

CA

# THE CHARTERED ACCOUNTANT

JOURNAL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA



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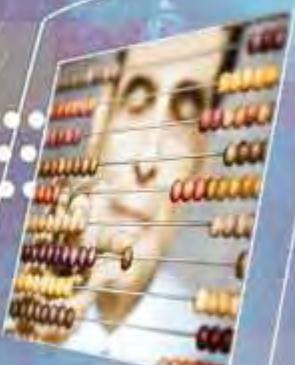


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## CHALLENGES BEFORE INDIAN ECONOMY

As rightly pointed by Finance Minister Pranab Mukherjee, there are indeed three primary challenges before the Indian economy which are – ‘to again achieve the high GDP growth rate of 9 per cent per annum’, ‘to deepen and broaden the agenda for inclusive development,’ and ‘to re-energise government and improve delivery mechanisms’. While the Government is going full throttle to meets them, many other short-term key challenges too continue to nag Indian economy. One such problem, which needs to be handled on topmost priority, is ‘food inflation’ (Consumer Price Index). India continues to battle double-digit food inflation even though food prices have fell sharply in rest of the world. Retail inflation hit a 10-year-high in July with consumer price indices for farm labourers and rural workers rising 12.9 and 12.67 per cent respectively. And the economists rightly think that the situation is not going to improve anytime soon, particularly in view of poor monsoons. This calls for swift and decisive action on part of Government, which may think of allowing private players to meet domestic demand through imports. Efforts are also needed to modernize food supply chain to salvage the situation.

However, there is some optimism too in the air as the growth outlook for Indian economy has improved. The country's economic growth is likely to be around 7 per cent for this fiscal, according to the estimates of Union Budget 2009. Even after we factor in the drought damage, the growth rate is still likely to be at least around 6.5 per cent, said the Finance Minister recently. These projections show some incipient signs of stabilization but certain crucial concerns remain. Although it appears that worst is over for the Indian economy, some major challenges still lie ahead. According to a recent CII survey, Industrial recovery is not yet complete as there have been large variations in growth rates among sectors. It is good that the number of high-growth sectors increased from 7 per cent in April-June 2008 to 10.4 per cent in the same period this year, reflecting that industry is building on the marginal signs of recovery. But the worry is that the percentage of sectors in the negative category has increased to 39 per

cent this quarter, compared with 21 per cent last year. As companies cut back investments, firms producing capital goods have been hit hard with some of the sub-sectors of capital goods reporting negative growth to the extent of minus 48 per cent. This situation calls for continuance of various State measures announced in the stimulus package and Union Budget at least till 31<sup>st</sup> March, 2010.

Reviving exports promises to be yet another formidable challenge for the government. Exports have declined by an average of 23 per cent since October last year. Exports grew at just 2.4 per cent during 2008-09, down from 28.9 per cent during 2007-08. The trend witnessed in April-June quarter of 2009 is all the more alarming as exports declined by over 31 per cent, year-on-year. The government needs to take urgent steps in this regard, particularly when the global economy appears on the mend after a deep downturn.

### XBRL

The world is yet to fully overcome the global financial crisis even as debates and discussions to defuse it rage on. A largely accepted point of view in such deliberations, as also endorsed by global Financial Crisis Advisory Group, has been that Financial Reporting has an important role to play in the resolution of the crisis. A recent G-20 summit also stressed the urgent need to improve the quality of financial information being provided by companies to various stakeholders and analysts to prevent a repeat of the crisis in future. And eXtensible Business Reporting Language (XBRL) is fast emerging as a global revolutionary tool to improve financial reporting and analysis with that objective. It is encouraging that today XBRL is on the agenda of all 117 countries, including India, who have decided to adopt IFRS. In India, the Institute of Chartered Accountants of India is playing pivotal role in promoting and propagating the XBRL to upgrade the financial reporting and analysis for immense benefit of national economy. This issue of the journal highlights the XBRL in Indian context to update the knowledge of ICAI members and readers.

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**Smile Please**

**IN THIS ISSUE**

**Dear CA Parivar,**

The enthusiasm of our members and students throughout the country in celebrating our Diamond Jubilee Year has indeed been overwhelming and I would also like to take this opportunity to extend my heartfelt gratitude to all our members, students, my colleagues in the Council, Regional Councils and Branch Managing Committee Members for making the Diamond Jubilee celebrations an unprecedented success. The celebrations showcased the myriad hues of our Institute - a perfect blend of professional outlook, social demeanour and humanitarian touch.

In my last communication, I had advised the prospective candidates for the forthcoming elections of the ICAI, both at

Central and Regional level, to show their capabilities and positive contribution to the profession rather than resorting to cheap publicity through mud-slinging activities. I sincerely trust that the candidates would heed to my advice and refrain from raising unnecessary issues at different forums. These practices of gaining publicity will ultimately harm our profession.

All elected members have amply proved their capabilities and enjoy the trust and confidence of the members. The elected members are bound by the laid down rules and regulations and have to work within the legal framework so constituted. Each activity that is undertaken by the Institute is debated in various committees, within their terms of reference and budget, and finalised based on its merits. There are eight Government nominees who have also been appointed on various Standing & Non-Standing committees. Perceptions of events may differ from person to person, but depending on a common consensus, plans and activities are chalked out for the year. This year being the Diamond Jubilee Year, our focus was on *Brand Building*. So we undertook events that were off the beaten path and which created the brand image of our Institute and its members. Some of these activities are part of our *social responsibility* which are undertaken with a view to increase professional bonhomie and sense of belonging with the members and students. To finance many of these activities we have also obtained sponsorships to the tune of Rs. 1.20 crore instead of spending the hard-earned money of our students and members. It is these sponsorships that help us to organise the events on a mega scale. Details of the various activities are given elsewhere in this journal for your reference.

**Dream turning into reality at the Bandra Kurla Complex**

As a Vice President I had the earnest desire to get built a world class ICAI Bhawan at the

Bandra Kurla Complex at Mumbai during my tenure as President. However, the project got delayed due to unwanted litigation. Today, I am immensely happy to inform you that the litigant has withdrawn writ petition filed against ICAI in this regard and the construction work for this dream-project shall commence soon. I promise you that this new building in the heart of one of Mumbai's main business and financial districts would be like a Jewel in the crown of the Institute.

**Centre of Excellence**

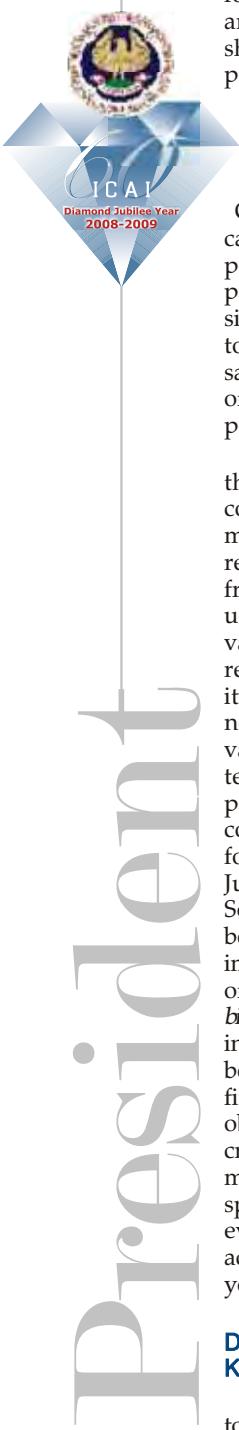
In 2006, the Council proposed to open Centres of Excellence in various key cities across India with world class facilities and infrastructure. Being the second largest accounting body in the world it was imperative that we have facilities and infrastructure that are at par with the best educational institutes around the world. Our infrastructure and facilities should be of such high standards that not only make us proud but we also become role models for the rest of the world. Our first Centre of Excellence at Hyderabad fulfils this long standing need and it is hoped that we will be able to open more such Centres in the coming few years.

Centres of Excellence with world class infrastructure facilities are expected to provide an ideal venue to hold international events, conferences, residential courses for member and students, workshops and training programmes on IFRS, XBRL and other emerging areas of profession interest. I am confident that all our members and students would be able to take advantage of these Centres as we open more and more of them in different parts of the country. With this objective, I have recently performed the foundation stone ceremony of Centre of Excellence at Bangalore which will be named as CA. Rameshwar Thakur Centre of Excellence to acknowledge the all round support given by him.

**XBRL**

As you know, we had established XBRL India Jurisdiction as part of a key initiative to promote and develop XBRL in India. Taking that initiative forward, we have since developed XBRL Taxonomy for Commercial and Industrial Companies and the Banking Taxonomy. We are developing other sector specific taxonomies as well.

The next step as part of our XBRL initiative is to approach various regulators, stakeholders and the user community at large and apprise them about the benefits of XBRL, finalise membership issues and prepare bye-laws. We have decided to set up a separate department to manage and promote XBRL India Jurisdiction. We have also created a separate website



[www.xbrl.org/in](http://www.xbrl.org/in) dedicated to the XBRL India Jurisdiction to make members and other users aware about the Indian XBRL Jurisdiction. We will also be sending a proposal to XBRL International Inc. to host the next XBRL International Conference in India in January 2010 for the benefit of our members. Plans are also afoot to include XBRL in the CA syllabus and in the CPE calendar. This issue of the journal also highlights the XBRL and its various aspects.

### New Direct Taxes Code Bill, 2009

As promised by the Finance Minister in his budget speech, the Direct Taxes Code Bill, 2009 has been released on 12th August, 2009 for comments which has been well received by the public at large. The code has been drafted in a transparent, lucid and simplified manner which can be easily comprehended by a common man.

The Ministry of Finance desires us to submit our suggestions on the new Direct Tax Code latest by 30th September, 2009. Accordingly, study groups have been formed all over the country to identify the issues arising from this new Bill for making suitable recommendations to the Government. We also propose to organize Seminars and Conferences all over the country in co-ordination with the Ministry of Finance to generate discussions and bring about awareness about the proposed law.

### International Recognition

It has been my ardent desire to make ICAI's presence felt globally. In this regard, you will be pleased to know that following our sustained efforts, the accounting world at large is now taking note of ICAI. Continuing that trend, the Mongolian CPA Institute has approached us to assist them in their professional programs at the end of their holidays this October.

Our Hyderabad Centre of Excellence will be hosting the Strategic and Finance Committee meeting of CAPA along with the training of the trainers (TOT) program on IFRS for private entities from 25<sup>th</sup> to 27<sup>th</sup> January 2010. This meet will introduce the CAPA members to our world class Centre of Excellence and its facilities. I am sure that the enthusiasm and drive of my Council colleagues and members from Hyderabad will ensure success of this convention.

### Satyam Case

You may recall that the High Powered Committee set by us to look into the entire Satyam fiasco has submitted its draft report to the Council. Based on the deliberation and discussions held in the Council, the report has

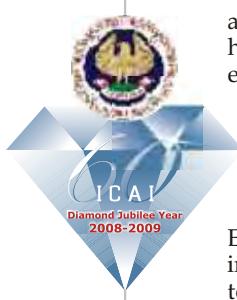


been finalized and submitted to the Ministry of Corporate Affairs. I am happy to say that our report was highly appreciated by the Ministry of Corporate Affairs which took note of the detailed content and the independent views of ICAI as a regulator. This was amply expressed by Smt. Renuka Kumar, Joint Secretary, Ministry of Corporate Affairs, during my detailed discussion with her relating to amendments required to be carried out on the various statutes as outlined in the report. We have also finalised and submitted to the Government the review of the general purpose financial statements of Satyam Computers for the last five years.

We are also reviewing and bringing about amendments in the Rules and Regulations of our Institute and are also in discussion with other Regulators to do likewise. We have also reconstituted our Committees and have withdrawn the name of CA. S.Gopalakrishnan from various non-standing committees. It has also been decided by the Executive Committee that not more than two firms with the same name would be allowed to practice in India. This decision will now be further deliberated and discussed by the Council. All these amendments would go a long way in better regulating the growth of our profession and build greater confidence amongst the stakeholders.

### Information Technology

I have always maintained that we have to be at the forefront of cutting edge technology to serve better. With that aim, we had begun a futuristic hi-tech 'Project Parivartan', which has made quite a headway with ICAI and Infosys IT teams receiving inputs from stakeholders from across the country, including RBI and SEBI. We have already received the Business IT Strategy



# President

Alignment document from Infosys. This document has extensively covered our various processes. With ICAI at the forefront in the implementation of XBRL and IFRS convergence, the regulatory bodies are looking up to us to lead the way. RBI and SEBI have come forward to extend all the possible support in this quest.

