, “Basic Principles Governing an Audit” and SA 200A, “Objective and Scope of an Audit of Financial Statements” correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200. ISA 200 (Revised and Redrafted), paragraph 11 states as follows:

“11. In conducting an audit of financial statements, the overall objectives of the auditor are:

(a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

(b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor’s findings”.

¹¹ Paragraphs 35-36 deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework, respectively.

¹² SA 330, “The Auditor’s Responses to Assessed Risks,” paragraph 27.

- material, individually or in aggregate;¹³ and
- (c) The evaluations required by paragraphs 12-15.
12. The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: Para. A1-A3)
13. In particular, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:
- The financial statements adequately disclose the significant accounting policies selected and applied;
 - The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
 - The accounting estimates made by management are reasonable;
 - The information presented in the financial statements is relevant, reliable, comparable and understandable;
 - The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and (Ref: Para. A4)
 - The terminology used in the financial statements, including the title of each financial statement, is appropriate.
14. When the financial statements are prepared in accordance with a fair presentation framework, the evaluation required by paragraphs 12-13 shall also include whether the financial statements achieve fair presentation. The auditor's evaluation as to whether the financial statements achieve fair presentation shall include consideration of:
- The overall presentation, structure and content of the financial statements; and
 - Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.
15. The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: Para. A5-A10)
- Form of Opinion**
16. The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
17. If the auditor:
- concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
 - is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor shall modify the opinion in the auditor's report in accordance with proposed SA 705.
18. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705. (Ref: Para. A11)
19. When the financial statements are prepared in accordance with a compliance framework, the auditor is not required to evaluate whether the financial statements achieve fair presentation. However, if in extremely rare circumstances the auditor concludes that such financial statements are misleading, the auditor shall discuss the matter with management and, depending on how it is resolved, shall determine whether, and how, to communicate it in the auditor's report. (Ref: Para. A12)
- Auditor's Report**
20. The auditor's report shall be in writing. (Ref: Para. A13-A14)
- Auditor's Report for Audits Conducted in Accordance with Standards on Auditing**
- Title**
21. The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor. (Ref: Para. A15)
- Addressee**
22. The auditor's report shall be addressed as required by the circumstances of the engagement. (Ref: Para. A16)
- Introductory Paragraph**
23. The introductory paragraph in the auditor's report shall: (Ref: Para. A17-A19)
- Identify the entity whose financial statements have been audited;
 - State that the financial statements have been audited;
 - Identify the title of each statement that comprises the financial statements;
 - Refer to the summary of significant accounting policies and other explanatory information; and
 - Specify the date or period covered by each financial statement comprising the financial statements.

¹³The proposed SA 450 has been approved by the Board for placing the same for the consideration of the Council. Paragraph 11 of the Exposure Draft (published in January 2009 issue of the Journal) of the SA 450, "Evaluation of Misstatements Identified during the Audit," states as follows: "11. The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider:

- The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and (Ref: Para. A13-A17, A19-A20)
- The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. (Ref: Para. A18)".

Management's Responsibility for the Financial Statements

24. This section of the auditor's report describes the responsibilities of those in the organisation that are responsible for the preparation of the financial statements. The auditor's report need not refer specifically to "management," but shall use the term that is appropriate in the context of the legal and/or regulatory framework applicable to the entity. In case of some entities, the appropriate reference may be to those charged with governance*.

25. The auditor's report shall include a section with the heading "*Management's [or other appropriate term] Responsibility for the Financial Statements.*"

26. The auditor's report shall describe management's responsibility for the preparation of the financial statements in the manner in which that responsibility is described in the terms of the audit engagement. The description shall include an explanation that management is responsible for the preparation of the financial statements in accordance with the applicable financial reporting framework; this responsibility includes the design, implementation and maintenance of internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error. (Ref: Para. A20-A22)

27. Where the financial statements are prepared in accordance with a fair presentation framework, the explanation of management's responsibility for the financial statements in the auditor's report shall refer to "the preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view," as appropriate in the circumstances.

Auditor's Responsibility

28. The auditor's report shall include a section with the heading "*Auditor's Responsibility.*"

29. The auditor's report shall state that the responsibility of the auditor is to express an opinion on the financial

statements based on the audit. (Ref: Para.A23)

30. The auditor's report shall state that the audit was conducted in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India. The auditor's report shall also explain that those Standards require that the auditor comply with ethical requirements and that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. (Ref: Para. A24-A25)

31. The auditor's report shall describe an audit by stating that:

- (a) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements;
- (b) The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of internal control; and
- (c) An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by management, as well as the overall presentation of the financial statements.

32. Where the financial statements are prepared in accordance with a fair presentation framework, the description of the audit in the auditor's report shall refer to "the entity's preparation and fair presentation of the financial statements" or "the entity's preparation of financial statements that give a true and fair view," as appropriate in the circumstances.

33. The auditor's report shall state whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Auditor's Opinion

34. The auditor's report shall include a section with the heading "*Opinion.*"

35. When expressing an unmodified opinion on financial statements prepared in accordance with a fair presentation framework, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent: (Ref: Para. A26-A32)

- (a) The financial statements present fairly, in all material respects, in accordance with [the applicable financial reporting framework]; or
- (b) The financial statements give a true and fair view of in accordance with [the applicable financial reporting framework].

36. When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor's opinion shall be that the financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework]. (Ref: Para. A26, A28-A32)

37. If the reference to the applicable financial reporting framework, in the auditor's opinion, is not to the Accounting Standards promulgated by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards)

* For example, the Board of Directors under the Companies Act, 1956.

Rules, 2006, or the Accounting Standards for Local Bodies promulgated by the Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India, as may be applicable, the auditor's opinion shall identify the jurisdiction of origin of the framework.

Other Reporting Responsibilities

38. If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibility under the SAs to report on the financial statements, these other reporting responsibilities shall be addressed in a separate section in the auditor's report that shall be sub-titled "Report on Other Legal and Regulatory Requirements," or otherwise as appropriate to the content of the section. (Ref: Para. A33-A34)

39. If the auditor's report contains a separate section on other reporting responsibilities, the headings, statements and explanations referred to in paragraphs 23-37 shall be under the sub-title "Report on the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Financial Statements." (Ref: Para. A35)

Signature of the Auditor

40. The auditor's report shall be signed. (Ref: Para. A36)

Date of the Auditor's Report

41. The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that: (Ref: Para. A37-A40)

- (a) All the statements that comprise the financial statements, including the related notes, have been prepared; and
- (b) Those with the recognised authority have asserted that they have taken responsibility for those financial statements.

Place of Signature

42. The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.

Auditor's Report Prescribed by Law or Regulation

43. If the auditor is required by any law or regulation to use a specific layout or wording of the auditor's report, the auditor's report shall refer to Standards on Auditing only if the auditor's report includes, at a minimum, each of the following elements: (Ref: Para. A41)

- (a) A title;
- (b) An addressee, as required by the circumstances of the engagement;
- (c) An introductory paragraph that identifies the financial statements audited;
- (d) A description of the responsibility of management (or other appropriate term, see paragraph 24) for the preparation of the financial statements;
- (e) A description of the auditor's responsibility to express an opinion on the financial statements and the scope of the audit, that includes:
 - A reference to Standards on Auditing and the law or regulation; and
 - A description of an audit in accordance with those Standards;
- (f) An opinion paragraph containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the jurisdiction of origin of the financial reporting framework, see paragraph 37);
- (g) The auditor's signature;
- (h) The date of the auditor's report; and
- (i) The place of signature.

Auditor's Report for Audits Conducted in Accordance with Both Auditing Standards issued by the Institute of Chartered Accountants of India and International Standards on Auditing

44. An auditor may be required to conduct an audit in accordance with the auditing Standards issued by the Institute of Chartered Accountants of India (the "national auditing standards"), but may additionally have complied with the International

Standards on Auditing (ISAs) in the conduct of the audit. If this is the case, the auditor's report may refer to International Standards on Auditing in addition to the national auditing standards, but the auditor shall do so only if: (Ref: Para. A42-A43)

- (a) There is no conflict between the requirements in the national auditing standards and those in ISAs that would lead the auditor (i) to form a different opinion, or (ii) not to include an Emphasis of Matter paragraph that, in the particular circumstances, is required by ISAs; and
- (b) The auditor's report includes, at a minimum, each of the elements set out in paragraph 43(a)-(i) when the auditor uses the layout or wording specified by the national auditing standards. Reference to law or regulation in paragraph 43(e) shall be read as reference to the national auditing standards. The auditor's report shall thereby identify such national auditing standards.

45. When the auditor's report refers to both the national auditing standards and International Standards on Auditing, the auditor's report shall identify the national auditing standards being the Standards on Auditing issued by the Institute of Chartered Accountants of India.

Supplementary Information Presented with the Financial Statements (Ref: Para. A44-A50)

46. If supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate whether such supplementary information is clearly differentiated from the audited financial statements. If such supplementary information is not clearly differentiated from the audited financial statements, the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall explain in the auditor's report that such supplementary information has not been audited.

47. Supplementary information that is not required by the applicable financial

reporting framework but is nevertheless an integral part of the financial statements because it cannot be clearly differentiated from the audited financial statements due to its nature and how it is presented shall be covered by the auditor's opinion.

Application and Other Explanatory Material

Qualitative Aspects of the Entity's Accounting Practices (Ref: Para. 12)

A1. Management makes a number of judgments about the amounts and disclosures in the financial statements.

A2. SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.¹⁴ In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:

- The selective correction of misstatements brought to manage-

ment's attention during the audit (e.g., correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings).

- Possible management bias in the making of accounting estimates.

A3. SA 540 (Revised) addresses possible management bias in making accounting estimates.¹⁵ Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

Disclosure of the Effect of Material Transactions and Events on the Information Conveyed in the Financial Statements (Ref: Para. 13(e))

A4. It is common for financial statements prepared in accordance with a general purpose framework to present an entity's Balance Sheet, Statement of Profit and Loss and Cash Flow statement. In such circumstances, the auditor evaluates whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material

transactions and events on the entity's financial position, financial performance and cash flows.

Description of the Applicable Financial Reporting Framework (Ref: Para. 15)

A5. As explained in proposed SA 200 (Revised), management and, where appropriate, those charged with governance have responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework and for an adequate description of that framework in the financial statements.¹⁶ That description is important because it advises users of the financial statements of the framework on which the financial statements are based.

A6. A description that the financial statements are prepared in accordance with a particular applicable financial reporting framework is appropriate only if the financial statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.

A7. A description of the applicable financial reporting framework that contains imprecise qualifying or limiting language (e.g., "the financial statements are in substantial compliance with Financial Reporting Standards") is not an adequate description of that framework as it

¹⁴ SA 260 (Revised), "Communication with Those Charged with Governance," Appendix.

¹⁵ SA 540 (Revised), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures," paragraph 21.

¹⁶ Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing." Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200. ISA 200 (Revised and Redrafted), paragraphs A2-A3 state as follows:

"A2. An audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have responsibility:

(a) For the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and

(b) To provide the auditor with:

(i) All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;

(ii) Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and

(iii) Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.

A3. As part of their responsibility for the preparation and presentation of the financial statements, management and, where appropriate, those charged with governance are responsible for:

- The identification of the applicable financial reporting framework, in the context of any relevant laws or regulations.
- The preparation and presentation of the financial statements in accordance with that framework.
- An adequate description of that framework in the financial statements.
- The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework."

¹⁷ Accounting Standards promulgated by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards) Rules, 2006, or the Accounting Standards for Local Bodies promulgated by the Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of

may mislead users of the financial statements.

Reference to More than One Financial Reporting Framework

A8. In some cases, the financial statements may represent that they are prepared in accordance with two financial reporting frameworks (e.g., the national framework and International Financial Reporting Standards). This may be because management is required, or has chosen, to prepare the financial statements in accordance with both frameworks, in which case both are applicable financial reporting frameworks. Such description is appropriate only if the financial statements comply with each of the frameworks individually. To be regarded as being prepared in accordance with both frameworks, the financial statements need to comply with both frameworks simultaneously and without any need for reconciling statements. In practice, simultaneous compliance is unlikely unless the jurisdiction has adopted the other framework (e.g., International Financial Reporting Standards) as its own national framework, or has eliminated all barriers to compliance with it.

A9. Financial statements that are prepared in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework, are not prepared in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.

A10. The financial statements may, however, be prepared in accordance with one applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements

comply with another framework (e.g., financial statements prepared in accordance with the national framework that also describe the extent to which they comply with International Financial Reporting Standards). Such description is supplementary financial information and, as discussed in paragraph 47, is considered an integral part of the financial statements and, accordingly, is covered by the auditor's opinion.

Form of Opinion (Ref: Para. 18-19)

A11. There may be cases where the financial statements, although prepared in accordance with the requirements of a fair presentation framework, do not achieve fair presentation. Where this is the case, it may be possible for management to include additional disclosures in the financial statements beyond those specifically required by the framework or, in extremely rare circumstances, to depart from a requirement in the framework in order to achieve fair presentation of the financial statements.

A12. It will be extremely rare for the auditor to consider financial statements that are prepared in accordance with a compliance framework to be misleading if, in accordance with proposed SA 210 (Revised), the auditor determined that the framework is acceptable.¹⁸

Auditor's Report (Ref: Para. 20)

A13. A written report encompasses reports issued in hard copy format and those using an electronic medium.

A14. The Appendix contains illustrations of auditors' reports on financial statements, incorporating the elements set forth in paragraphs 21-42.

Auditor's Report for Audits Conducted in Accordance with Standards on Auditing

Title (Ref: Para. 21)

A15. A title indicating the report is the report of an independent auditor, for

example, "Independent Auditor's Report," affirms that the auditor has met all of the relevant ethical requirements regarding independence and, therefore, distinguishes the independent auditor's report from reports issued by others.

Addressee (Ref: Para. 22)

A16. The law or regulation applicable to the entity often specifies to whom the auditor's report is to be addressed. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.

Introductory Paragraph (Ref: Para. 23)

A17. The introductory paragraph states, for example, that the auditor has audited the accompanying financial statements of the entity, which comprise [state the title of each financial statement comprising the complete set of financial statements required by the applicable financial reporting framework, specifying the date or period covered by each financial statement] and referring to the summary of significant accounting policies and other explanatory information.

A18. When the auditor is aware that the audited financial statements will be included in a document that contains other information, such as an annual report, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the audited financial statements are presented. This helps users to identify the financial statements to which the auditor's report relates.

A19. The auditor's opinion covers the complete set of financial statements as defined by the applicable financial reporting framework. For example, in the case of many general purpose frameworks, the financial statements include: a Balance Sheet, Statement

¹⁸ Proposed SA 210 (Revised), "Agreeing the Terms of Audit Engagements," paragraph [6(a)].

of Profit and Loss, a Cash Flow Statement, and a summary of significant accounting policies and other explanatory information. In case of some entities, additional information might also be considered to be an integral part of the financial statements.

Management's Responsibility for the Financial Statements (Ref: Para. 26)

A20. Proposed SA 200 (Revised) explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted.¹⁹ Management and, where appropriate, those charged with governance are responsible for the preparation of the financial statements in accordance with the applicable financial reporting framework. For example, in the case of many general purpose frameworks, management is responsible for the preparation of financial statements that fairly present the financial position, financial performance and cash flows of the entity in accordance with those frameworks. This responsibility includes the design, implementation and maintenance of internal control relevant

to the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In some cases, law or regulation prescribing management's responsibilities may specifically refer to a responsibility for the adequacy of accounting books and records, or accounting system. As books, records and systems are an integral part of internal control (as defined in SA 315²⁰) no specific reference is made to them in paragraph 26 for the description of management's responsibilities.

A21. There may be circumstances when it is appropriate for the auditor to add to the description of management's responsibility in paragraph 26 to reflect additional responsibilities that are relevant to the preparation of the financial statements in the context of the particular jurisdiction or the nature of the entity.

A22. Proposed SA 210 (Revised) explains that, if law or regulation prescribes the responsibilities of management and, where appropriate, those charged with governance in relation to financial reporting, the auditor may determine that the law or regulation includes responsibilities that are equivalent in effect to those set out in Proposed SA 210. (Revised). For such respon-

sibilities that are equivalent, the auditor may use the wording of the law or regulation to describe them in the engagement letter or other suitable form of written agreement. For those that are not prescribed by law or regulation such that their effect is equivalent, the engagement letter or other suitable form of written agreement reflects the description in Proposed SA 210 (Revised).²¹ *Auditor's Responsibility (Ref: Para. 29-30)*

A23. The auditor's report states that the auditor's responsibility is to express an opinion on the financial statements based on the audit in order to contrast it to management's responsibility for the preparation of the financial statements.

A24. The reference to the Standards used conveys to the users of the auditor's report that the audit has been conducted in accordance with established Standards.

A25. In accordance with Proposed SA 200 (Revised), the auditor does not represent compliance with SAs in the auditor's report unless the auditor has complied with the requirements of the proposed SA 200 (Revised) and all other SAs relevant to the audit²².

Auditor's Opinion (Ref: Para. 35-37)

Wording of the auditor's opinion prescribed by law or regulation

¹⁹Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200. ISA 200 (Revised and Redrafted), paragraph 13(i) states as follows:

(j) Premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted – That management and, where appropriate, those charged with governance have the following responsibilities that are fundamental to the conduct of an audit in accordance with ISAs. That is, responsibility:

(i) For the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and

(ii) To provide the auditor with:

a. All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;

b. Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and

c. Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.

In the case of a fair presentation framework, the responsibility is for the preparation and fair presentation of the financial statements in accordance with the financial reporting framework; or the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework. This applies to all references to "preparation and presentation of the financial statements" in the ISAs.

The "premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted" may also be referred to as the "premise."

²⁰ SA 315, "Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and Its Environment," paragraph 4(c).

²¹ Proposed SA 210 (Revised), paragraph 6(b)

²² Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200. ISA 200 (Revised and Redrafted), paragraph 20 states as follows:

"The auditor shall not represent compliance with ISAs in the auditor's report unless the auditor has complied with the requirements of this ISA and all other ISAs relevant to the audit."

A26. Proposed SA 210 (Revised) explains that, in some cases, law or regulation prescribes the wording of the auditor's report (which in particular includes the auditor's opinion) in terms that are significantly different from the requirements of SAs. In these circumstances, proposed SA 210 (Revised) requires the auditor to evaluate:

- (a) Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,
- (b) Whether additional explanation in the auditor's report can mitigate possible misunderstanding.

If the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, proposed SA 210 (Revised) requires the auditor not to accept the audit engagement, unless required by law or regulation to do so. In accordance with proposed SA 210 (Revised), an audit conducted in accordance with such law or regulation does not comply with SAs. Accordingly, the auditor does not include any reference in the auditor's report to the audit having been conducted in accordance with Standards on Auditing.²³

"Present fairly, in all material respects" or "give a true and fair view"

A27. Whether the phrase "present fairly, in all material respects," or the phrase "give a true and fair view" is used in any particular jurisdiction is determined by the law or regulation governing the audit of financial statements in that jurisdiction, or by generally accepted practice in that jurisdiction. Where law or regulation requires the use of different wording, this does not affect the requirement in paragraph 14 of this SA for the auditor to evaluate the fair presentation of financial statements prepared in accordance with a fair presentation framework.

Description of information that the financial statements present

A28. In the case of financial statements prepared in accordance with a fair presentation framework, the auditor's opinion states that the financial statements present fairly, in all material respects, or give a true and fair view of the information that the financial statements are designed to present, for example, in the case of many general purpose frameworks, the financial position of the entity as at the end of the period and the entity's financial performance and cash flows for the period then ended.

Description of the applicable financial reporting framework and how it may affect the auditor's opinion

A29. The identification of the applicable financial reporting framework in the auditor's opinion is intended to advise users of the auditor's report of the context in which the auditor's opinion is expressed; it is not intended to limit the evaluation required in paragraph 14. The applicable financial reporting framework is identified in such terms as:

"... in accordance with International Financial Reporting Standards" or
 "... in accordance with accounting principles generally accepted in India ..."