Our webcast channel is growing in leaps and bounds with more than 10,000 members having already visited the site. Further expanding this successful and highly beneficial venture, we will soon extend the webcast facility to our students as well, who will reap the maximum benefits from this initiative.

Taking technology one step further we have decided to use P-EVM (Preferential Electronic Voting Machine) for our forthcoming Central and Regional elections. These touch based voting machines will ensure that our elections will be conducted in an efficient, transparent and speedy manner. Due to their touch screen interface, members will now be able to vote for both Regional and Central Councils one after another in a matter of seconds. I am sure that all our members will find this voting method smooth and efficient. It will also lead to savings in paper that will indirectly lead to lesser pressure on the environment.

In yet another crucial hi-tech initiative, we have launched a new ISA eLearning site. This is a value added facility where currently one can access two modules on Network Security. It will be further upgraded by adding more modules. This site can be used as a development source by taking the self assessment quiz which asks random questions and also gives explanations as to the correct choice. The unique feature of the ISA eLearning site, as compared to other eLearning courses elsewhere, is that here experts would be directly presenting useful content with audio presentations. Members pursuing or having completed the ISA PQC can access the site using their ISA Number and Password at <http://cit.icai.org>. I strongly recommend that ISA Members should benefit from this on-demand learning and development facility.

Earlier, obtaining a Firm Constitution Certificate always posed a big problem as considerable time was spent on this activity due to administrative issues. Now one need not fret anymore. Issue of Firm Constitution Certificate as on first day of every calendar year has now become a matter of routine. Members can now download their firm constitution certificate online, as and when desired, from the website of the Institute on their own as the facility has already been activated. This new service will help members to download the certificate by entering their firm registration number and date of establishment correctly.

## Insurance Sector – Unlocking Opportunities

The interaction between our Institute and Insurance Regulatory and Development Authority (IRDA) has been cemented further with the nomination of CA. S.N. Jaysimhan on our Financial Reporting Review Board by IRDA. He has requested the Board to review the financial statements of certain major insurance companies to bring to light non-compliances that might have been committed which can then form the basis to prepare a Technical Guide for the Insurance Sector, making it an excellent reference manual for the future.

Taking cognizance of our suggestions, IRDA has agreed to protect the interests of the shareholders by employing the services of CAs. It has declared that Insurers having Assets under Management (AUM) of not more than Rs. 1000 crore shall conduct a Quarterly Internal Audit to cover both Transactions and related Systems. Those Insurers having AUM above Rs. 1000 crore would appoint a Chartered Accountant firm for Concurrent Audit to have the transactions and related Systems audited.

To give our members the support they require, the Committee on Insurance and Pension has published a Technical Guide on Internal/Concurrent Audit of Investment Functions of Insurance Companies. This timely publication will guide our members to conduct Insurance audits in the most proficient way possible. We are also trying to ease the path for our members by discussing with IRDA the possibilities of them conducting intensive training programs on Internal / Concurrent audit for our members.

## Mechanism for Timely Feedback to SCODA

I recently participated in a meeting of SEBI Committee on Disclosures and Accounting Standards (SCODA) in Mumbai as a member. During the course of this meeting I realised that our Institute could participate and contribute meaningfully to the issues that were being discussed at SCODA such as formats for the report by the statutory auditor of the Companies coming out with IDR issuances, enhanced disclosures for utilisation of issue proceeds, voluntary adoption of IFRS by listed entities and frequency of disclosure of balance sheet of listed companies. In order that the spirit of teamwork is fostered by establishing a rapport with the capital market regulator with respect to accounting and auditing issues, I have issued instructions for putting in place a systematic mechanism of timely flow of feedback between the two organisations.

## National Foundation for Corporate Governance

I had the opportunity to attend the meeting of the Governing Council of the National

Foundation for Corporate Governance (NFCG) which was attended by the Honorable Minister of Corporate Affairs Shri Salman Khurshid and Shri Anurag Goel, Secretary, Ministry of Corporate Affairs, amongst others. The Honorable Minister was present in the meeting during the discussion on issues of interest to our profession such as rotation of auditors, holding the audit firms responsible for failure of due diligence of duties by its partner(s), separation of qualification and regulatory functions currently exercised by a single Institute and others. From my side, I expressed the view that the qualification and regulatory function currently exercised by a single Institute should not be separated. I was fully supported in this issue by the President, ICSI who agreed to my view of maintaining the current status quo and the matter was deferred for further discussion and deliberation.

### **Helping the Government**

As you well know, the Government Accounting Standards Advisory Board (GASAB) holds our Institute in high esteem. The Board has suggested that ICAI formulate the Indian Government Financial Reporting Standard (IGFRS) and GASAB could review the same. We have submitted a proposal with regard to the formulation of the Accrual Accounting Standards for the Government by the ICAI for the consideration of the GASAB. According to the proposal, the GASAB may approve the IGFRSs to be formulated by the ICAI the way NACAS is currently approving the Accounting Standards for Companies.

In addition to the above, the Ministry of Corporate Affairs had approached the Institute to draw on our expertise and recommend changes to court rules regarding the winding up of companies. After studying the issue from every angle – practical as well as regulatory – and getting feedback from the Official Liquidator, broad parameters were appointed. The special Study Group formulated a preliminary draft that prescribed time limits wherever they were not set in the rules. Also suggested was an increase in the Official Liquidator's powers so as to lessen legal convolutions and to reducing the total time frame for winding up a company down to around 2-3 years. All these deliberations will be presented to the Ministry which will further look into the matter and decide on a final course of action. We feel deeply privileged that the Ministry has entrusted us with this task and I am sure that our input will have a positive impact on this vital aspect of Company Law Administration.

### **Convergence with IFRS**

To ease convergence with IFRS, Ministry of Corporate Affairs has constituted a core group under the chairmanship of Shri Anurag

Goel, Secretary, Ministry of Corporate Affairs to deal with all relevant convergence concerns. I am proud to say that three members from ICAI have been nominated for the core group, who are President ICAI, Chairman ASB & Chairman AASB. At the very first meeting of this core group, ICAI's presentation on work done on IFRS implementation was highly appreciated. The whole committee, including the Chairman Mr. Anurag Goel, was enormously impressed not only by the quality and depth of our work but also the way it was presented to them. Here, I would like to stress that ICAI is very well prepared to implement IFRS from 2011 and there should not be any element of doubt in this regard in the minds of the stakeholders. I am also pleased to inform you that the Institute has proactively also launched a website on IFRS and has prepared study materials for each individual IFRS.

### **Reduction in Retention Period for Engagement Documentation**

The Council, pursuant to the provisions of Rule 12 of the Chartered Accountants (Procedures of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007, has reduced the retention period for the engagement documentation from 10 years from the date of the auditor's report, or, if later, the date of the group auditor's report, as required by paragraph 83 of SQC 1 to seven years from the date of the auditor's report, or, if later, the date of the group auditor's report. The paragraph 83 of SQC 1 accordingly stands amended.

### **Companies Bill, 2009**

The corporate form of organisation is increasingly emerging as the preferred vehicle for economic and commercial activity. This has contributed significantly to the growth of the Indian economy and the emergence of service, information and knowledge-based enterprises. Companies are now mobilising resources at a scale unimaginable even a decade ago, continuously bringing new activities into the fold of the Indian economy. A need was being felt to help sustain the growth of the Indian corporate sector by enabling a new legal framework that would be compact, amenable to clear interpretation, and respond in a timely and appropriate manner to meet the requirements of ever evolving economic activities and business models, while fostering a positive environment for investment and growth.

Against this backdrop, the introduction of the Companies Bill, 2009 in Lok Sabha on 3<sup>rd</sup> August, 2009 is welcome move, more so for the professionals.

The Bill proposes to open up new avenues for the professionals, especially Chartered



**President**

Accountants, and at the same time casts a lot of responsibility on them for the conduct of affairs of the companies. Articulation of shareholders democracy with protection of the rights of minority stakeholders, responsible self-regulation with disclosures and accountability, substitution of government control over internal corporate processes and decisions by shareholder control, new structures like One Person Companies, etc. are some of the prominent features of the Companies Bill, 2009, which shall, on enactment, allow the country to have a modern legislation for the growth and regulation of the corporate sector.

### **DISA Recognition**

The world economy is integrating at a rapid pace. My brethren are amongst the top professionals trained in India. One of my main goals has been to make it possible for our members to work on an international level. I am in discussion with ISACA for giving recognition to ICAI's DISA qualification and am quite close to finalizing an MoU with ISACA to not only agree to recognise ICAI's DISA qualification but also give it a global recognition as ICAI-CISA. Once the MoU is signed, our members with DISA qualification will have much better global prospects.

### **ICAI Job Portal**

Taking yet another major step to help and serve our parivar better, we have launched a comprehensive ICAI Job Portal, dedicated to our profession. This portal will benefit all our members – new or old, raw or experienced, as well as industry in line with other popular job portals. I am sure this portal will prove to immensely beneficial to both the members looking for career opportunities and the industry looking for chartered accountants or Accounting Technicians.

The Campus Placement Program for qualified Chartered Accountants who have qualified in May 2009 and November 2008 final examinations will be held at 17 centers. I request our members to take part and support this program to make it successful for everyone. As you know, the recent Campus Placement Programme met with huge success despite the economic slowdown.

### **Infrastructure**

We are growing fast, so much so that almost every day somewhere in the country a new infrastructure project is undertaken by the Institute or its constituents with the support of Branch Managing Committee members and the Government which has provided us land on subsidised rates at various places. This positive enthusiasm to share and to grow is what fuels us. It is the spark that leads to such spectacular results

like the Centre of Excellence in Hyderabad, the Institute's building in Noida and others. In the last few weeks we have acquired land and performed *bhoomi poojan* for our branches in Kota, Bhilwara, Mathura, Kakinada, Vijaywada, and Sangrur. We have also recently inaugurated a seminar hall in Guntur and an auditorium in Indore besides opening 15 more ITT Labs including at Rajamahendravaram and Ratlam. At this rate of growth I believe that my dream of a branch office in every city and town of India will be fulfilled in the foreseeable future.

### **ICAI ARF - Department of Posts Project**

In a move that will culminate in opening new avenues of practice for our members, ICAI ARF has recently taken up a pilot project for Department of Posts for the implementation of accrual accounting system in two primary postal units. The MoU along with a Strategy Paper in this regard was recently signed by me, being the Chairman, ICAI ARF and the Joint Secretary cum FA of Department of Posts. This pilot project and its relevant studies are scheduled to be completed by June 2010.

### **Student Programs**

Students are our future and giving them the best education will always be my priority. In this regard, you will be pleased to know that our positive efforts have seen the sixth batch of 60 participants complete their three month residential program at the world renowned IIM Indore. In fact the seventh batch has already begun with 54 participants studying at the National Institute of Financial Management, Faridabad.

Our skill and proficiency increases every day and nowhere was it more evident than at the recently organized National Convention for CA Students. The quality of the lectures was so good that the convention was unanimously appreciated by the participants. In fact, taking into account the success of the convention, we are considering making attendance mandatory for all students in such programmes. This will also enable the students to fully appreciate and comprehend the CA Course and its benefits.

We are introducing a three part Test Series for students comprising Concepts, Questions and Answers to enable them to practice and gain more confidence.

### **Results of the CA Final Examination**

That our profession is highly sought after is obvious from the fact that the number of candidates appearing for CA exams is increasing every year. A total of 18625 candidates appeared in both groups of which 2579 passed. There has been an increase in the

number of students appearing for the exams by at least 4000 for each group as well as for both the groups compared to last years November exams. This is indeed good news and so is the fact that we are also keeping pace by increasing the number of examination centers every year. Currently we have 252 examination centers with more locations being allocated every year.

However, the results declared for the New Syllabus has not been encouraging. A total of only 9 students passed out of which only 2 students passed in both groups. I have constantly been reiterating that students should take their article training and the CA Course more seriously. Practical training would immensely benefit the students in their examinations as well as in gaining experience.

### **Continuing Professional Education**

With a view to realize the very objective of the Continuing Professional Education and serve the members promptly at their door steps, we have been forming CPE Study Circles, CPE Chapters and CPE Study Groups from time to time across the country. You will appreciate that continuing with that initiative, during the current Council year we have so far given approval for formation of One Study Circle (KCAS Study Circle of CIRC, Kanpur), Two Study Chapters - one each at Malegaon of WIRC and Haridwar of CIRC, and 14 Study Groups.