A30. When the applicable financial reporting framework encompasses financial reporting standards and legal or regulatory requirements, the framework is identified in such terms as "...the information required by the Companies Act, 1956, in the manner so required and (give a true and fair view) in conformity with the accounting principles generally accepted in India." Proposed SA 210 (Revised) deals with circumstances where there are conflicts between the financial reporting standards and the legislative or regulatory requirements.²⁴

A31. As indicated in paragraph A8, the financial statements may be prepared in accordance with two financial reporting frameworks, which are therefore both applicable financial reporting frameworks. Accordingly, each framework is considered sepa-

rately when forming the auditor's opinion on the financial statements, and the auditor's opinion in accordance with paragraphs 35-36 refers to both frameworks as follows:

- (a) If the financial statements comply with each of the frameworks individually, two opinions are expressed: that is, that the financial statements are prepared in accordance with one of the applicable financial reporting frameworks (e.g., the national framework) and an opinion that the financial statements are prepared in accordance with the other applicable financial reporting framework (e.g., International Financial Reporting Standards). These opinions may be expressed separately or in a single sentence (e.g., the financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in India and with International Financial Reporting Standards).
- (b) If the financial statements comply with one of the frameworks but fail to comply with the other framework, an unmodified opinion can be given that the financial statements are prepared in accordance with the one framework (e.g., the national framework) but a modified opinion given with regard to the other framework (e.g., International Financial Reporting Standards) in accordance with proposed SA 705.

A32. As indicated in paragraph A10, the financial statements may represent compliance with the applicable financial reporting framework and, in addition, disclose the extent of compliance with another financial reporting framework. As explained in paragraph A45, such supplementary information is covered by the auditor's opinion as it cannot be clearly differentiated from the financial statements.

- (a) If the disclosure as to the compliance with the other framework is misleading, a modified opinion is

²³ SA 210, paragraph 21.

²⁴ Proposed SA 210 (Revised), paragraph [18].

expressed in accordance with proposed SA 705.

- (b) If the disclosure is not misleading, but the auditor judges it to be of such importance that it is fundamental to the users' understanding of the financial statements, an Emphasis of Matter paragraph is added in accordance with proposed SA 706, drawing attention to the disclosure.

A32a. There can be situations where an entity or a class of entities obtains written permission from the Central Government of India or a regulator or by order of a court of law having jurisdiction to make such an order, to prepare its financial statements without meeting specific recognition, measurement, presentation or disclosure requirements of the applicable financial reporting framework. Such a change shall be treated as a modification of the financial reporting framework and not as inability of the auditor to obtain sufficient appropriate audit evidence. If the effect of this is material, the auditor shall describe in sufficient detail the resultant deviation from the financial reporting framework in an Emphasis of Matter paragraph in accordance with the proposed SA 706.

Other Reporting Responsibilities (Ref: Para. 38-39)

A33 In case of some entities, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility under the SAs to report on the financial statements. For example, the auditor may be asked to report certain matters if they come to the auditor's attention during the course of the audit of the financial statements. Alternatively, the auditor may be asked to perform and report on additional specified procedures, or to express an opinion on specific matters, such as the adequacy of accounting books and records. Auditing standards often provide guidance on the auditor's responsibilities with respect to

specific additional reporting responsibilities in such situations.

A34. In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

A35. These other reporting responsibilities are addressed in a separate section of the auditor's report in order to clearly distinguish them from the auditor's responsibility under the SAs to report on the financial statements. Where relevant, this section may contain sub-heading(s) that describe(s) the content of the other reporting responsibility paragraph(s).

Signature of the Auditor (Ref: Para. 40)

A36. The report is signed by the auditor in his personal name. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm. The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India.

Date of the Auditor's Report (Ref: Para. 41)

A37. The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in SA 560.²⁵

A38. Since the auditor's opinion is provided on the financial statements and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements that comprise the financial statements, including the related notes, have been prepared

and management has accepted responsibility for them.

A39. In case of some entities, the applicable law or regulation identifies the individuals or bodies (e.g., the directors) that are responsible for concluding that all the statements that comprise the financial statements, including the related notes, have been prepared, and specifies the necessary approval process. In such cases, evidence is obtained of that approval before dating the report on the financial statements. In case of some other entities, however, the approval process is not prescribed in law or regulation. In such cases, the procedure the entity follows in preparing and finalising its financial statements in view of its management and governance structures is considered in order to identify the individuals or body with the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared. In some cases, law or regulation identifies the point in the financial statement reporting process at which the audit is expected to be complete.

A40. In some entities, final approval of the financial statements by shareholders is required before the financial statements are issued publicly. In these entities, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements for purposes of SAs is the earlier date on which those with the recognised authority determine that all the statements that comprise the financial statements, including the related notes, have been prepared and that those with the recognised authority have asserted that they have taken responsibility for them.

Auditor's Report Prescribed by Law or Regulation (Ref: Para. 43)

A41. Proposed SA 200 (Revised) explains that the auditor may be

²⁵ SA 560, "Subsequent Events," paragraphs 10-17.

required to comply with legal or regulatory requirements in addition to SAs²⁶. Where this is the case, the auditor may be obliged to use a layout or wording in the auditor's report that differs from that described in this SA. As explained in paragraph 4, consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognised standards. When the differences between the legal or regulatory requirements and SAs relate only to the layout and wording of the auditor's report and, at a minimum, each of the elements identified in paragraph 43(a)-(i) are included in the auditor's report, the auditor's report may refer to Standards on Auditing. Accordingly, in such circumstances the auditor is considered to have complied with the requirements of SAs, even when the layout and wording used in the auditor's report are specified by legal or regulatory reporting requirements. Where specific requirements in a particular law or regulation do not conflict with SAs, adoption of the layout and wording used in this SA assists users of the auditor's report more readily to recognise the auditor's report as a report on an audit conducted in accordance with SAs. (Proposed SA 210 (Revised) deals with circumstances where law or regulation prescribes the layout or wording of the auditor's report in terms that are significantly different from the requirements of SAs.)

Auditor's Report for Audits Conducted in Accordance with Both Auditing Standards issued by the

Institute of Chartered Accountants of India (national auditing standards) and International Standards on Auditing (Ref: Para. 44)

A42. The auditor may refer in the auditor's report to the audit having been conducted in accordance with both International Standards on Auditing as well as the national auditing standards, i.e., the Standards on Auditing issued by the Institute of Chartered Accountants of India when, in addition to complying with the national auditing standards, the auditor complies with each of the ISAs relevant to the audit²⁷.

A43. A reference to both International Standards on Auditing and the national auditing standards is not appropriate if there is a conflict between the requirements in SAs and those in the national auditing standards that would lead the auditor to form a different opinion or not to include an Emphasis of Matter paragraph that, in the particular circumstances, is required by ISAs. In such a case, the auditor's report refers only to the auditing standards (either International Standards on Auditing or the national auditing standards) in accordance with which the auditor's report has been prepared.

Supplementary Information Presented with the Financial Statements (Ref: Para. 46-47)

A44. In some circumstances, the entity may be required by law, regulation or Standards, or may voluntarily choose, to present together with the financial statements supplementary information that is not required by the applicable financial reporting framework. For example, supplementary information might be presented to enhance a

user's understanding of the applicable financial reporting framework or to provide further explanation of specific financial statement items. Such information is normally presented in either supplementary schedules or as additional notes.

A45. The auditor's opinion covers supplementary information that cannot be clearly differentiated from the financial statements because of its nature and how it is presented. For example, this would be the case when the notes to the financial statements include an explanation of the extent to which the financial statements comply with another financial reporting framework. The auditor's opinion would also cover notes or supplementary schedules that are cross-referenced from the financial statements.

A46. Supplementary information that is covered by the auditor's opinion does not need to be specifically referred to in the introductory paragraph of the auditor's report when the reference to the notes in the description of the statements that comprise the financial statements in the introductory paragraph is sufficient.

A47. The law or regulation applicable to the entity may not require that the supplementary information be audited, and management may decide not to ask the auditor to include the supplementary information within the scope of the audit of the financial statements.

A48. The auditor's evaluation whether unaudited supplementary information is presented in a manner that could be construed as being covered by the auditor's opinion includes, for example, where that information is presented in relation to the financial

²⁶ Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200. ISA 200 (Revised and Redrafted), paragraph A55 states as follows:

"In performing an audit, the auditor may be required to comply with legal or regulatory requirements in addition to the ISAs. The ISAs do not override laws and regulations that govern an audit of financial statements. In the event that those laws and regulations differ from the ISAs, an audit conducted only in accordance with laws and regulations will not automatically comply with ISAs".

²⁷ Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200. ISA 200 (Revised and Redrafted), paragraph A56 states as follows:

"The auditor may also conduct the audit in accordance with both ISAs and auditing standards of a specific jurisdiction or country. In such cases, in addition to complying with each of the ISAs relevant to the audit, it may be necessary for the auditor to perform additional audit procedures in order to comply with the relevant standards of that jurisdiction or country."

statements and any audited supplementary information, and whether it is clearly labeled as “unaudited.”

A49. Management could change the presentation of unaudited supplementary information that could be construed as being covered by the auditor’s opinion, for example, by:

- Removing any cross references from the financial statements to unaudited supplementary schedules or unaudited notes so that the demarcation between the audited and unaudited information is sufficiently clear.
- Placing the unaudited supplementary information outside of the financial statements or, if that is not possible in the circumstances, at a minimum, place the unaudited notes together at the end of the required notes to the financial statements and clearly label them as unaudited. Unaudited notes that are intermingled with the audited notes can be misinterpreted as being audited.

A50. The fact that supplementary information is unaudited does not relieve the auditor of the responsibility to read that information to identify material inconsistencies with the audited financial statements. The auditor’s responsibilities with respect to unaudited supplementary information are consistent with those described in SA 720.²⁸

Material Modifications *vis-a-vis* ISA 700, “Forming an Opinion and Reporting on Financial Statements”

Additions

1. Paragraph 9 of ISA 700 explains what constitutes the International Financial Reporting Standards (IFRS) for the ISA 700. Since in India, financial reporting standards, used for the preparation and presentation of financial statements, can be ‘Accounting Standards promulgated by the Accounting Standards Board of the Institute of Chartered Accountants of India or Accounting Standards, notified by the Central Government by publishing the same as

Companies (Accounting Standards) Rules, 2006’ or ‘Accounting Standards for Local Bodies promulgated by the Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India (ICAI)’, the paragraph 9 has accordingly been changed. Corresponding changes have also been made at the relevant places of the Standard.

2. Paragraph 42 of ISA 700 states that the auditor’s report shall name the location in the jurisdiction where the auditor practices. Since the practices prevailing in India requires the auditor to mention the “Place of Signature” instead of the “Auditor’s Address” in the auditor’s report, the requirement of mentioning the auditor’s address has been replaced with the place of signature, which is the name of specific location, which is ordinarily the city where the audit report is signed. Corresponding changes have also been made at the relevant places of the Standard.

3. Paragraph A36 of ISA 700 explains who is eligible for signing the auditor’s report in the different situations. Since in India, audit report may be signed by the auditor in his personal name in case of sole practitioner and where the firm is appointed as the auditor, the report may be signed in the personal name of the auditor and in the name of the audit firm, the paragraph has accordingly been changed. Since as per the Indian practice, the partner/ proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India, the said requirement has also been incorporated in the paragraph A36 of proposed SA 700.

Appendix (Ref: Para. A14)

Illustrative Formats of Auditors’ Reports on Financial Statements

Illustration 1:

Circumstances include the following:

- o *Audit of a complete set of separate general purpose financial statements of a company prepared*

under the Companies Act, 1956 financial reporting frame-work, which is a fair presentation framework.

- o *The terms of the audit engagement reflect description of management’s responsibility for the financial statements in SA 210.*
- o *The report is unmodified and does not include either an Emphasis of Matter paragraph or an Other Matter(s) paragraph.*
- o *In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.*

INDEPENDENT AUDITOR’S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited (“the Company”), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors’ Responsibility for the Financial Statements

Board of Directors is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 (“the Act”). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements

²⁸ SA 720, “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements”.

based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date; and

(c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.
2. As required by section 227(3) of the Act, we report that:
 - a. we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
 - b. in our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]²⁹;
 - c. the Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]³⁰;
 - d. in our opinion, the Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement comply with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956;
 - e. on the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none

of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Companies Act, 1956.

- f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.

For XYZ and Co.
Chartered Accountants

Signature
(Name of the Member Signing the
Audit Report)
(Designation³¹)
Membership Number

Place of Signature

Date

Illustration 2:

Circumstances include the following:

- *Audit of a complete set of consolidated general purpose financial statements of a parent company prepared under accounting principles generally accepted in India, as required for compliance with SEBI's regulatory requirement, which is a fair presentation framework.*
- *The terms of the group audit engagement reflect description of management's responsibility for the financial statements in SA 210.*
- *The report is unmodified and does not include either an Emphasis of Matter paragraph or an Other Matter(s) paragraph.*

INDEPENDENT AUDITOR'S REPORT
To the Board of Directors of ABC
Company Limited

We³² have audited the accompanying

²⁹ To be included if relevant.

³⁰ To be included if relevant.

³¹ Partner or Proprietor, as the case may be.

³² As there is no reporting on 'Other Legal and Regulatory Requirements', there is no necessity of including the heading 'Report on the Financial Statements' above the introductory paragraph.

consolidated financial statements of ABC Company Limited (“the Company”) and its subsidiaries, which comprise the consolidated Balance Sheet as at March 31, 20XX, and the consolidated Statement of Profit and Loss and the consolidated Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Director’s Responsibility for the Consolidated Financial Statements

Board of Directors is responsible for the preparation of these consolidated financial statements that give a true and fair view of the consolidated financial position, consolidated financial performance and consolidated cash flows of the Company in accordance with accounting principles generally accepted in India. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the consolidated financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the

consolidated financial statements. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company’s preparation and presentation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances [but not for the purposes of expressing an opinion on the effectiveness of the Company’s internal control]³³.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the consolidated financial statements give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the consolidated Profit and Loss Account, of the profit/ loss for the year ended on that date; and
- (c) in the case of the consolidated Cash Flow Statement, of the cash

flows for the year ended on that date.

For XYZ and Co.
Chartered Accountants

Signature
(Name of the Member Signing the
Audit Report)
(Designation³⁴)
Membership Number

Place of Signature

Date

Illustration 3:

Circumstances include the following:

- *Audit of a complete set of separate general purpose financial statements of an entity prepared in accordance with the requirements of XYZ Law of India under a compliance framework.*
- *The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in SA 210.*
- *The report is unmodified and does not include either an Emphasis of Matter paragraph or an Other Matter(s) paragraph.*

**INDEPENDENT AUDITOR’S REPORT
[Appropriate Addressee]**

We³⁵ have audited the accompanying financial statements of ABC and Associates which comprise the Balance Sheet as at March 31, 20XX, and the Profit and Loss Account³⁶ for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements in accordance with XYZ Law of India. This responsibility includes the

³³ Words in the parentheses may be omitted if the financial reporting framework requires the auditor to specifically report on the effectiveness of the entity’s internal control.

³⁴ Partner or Proprietor, as the case may be.

³⁵ As there is no reporting on ‘Other Legal and Regulatory Requirements’, there is no necessity of including the heading ‘Report on the Financial Statements’ above the introductory paragraph.

³⁶ Provide titles of all financial statements that comprise a full set of financial statements required by XYZ Law of India.

design, implementation and maintenance of internal control relevant to the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances [but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control]³⁷. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we

have obtained is sufficient and, appropriate to provide a basis for our audit opinion.

Opinion³⁸

In our opinion and to the best of our information and according to the explanations given to us, the financial statements of ABC and Associates for the year ended March 31, 20XX are prepared, in all material respects, in accordance with XYZ Law of India.

For XYZ and Co.
Chartered Accountants

Signature
(Name of the Member Signing the
Audit Report)
(Designation³⁹)
Membership Number

Place of Signature

Date

Limited Revision Consequential to issuance of the Exposure Draft of the Standard on Auditing (SA) 700 (Revised), "Forming an Opinion and Reporting on Financial Statements"

The proposed amendments to the Standard on Auditing (SA) 560(Revised) have been shown in track change mode.

SA 560 (Revised), "Subsequent Events"

5(b). Date of approval of the financial statements – The date on which all the statements that comprise the financial statements, including the related notes, have been prepared and those with the recognised authority have asserted that they have taken responsibility for those financial statements.

A2. In some jurisdictions, law or regulation identifies the individuals or bodies (for example, management or

those charged with governance) that are responsible for concluding that all the statements that comprise the financial statements, including the related notes, have been prepared, and specifies the necessary approval process. In other jurisdictions, the approval process is not prescribed in law or regulation and the entity follows its own procedures in preparing and finalising its financial statements in view of its management and governance structures. In some jurisdictions, final approval of the financial statements by shareholders is required. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements has been obtained. The date of approval of the financial statements for purposes of the ISAs is the earlier date on which those with the recognised authority determines that all the statements that comprise the financial statements, including the related notes, have been prepared and that those with the recognised authority have asserted that they have taken responsibility for those financial statements.

A3. The auditor's report cannot be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements,¹ including evidence that all the statements that comprise the financial statements, including the related notes, have been prepared and that those with the recognised authority have asserted that they have taken responsibility for those financial statements...

³⁷ Words in parentheses may be omitted if the financial reporting framework under XYZ Law of India requires the auditor to specifically report on the effectiveness of the entity's internal control.

³⁸ Note that the opinion excludes the words 'true and fair' as this report is not under a fair presentation framework.

³⁹ Partner or Proprietor, as the case may be.

¹ SA 700 (Revised), paragraph 41. In some cases, law or regulation also identifies the point in the financial statement reporting process at which the audit is expected to be complete.

Exposure Draft

Standard on Auditing 705

Modifications to the Opinion in the Independent Auditor's Report

(Effective for audits of financial statements for periods beginning on or after)

Your comments on the Exposure Draft should reach us by **July 31, 2009**. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

Secretary, Auditing and Assurance Standards Board
The Institute of Chartered Accountants of India
ICAI Bhawan, C-1, Sector-1, NOIDA, Uttar Pradesh – 201 301.
 Comments can also be emailed at: aasb@icai.org

Standard on Auditing (SA) 705, “Modifications to the Opinion in the Independent Auditor's Report” should be read in the context of the “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services”, which sets out the authority of SAs and Proposed SA 200 (Revised), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing²”.

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with Proposed SA 700 (Revised)³, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

Types of Modified Opinions

2. This SA establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon: (Ref: Para A1)

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Effective Date

3. This SA is effective for audits of financial statements for periods beginning on or after _____.

Objective

4. The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Definitions

5. For purposes of the SAs, the following terms have the meanings attributed below:

- (a) Pervasive – A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of

misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment:

- (i) Are not confined to specific elements, accounts or items of the financial statements;
 - (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or
 - (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.
- (b) Modified opinion – A qualified opinion, an adverse opinion or a disclaimer of opinion.

Requirements

Circumstances when a Modification to the Auditor's Opinion Is Required

6. The auditor shall modify the opinion in the auditor's report when:
- (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a

¹ Published in the July, 2007 issue of the Journal.

² Presently, SA 200, “Basic Principles Governing an Audit” and SA 200A, “Objective and Scope of an Audit of Financial Statements” correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200.

³ Proposed SA 700 (Revised), “Forming an Opinion and Reporting on Financial Statements”. The Exposure Draft of the said SA is published elsewhere in this issue of the Journal.

whole are not free from material misstatement; or (Ref: Para. A2-A7)

- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: Para. A8-A12)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

7. The auditor shall express a qualified opinion when:

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

8. The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Disclaimer of Opinion

9. The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

10 The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtain-

ed sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor has Accepted the Engagement

11. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

12. If management refuses to remove the limitation referred to in paragraph 11, the auditor shall communicate the matter to those charged with governance and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

13. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall: (Ref: Para A13-A14)

- (i) Resign from the audit, where practicable and not prohibited by law or regulation; or

- (ii) If resignation from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

14. If the auditor resigns as contemplated by paragraph 13(b)(i), before resigning, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion. (Ref: Para. A15)

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion

15. When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report⁴ in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: Para. A16)

Form and Content of the Auditor's Report When the Opinion is Modified

Basis for Modification Paragraph

16. When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by the proposed SA 700 (Revised), include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification. The auditor shall place this paragraph immediately before the opinion paragraph in the auditor's report and use the heading "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate. (Ref: Para. A17)

⁴ [Proposed] SA 805, "Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" deals with circumstances where the auditor is engaged to express a separate opinion on one or more specific elements, accounts or items of a financial statement. The Auditing and Assurance Standards Board has already initiated the project for drafting a Standard corresponding to ISA 805.