You will appreciate, that our recently launched initiative to form CPE Study Circles for members in industry has taken off very well. As many as 14 such study circles have already been constituted across the country, which are offering ample opportunities to members to interact and share knowledge. Many of these Study Circles have already started conducting CPE Programs on topics of contemporary relevance, justifying our decision to go in for a separate CPE delivery mechanism for our Members in Industry. Many more such study circles are on the cards. I urge members in industry to join these study circles for their professional growth and comply with their CPE requirements.

### **World Congress of Accountants, 2010**

The XVIII World Congress of Accountants, on the theme "Accountants: Sustaining Value Creation", is scheduled to be held in Kuala Lumpur, Malaysia from November 08-11, 2010.

A wide array of speakers and panel discussions will cover various aspects of issues that could affect, directly or indirectly, accountants in the foreseeable future. This is a great opportunity for us to showcase the strengths of Indian Chartered Accountants. I am positive that the international community

and panelists will be most impressed by the informed views and contributions by our erudite members. Do not miss this opportunity to interact on the global stage. For further details regarding the programme, members can log on to the following link: [http://www.wcoa2010\\_kualalumpur.com/congress/cpe.html](http://www.wcoa2010_kualalumpur.com/congress/cpe.html)

Meanwhile, I have requested IFAC to grant ICAI three speaker slots for this World Congress of Accountants 2010 as this is a golden opportunity to showcase the activities of our Institute on the international stage.

Observing the success of our Diamond Jubilee Celebrations, IFAC has communicated with us to know if we would be interested in hosting the World Congress of Accountants 2014. This is indeed an honour to which we would respond soon after due deliberations.

### **Women Steering Group**

I am pleased to share with you the success of 2<sup>nd</sup> conference of Women Steering Group of ICAI held in Indore on 22<sup>nd</sup> August 2009. After the success of 1<sup>st</sup> conference, organised in Delhi in June, 2009, the success of the 2<sup>nd</sup> conference further boosted the mission of the Group. The event was graced by Smt. Malini Gaud, Member of Madhya Pradesh Legislative Assembly who delivered key note address to women fraternity present there.

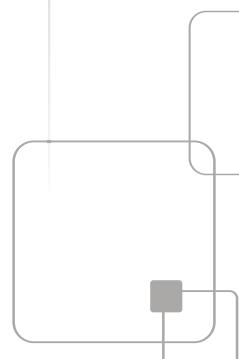
Panels and presentations on the theme of 'Women Taking the Lead' left the delegates highly impressed. The conference, first of its kind in CIRC, was a great success with large participation from women CAs not only from Indore but also from Bhopal, Ujjain, Dewas and other cities. Taking note of enthusiastic response to this event, I have decided to dedicate the whole December 2009 issue of the CA Journal to Women Chartered Accountants and therefore invite entire female fraternity of ICAI to contribute articles for this special issue.

The annual festival season is round the corner. Please accept my warmest wishes for the coming festivals. Let us celebrate these festivals and pray for our nation, but let us also not forget that God helps those who help themselves. In the words of Swami Vivekananda, "Stand up, be bold, be strong. Take the whole responsibility on your own shoulders, and know that you are the creator of your own destiny. All the strength and succor you want is within yourself. Therefore, make your own future".

My pranaams to all,

CA. Uttam Prakash Agarwal

August 27, 2009



# Path Breaking Initiatives in last six months

If you want to succeed you should strike out on ***new paths***, rather than travel the worn ***paths*** of accepted success. - John D. Rockefeller

This year we have done precisely that. After 60 years of providing excellent service to our members and students, it was time to reflect on the past and forge new paths to take us into the future. We did things differently and with good reason. The results are there for all to see. Of course, one always encounters dissent on the path less trodden, but one has to have the courage and conviction to forge ahead. We dedicated the Diamond Jubilee Year to build the brand image of the Institute and its members and embrace social causes that have global impact. We also dedicated ourselves to improve infrastructure of the Institute across the country and take our Institute across the oceans.

For the past several years, every Regional Council organises Branch Co-ordination Meetings twice a year and invites the Chairman and Secretary of all the Branches in the Region to give a common direction to the activities of the Region and to sort out problems. On most occasions these Branch co-ordination meetings coincided with certain other programme, leaving very little time for a meeting of this magnitude and importance. During my tenure as Regional Council Member and Chairman of WIRC, I realised that these meetings had become more of a formality and achieved little. Also I realised that there is a disconnect between the Branches and the Headquarter as well as between Regions.

On assuming office as President, I thought of creating a national platform on which the entire Central Council, Regional Councils and the office bearers of the Branches could meet, interact and plan activities to meet the common objectives and strategy of the Council so as to give a centralised direction in a unified manner. For the first time in the history of the Institute, an opportunity was created for all the people at the helm of affairs to gather, interact and deliberate. The very objective of creating such a national platform is to provide a clear action plan for the full tenure of the Council so that all tiers of ICAI leadership as well as our Committees and Staff can work to achieve common objectives of the Council instead of working for any personalised yearly agenda. The first challenge was to find a single venue that can accommodate all 700 people for three days.

This challenge was met by organising the Residential National Leadership and Yog Camp in the pristine surroundings of Swami Ramdevji's ashram at Haridwar. There was no specific programme planned but suddenly everything fell in place. For a period of four days, 700 members stayed, attended discourses, ate and had professional debates. The programme was telecast live by Aastha channel, which enjoys the highest TRP rating, to over 125 countries for all 3 days without any cost to the Institute. Also Swami Ramdevji spoke to the CA profession which was seen by people around the world. At the end of this 4 day rejuvenating session, an amount of Rs. 500,000 was paid as a token gesture to the ashram in appreciation of the services rendered to us by way of lodging, boarding, breakfast, lunch, dinner and conference hall. All other expenses were incurred in distribution of technical materials to the ICAI leadership to equip them to better manage the activities of the Institute. Normally, the truncated version of the Branch Co-ordination Meets which used to take place earlier would cumulatively cost more than a crore of rupees for a period of 3 years and that too without this high level of interaction.

Last year, we had started the convocation ceremony to confer certificates and welcome new members into the profession. Today, almost all educational Institutes irrespective of their size and scope have a convocation ceremony to create a sense of belongingness amongst their fraternity. These ceremonies also instill a sense of pride amongst the new members and gives them an occasion to network amongst themselves and various members at the helm of affairs. They also help in the brand building exercise of our Institute and its members. This platform also provides them an opportunity to make an excellent presentation of themselves, something that is very necessary when they take their first steps in the world as a full-fledged professional. Now instead of receiving a certificate through post

or courier which is just inserted through the door, they proudly receive the certificates at the Convocation Ceremony in recognition of the hard work put in by them. There has been a tremendous spurt in the number of students enrolling and appearing for the various examinations and in the Campus Orientation programmes. This in turn has resulted in improving the confidence levels and pay packets of our new members.

We always strive to build excellent public relations with various Government agencies and other Regulators and enhance the image of our Institute and the services rendered by our members. In this Diamond Jubilee Year a joint initiative was taken for the first time by our Institute and All India IRS for playing a T-20 Cricket Match at the Ferozshah Kotla Stadium. The match was inaugurated by Shri S.S.Moorthy, Chairman, CBDT. Earlier, a ceremonial T-10 match was also held between Team President 11 ICAI and Team Chairman 11 CBDT. The event was covered live on DD Sports and the total amount paid to DD Sports was just Rs. 200,000. The match was also re-telecast at no additional cost to the Institute. The Institute logo was prominently displayed at all times during the telecast. The match was enthusiastically witnessed by over 6,000 members and students at the stadium and by our members and all IRS officers throughout the country.

We now have a very good interaction with the IRS and have a better understanding of each other and have decided to work closely together for the benefit of the nation. The CBDT Chairman has visited the Institute on three occasions and our Pre-Budget Memorandum was handed over to the CBDT Chairman and CBEC Chairman. Many of our suggestions found place in the Budget proposals and the CBDT Chairman attended the Post Budget Workshop organised by our Institute. The CBDT Chairman has also participated in various Regional Council programmes.

This year, I wanted to focus my energies on infrastructure development. In order to broad base this activity, I diluted my role and formed a new Infrastructure Committee to oversee the speedy implementation of infrastructure projects across the country. The Representation Committee has also done excellent work by making over 20 Representations to various Government Bodies and Regulators. Earlier, the Institute did not have any HR Policy resulting in lopsided man power allocation. Some departments had too many people and other departments were overworked. Now with a new HR Committee, we have an excellent HR and Recruitment Policy.

In the year 2006, a decision was taken by the Council to establish Centres of Excellence throughout the country. As the second largest accounting body in the world it was imperative that we have facilities and infrastructure that are at par with the best educational institutes around the world. This year we set the ball rolling by opening our first Centre of Excellence at Hyderabad that fulfils this long standing need and it is hoped that we will be able to open more such Centres in the coming few years. We have also acquired the land for another Centre of Excellence at Bangalore.

These Centres of Excellence with world class infrastructure facilities would provide an ideal venue to hold international events, conferences, residential courses for students, workshops and training programmes on IFRS, XBRL and other emerging areas of practice. Also more and more Research related projects can now be undertaken at these Centres. I am confident that all our members and students would be able to take advantage of these Centres as we open more and more of them in different parts of the country.

All the above activities are carried out with the objective to take the Institute to greater heights. Perspectives of individuals may differ, but as far as the work is done with a clear conscience, within the legal framework for the benefit of the Institute and its members one can hold his head high and smile at one's detractors.

- President, ICAI



**Workshop on Union Budget 2009-10**

CA. Uttam Prakash Agarwal, President ICAI presenting a memento to Shri S.N. Moorthy, Chairman, CBDT during the *Workshop on Union Budget 2009-10* organised at ICAI on 17<sup>th</sup> July, 2009.



**Inauguration of Certificate Course**

CA. Uttam Prakash Agarwal, President ICAI Inaugurating the 3<sup>rd</sup> Batch of Certificate Course on International Taxation at New Delhi in the presence of CA. Sudhir Agarwal, Past Chairman NIRC and other dignitaries.



**Bhoomi Poojan at Bhilwara Branch**

CA. Uttam Prakash Agarwal, President ICAI along with Central Council Members CA. Vijay Garg, CA. Anuj Goyal, CA. Jaydeep N.Shah and Branch Chairman CA. Shiv Jhanwar performing Bhoomi Poojan at the Bhilwara branch on 28<sup>th</sup> July, 2009. Branch managing committee members and other dignitaries were also present on the occasion.



**Bhoomi Poojan at Kota Branch**

CA. Uttam Prakash Agarwal, President ICAI seen with CA. Anuj Goyal, Central Council Member; CA. Vijay Garg, Central Council Member; CA. Dhruv Kumar Agrawal, Chairman-CIRC; CA. Pawan Lalpuria, Chairman-Kota Branch and other dignitaries during the Bhoomi Poojan ceremony for the Kota branch building on 30<sup>th</sup> July, 2009.



**National Conference on Professional Development & Enrichment**

CA. Uttam Prakash Agarwal, President, ICAI addressing the participants at the *National Conference on Professional Development and Enrichment* organised by Professional Development Committee at Goa on 7<sup>th</sup> August, 2009. Also seen in the photograph are Central Council Members CA. Preeti Mahatme, CA. Anuj Goyal and Shri K.P.Sasidharan and Regional Council member CA. Dhiraj Khandelwal.



**Inauguration of Building Project of Vijayawada Branch**

Inauguration of Building Project of Vijayawada Branch of ICAI by CA. Uttam Prakash Agarwal, President ICAI on 17<sup>th</sup> August, 2009. CA. Shantilal Daga, Central Council member; CA. M. Devaraja Reddy, Chairman, SIRC; branch managing committee members and other dignitaries also graced the occasion.



**Foundation Stone Laying Ceremony in Mathura.**

CA. Uttam Prakash Agarwal, President ICAI along with CA. Akshay Kumar Gupta, Central Council Member CA. Anuj Goyal, Central Council Member; CA. Kuldeep Arora, Chairman Mathura Branch performing *poojan* during the Foundation Stone laying ceremony at Mathura Branch on 13<sup>th</sup> August, 2009

## PHOTOGRAPHS



Inauguration of Seminar Hall at Guntur Branch

Inauguration of Seminar hall at Guntur Branch by CA. Uttam Prakash Agarwal, President ICAI on 17<sup>th</sup> August, 2009 In the presence of CA. Shantilal Daga, Central Council Member, CA. M. Devaraja Reddy, Chairman, SIRC, branch managing committee members and other dignitaries.