17. If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor shall include in the basis for modification paragraph a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor shall so state in the basis for modification paragraph. (Ref: Para. A18)

18. If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the basis for modification paragraph an explanation of how the disclosures are misstated.

19. If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall:

- (a) Discuss the non-disclosure with those charged with governance;
- (b) Describe in the basis for modification paragraph the nature of the omitted information; and
- (c) Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: Para. A19)

20. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the basis for modification paragraph, the reasons for that inability.

21. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the basis for modification paragraph the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof. (Ref: Para. A20)

Opinion Paragraph

22. When the auditor modifies the audit opinion, the auditor shall use the heading “*Qualified Opinion*,” “*Adverse Opinion*,” or “*Disclaimer of Opinion*,” as appropriate, for the opinion paragraph. (Ref: Para. A21, A23-A24)

23. When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state in the opinion paragraph that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph:

- (a) The financial statements present fairly, in all material respects (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or
- (b) The financial statements have been prepared, in all material respects, in accordance with the applicable financial framework when reporting in accordance with a compliance framework.

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase “except for the possible effects of the matter(s)...” for the modified opinion. (Ref: Para. A22)

24. When the auditor expresses an adverse opinion, the auditor shall state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph:

- (a) The financial statements do not present fairly (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or
- (b) The financial statements have not been prepared, in all material

respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.

25. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall state in the opinion paragraph that:

- (a) because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; and, accordingly,
- (b) the auditor does not express an opinion on the financial statements.

Description of Auditor's Responsibility when the Auditor Expresses a Qualified or Adverse Opinion

26. When the auditor expresses a qualified or adverse opinion, the auditor shall amend the description of the auditor's responsibility to state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's modified audit opinion.

Description of Auditor's Responsibility When the Auditor Disclaims an Opinion

27. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the introductory paragraph of the auditor's report to state that the auditor was engaged to audit the financial statements. The auditor shall also amend the description of the auditor's responsibility and the description of the scope of the audit to state only the following: “Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matter(s) described in the Basis for Disclaimer of

Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion”.

Communication with Those Charged with Governance

28. When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate

with those charged with governance the circumstances that led to the expected modification and the proposed wording of the modification. (Ref: Para. A25)

Application and Other Explanatory Material
Scope of this SA

Types of Modified Opinions (Ref: Para. 2)

A1. The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but Not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Nature of Material Misstatements (Ref: Para. 6(a))

A2. Proposed SA 700 (Revised) requires the auditor, in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement⁵. This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with proposed SA 450⁶.

A3. Proposed SA 450 defines a misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to:

- (a) The appropriateness of the selected accounting policies;
- (b) The application of the selected accounting policies; or
- (c) The appropriateness or adequacy of disclosures in the financial statements.

Appropriateness of the Selected Accounting Policies

A4. In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise when:

- (a) The selected accounting policies are not consistent with the applicable financial reporting framework; or
- (b) The financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation.

A5. Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. Where the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements.

Application of the Selected Accounting Policies

A6. In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise:

- (a) When management has not applied the selected accounting

policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application); or

- (b) Due to the method of application of the selected accounting policies (such as an unintentional error in application).

Appropriateness or Adequacy of Disclosures in the Financial Statements

A7. In relation to the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when:

- (a) The financial statements do not include all of the disclosures required by the applicable financial reporting framework;
- (b) The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or
- (c) The financial statements do not provide the disclosures necessary to achieve fair presentation.

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 6(b))

A8. The auditor's inability to obtain sufficient appropriate audit evidence

⁵ Proposed SA 700 (Revised), paragraph 11.

⁶ Proposed SA 450, "Evaluation of Misstatements Identified during the Audit" paragraph 4(a).

(also referred to as a limitation on the scope of the audit) may arise from:

- (a) Circumstances beyond the control of the entity;
- (b) Circumstances relating to the nature or timing of the auditor's work; or
- (c) Limitations imposed by management.

A9. An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements of paragraphs 7(b) and 10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.

A10. Examples of circumstances beyond the control of the entity include when:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

A11. Examples of circumstances relating to the nature or timing of the auditor's work include when:

- The entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.
- The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

A12. Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement (Ref: Para. 13(b)-14)

A13. The practicability of resigning from the audit may depend upon the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation in the Basis for Disclaimer of Opinion paragraph prior to resigning.

A14. In certain circumstances, resignation from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor appointed to audit the financial statements of public sector entities. It may also be the case of entities where the auditor is appointed to audit the financial statements covering a specific period, or appointed for a specific period and is prohibited from resigning before the completion of the audit of those financial statements or before the end of that period, respectively. The auditor may also consider it necessary to include an Other Matter paragraph in the auditor's report⁷.

A15. When the auditor concludes that resignation from the audit is necessary because of a scope limitation, there may be a professional,

regulatory or legal requirement for the auditor to communicate matters relating to the resignation from the engagement to regulators or the entity's owners.

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion (Ref: Para. 15)

A16. The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:

- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under a different financial reporting framework.⁸
- The expression of a disclaimer of opinion regarding the results of operations, and cash flows, where relevant, and an unmodified opinion regarding the financial position (see SA 510)⁹. In this case, the auditor has not expressed a disclaimer of opinion on the financial statements as a whole.

Form and Content of the Auditor's Report When the Opinion Is Modified Basis for Modification Paragraph (Ref: Para. 16-17, 19(b), 21)

A17. Consistency in the auditor's report helps to promote the users' understanding and to identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and in the description of the basis for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

A18. Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in

⁷ Proposed SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" paragraph A5.

⁸ See paragraph A31 of proposed SA 700 (Revised) for a description of this circumstance.

⁹ SA 510 (Revised), "Initial Audit Engagements – Opening Balances" paragraph 10.

aggregate, on the financial statements should be mentioned in the auditor's report. In circumstances where it is not practicable to quantify the effect of modifications made in the audit report accurately, the auditor may do so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements. An example of the financial effects of material misstatements that the auditor may describe in the basis for modification paragraph in the auditor's report is the quantification of the effects on income tax, income before taxes, net income and reserves if inventory is overstated.

A19. Disclosing the omitted information in the basis for modification paragraph would not be practicable if:

- (a) The disclosures have not been prepared by management or the disclosures are otherwise not readily available to the auditor; or
- (b) In the auditor's judgment, the disclosures would be unduly voluminous in relation to the auditor's report.

A20. An adverse opinion or a disclaimer of opinion relating to a specific matter described in the basis for qualification paragraph does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements.

Opinion Paragraph (Ref: Para. 22-23)

A21. Inclusion of this paragraph heading makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.

A22. When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the opinion paragraph as these are not sufficiently clear or forceful.

Illustrative Auditors' Reports

A23. Illustrations 1 and 2 in the Appendix contain auditors' reports with qualified and adverse opinions, respectively, as the financial statements are materially misstated.

A24. Illustration 3 in the Appendix contains an auditor's report with a qualified opinion as the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 4 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability are both material and pervasive.

Communication with Those Charged with Governance (Ref: Para. 28)

A25. Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed wording of the modification enables:

- (a) The auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);
- (b) The auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s), or to confirm matters of disagreement with management as such; and
- (c) Those charged with governance to have an opportunity, where appropriate, to provide the auditor with further information and explanations in respect of the

matter(s) giving rise to the expected modification(s).

Material Modifications vis-a-vis ISA 705, "Modifications to the Opinion in the Independent Auditor's Report"

Additions

1. Paragraphs 17 and A18 of ISA 705 requires the auditor to include in the basis for modification paragraph, a description and quantification of the financial effect of the misstatement. Since the said paragraph covers only the effect of the individual quantification of the misstatement on the financial statements, the paragraph A18 has been changed also to include the effect of the aggregate quantifications of the misstatements on the financial statements.

Appendix

(Ref: Para. A23-24)

Illustrative Formats of Auditors' Reports with Modifications to the Opinion

Illustration 1

Circumstances include the following:

- *Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.*
- *The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.*
- *Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements. The audit opinion is qualified for the misstatement.*
- *In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.*

INDEPENDENT AUDITOR'S REPORT To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying

financial statements of ABC Company Limited (“the Company”), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 (“the Act”). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing of the Institute of Chartered Accountants of India. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the

financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion¹⁰

The Company's inventories are carried in the Balance Sheet at Rs. XXX. Management has not stated the inventories at the lower of cost and net realisable value but has stated them solely at cost, which constitutes a departure from the Accounting Standards referred to in sub-section (3C) of section 211 of the Act. The Company's records indicate that had management stated the inventories at the lower of cost and net realisable value, an amount of Rs. XXX would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by Rs. XXX, and income tax, net profit and shareholders' funds would have been reduced by Rs. XXX, Rs. XXX and Rs. XXX, respectively.

Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;*
- (b) in the case of the Profit and Loss Account, of the profit/ loss for the*

- year ended on that date; and*
- (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.*

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 (“the Order”) issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required by section 227(3) of the Act, we report that:

- a. We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
- b. In our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]¹¹;
- c. The Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]¹²;
- d. Except for the effects of the matter described in the Basis for Qualified Opinion paragraph, in our opinion, the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;
- e. On the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in

¹⁰ “Basis for Qualified Opinion” and “Qualified Opinion” paragraphs are in italics as required under Sec. 227(3)(e) of the Act.

¹¹ To be included if relevant.

¹² To be included if relevant.

terms of clause (g) of sub-section (1) of section 274 of the Act.

- f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company

For XYZ and Co.
Chartered Accountants

Signature
(Name of the Member
Signing the Audit Report)
(Designation¹³)
Membership Number

Place of Signature

Date

Illustration 2:

Circumstances include the following:

- *Audit of a complete set of consolidated general purpose financial statements of a parent company prepared under accounting principles generally accepted in India (as required for compliance with SEBI's regulatory requirement).*
- *The terms of the group audit engagement reflect description of management's responsibility for the financial statements in SA 210.*
- *The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so. An adverse audit opinion is given under the circumstances.*

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of ABC Company Limited

We¹⁴ have audited the accompanying consolidated financial statements of

ABC Company Limited ("the Company") and its subsidiaries, which comprise the consolidated Balance Sheet as at March 31, 20XX, and the consolidated Statement of Profit and Loss and consolidated Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors' Responsibility for the Consolidated Financial Statements

Board of Directors is responsible for the preparation of these consolidated financial statements that give a true and fair view of the consolidated financial position, consolidated financial performance and consolidated cash flows of the Company in accordance with accounting principles generally accepted in India. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the consolidated financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements,

whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and presentation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances [but not for the purposes of expressing an opinion on the effectiveness of the Company's internal control]¹⁵.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

Basis for Adverse Opinion

As explained in Note X, the Company has not consolidated the financial statements of subsidiary XYZ Company it acquired during 20XX because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This acquisition is therefore accounted for as an investment. Under the accounting principles generally accepted in India, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ been consolidated, many elements in the accompanying financial statements would have been materially affected. The effects on the financial statements of the failure to consolidate have not been determined.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India:

¹³ Partner or Proprietor, as the case may be.

¹⁴ As there is no reporting on "Other Legal Requirements", there is no necessity of including the heading "Report on the Financial Statements" above the introductory paragraph.

- (a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the consolidated Profit and Loss Account, of the profit/loss for the year ended on that date; and
- (c) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.

For XYZ and Co.
Chartered Accountants

Signature

(Name of the Member Signing the
Audit Report)
(Designation¹⁶)

Membership Number

Place of Signature
Date

Illustration 3:

Circumstances include the following:

- *Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.*
- *The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.*
- *The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statement. The audit opinion was qualified for the misstatement.*
- *In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.*

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors' Responsibility for the Financial Statements

Board of Directors is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing of the Institute of Chartered Accountants of India. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial state-

ments, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

ABC Company Limited's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at Rs. XXX in the Balance Sheet as at March 31, 20XX, and ABC's share of XYZ Company's net income of Rs. XXX is included in ABC Company Limited's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company Limited's investment in XYZ Company as at March 31, 20XX and ABC Company Limited's share of XYZ Company's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the possible effects¹⁷ of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting

INDEPENDENT AUDITOR'S REPORT

¹⁶ Words in parentheses may be omitted if the financial reporting framework requires the auditor to specifically report on the effectiveness of the entity's internal control.

¹⁶ Partner or Proprietor, as the case may be.

¹⁷ Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and
- (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required by section 227(3) of the Companies Act, 1956, we report that:

- a. we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit except for the matter described in the Basis for Qualified Opinion paragraph;
- b. in our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]¹⁸;
- c. the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]¹⁹;
- d. except for the possible effects²⁰ of the matter described in the Basis for Qualified Opinion paragraph, in our opinion, the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with

the accounting standards referred to in sub-section (3C) of section 211 of the Act;

- e. on the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.
- f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.

For XYZ and Co.
Chartered Accountants

Signature
(Name of the Member Signing
the Audit Report)
(Designation²¹)
Membership Number

Place of Signature

Date

Illustration 4:

Circumstances include the following:

- *Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.*
- *The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.*
- *The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. That is, the auditor was unable to obtain audit evidence about the financial information of a joint venture investment that re-presents over 90% of the Company's net assets.*

The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. A disclaimer of audit opinion is given in the circumstances.

- *In addition to the audit of financial statements, the auditor has other reporting responsibilities re-quired under the Companies Act, 1956 and/or other regulatory requirements.*

INDEPENDENT AUDITOR'S REPORT To the Members of ABC Company Limited

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and the Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit in accordance with the Standards on Auditing issued

¹⁸ To be included if relevant.

¹⁹ To be included if relevant.

²⁰ Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

²¹ Partner or Proprietor, as the case may be.

by the Institute of Chartered Accountants of India. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

The Company's investment in its joint venture XYZ Company is carried at Rs. XXX on the Company's Balance Sheet, which represents over 90% of the Company's net assets as at March 31, 20XX. We were not allowed access to the management and the auditors of XYZ Company. As a result, we were unable to determine whether any adjustments were necessary in respect of the Company's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ Company's income and expenses for the year, and the elements making up the cash flow statement.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required by section 227(3) of the Companies Act, 1956, we report that:

a. As described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain all the

information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;

- b. Due to the possible effects²² of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]²³;
- c. The Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]²⁴;
- d. Due to the possible effects of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;
- e. On the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.
- f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.

For XYZ and Co.
Chartered Accountants

Signature

(Name of the Member Signing the
Audit Report)
(Designation²⁵)

Membership Number

Place of Signature

Date

Illustration 5:

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. A disclaimer of audit opinion is given in the circumstances.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow

²² Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

²³ To be included if relevant.

²⁴ To be included if relevant.

²⁵ Partner or Proprietor, as the case may be.

Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were appointed as auditors of the Company after March 31, 20XX and thus could not observe the counting of physical inventories at the beginning and end of the year. Accordingly, we were unable to satisfy ourselves by alternative means concerning the inventory quantities held at December 31, 20X0 and March 31, 20X1 which are stated in the Balance Sheet at Rs. XXX and Rs. XXX, respectively.

In addition, the introduction of a new computerised accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our audit report,

management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of Rs. XXX as at March 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the Statement of Profit and Loss and Cash Flow Statement.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required by section 227(3) of the Companies Act, 1956, we report that:

a. As described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;

b. Due to the possible effects²⁶ of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether proper books of account as required by law have been kept by the Company so far as appears

from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]²⁷;

c. The Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]²⁸;

d. Due to the possible effects of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether the Balance Sheet, statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;

e. On the basis of written representations received from the directors as on March 31, 20X1, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20X1, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.

f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.

For XYZ and Co.
Chartered Accountants

Signature
(Name of the Member Signing the
Audit Report)
(Designation²⁹)
Membership Number

Place of Signature
Date

²⁶ Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

²⁷ To be included if relevant.

²⁸ To be included if relevant.

²⁹ Partner or Proprietor, as the case may be.

Exposure Draft

Standard on Auditing 706

Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

(Effective for audits of financial statements for periods beginning on or after -----)

Your comments on the Exposure Draft should reach us by **July 31, 2009**. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

Secretary, Auditing and Assurance Standards Board
The Institute of Chartered Accountants of India
ICAI Bhawan, C-1, Sector-1, NOIDA, Uttar Pradesh - 201 301.
 Comments can also be emailed at: aasb@icai.org

Standard on Auditing (SA) 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services¹," which sets out the authority of SAs and proposed SA 200(Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing²".

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with additional communication in the auditor's report when the auditor considers it necessary to:
 - (a) Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or
 - (b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.
2. Other Standards on Auditing (SAs) may contain specific requirements for the auditor to include Emphasis of Matter paragraphs or Other Matter paragraphs in the auditor's report. In those circumstances, the requirements in this SA regarding the form and placement of such paragraphs apply.

Effective Date

3. This SA is effective for audits of

financial statements for periods beginning on or after

Objective

4. The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:
 - (a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
 - (b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Definitions

5. For the purposes of the SAs, the following terms have the meanings attributed below:
 - (a) Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial

statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

- (b) Other Matter paragraph – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Requirements

Emphasis of Matter Paragraphs in the Auditor's Report

6. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial

¹ Published in the July, 2007 issue of the Journal.

² Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200.

statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements. (Ref: Para. A1-A2)

7. When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (a) Include it immediately after the Opinion paragraph in the auditor's report;
- (b) Use the heading "Emphasis of Matter", or other appropriate heading;
- (c) Include in the paragraph a clear reference to the matter being emphasised and to where relevant disclosures that fully describe the matter can be found in the financial statements; and
- (d) Indicate that the auditor's opinion is not modified in respect of the matter emphasised. (Ref: Para. A3-A4)

Other Matter Paragraphs in the Auditor's Report

8. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter", or other appropriate heading. The auditor shall include this paragraph immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section. (Ref: Para. A5-A11)

Communication with Those Charged with Governance

9. If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the

proposed wording of this paragraph. (Ref: Para. A12)

Application and Other Explanatory Material

Emphasis of Matter Paragraphs in the Auditor's Report

Circumstances in Which an Emphasis of Matter Paragraph May Be Necessary (Ref: Para. 6)

A1. Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- Early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

A2. A widespread use of Emphasis of Matter paragraphs diminishes the effectiveness of the auditor's communication of such matters. Additionally, to include more information in an Emphasis of Matter paragraph than is presented or disclosed in the financial statements may imply that the matter has not been appropriately presented or disclosed; accordingly, paragraph 6 limits the use of an Emphasis of Matter paragraph to matters presented or disclosed in the financial statements.

Including an Emphasis of Matter Paragraph in the Auditor's Report (Ref: Para. 7)

A3. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for either:

- (a) The auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion, when required by the circumstances of a specific audit engagement (see Proposed SA 705³); or

(b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make.

A4. The illustrative report in the Appendix includes an Emphasis of Matter paragraph in an auditor's report that contains a qualified opinion.

Other Matter Paragraphs in the Auditor's Report (Ref: Para. 8)

Circumstances in Which an Other Matter Paragraph May Be Necessary Relevant to Users' Understanding of the Audit

A5. In the rare circumstance where the auditor is unable to resign from an engagement even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive,⁴ the auditor may consider it necessary to include an Other Matter paragraph in the auditor's report to explain why it is not possible for the auditor to resign from the engagement.

Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report

A6. Law, regulation or generally accepted practice in a jurisdiction may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. Where relevant, one or more sub-headings may be used that describe the content of the Other Matter paragraph.

A7. An Other Matter paragraph does not deal with circumstances where the auditor has other reporting responsibilities that are in addition to the auditor's responsibility under the SAs to report on the financial statements (see "Other Reporting Responsibilities" section in Proposed SA 700 (Revised)⁵), or where the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters.

³ Proposed SA 705, "Modifications to the Opinion in the Independent Auditor's Report." The Exposure Draft of SA 705 has been published elsewhere in this issue of the Journal.

⁴ See paragraph 13(b)(ii) of SA 705 for a discussion of this circumstance.

⁵ [Proposed SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements," paragraph 38.] The Exposure Draft of the Proposed SA 700 (Revised) has been published elsewhere in this issue of the Journal.