Foundation Stone Laying Ceremony at Kakinada Branch

President ICAI CA. Uttam Prakash Agarwal at foundation stone laying ceremony of Kakinada Branch of SIRC of ICAI on 18<sup>th</sup> August 2009 accompanied by Central Council Members CA. Shantilal Daga and CA. J. Venkateswarlu, Regional Council Members CA. G.V. Satyanarayana and CA. D. Prasanna Kumar, Branch Chairman – CA. Boda Ramam and Branch Secretary CA. Surey Srinivas.



Conference of the Women Steering Group

CA. Uttam Prakash Agarwal, President, ICAI lighting the lamp to inaugurate the 2nd Conference of the Women Steering Group organised at ICAI Auditorium, Indore on 22<sup>nd</sup> August, 2009. Also seen in the photograph are Smt. Malini Gaud, Chief Guest, MLA; CA. Amarjit Chopra, Vice-president, ICAI; CA. Manoj Fadnis, Central Council Member, CA. Anuj Goyal, Central Council Member, CA. Priya Bhansali, Convener, WSG; CA. Pooja Gupta, Dy. Convener, WSG; and CA. Kemisha Soni, Member, WSG.



Inauguration of ICAI Auditorium at Indore

Inauguration of ICAI Auditorium at Indore by President ICAI, CA. Uttam Prakash Agarwal on 22<sup>nd</sup> August, 2009. Also seen in the photograph are: Vice President ICAI, CA. Amarjit Chopra; Central Council Members CA. Manoj Fadnis and CA. Anuj Goyal; Vice Chairman CIRC CA. Rajesh Selot and Chairman Indore Branch CA. Shailendra Porwal.



Inauguration of ITT lab at Rajamahendravaram

Inauguration of ITT lab at Rajamahendravaram Branch by CA. Uttam Prakash Agarwal, President, ICAI on 18<sup>th</sup> August, 2009. CA. Shantilal Daga, Central Council Member and Branch Managing committee members look on.



Inaugurating the ITT lab at Ratlam

CA. Uttam Prakash Agarwal, President, ICAI along with CA. Anuj Goyal, Central Council Member after inaugurating the ITT lab at Ratlam CPE Chapter of CIRC of ICAI on 22<sup>nd</sup> August, 2009



Convocation 2009 – Ghaziabad

CA. Uttam Prakash Agarwal, President ICAI presenting Merit Certificate during Convocation 2009 held at Ghaziabad on August 16, 2009. CA. Anuj Goyal, Central Council Member and other dignitaries are also seen in the photograph.



Convocation 2009 – Bangalore

Group photograph taken during Convocation 2009 held at Bangalore on August 2, 2009. Sitting on the dais from left to right are CA. M. Devaraja Reddy, Chairman SIRC, CA. V.C James, Central Council Member, CA. Uttam Prakash Agarwal, President, ICAI, CA. K. Raghu, Central Council Member and CA. C. S. Srinivas, Chairman Bangalore branch.

CPE  
20  
HRS

## Auditors Training Programme on Finacle CBS



**Organised by:** Committee on Information Technology, ICAI.

Location	Hosted by	Course Dates	Venue
Pune	Pune Branch of WIRC of ICAI	October 26-30, 2009	Infosys Campus Pune
Chennai	SIRC of ICAI	December, 05-09, 2009	Infosys Campus Chennai

The Committee on Information Technology is going to organize a **NON Residential** training programme on "Auditors Training Programme on Finacle CBS" in association with M/s. Infosys Technologies at Pune & Chennai at the above mentioned dates. This course aims to provide hands-on training on the basic use of Finacle CBS (Version 7) and an introduction to the use of its Audit & Control features. Delegates have to make their own lodging and boarding arrangements. Registration is on First-Cum-First-Serve basis for 25 delegates on receipt of application with Fee of **Rs. 25,000/- (Rupees Twenty Five Thousand only)** per delegate payable by DD/ Pay-Order/ Online (<http://icai.org/ccm.html?progid=48>) drawn in favour of "The Secretary, ICAI" payable at Delhi and has to be sent to "The Secretary, Committee on Information Technology, The Institute of Chartered Accountants of India, ICAI Bhawan, Plot No. 52-54, Vishwas Nagar, Shahdara, Delhi – 110 032.

Further details, pre-requisites and course schedule are available at [www.icai.org](http://www.icai.org). Please contact: [cit@icai.in](mailto:cit@icai.in) Ph.011-3021 0619/ 621 for further details and assistance, if any.

### COURSE CO-ORDINATORS

CA. K. Raghu, Chairman, IT Committee, [kraghu9999@gmail.com](mailto:kraghu9999@gmail.com) (M): M-09341219091  
 CA. Milind Gramopaddhye, Chairman, Pune Branch [mgramo@gmail.com](mailto:mgramo@gmail.com) (M): 09823015622  
 CA. M. Devaraja Reddy, Chairman SIRC of ICAI [devarajreddy@yahoo.com](mailto:devarajreddy@yahoo.com) (M): 9399935799  
 CA. K.J.Bansal, Member, Editorial Board [klbansal@gmail.com](mailto:klbansal@gmail.com) (M): 09371010904

### CLASSIFIEDS

**4739**

An old firm having offices in metros & state capitals, seeks merger offer from sole proprietors of more than 15 years experience or members with experience in international firms / international funding. Write with details to [binayak2008@rediffmail.com](mailto:binayak2008@rediffmail.com) or contact (M) 9937620718.

**4740**

Kochi based firm of Chartered Accountants require young/experienced CA's. Selected candidates will have excellent exposure to tax/company/Information Systems audit & consultancy and be groomed to eventually become partners of the firm. We are also looking for firms interested in merger/networking. Please mail your proposals to: [sebdom1@gmail.com](mailto:sebdom1@gmail.com)

### ICAI NATIONAL CONFERENCE

CA - Core of Global Economy - Practice & Innovations



On 19<sup>th</sup> & 20<sup>th</sup> September, 2009  
 at Hotel Shivalik View, Chandigarh.

**Organised by:** Professional Development Committee of ICAI

**Hosted by:** The Chandigarh Branch of NIRC of ICAI.

**Inaugural Address:** CA. Uttam Prakash Agarwal, President ICAI

### Delegate Fees

**Advance Registration:** Rs. 1500/- (per delegate)

**On Spot registration:** Rs. 1750/- (per delegate)

**Accompanying Spouse:** Rs. 1000/ (per delegate)

**Students:** Rs 1000/ (per delegate).

Fee should be paid by Demand Draft/Local Cheques drawn in favour of "Chandigarh Branch (NIRC) of ICAI" payable at Chandigarh.

**Conference Chairman:** CA. Anuj Goyal,

Chairman, Professional Development Committee M: 09312258364 Email: [anujgoyal@icai.org](mailto:anujgoyal@icai.org)

**Conference Director:** CA. Raman Seth

Chairman, Chandigarh Branch of ICAI

M: 09888388388 Email: [ca88seth@yahoo.co.in](mailto:ca88seth@yahoo.co.in)

**Conference Co-ordinators:** CA. Balwant Singh

Member, Accounting Standards Board, ICAI

M: 09814168636 Email: [balwinder@ifrsonline.in](mailto:balwinder@ifrsonline.in)

CA. Om Pawan Kumar Singla, Treasurer

Chandigarh Branch of ICAI

M: 09814122754 Email: [singla\\_pawan@yahoo.com](mailto:singla_pawan@yahoo.com)

**For any other query please contact: Secretariat of Professional Development Committee,**

Ph: 011-30110508 Email: [pdc@icai.in](mailto:pdc@icai.in)

**Chandigarh Branch NIRC of ICAI,**

Ph: 0172 – 5067756; E-mail: [chandigarh@icai.org](mailto:chandigarh@icai.org)

### ACKNOWLEDGMENT



You will be pleased to know that that the long pending issue-dispute of the key Land for Mumbai Bandra-Kurla complex has been resolved which paved way to start construction of our much awaited project. Further, Jaipur Development authority has also refunded more than Rs.525 lacs the money deposited for the proposed university project along with interest of Rs.39 lacs. We acknowledge the efforts put in by CA. Shyamlal Agarwal, Co-opted Member Infrastructure-Committee in resolving the above said issues.



## Foundation Stone of ICAI's CA Rameshwar Thakur Centre of Excellence laid in Bangalore

With a view to make Chartered Accountant a matchless multi-dimensional professional, the Institute of Chartered Accountants of India has embarked on a mission to set up a string of Centres of Excellence across the country. Taking that mission forward, the ICAI President laid the foundation stone of the ICAI's ambitious '*CA. Rameshwar Thakur Centre of Excellence*' in Bangalore on 15<sup>th</sup> August, 2009. Following is a brief report of that event.

The Foundation Stone for ICAI's CA Rameshwar Thakur Centre of Excellence at Bangalore was laid by CA. Uttam Prakash Agarwal, President, ICAI on 15<sup>th</sup> August, 2009 at a colourful and joyous function held at Survey No. 9, Kalyanapura Village, Soloru Hobli (Off Bangalore-Mangalore Highway), Bangalore. This proposed CA Rameshwar Thakur ICAI Centre of Excellence Bangalore, spread in 10 acres of land, would be a global training and knowledge centre and will be a treasury of cutting-edge knowledge facilities, providing world-class training to the members and CA students. The Centre would serve as an inexhaustible resource for the generations of CAs to come. The land for the Center of Excellence has been acquired by ICAI at a cost of Rs. 45 lakhs.

CA. Uttam Prakash Agarwal, President, ICAI

lighted the traditional lamp and laid the Foundation Stone for the project in the presence of CA. K. Raghu, Central Council Member, ICAI and Convenor, Centre of Excellence - Bangalore, CA. M. Devaraja Reddy, Chairman, SIRC of ICAI, CA. B.P. Rao, Past President, ICAI and other dignitaries. The function was witnessed by a galaxy of present members of SIRC, members of the Managing Committee of Bangalore branch of ICAI, Past Central Council Members of ICAI, Past Chairmen of SIRC, Past Chairmen of Bangalore Branch and Past Members of SIRC, host of distinguished invitees and students.

In his presidential address, CA. Uttam Prakash Agarwal recalled the background of the concept of the Centres of Excellence which have come up in Jaipur and Hyderabad and expressed immense happiness in having one Centre of Excellence at Bangalore, the IT hub city of India. He also narrated the happy experience during the course of his interaction with His Excellency CA. Rameshwar Thakur who as the then Governor of Karnataka positively responded to the request for allotment of land to the Institute for the creation of Centre of Excellence and it is in the fitness of things the Centre is being named after him in recognition of his contribution to the Institute. He assured the members that the project would be completed in a record time.



CA. K. Raghu, Central Council Member, ICAI and Convenor of Centre of Excellence, Bangalore thanked the President for the support and guidance extended in having the dream project of Centre of Excellence allotted to Bangalore and the confidence reposed in him and assured that he would endeavour to complete the project expeditiously. He also acknowledged the support given by the members of the Bangalore Branch who have been a source of strength and expressed confidence that the world-class technology would be in place in the Centre of Excellence. He also thanked ICAI's Past President His Excellency CA. Rameshwar Thakur, who as the then Governor of Karnataka, had been instrumental in the land being allotted to the Institute. He also narrated the sequence of events which ultimately culminated in the land being allotted and made an overview of the structure of the Centre of Excellence to come up through a presentation.

CA. C.S. Srinivas, Chairman, Bangalore Branch of SIRC warmly welcomed the gathering and CA. T. R. Venkatesh Babu proposed hearty vote of thanks.

The meeting was preceded by a Bhoomi Pooja performed at the site and to commemorate the occasion, saplings were planted by the dignitaries present. CA. Uttam Prakash Agarwal, President, ICAI also unfurled the National Flag on the occasion of the Independence Day and distributed scholarship to the needy students awarded based on merit-cum-need initiated by the Bangalore Branch of SIRC.

## Proposed Facilities in the Centre of Excellence

### • State-of-the-art Institutional Facilities

- One 500-seat Auditorium
- Two 150-seat Auditoriums
- Six IT Labs
- Eight Training Rooms
- Library
- Cafeteria

### • Comprehensive Residential Facilities

- Students' Hostels
- Members' Hostel
- Faculty Housing
- Dean's Residence

### • World-class Recreational Facilities

- Swimming Pool
- Clubhouse



## TOPPERS OF CHARTERED ACCOUNTANTS, FINAL EXAMINATION, JUNE, 2009



### ALL INDIA TOPPER 1<sup>st</sup> RANK

**NAME :** MR. GIRIRAJ AJMERA  
**CITY :** BHILWARA  
**ROLL # :** 25862  
**MARKS :** 561/800  
**% :** 70.13



### ALL INDIA TOPPER 2<sup>nd</sup> RANK

**NAME :** MR. AKRAM JAMAL  
**CITY :** KOLKATA  
**ROLL # :** 23700  
**MARKS :** 545/800  
**% :** 68.13



### ALL INDIA TOPPER 3<sup>rd</sup> RANK

**NAME :** MR. VIKESH MUNDHRA  
**CITY :** SURAT  
**ROLL # :** 9755  
**MARKS :** 541/800  
**% :** 67.63



### ALL INDIA TOPPER 3<sup>rd</sup> RANK

**NAME :** MS. RUCHIKA KATYAL  
**CITY :** ROHTAK  
**ROLL # :** 35796  
**MARKS :** 541/800  
**% :** 67.63

# Know Your Ethics\*

(Continued from August 2009 issue)

- Based on an ethical point of view the CA Director of a Company should not participate in board meeting and withdraw himself when the item relating to his client(s) is considered by the Board.
- Members from industry as well as from Practice can pursue the AMFI (Association of Mutual Funds in India) Course. However, as to the question whether a member can be registered with it so as to take the role of Financial Intermediary, it has been decided that members in Industry/ otherwise not in practice can obtain the membership by registering them with a mutual fund / Association whereas members in practice cannot do so whether holding full time COP or Part time COP.
- Engagement by a member in practice in the business of buying and selling shares amounts to be 'any business' within the meaning of Clause (11) of Part I of the First Schedule and hence the prior permission of the Council is required.
- It is prohibitive to undertake the assignments of Internal Audit of a client and entry of the transaction for Accounting, simultaneously being violative of the provisions of the 'Guidance Note on Independence of Auditors'.
- Concurrent audit and the assignment of Quarterly review of the same entity cannot be taken simultaneously as the concurrent audit being a kind of internal audit and the quarterly review being a kind of Statutory audit undertaken simultaneously are prohibited under the provisions of 'Guidance Note on Independence of Auditors'.
- Publishing a book by a firm containing its history for the purpose of distributing to clients, associates, friends and well wishers and printing of the words 'Celebrating 75 years in the Profession' on special letterheads and envelopes of the firm will lead to solicitation of professional work, hence not permissible as per the provisions of Clauses (6) and (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949.
- Member is not permitted to use his letterhead containing the name and address of his firm for presenting before the public at large, as it contains a promotional element and leads to solicitation of professional work.

## Ethical Issues in Question–Answer Form

**Q.** What is 'professional or other misconduct'?

**A.** 'Professional or other misconduct' refers to an

action or omission listed out in the two schedules of the CA Act, 1949. However, this does not purport to be a comprehensive definition as the scope of this term is expanding in view of the power conferred under the Act on the Director (Discipline) to enquire into the conduct of members under any other circumstances.

**Q.** What is the distinction between the two Schedules?

**A.** The two Schedules are distinguished on the basis of gravity of misconduct described therein. The misconduct listed in the Second Schedule is understood to be grave and serious prescribing higher punishment.

**Q.** Can a Member in practice render 'Management Consultancy and other Services'?

**A.** Yes, the areas permitted under the 'Management Consultancy and other Services' have been specified by the Council (appearing at pages 103-104 of the Code of Ethics, 2009) pursuant to Section 2(2)(iv) of the CA Act, 1949.

**Q.** Whether a member in practice is permitted to undertake the management of NRI funds?

**A.** No, a member in practice is not permitted to undertake such services as it is not covered under 'Management Consultancy and other Services' specified by the Council.

**Q.** Can a chartered accountant in practice provide 'Portfolio Management Services' (PMS)?

**A.** No, as the 'Management Consultancy and other Services' expressly bars the activities of broking, underwriting and portfolio management.

**Q.** Can a chartered accountant undertake practice after getting the CA final pass certificate?

**A.** No, a chartered Accountant requires the Certificate of Practice (CoP) issued by the Institute after getting the final pass certificate to practice as a chartered accountant.

**Q.** Can a chartered accountant in practice work as a 'collection agent'?

**A.** No, a chartered accountant in practice cannot work as a 'collection agent' as the 'Management Consultancy and other Services' specified by the Council do not permit such engagement.

(...To be Continued)

\*Contributed by Ethical Standards Board of ICAI

# LEGAL DECISIONS<sup>1</sup>

## DIRECTTAX



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

Where standard warranty was required to be given during sell and assessee made provision for warranty which exceeded actual expenditure and excess amount was reversed, claim for deduction under section 37 of said excess amount could not be denied

**Rotork Controls India (P.) Ltd. vs. Commissioner of Income Tax (Supreme Court), 12<sup>th</sup> May 2009**

A provision is a liability which can be measured only by using a substantial degree of estimation. A provision is recognized when: (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision can be recognized.

Liability is defined as a present obligation arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

A past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It is only those obligations arising from past events existing independently of the future conduct of the business of the enterprise that is recognized as provision. For a liability to qualify for recognition there must be not only

present obligation but also the probability of an outflow of resources to settle that obligation. Where there are a number of obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement, is determined by considering the said obligations as a whole. In this connection, it may be noted that in the case of a manufacture and sale of one single item the provision for warranty could constitute a contingent liability not entitled to deduction under Section 37. However, when there is manufacture and sale of an army of items running into thousands of units of sophisticated goods, the past event of defects being detected in some of such items leads to a present obligation which results in an enterprise having no alternative to settling that obligation.

The assessee-company had been manufacturing and selling Valve Actuators. At the time of sale the assessee provided a Standard Warranty for a period and undertook to rectify or replace the defective part free of charge. This warranty is given under certain conditions stipulated in the warranty clause. The assessee made a provision for warranty at the rate of 1.5% of the turnover. This provision was made by the assessee on account of warranty claims likely to arise on the sales effected by the appellant and to cover up that expenditure. During the assessment year 1991-92, since the provision made was for Rs.10,18,800/- which exceeded the actual expenditure, the assessee reversed Rs.5,00,246 as Reversal of Excess Provision. Consequently, the assessee claimed deduction in respect of the net provision of Rs.5,18,554/- which was disallowed by the revenue on the ground that the liability was merely a contingent liability not allowable as a deduction under Section 37.

The Supreme Court held that Valve Actuators are sophisticated goods. Over the years appellant had been manufacturing Valve Actuators in large numbers. The statistical data indicated that every year some of these manufactured Actuators were found to be defective. The statistical data over the years also indicated that being sophisticated item no customer was prepared to buy Valve Actuator without a warranty. Therefore, warranty became integral part of the sale price of the Valve Actuator(s). In other words, warranty stood attached to the sale price of the product. These aspects were important. Obligations arising from past events have to be recognized as provisions. These past events are known as obligating events. In the instant case, therefore, warranty provision needed to be recognized because the appellant was an enterprise having a present obligation as a result of past events resulting in an outflow of resources. Lastly, a reliable estimate could be made of the amount of the obligation. In short, all conditions for recognition of a provision were satisfied in this case.

When Valve Actuators were sold and the warranty costs were an integral part of that sale price then the appellant had to provide for such warranty costs in its account for the relevant year, otherwise the matching concept would fail. In such a case the option of making a provision for warranty only when the customer would make a claim was also inappropriate. Under the circumstances, the option of providing for warranty at 2% of turnover of the company based on past experience (historical trend) was most appropriate because it fulfilled accrual concept as well as the matching concept.

For determining an appropriate historical trend, it is important that the company has a proper account-

<sup>1</sup>. These cases have been compiled and contributed by Mr. Susanta K. Sahu, Secretary, Committee on Economic and Commercial Laws.

ing system for capturing relationship between the nature of the sales, the warranty provisions made and the actual expenses incurred against it subsequently. Thus, the decision on the warranty provision should be based on past experience of the company. A detailed assessment of the warranty provisioning policy is required particularly if the experience suggests that warranty provisions are generally reversed if they remained unutilized at the end of the period prescribed in the warranty. Therefore, one should scrutinize the historical trend of warranty provisions made and the actual expenses incurred against it. On this basis a sensible estimate should be made. The warranty provision for the products should be based on the estimate at year end of future warranty expenses. Such estimates need reassessment every year. As one reaches close to the end of the warranty period, the probability that the warranty expenses will be incurred is considerably reduced and that should be reflected in the estimation amount. Whether this should be done through a pro rata reversal or otherwise would require assessment of historical trend. If warranty provisions are based on experience and historical trend(s) and if the working is robust then the question of reversal in the subsequent years, may not arise in a significant way.

On the facts and circumstances of this case, provision for warranty was rightly made by the appellant-enterprise because it had incurred a present obligation as a result of past events. There was also an outflow of resources. A reliable estimate of the obligation was also possible. The appellant had incurred a liability, during the relevant assessment year which was entitled to deduction under Section 37. Therefore, all conditions for recognizing a liability for the purposes of provisioning stood satisfied in this case. It is important to note that there are four important aspects of provisioning. They are - provisioning which relates to present obligation, it arises out of obligating events, it involves outflow

of resources and lastly it involves reliable estimation of obligation.

The present value of the contingent liability like the warranty expense, if properly ascertained and discounted on accrued basis, could be an item of deduction under Section 37. The principle of estimation of the contingent liability is not the normal rule. It would depend on the nature of business, the nature of sales, the nature of the product manufactured and sold and the scientific method of accounting being adopted by the assessee. It will also depend upon the historical trend. It would also depend upon the number of articles produced. If it is a case of single item being produced then the principle of estimation of contingent liability on pro rata basis may not apply. However, in the instant case, it was not so. In the instant case large number of items being produced. They were sophisticated goods. They were supported by the historical trend, namely, defects being detected in some of the items. The data also indicated that the warranty cost(s) was embedded in the sale price. The data also indicated that the warranty was attached to the sale price.

A liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow of resources and in respect of which a reliable estimate is possible of the amount of obligation.

If the historical trend indicates that large number of sophisticated goods were being manufactured in the past and in the past if the facts established show that defects existed in some of the items manufactured and sold, then the provision made for warranty in respect of the army of such sophisticated goods would be entitled to deduction from the gross receipts under section 37. It would all depend on the data systematically maintained by the assessee. In view of the above, the assessee succeeded.

#### **Section 43B of the Income-tax Act, 1961- Certain deductions to be only on actual payments**

**Bottling fees chargeable from assessee under Rules framed under Rajasthan Excise Act, 1950 and interest chargeable on late payment of bottling fees, would not amount to tax, duty, cess or fees and such fees are not covered by section 43B  
Commissioner of Income-tax vs. McDowell & Co. Ltd., (Supreme Court), 8<sup>th</sup> May 2009**

Bottling fees chargeable from the assessee producer of IMFL under the Rules framed under the Rajasthan Excise Act, 1950 and interest chargeable on late payment of bottling fees, would not amount to tax, duty, cess or fees within the meaning of Section 43B, so as to attract the said provisions while considering allowability of deduction of such expenses.

The Assessing Officer as well as the Commissioner (Appeals) took stand that the assessee was not entitled to deductions in terms of Section 43B. The amount in question related to payability of excise duty on wastages. The assessee took the stand that the provision for excise duty made on wastage of IMFL in transit which was debited to the customers account and credited to this account did not bring in application of Section 43B. The Income Tax Officer as well as the Commissioner held that the assessee's stand was not acceptable. However, the Tribunal and the High Court decided the issues in favour of the assessee.

The Supreme Court held that section 43B after amendment w.e.f. 1.4.1989 refers to any sum payable by assessee by way of tax, duty or fee by whatever name called under any law for the time being in force. The basic requirement, therefore, is that the amount payable must be by way of tax, duty and cess under any law for the time being in force. The bottling fees for acquiring a right of bottling of IMFL which is determined under the Excise Act and Rule 69 of the Rajasthan Excise Rules, 1962 is payable by the assessee as consideration for acquiring the exclusive privilege. It is neither fee nor tax but the consideration for grant of approval by the Government

as terms of contract in exercise of its rights to enter a contract in respect of the exclusive right to deal in bottling liquor in all its manifestations. It would be pertinent to note that the expression now used in Section 43B(i)(a) is "Tax, Duty, Cess or fee or by whatever name called". It denotes that items enumerated constitute species of the same genus and the expression 'by whatever name called' which follows preceding words 'Tax', 'Duty', 'Cess' or 'fee' has been used *eiusdem generis* to confine the application of the provisions not on the basis of mere nomenclatures, but notwithstanding name, they must fall within the genus 'taxation' to which expression 'Tax', 'Duty', 'Cess' or 'Fee' as a group of its specie belong viz. compulsory exaction in the exercise of State's power of taxation where levy and collection is duly authorised by law as distinct from amount chargeable on principle as consideration payable under contract.