Reporting on more than one set of financial statements

A8. An entity may prepare one set of financial statements in accordance with a general purpose framework (e.g., the national framework) and another set of financial statements in accordance with another general purpose framework (e.g., International Financial Reporting Standards), and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an Other Matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

Restriction on distribution or use of the auditor's report

A9. Financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs. Since the auditor's report is intended for specific users, the auditor may consider it necessary in the circumstances to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.

Including an Other Matter Paragraph in the Auditor's Report

A10. The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements. An Other Matter paragraph does not include information that the auditor is prohibited from providing by law, regulation or other standards, for example, ethical standards relating to confidentiality of information. An Other Matter paragraph also does not include information that is required to be provided by management.

A11. The placement of an Other Matter paragraph depends on the nature of the information to be communicated. When an Other Matter paragraph is included to draw users' attention to a matter relevant to their understanding of the audit of the financial statements, the paragraph is included immediately after the Opinion paragraph and any Emphasis of Matter paragraph. When an Other Matter paragraph is included to draw users' attention to a matter relating to Other Reporting Responsibilities addressed in the auditor's report, the paragraph may be included in the section sub-titled "Report on Other Legal and Regulatory Requirements." Alternatively, when relevant to all the auditor's responsibilities or users' understanding of the auditor's report, the Other Matter paragraph may be included as a separate section following the Report on the Financial Statements and the Report on Other Legal and Regulatory Requirements.

Communication with Those Charged with Governance (Ref: Para. 9)

A12. Such communication enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report, and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of an Other Matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

Material Modifications vis-a-vis ISA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report"

SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" does not contain any material modifications vis-a-vis ISA 706.

Appendix

(Ref: Para. A4)

Illustrative Formats of an Auditor's Report that Includes an Emphasis of Matter Paragraph

Illustration 1:

Circumstances include the following:

- *Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.*
- *The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.*
- *Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements. The audit opinion is qualified for the misstatement.*
- *There is uncertainty relating to a pending exceptional litigation matter. This is highlighted in the auditor's report by an Emphasis of Matter paragraph.*
- *In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.*

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors' Responsibility for the Financial Statements

Board of Directors is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and main-

tenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

The Company's inventories are carried in the Balance Sheet at Rs. XXX. Management has not stated the inventories at the lower of cost and net realisable value but has stated them solely at cost, which constitutes a departure from the accounting standards referred to in sub-section (3C) of section 211 of the Act. The

Company's records indicate that had management stated the inventories at the lower of cost and net realisable value, an amount of Rs. XXX would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by Rs. XXX, and income tax, net income and shareholders' equity would have been reduced by Rs. XXX, Rs. XXX and Rs. XXX, respectively.

Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date; and
- (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Emphasis of Matter

We draw attention to Note X to the financial statements which describes the uncertainty⁶ related to the outcome of the lawsuit filed against the Company by XYZ Company. Our opinion is not qualified in respect of this matter.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

2. As required under provisions of section 227(3) of the Companies Act, 1956, we report that:

- a. we have obtained all the infor-

mation and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;

- b. in our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]⁷;
- c. the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]⁸;
- d. except for the matter described in the Basis for Qualified Opinion paragraph, in our opinion, the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;
- e. on the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.
- f. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.

For XYZ and Co.

Chartered Accountants

Signature
(Name of the Member Signing the
Audit Report)
(Designation⁹)
Membership Number

⁶ In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.

⁷ To be included if relevant.

⁸ To be included if relevant.

⁹ Partner or Proprietor, as the case may be.

Place of Signature
Date

Illustration 2:

Circumstances include the following:

- *Audit of a complete set of consolidated general purpose financial statements of a parent company prepared under accounting principles generally accepted in India, as required for compliance with SEBI's regulatory requirement, which is a fair presentation framework.*
- *The terms of the group audit engagement reflect description of management's responsibility for the financial statements in SA 210.*
- *The report includes an Other Matter paragraph in respect of the auditor's responsibility in respect of subsidiaries not audited by him but which form part of the consolidated financial statements under report.*

**INDEPENDENT AUDITOR'S REPORT
To the Board of Directors of ABC
Company Limited**

We¹⁰ have audited the accompanying consolidated financial statements of ABC Company Limited ("the Company") and its subsidiaries, which comprise the consolidated Balance Sheet as at March 31, 20XX, and the consolidated Statement of Profit and Loss and consolidated Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors' Responsibility for the Consolidated Financial Statements

Board of Directors is responsible for the preparation of these consolidated financial statements that give a true and fair view of the consolidated financial position, consolidated financial performance and consolidated cash flows of the Company in accordance with accounting principles generally accepted in India; this

includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the consolidated financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing of the Institute of Chartered Accountants of India. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and presentation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances [but not for the purposes of expressing an opinion on the effectiveness of the Company's internal control]¹¹.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we

have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the other auditors on the financial statements of the subsidiaries as noted below, the consolidated financial statements give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the consolidated Profit and Loss Account, of the profit/ loss for the year ended on that date; and
- (c) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.

Other Matter¹²

We did not audit the financial statements of certain subsidiaries, whose financial statements reflect total assets (net) of Rs. XXXX as at March 31, 20XX, total revenues of Rs. XXXX and net cash outflows amounting to Rs. XXXX for the year then ended. These financial statements have been audited by other auditors whose reports have been furnished to us by the Management, and our opinion is based solely on the reports of the other auditors. Our opinion is not qualified in respect of this matter.

For XYZ and Co.
Chartered Accountants

Signature
(Name of the Member Signing the
Audit Report)
(Designation¹³)
Membership Number

Place of Signature
Date

¹⁰ As there is no reporting on 'Other Legal and Regulatory Requirements', there is no necessity of including the heading 'Report on the Financial Statements' above the introductory paragraph.

¹¹ Words in parentheses may be omitted if the financial reporting framework requires the auditor to specifically report on the effectiveness of the entity's internal control.

¹² This matter is given in "Other Matter" paragraph as it is currently permitted in India for an auditor to sign off a consolidated audit opinion, even where he has not performed a substantial part of the audit himself.

¹³ Partner or Proprietor, as the case may be.

Things to be Considered While Selecting a Plot

In the last issue of the journal we learnt about most types of shapes of a plot and the significance of related prominent directions. As such, you know two basic things – How to check the plot and which one to select based on its shape and directions. Now let me go ahead with other basic things which will guide you while selecting or purchasing a plot



Kashyap Nitin Pathak

The author is a Vastu expert.

He can be reached at kash3001@rediffmail.com

Colour of the Plot

White:

It is the colour of purity and if this is the colour of the plot then the result will be good and positive. The expense in making the house will be lesser. There will be no delays in the plan of building the house. The owner will earn wealth with lesser efforts.

Yellowish:

The yellow colour is the colour of Jupiter and it is best suited for building a house which can be resold in the future. The meaning is that when this house will be sold, it will reap big gains. The construction cost will be higher than budgeted.

Reddish:

This is the most common colour of the plot. Red is the colour of Mars and when a house is built on this type of plot it will be very strong. Construction on this plot will involve more labour. It is suitable for all residential needs.

Black:

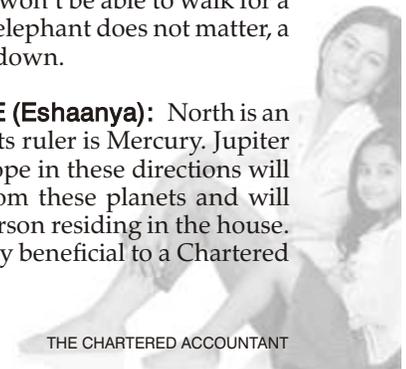
When the colour of the plot is absolutely black it is not advisable to buy the land. This will result in extremely high expenditure in making the house and the owner will face a lot of legal issues during construction phase. There will be no mental peace in the house built on such land.

Slope of the Plot

Slope of the plot can be gauged by the natural flow of water on the plot if evenly spread. The slope is also one of the deciding factors because the land which is uneven on any side will be more impacted by the directional strength and the planet that direction is ruled by. Vastu professionals do not give relative importance to the slope aspect which is generally seen as a small fault (*Dosh*) but the truth is "if an elephant walking in the jungle is hurt by a small

thorn in any of his leg, he won't be able to walk for a long time" The size of the elephant does not matter, a small factor can bring him down.

Slope towards North / NE (Eshaanya): North is an auspicious direction and its ruler is Mercury. Jupiter rules NE or *eshaanya*. A slope in these directions will attract the cosmic rays from these planets and will accordingly impact the person residing in the house. A slope in the North is very beneficial to a Chartered



Accountant's office. Business will prosper and there will be happiness for the entire family. The directional strength will assist the CA in solving even difficult issues. There will be continuous income from more than one source. There will also be a good level of knowledge exchange exercises with this direction hence it is the best suited for a school, college, university and library.

Slope towards West / SW (Nairutya): West as a direction cannot give many positive results. The ruler of this direction is Saturn and SW is ruled by Rahu Ketu. These are all evil planets and will drive the owner to unnecessary expenses, business losses and debts. The family cannot be happy in spite of having everything and spending on all the leisures of life. Health and relationships will also be an issue for this directional slope. A slope only towards the SW direction will make an owner work very hard only to get lesser financial benefit when compared to his efforts.

Slope towards South / SE (Agni): We all know by now that South is a direction which Vastu has given the least importance for its negativity. South is ruled by Mars and SE by Venus. SE is known as the Agni direction and a slope in SE has been evident in families who have faced sudden death of its members in the house. We read in the newspapers of families who were travelling together and who met with an accident. This factor should be checked in cases like these. Sudden phase of downturn in life like a business loss, loss of job and keeping the house on mortgage has been observed in the lives of occupants of the house built on plot with such slope.

Slope towards the East (only): Sun, the life giving source to the earth has an impact on this direction. The individual living in a house with this slope will be a very powerful person in the society with good governmental contacts. It enhances the family with male births and very sharp children. A lot of government servants, politicians, doctors who have houses, row houses or bungalows had this peculiar feature. It also brings good wealth to the owner.

Slope towards NW(only) (Vayavya): Moon is the ruler of NW and it has been observed that individuals who have some health problems and who shifted to new houses with this factor had to face the worst in health.