The 'Tax', 'Duty', 'Cess' or 'fee' constituting a class denotes to various kinds of imposts by State in its sovereign power of taxation to raise revenue for the State. Within the expression of each specie each expression denotes different kind of impost depending on the purpose for which they are levied. This power can be exercised in any of its manifestation only under any law authorising levy and collection of tax as envisaged under Article 265 of the Constitution which uses only expression that no 'tax' shall be levied and collected except authorized by law.

It in its elementary meaning conveys that to support a tax, legislative action is essential, it cannot be levied and collected in the absence of any legislative sanction by exercise of executive power of State under Article 73 of the Constitution by the Union or Article 162 of the Constitution by the State. Under Article 366 (28) of the Constitution, "Taxation" has been defined to include the imposition of any tax or impost whether general or local or special and tax shall

be construed accordingly. "Impost" means compulsory levy.

The well known and well settled characteristic of 'Tax' in its wider sense includes all imposts. Imposts in the context have following characteristics:

- (i) The power to tax is an incident of sovereignty.
- (ii) 'Law' in the context of Article 265 means an Act of legislature and cannot comprise an executive order or rule without express statutory authority.
- (iii) The term 'Tax' under Article 265 read with Article 366(28) includes imposts of every kind viz., tax, duty, cess or fees.
- (iv) As an incident of sovereignty and in the nature of compulsory exaction, a liability founded on principle of contract cannot be a "tax" in its technical sense as an impost, general, local or special.

The Supreme Court has in the light of decisions starting from *State of Bombay v. F.N. Balsara* (AIR 1951 SC 318) held that the expression "fee" is not used in the State excise laws or rules in the technical sense of the expression. By 'licence fee' or 'fixed fee' under excise laws relating to potable liquors/ intoxicant means the price or consideration which the Government charges to the licences for parting with its exclusive privilege and granting them to the licencees. There is no fundamental right to do trade or business in intoxicants. The State under its regulatory powers has the right to prohibit absolutely every form of activity in relation to intoxicants, its manufacture, storage, export, import, sale and possession in all their manifestations these rights are vested in the State.

It is the duty of revenue authorities to ascertain whether the deduction which is to be tested on the touchstone of section 43B(a) in the amount payable is by way of tax or duty or fees or cess.

The amount in the instant case did not fall within the purview of section 43B.

### **Section 43B of the Income-tax Act, 1961 – Certain deductions to be only on actual payments**

**Furnishing of bank-guarantee is not same as making actual payment as required under section 43B**

**Commissioner of Income-tax vs. McDowell & Co. Ltd., (Supreme Court), 8<sup>th</sup> May 2009**

The question arose as to whether unpaid amount of bottling fee, on furnishing of bank guarantee, is to be treated as actual payment and previous section 43B would be applicable.

The Supreme Court held that the requirement of Section 43B is the actual payment and not deemed payment as condition precedent for making the claim for deduction in respect of any of the expenditure incurred by the assessee during the relevant previous year specified in Section 43B. The furnishing of bank guarantee cannot be equated with actual payment which requires that money must flow from the assessee to the public exchequer as required under Section 43B. By no stretch of imagination it can be said that furnishing of bank guarantee is actual payment of tax or duty in cash. The bank guarantee is nothing but a guarantee for payment on some happening and that cannot be actual payment as required under Section 43B for allowance as deduction in the computation of profits.

## **INDIRECT TAX**



### **Excise & Customs**

**Section 14 of the Customs Act, 1962 read with rule 5 of the Customs Valuation Rules, 1988 - Valuation of goods for purpose of assessment**

**Whether it is price of goods or it is price agreed upon by parties should be deciding factor at time of computation value of goods**

**Radhey Shyam Ratanlal vs. Commissioner of Customs (Adjudication), Mumbai, (Supreme Court), 6<sup>th</sup> May 2009**

Section 14 of the Act relates to valuation of goods for the purpose of assessment and inter alia provides that the value of any goods chargeable to duty of customs would be deemed to be the price at which such or like goods are ordinarily sold or offered for sale for delivery at the time and place of importation in the course of international trade where the seller and the buyer have no interest in the business of each other or one of them has no interest in the business of the other and the price is the sole consideration for the sale or offer for sale. By inserting sub-section (1A) of section 14 which was inserted with effect from 16.8.1988, it was provided that subject to the provisions of sub-section (1) of section 14, the price referred to in the sub-section in respect of imported goods would be determined in accordance with the rules made in this behalf.

Further, rule 4 deals with the transaction value which is required to be determined under aforesaid rule. Under rule 4 of the Valuation Rules, the transaction value of imported goods shall be the price actually paid or payable for the goods when sold for export to India. In accordance with the provisions of rule 9, such transaction value is required to be accepted subject to the proviso to sub-rule (2). But the expression used in section 14 and rule 4 clearly indicates that the transaction value of imported goods would be accepted as provided by sub-rule (2) of rule 4 but such value is always subject to the provision of sub-section (1) of section 14 in view of the opening expression used in sub-section (1A) of section 14 which opens with the expression "subject to the provisions of sub-section (1) of section 14." Therefore, the provisions of sub-Section (1) of Section 14 would prevail when the transaction value required to be determined under Rule 4 does not reflect the price at which such or like goods are ordinarily sold or offered for sale for delivery at the time and place of importation. There cannot be any dispute with regard to said interpretation that it is the provision which will always prevail. In

other words the deemed value contemplated under Section 14(1) would prevail when the price declared does not reflect the price at which such or like goods are ordinarily sold or offered for sale for delivery at the time and place of importation. Under Rule 5, it is inter alia provided that the value of imported goods shall be the transaction value of identical goods sold for export to India and imported on or about the same time, goods being valued subject to provisions of rule 3. It is also provided in the said rule that in applying the said rule the transaction value of identical goods and sale at the same commercial level and substantially of the same quantity, would be used to determine the value of the imported goods.

The appellants entered into a contract with one 'K' of Singapore for import of cloves of Zanzibar/ Indonesian origin. The entire proceeding arises out of a contract of importation of cloves of the bulk quantity of 300 MTs at US Dollars 2600 PMTCIF during 2000-2001.

According to the Customs department, the price of cloves imported should be USD 5500/USD 5600 PMT.

The Supreme Court held that the appellant claimed a transaction value, but such value could not be supported by production of the original contract or the invoices relating to procurement of cloves to the appellant under the Bills of Entry in question. The said documents were called for and were directed to be produced, but same could not be produced.

The department relied upon the contemporaneous documents like the Weekly Bulletin of Spices Market and also the Public Ledger. The Weekly Bulletin of Spices Market published by the Trade Information Services of the Spices Board of the Ministry of Commerce and Industry, Government of India indicated that the price of Indonesian cloves on 24.11.2000 was US\$ 4765 PMT and that of Zanzibar cloves was US\$ 4650 PMT. Such bulletin also indicated that by 23.12.2001 the price of Zanzibar cloves had reached

Rs.6100/- PMT. The Public Ledger which is also considered as International Publication of Report indicated that the price of cloves in the international market on 27.11.2000 was US Dollars 4700 which reached US Dollars 6300 on 26.3.2001.

The records produced showed that the nature of business of 'K' of Singapore was primarily dealing with sport goods and not cloves. There was also a reference of the document on record particularly the relevant bill of lading which indicated that cloves were imported by the appellants from Ijimasia Pvt. Ltd. through 'K' at the price of US Dollars 5600 PMT through bill of entry dated 7.2.2001. The value of the said Zanzibar cloves were shown as US Dollars 5600 PMT. It also came in evidence that 9.5648 MTs cloves of Indonesian origin shipped from Singapore imported by Spices Trading Corporation under bill of entry dated 8.5.2001 were bought at the rate of US Dollars 5500. The said consignment was shipped on 25.2.2001 as per the bill of lading. Another consignment of 9.300 MTs of cloves of Comoros origin was also imported by M/s. Spices Trading Corporation at the same unit price. A table of imports made by the appellants in the Bill of Entry in question was placed on record.

The Supreme Court held that the evidence, which existed on record clearly supported the findings and the conclusions arrived at by the Commissioner. The findings and conclusions could not be said to be perverse. They were based on cogent reasons which were found to be forceful and reasonable. Therefore, the department had correctly impugned proper assessment value on the goods in question imported by the appellant.

#### **Service Tax**

#### **Section 65 of the Finance Act, 1994 - Renting of immovable property**

**Section 65(105)(zzz) does not in terms entail that renting out of immovable property for use in course or furtherance of business of**

**commerce would by itself constitute a taxable service and be exigible to service tax.**

**Home Solution Retail India Limited vs. Union of India and others, 18<sup>th</sup> April 2009 [DELHI]**

By virtue of the Notification No. 24/2007 dated 22.5.2007 issued by the Secretary, Ministry of Finance, Department of Revenue, the Central Government exempted the "taxable service of renting of immovable property", referred to in Section 65(105) (zzzz) of the Finance Act, 1994, from so much of the service tax levy as was in excess of the service tax calculated on a value which is equivalent to the gross amount charged for renting of such immovable property less taxes on such property, namely property tax levied or collected by local bodies. An example has also been provided in the said notification by way of illustration. The example is as under:

"Example- Property tax paid for April to September = Rs. 12,000/-  
Rent received for April = Rs. 100,000/-  
Service tax payable for April = Rs. 98,000/- (100,000-2,000) = applicable rate of service tax."

The writ petitioners contended that though this notification speaks of an exemption it also refers to the taxable service as a taxable service of renting of immovable property. This is not so provided under the Act. It was contended that Section 65(105) (zzzz) refers to the service provided or to be provided to any person, by any other person, in relation to renting of immovable property for use in the course or furtherance of business or commerce. The reference in the said provision is not to the taxable service of renting of immovable property but to the taxable service "in relation to" the renting of immovable property. While the act does not treat renting of immovable property as a taxable service, the notification proceeds on the basis that the taxable service is the renting of immovable property itself. It is on this basis that it had been contended that service tax is sought to be recovered from the owners, licensees, etc. of such

properties on a pure misreading of the statutory provision.

Similarly, the impugned Circular No. 98/1/2008-ST dated 4.1.2008 whilst giving a clarification in respect of commercial and industrial construction service has purported to clarify that the "right to use immovable property is leviable to service tax under the renting of immovable property service". Consequently, by the said clarification, the Union of India is seeking to levy service tax on renting of immovable property instead of on services in relation to renting of immovable property. According to the petitioners, the clarification therefore travels beyond the provisions of the said act by contemplating a service tax on the renting of immovable property itself.

The High Court held that service tax is a value added tax. It is a tax on value addition provided by a service provider. It is obvious that it must have connection with a service and, there must be some value addition by that service. If there is no value addition, then there is no service. With this in mind, it would be instructive to analyse the provisions of Section 65(105)(zzzz). It has reference to a service provided or to be provided to any person, by any other person in relation to 'renting of immovable property for use in the course or furtherance of business or commerce'. The wordings of the provision are so structured as to entail a service provided or to be provided to 'A' by 'B' in relation to 'C'. Here, 'A' is the recipient of the service, 'B' is the service provider and 'C' is the subject matter. The expression 'in relation to' may be of widest amplitude, but it has been used in the said Act as per its context. Sometimes, 'in relation to' would include the subject matter following it and on other occasions it would not. As in the case of the service of dry cleaning, the expression 'in relation to dry cleaning' also has reference to the very service of dry cleaning. On the other hand, the service referred to in Section 65(105)(v), which refers to a service provided by a real estate agent 'in relation to real estate', does not, obviously, include the subject matter

as a service. This is so because real estate by itself cannot by any stretch of imagination be regarded as a service. Going back to the structured sentence, i.e. service provided or to be provided to 'A' by 'B' in relation to 'C', it is obvious that 'C' can either be a service (such as dry cleaning, hair dressing, etc.) or not a service by itself, such as real estate. The expression 'in relation to' would, therefore, have different meanings depending on whether 'C' is a service or is not a service. If 'C' is a service, then the expression 'in relation to' means the service 'C' as well as any other service having connection with the service 'C'. Where 'C' is not a service, the expression 'in relation to' would have reference only to some service which has a connection with 'C'. But, this would not imply that 'C' itself is a service.