Fragrance or Smell of the Plot

You may find this a bit strange but the plot does smell. It may have a good or a bad fragrance and its smell might resemble something in your mind. Smell resembling ghee or oil indicates that the land is fertile and can be bought. It will usually be auspicious to buy such a land for residential purposes. Smell of blood shows that it will make the owner courageous and he will be able to take big tough decisions. Smell of foodgrains (dhanaya) as if you are in a farm is a very good sign and it is the best for any business. It can bring good growth and prosperity in any commercial venture to be undertaken. Smell of liquor as if the

smell of fermented grapes is not a good sign. It brings poverty to the owner and mental discord within the family.

Taste of the soil

As a Vastu practitioner, this is the toughest task! Can there be a taste of soil? The answer is yes. But not too many people apply this test. It is of course not a comprehensive test which can be a deciding factor but because they do form a principal in Vastu, I am listing them down here.

Like the usual tastes of life if the taste of the soil is sweet then it represents a sweet future for you. Family unity will be very good and people will stand besides each other in times of trouble. Slightly spicy taste of the soil is favourable for people in the military, police, or for builders. This taste represents Mars and is related to courage, construction, longer tasks and hard work. A sour or a dirty tasting plot should not be bought as it indicates higher expenditure for the owner. It will also give a bad experience to the family members as far as health is concerned.

Magnetic Field of a Plot

This can be checked with the help of a compass. Place the compass at the centre of the plot and figure out the four directions. The pointers reflect the place where you should be able to build the walls. If this is possible then the magnetic field of the plot is balanced and all energies as well as directional strength can be maintained to reap the best benefits. Such a plot will favour all Vastu principles if applied. If this is not possible then a lot of remedial measures will be required in the house, depending on many other factors.

Plots Which Should Not be Bought

1. Any plot which is opposite to the temple of deities like Vishnu, Surya Narayan, Lord Shiva should not be purchased.
2. Any plot the behind of which there is any temple is considered inauspicious and should not be bought.
3. If the shadow of the flag of a temple which is called (Dhawaja) falls on the plot in the second and third phase of the day i.e afternoon and evening, it is not considered auspicious. Construction on such a plot is not advisable.
4. If there are shops opposite to the main door of the plot where leather is sold or where there is a slaughter house or a hair cutting saloon, it is not advisable to buy such a plot.
5. The plot whose front is obstructed by anything which blocks the sight and natural morning sunlight, should not be bought.
6. If there is a crematorium or a burial ground opposite the plot, then such a plot should not be bought at all.

PERSONALITY READING

(based on Numerology)



Puja Mathur
The contributor is
Tarot Card reader.
She can be reached at
pujatarot@yahoo.com

No.1. SUN: (1st,10th,19th,28th)

People born on 1st,10th,19th and 28th of any month are ruled by sun. They are very smart, intelligent, softspoken, very ambitious and popular.

Lucky dates : (1st,10th,19th and 28th)
Lucky colours : All shades of yellow, gold and yellowish orange.

Favourable day : Sunday
Lucky gems : Ruby

Favourable careers : Computer software, aviation, leadership, marketing, consultancy.

Advisable food : Brinjals, raisins, capsicum, citrus foods and saffron.
Avoid heavy foods

No.2. MOON: (2nd,11th, 20th, 29th)

People born on these dates are ruled by moon. They are moody, imaginative, secretive, romantic, creative and hardworking.

Lucky dates : (2nd, 11th, 20th, 29th)
Lucky colours : All shades of cream, green and white

Favourable day : Monday
Lucky gems : Moon stone and pearl

Favourable careers : Acting, creative work, tours and travels, advertising and journalism and teaching.

Advisable food : Cabbage, leafy vegetables, salad.
Avoid Non-Veg.

No.3. JUPITER: (3rd, 12th, 21st, 30th)

People born on these dates are ruled by Jupiter. They are very confident, bold, blunt, fantasizing, creative, ambitious, independent, balanced and spiritual.

Lucky dates : (3rd, 12th, 21st, 30th)
Lucky colours : Yellow, crimson, purple and violet
Favourable day : Thursday

Lucky gems : Yellow sapphire, amethyst
Favourable careers : Counsellor, spiritual healer, writer, manager, law and teaching.

Advisable food : Apple, asparagus, cherries, berries, olives, pineapple and nutmeg.

No.4. RAHU: (4th,13th,22nd,31st)

People born on these dates are ruled by Rahu. They are very sensitive, generous, practical, stubborn and efficient.

Lucky dates : (4th, 13th, 22nd, 31st)
Lucky colours : All shades of blue and grey.
Favourable day : Saturday

Lucky gems : Dark sapphire
Favourable careers : Archaeology, social welfare, engineering, marketing and aviation.

Advisable food : Green vegetables and all green coloured foods. Avoid spices, meat and alcohol.

No.5. MERCURY: (5th, 14th, 23rd)

People born on these dates are ruled by Mercury. They are highly intelligent, cunning, calculative, organized, self-reliant and spendthrift.

Lucky dates : (5th, 14th, 23rd)

Lucky colours : Silver and white

Favourable day : Friday

Lucky gems : Diamond and white sapphire

Favourable careers : Lawyer, accountant, politician, salesman and communicators.

Advisable food : Oats, almonds, celery and parsley.

No.6. VENUS: (6th, 15th, 24th)

People born on these dates are ruled by Venus. They are artistic, aristocratic, romantic, youthful, soft-hearted and wise.

Lucky dates : (6th, 15th, 24th)

Lucky colours : All shades of red and blue

Favourable day : Friday

Lucky gems : Emerald and diamond

Favourable careers : Hotel management, export-import, foreign services, musician, artist and painter

Advisable food : Leafy vegetables, almond, apple and melons

No.7. KETU: (7th, 16th, 25th)

People born on these dates are ruled by Ketu. They are kind hearted, sentimental, innovative, adjustable, restless, loving and well-organised.

Lucky dates : (7th, 16th, 25th)

Lucky colours : White and yellow

Favourable day : Sunday

Lucky gems : Moonstone and cat's eye

Favourable careers : Teaching, catering, writer, creative jobs and event organizer

Advisable food : Fresh juice, salad, mushrooms, grapes. Avoid junk food.

No.8. SATURN: (8th, 17th, 26th)

People born on these dates are ruled by Saturn. They are introvert, honest, short-tempered, clever, trustworthy and authoritative.

Lucky dates : (8th, 17th, 26th)

Lucky colours : Black, blue and grey

Favourable day : Saturday

Lucky gems : Dark blue sapphire

Favourable careers : Private detective, spiritual leader, surgeon, engineer, marketing and defence services

Advisable food : Fresh fruits, herbs, vegetables and soups. Avoid rich foods.

No.9. MARS: (9th, 18th, 27th)

People born on these dates are ruled by Mars. They are adventurous, kind-hearted, loving, honest, egoist and genuine.

Lucky dates : (9th, 18th, 27th)

Lucky colours : All shades of red

Favourable day : Tuesday

Lucky gems : Red coral and blood stone

Favourable careers : Defence services, actor, general leadership, chef and anchor.

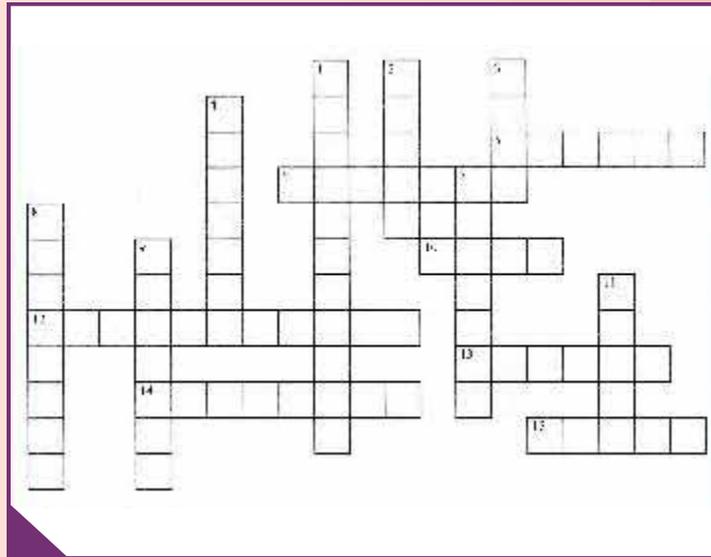
Advisable food : All spices, ginger, garlic, capsicum and mushroom. Avoid alcohol.

CROSS

WORD 036

ACROSS

5. Term BRIC stands for _____, Russia, India and China economies. (6)
6. A new technological initiative taken by the ICAI for improved communication with the CA *Pariwar*. (7)
10. Indian companies are now permitted to buyback _____ up to US\$ 100 million of the redemption value per company, out of internal accruals, with the prior approval of RBI.
12. In which case it was held that if the asset is not used but given on lease, then the asset would be considered for computing net wealth. (5,6)
13. Pacioli's text on accounting methods *De Computis et Scripturis* contained _____ six short chapters. (6)
14. As per recent circular customs duly leviable on _____ shall be charged at *nil* rate. (3,5)
15. Luca Pacioli, the father of accounting, had strong associations with a great renaissance artist, _____ (give his last name), who even illustrated Pacioli's texts. (5)



DOWN

1. _____ revenues arise from those transactions where the government receives income as a matter of its right without any obligation to provide specific services. (3,8)
2. Abbreviation of one of the recently started certificate course of the ICAI.
3. The Securities and Exchange Board of India has issued a simplified Listing Agreement for _____ securities. (4)
4. One of the threats to computer. (7)
7. An NGO can be formed as _____ also. (7)
8. As per *Revised Guidelines of Network* an entity shall not be treated as an affiliate of another merely for the reason that they share professional knowledge and _____. (4,4)
9. Open offer is triggered on acquisition of _____. (7)
11. Audit means 'he hears' in _____ language. (5)

Note: Members can claim one hour CPE Credit – Unstructured Learning through self-declaration for attempting above Crossword.

SOLUTION Crossword

035



OUT OF THE BOX



Once I've overcome my fear of public speaking, I've developed a new phobia ... fear of facing sleeping audience!



A Manager of a retail clothing store is reviewing a potential employee's application and notices that the man has never worked in retail before.

He says to the man, 'For a man with no experience, you are certainly asking for a high salary.'

'Well Sir,' the applicant replies, 'the work is so much harder when you don't know what you're doing!'