One should understand as to whether renting of immovable property for use in the course or furtherance of business or commerce by itself is a service. There is no dispute that any service connected with the renting of such immovable property would fall within the ambit of Section 65(105)(zzzz) and would be exigible to service tax. The question is whether renting of such immovable property by itself constitutes a service and, thereby, a taxable service. Service tax is a value added tax. It is a tax on the value addition provided by some service provider. Insofar as renting of immovable property for use in the course or furtherance of business or commerce is concerned, any value addition cannot be discerned. Consequently, the renting of immovable property for use in the course or furtherance of business or commerce by itself does not entail any value addition and, therefore, cannot be regarded as a service. Of course, if there is some other service, such as air conditioning service provided along with the renting of immovable property, then it would fall within Section 65(105)(zzzz). Section 65(105)(zzzz) does not in terms entail that the renting out of immovable property for use in the course or furtherance of business or commerce would by itself constitute a taxable service and be exigible to

service tax. The obvious consequence of this finding is that the interpretation placed by the impugned notification and circular on the said provision is not correct. Consequently, the same are ultra vires the said Act and to the extent that they authorize the levy of service tax on renting of immovable property per se, they are to be set aside.

## OTHER LAWS



### SICA

#### **Section 22 of the Sick Industrial Companies (Special Provisions) Act, 1985 – Suspension of Legal Proceedings, Contracts, etc.**

Where transaction of supply of goods takes place prior to reference to BIFR, but civil suit on non-payment was made subsequent to reference, Civil Court's jurisdiction was ousted in terms of provisions of section 22 and judgment, if any, would be coram non judis

#### **M.D., Bhoruka Textiles Limited vs. Kashmiri Rice Industries, (Supreme Court), 15<sup>th</sup> May 2009**

The respondent-partnership firm entered into a contract on 6-9-2001 for supply of paddy husk with the appellant. The respondent supplied husk during the period 17.9.2001 and 28.11.2001. Despite supply of the agreed quantity of paddy husk, the appellant failed and/or neglected to pay the price therefor. In the meantime, reference to BIFR in terms of Section 16 was made on 27.12.2001. The said reference was registered by the BIFR on 20.03.2002. The respondent filed the suit for recovery on 17.12.2002. The transaction in question was prior to the reference. It was also apparent from the record that respondent was aware of the fact that the appellant had made reference to the BIFR in terms of the provisions of the Act. It was also not in dispute that prior to institution of

the suit, the respondent did not obtain consent of the Board.

The Supreme Court held that section 22 must be interpreted giving a plain meaning to its contents. An enquiry in terms of Section 16 of the Act by the Board is permissible upon receipt of a reference. Thus, reference having been made on 27.12.2001 and the suit having been filed on 17.12.2002, the receipt of a reference must be held to be the starting period for proceeding with the enquiry. The effect of the provisions of the Act had been considered by a Three Judge Bench decision of the Supreme Court in Tata Motors Ltd. v. Pharmaceutical Products of India Ltd. & Anr. [(2008) 7 SCC 619], wherein it, in no uncertain terms, held that SICA is a special statute and, thus, overrides other acts like Companies Act, 1956.

If the civil court's jurisdiction was ousted in terms of the provisions of section 22, any judgment rendered by it would be coram non judis. It is a well settled principle of law that a judgment and decree passed by a court or tribunal lacking inherent jurisdiction would be a nullity.

### Banking Laws

#### **Section 138 of the Negotiable Instrument Act, 1881 – Dishonour of Cheque for insufficiency, etc. of funds in account**

Return of a cheque by bank on ground that it was reported lost by drawer of cheque would not attract penal provisions contained in section 138

#### **Raj Kumar Khurana vs. State of (NCT of Delhi), (Supreme Court), 5<sup>th</sup> May 2009**

The appellant kept two blank cheques in his office along with some stamp papers. They were said to have been stolen from his office. Information as regards missing of the said cheques was also given to the bank. He lodged a First Information Report. The blank cheques were allegedly filled up on 24.06.2001. They were presented before the bank but the same were returned dishonoured with the remarks "said cheque reported lost by the drawer". The respondent No. 2 filed a complaint

petition in the Court of Chief Metropolitan Magistrate under section 138 for dishonour of cheque.

The Supreme Court held that a bare perusal of section 138 would clearly go to show that by reason thereof a legal fiction has been created. A legal fiction, as is well known, although is required to be given full effect, has its own limitations. It cannot be taken recourse to for any purpose other than the one mentioned in the statute itself.

Section 138 moreover provides for a penal provision. A penal provision created by reason of a legal fiction must receive strict construction. Such a penal provision, enacted in terms of the legal fiction drawn would be attracted when a cheque is returned by the bank unpaid. Such non-payment may either be: (i) because of the amount of money standing to the credit of that account is insufficient to honour the cheque, or (ii) it exceeds the amount arranged to be paid from that account by an agreement made with that bank.

Before a proceeding thereunder is initiated, all the legal requirements therefor must be complied with. The court must be satisfied that all the ingredients of commission of an offence under the said provision have been complied with.

The parameters for invoking the provisions of Section 138, thus, being limited, refusal on the part of the bank to honour the cheque would not bring the matter within the mischief of the provisions of Section 138.

The court while exercising its jurisdiction for taking cognizance of an offence under Section 138 was required to consider only the allegations made in the complaint petition and the evidence of the complainant and his witnesses, if any. It could not have taken into consideration the result of the complaint petition filed by the respondent No. 2 or the closer report filed by the Superintendent of Police in the First Information Report lodged by the appellant against him. Thus, the complaint petition does not disclose an offence punishable under Section 138.

# CIRCULARS / NOTIFICATIONS

## DIRECT TAXES

### I. Notifications

**1. Notification No. 58/2009-FT & TR-II [F.No. 503/10/95-FT & TR-II], dated 16-7-2009**



The Agreement between the Government of the Republic of India and the Government of the Republic of Tajikistan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on income signed in India on the 20<sup>th</sup> November, 2008 came into force on the 10<sup>th</sup> April, 2009, being the date of the later of the notifications after completion of the procedures as required by the respective laws for the entry into force of this Agreement, in accordance with Article 30 of the said Agreement.

In exercise of the powers conferred by section 90 of the Income-tax Act, 1961, the Central Government hereby directs that all the provisions of the said Agreement shall be given effect to in the Union of India with effect from the 1<sup>st</sup> April, 2010.

The complete text of the said notification can be downloaded from [www.incometaxindia.gov.in](http://www.incometaxindia.gov.in)

### II. Announcements

#### 1. Extension of time limit for filing Form ITR-V

The Central Board of Direct Taxes had, vide circular No. 3/2009 dated 21.05.2009, allowed assessees who file their income tax returns in electronic form without digital signature to submit their verified ITR-V form, within a period of 30 days, thereafter. The ITR-V form was required to be sent to Post Bag No.1, Electronic City Post Office, Bengaluru, Karnataka-560 100, by ordinary post.

It has now been decided to extend the time limit for filing the ITR-V form by relaxing the stipulations in the circular dated 21.05.2009. The ITR-V form relating to returns which have been filed electronically (without digital signature) on or after 1<sup>st</sup> April,

2009 can now be filed on or before the 30<sup>th</sup> September, 2009 or within a period of 60 days of uploading of the electronic return data, whichever is later. The ITR-V should continue to be sent by ordinary post to Post Bag No. 1, Electronic City Post Office, Bengaluru, Karnataka-560 100.

### 2. Draft Direct Taxes Code

The Hon'ble Finance Minister released the Draft Direct Tax Code and the Discussion Paper on 12<sup>th</sup> August, 2009. An attempt has been made to simplify the language to enable better comprehension and to remove ambiguity to foster voluntary compliance.

The complete text of the direct taxes Code Bill, 2009 and the discussion paper can be downloaded from [www.finmin.nic.in](http://www.finmin.nic.in)

(Matter on Direct Taxes has been contributed by the Direct Taxes Committee of the ICAI)

## INDIRECT TAXES

## SERVICE TAX

### I. Notification

**1. Notification No. 24/2009 ST dated 27.07.2009** has exempted taxable service, referred to in sub-clause (zzg) of clause (105) of section 65 of the Finance Act, 1994, provided to any person by any other person in relation to management, maintenance or repair of roads, from the whole of the service tax leviable thereon under section 66 of the said Finance Act.



### II. Circular

#### 1. Circular No. 115/2009-ST. dated 31.07.2009 has been issued to clarify the following points:

- i) Applicability of service tax under 'Business Auxiliary service' on commission paid to Managing Director / Directors (whole time, or Independent) by the company
- Clarification:** Some Companies make payments to Managing Director/Directors (Whole-time or Independent), terming the same

as 'Commissions'. The said amount paid by a company to their Managing Director/ Directors (Whole-time or Independent) even if termed as commission, is not the 'commission' that is within the scope of business auxiliary service and hence service tax would not be leviable on such amount.

- ii) Applicability of service tax on Independent Directors who are part of the Board of Directors under 'Management Consultant service'

**Clarification:** Remunerations paid to Managing Director / Directors of companies whether whole-time or independent when being compensated for their performance as Managing Director/ Directors would not be liable to service tax. However, in case such directors provide any advice or consultancy to the company, for which they are being compensated separately, such service would become chargeable to service tax.

The complete text of the above-mentioned notification and circular related to service tax can be downloaded from [www.servicetax.gov.in](http://www.servicetax.gov.in)

(Matter on Indirect Taxes has been contributed by the Indirect Taxes Committee of the ICAI)

## FEMA

**1. RBI/2009-10/ 101,  
A.P. (DIR Series)  
Circular No.03  
dated July 17, 2009.**



**Deferred Payment Protocols**  
dated April 30, 1981 and December 23, 1985 between Government of India and erstwhile USSR

Attention of Authorised Dealer Category-I (AD Category-I) banks is invited to A.P. (DIR Series) Circular No. 2 dated July 3, 2009, wherein the rupee value of the special currency basket was indicated as Rs. 64.6153

effective from May 22, 2009.

AD Category-I banks are advised that a further revision has taken place on June 22, 2009 and accordingly, the rupee value of the special currency basket has been fixed at Rs. 66.5719 with effect from June 25, 2009.

The Directions contained in this circular have been issued under sections 10(4) and 11(1) of the Foreign Exchange Management Act (FEMA), 1999 (42 of 1999) and are without prejudice to permissions / approvals, if any, required under any other law.

**2. RBI/2009-10/106 A.P. (DIR Series) Circular No. 05 dated July 22, 2009**

**Issue of Indian Depository Receipts (IDRs)**

1. In order to facilitate the eligible companies resident outside India to issue Indian Depository Receipts (IDRs) through a Domestic Depository and to permit persons resident in India and outside India to purchase, possess, transfer and redeem IDRs, it has been decided to operationalise the IDR Rules, notified by the Government of India, as amended from time to time, with immediate effect.

Accordingly, eligible companies resident outside India may issue Indian Depository Receipts (IDRs) through a Domestic Depository, subject to compliance with the Companies (Issue of Depository Receipts) Rules, 2004 and subsequent amendments made thereto and the SEBI (DIP) Guidelines, 2000, as amended from time to time. In case of raising of funds through issuance of IDRs by financial/banking companies having presence in India, either through a branch or subsidiary, the approval of the sectoral regulator(s) should be obtained before the issuance of IDRs.

2. The FEMA Regulations shall not be applicable to persons resident in India as defined under section 2(v) of FEMA, 1999, for investing in IDRs and subsequent transfer arising out of transaction on a recognized Stock Exchange in India. Foreign Institutional Investors (FIIs) including SEBI approved sub-accounts of the FIIs, registered with SEBI and Non-Resident Indians (NRIs) may also invest, purchase, hold and transfer IDRs of eligible companies resident outside India and issued in the Indian capital market, subject to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 notified vide Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time. Further, NRIs are allowed to invest in the IDRs out of funds held in their NRE / FCNR(B) account, maintained with an Authorised Dealer / Authorised bank.

**3. RBI/2009-10/112 A. P. (DIR Series) Circular No. 06 and A. P. (FL/RL Series) Circular No. 01 dated August 3, 2009.**

**Memorandum of Instructions governing money changing activities**

In view of difficulties experiencing by the Authorised Persons in obtaining conduct certificate from local police authorities in respect of agents/ franchisees, which are incorporated entities in terms of paragraph (C) 4 of Annex-I to the A. P. (DIR Series) Circular No. 57 [A.P. (FL/RL Series) Circular No. 04] dated March 9, 2009, the existing requirement has been reviewed by the RBI. Accordingly, now ADs Category - I/ ADs Category - II/ FFMCs have been permitted to accept certified copy of the Memorandum and Articles of Association and Certificate of Incorporation in lieu of conduct certificate from the local police authorities, in respect of agents/ franchisees, which are incorporated entities.

The complete text of the above-mentioned circulars related to FEMA can be downloaded from [www.rbi.org.in](http://www.rbi.org.in)

(Matter on FEMA has been contributed by CA. Manoj Shah and CA. Hinesh Doshi)

## **CORPORATE LAWS**

### **1. Inter-Scheme Transfers of Corporate Bonds by Mutual Funds**



The SEBI has issued Circular No. SEBI/IMD/ DOF1/Bond/Cir-3/2009 dtd. 31.07.2009 clarifying that Mutual Funds, while reporting their trades in corporate bonds, shall also report their inter-scheme transfers on the platforms of BSE, NSE and FIMMDA. The Mutual funds, or the brokers / intermediaries acting on their behalf, shall ensure that inter-scheme transfers are indicated separately while reporting the same.

### **2. Updations in offer documents filed with SEBI**

The SEBI has issued Circular No. SEBI/CFD/MB/IS/4/2009/31/07 dtd. 31.07.2009 specifying the procedure for submitting updated offer documents, including what will constitute "significant changes", "additional fees", etc. with SEBI and instructing registered merchant bankers for due compliance in relation to filing of updated offer document, with the Board, with fees and without fees. The Circular also specifies fresh filing of draft offer document with SEBI along with requirements in relation to

- Change in promoter or persons in control of the company.
- Change in more than half of the board of directors of the company.
- Change in main object clause of the company.
- Additions to objects of the issue, which taken together result in a change in the estimated issue size or estimated means of finance by more than 10%.
- Deletions to objects of the issue, which taken together result in a change in the estimated issue size or estimated means of finance by more than 10%.
- Any increase or decrease in estimated issue size by more than 10%.

g) Any increase or decrease in the estimated deployment of funds in any of the objects of the issue by more than 10%.

h) Changes which may result in non-compliance of the provisions of the SEBI (DIP) Guidelines, 2000 and the merchant banker intends to seek an exemption under clause 17.2A of the SEBI (DIP) Guidelines, 2000.

### **3. Amendment to SEBI DIP guidelines**

The SEBI has issued Circular No. SEBI/CFD/DIL/DIP/37/2009/31/07 dtd. 31.07.2009 amending the SEBI (Disclosure and Investor Protection) Guidelines, 2000 in order to align the disclosure requirements pertaining to issuance of Indian Depository Receipts (IDRs) with the recent amendments made to the Companies (Issue of Indian Depository Receipts) Rules, 2004 (hereinafter referred to as 'the Rules') by the Ministry of Corporate Affairs and to bring in more clarity with respect to the disclosure requirements pertaining to the IDR issuances, amendment is carried out to Chapter VIA of the SEBI (DIP) Guidelines considering the need to explicitly mention the extent of applicability of the provisions of the DIP Guidelines to the IDR issuances. The amendments in the DIP Guidelines mainly relate to the disclosure of financial information pertaining to the issuing company and the extent of applicability of the DIP Guidelines to IDR issues.

### **4. Amendment to SEBI Takeover regulations**

The SEBI has issued Circular No. CFD/DCR/TO/Cir-01/2009/06/08 dtd. 06.08.2009 on SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 clarifying that subject to the conditions as specified in this newly inserted proviso, an acquirer (together with persons acting in concert with him), holding fifty five per cent (55%) or more but less than seventy five percent (75%) of the shares or voting rights in a target company, may acquire (either by himself or through or with persons acting in concert with him) additional shares or voting rights entitling him up to five per cent (5%) voting rights in the target company without making a public announcement under the

Takeover Regulations. Certain other clarifications issued by the SEBI in this regard may be referred in the complete circular.

### **5. Application Supported by Blocked Amount process**

The SEBI has issued Circular No. SEBI/CFD/DIL/MB/IS/5/2009/05/08 dtd. 05.08.2009 in relation to the ASBA process made applicable to all book built public issues opening on or after September 1, 2008 and which had a poor response. SEBI has pointed out that one of the reasons for poor response to ASBA was stated to be lack of incentive for Self Certified Syndicate Banks (SCSBs) to do the assigned task of accepting ASBAs, uploading details in the bidding system and blocking or unblocking of the account. It was pointed out that while commission is being paid for non-ASBA applications, no commission was being paid for ASBA applications. The payment of commissions in the issue process should be based on the principle of fairness which demands a level playing field for both ASBA and non-ASBA applications. It is now clarified that for the purpose of payment of commission, both type of applications i.e. whether uploaded by Syndicate Members (non-ASBA) or by SCSBs (ASBA), shall be treated on par and the commission shall be paid accordingly to Syndicate Members or SCSBs, as the case may be.

### **6. Exit load – Parity among all classes of unit holders**

The SEBI has issued Circular No. SEBI / IMD / CIR No. 6 /172445/ 2009 dtd. 07.08.2009 observing that the mutual funds are making distinction between the unit holders by charging differential exit loads based on the amount of subscription. In order to have parity among all classes of unit holders, it has now been decided that no distinction among unit holders should be made based on the amount of subscription while charging exit loads.

The complete text of above-mentioned circulars related to Corporate Laws may be referred at [www.sebi.gov.in](http://www.sebi.gov.in)

(Matter on Corporate Laws has been contributed by CA. Jayesh Thakur)

# DISCIPLINARY CASE

*Summary of a disciplinary case - Council of the Institute of Chartered Accountants of India Vs. Shri Rajesh Rastogi<sup>1</sup> (Chartered Accountant Reference No. 1 of 2005) decided on 26.03.2007 & 03.04.2007 by the High Court of Delhi, New Delhi under Section 21(5) of the Chartered Accountants Act, 1949.*

## Facts of the case:

Hony. Secretary, Delhi Prashasan Adhikari Co-operative Group Housing Society Ltd., Delhi (hereinafter referred to as the "Complainant") filed a complaint against Shri Rajesh Rastogi of M/s. Kaul Associates, (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 the Respondent-firm was appointed on 10<sup>th</sup> August, 1992 by Registrar, Co-operative Societies, Government of NCT of Delhi, New Delhi to undertake statutory audit of Delhi Prashasan Adhikari Co-operative Group Housing Society Ltd., (hereinafter referred to as the "Society") for the co-operative year 1991-92 including all pending audits, if any, within 60 days after the receipt of the aforesaid letter of appointment. But the Respondent-firm could audit the accounts of the said Society only for the year 1991-92 and that too after 27 months. Despite the above, the complainant also pointed out number of inaccuracies and ambiguities in the said audited account.

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 invited the attention of the Respondent to the provisions of Regulation 15(2) of the Chartered Accountants Regulation, 1988 and asked the respondent whether he wished to plead guilty or to proceed with the hearing.

The Respondent, in respect to the charge, pleaded guilty and stated that "whatever mistakes have been committed are due to either inexperience in audit or lack of supervision of audit staff. There is no *mala fide* intention on the part of the Respondent". Further to the best of his knowledge and belief, no fraud had been committed in the Society in the period covered under his audit. The Respondent further submitted that mistakes are either more in the nature of wrong posting to the various accounts heads or in the nature of not passing adjustment entries in the books of accounts at the close of the year.

The Disciplinary Committee after taking into account the aforesaid facts and circumstances of the case, looking into the state of affairs as depicted in the manual Books of Accounts including Cash Book and Ledger and also considering the fact that Respondent had pleaded guilty, came to the conclusion that Respondent was guilty of professional misconduct within the meaning of Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 in terms of Section 21 read with Section 22 of the said Act.

The Council on consideration of the report of the Disciplinary Committee, along with the written representation of the Complainant and Respondent and also the oral submissions made by them before it, accepted the report of Disciplinary Committee and found that the Respondent was guilty of professional misconduct within the meaning of Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 in terms of Section 21 read with Section 22 of the said Act. The Council decided to

recommend to the High Court that the Respondent be reprimanded. As required under Section 21(5) of the Act, the matter was referred to the Delhi High Court with the recommendations of the Council.

The Judgment of the Division Bench of the High Court of Delhi at New Delhi comprising of Hon'ble Mr. Justice Madan B. Lokur and Hon'ble Justice V. B. Gupta is summarized below:

## Decision of the Hon'ble Court:

The Hon'ble Court observed that the Complainant-Society in its complaint had requested that exemplary punishment should be awarded to the Respondent and he should also be asked to reimburse the audit fee and the expenditure incurred by the Complainant.

The Hon'ble Court looking into the facts of the case that the Respondent had pleaded guilty to the allegations made against him, confirmed the punishment of reprimand imposed upon the Respondent by the Council of the Institute. As regards the refund of Audit fees and expense the court issued the notice to the complainant-society which had put in appearance before the Hon'ble Court and sought refund of Rs. 5715/- . The Respondent agreed to pay the above amount and accordingly, the Hon'ble Court directed the Respondent to return the amount of Rs. 6,000/- (rounded off) to the Complainant within a week, which was paid by the Respondent and the Hon'ble Court recorded the payment of above amount by Respondent in its order dated 3<sup>rd</sup> April, 2007.

On overall consideration of the matter, the Hon'ble High Court accepted the finding & recommendation of the Council and ordered that the Respondent be reprimanded.

<sup>1</sup> For full text of the Judgment please see Institute's publication viz. Disciplinary Case Vol. IX, Part I, p. 175 or visit Editorial Board page at [http://www.icai.org/post.html?post\\_id=967&c\\_id=59](http://www.icai.org/post.html?post_id=967&c_id=59)

# Accounting for expenditure incurred on evacuation of accumulated ash in the ash dyke.

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 Government of India enterprise was incorporated in the year 1975 as a company under the Companies Act, 1956, to engage in the business of electricity generation by setting up coal based super thermal power stations across the country. Subsequently, it has set up gas and liquid fuel based power generating stations also. The company has diversified into oil and gas exploration, coal mining, hydro-power generation, consultancy and also into power trading, power distribution, etc., through its subsidiaries and joint ventures.

2. In coal based power stations of the company set up in early eighties, the disposal of ash left after burning of coal was generally addressed by construction of ash dykes. An ash dyke is constructed by enclosing a large area of land by high walls on the periphery so that a deep cavity results in which ash in the form of slurry is disposed. Over a period of time, the ash gets accumulated and fills up the dyke, and then to fill up ash, additional capacity is created by either raising the ash dyke walls or construction of a new ash dyke on an additional land. When an ash dyke is further raised, it is done gradually in a number of phases and with each phase of raising, additional capacity for disposal of ash is created which takes care of the requirement of the station for a period ranging from 1 to 5 years. The querist has informed that the expenditure incurred in the construction of the ash dyke as well as its further raising is capitalised as per paragraphs 6.1, 12.1 and 23 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', issued by the Institute of Chartered Accountants of India and the total cost of the ash dyke is amortised over the revised useful life of the ash dyke.

3. As per the querist, the basic principle behind capitalisation of the expenditure incurred on raising of ash dyke and treating it as an asset is that

the fruits of the expenditure so incurred, i.e., capacity created for disposal of ash, are enjoyed over a number of accounting periods and the capitalised expenditure is depreciated over the revised useful life of the ash dyke.

4. The querist has informed that some of the old stations of the company have exhausted all the land earmarked for ash disposal and after a number of raisings of the ash dyke, there is no scope for further raisings of the ash dyke as it is considered to be a potential hazard for the neighbouring habitat. Further, it is now proposed that further capacity for disposal of ash at the station be created by incurring expenditure on evacuating the ash accumulated in the existing ash dyke. The ash accumulated over a number of years is proposed to be dug up and evacuated by transporting it to distant places where it can be used for filling up low lying areas or in road embankments.

5. According to the querist, the expenditure incurred on raising of ash dyke is capitalised only because it creates additional capacity for ash disposal which can be used over a number of years. Similarly, the querist has argued that capacity for disposal of ash can be created by digging a deep pit, well or a cavity on virgin land and such expenditure would also qualify for capitalisation as the facility so created would be held with the intention of being used for the purpose of providing services of safe ash disposal in the normal course of business of electricity generation. The querist has mentioned that similar capacity for ash disposal is now proposed to be created at a comparable cost by evacuating the accumulated ash from the existing ash dyke and disposing it in far away uninhabited low lying areas or in construction activities. The only difference in this case is that instead of digging earth, the ash accumulated in

the ash dyke over a number of years is proposed to be dug and disposed of for creation of capacity for further ash disposal. Accordingly, the querist has informed that the expenditure so incurred in evacuation of ash from the existing ash dyke is proposed to be capitalised and depreciated over the remaining extended life of the ash dyke.

## B. Query

6. The querist has sought the opinion of the Expert Advisory Committee as to whether the proposed accounting treatment of capitalisation of expenditure incurred on evacuation of ash from fully raised ash dyke resulting in further creation of capacity for future disposal of ash as suggested in paragraph 5 above would be in accordance with paragraphs 12.1 and 23 of AS 10.

## C. Points considered by the Committee

7. The Committee restricts itself to the particular issue raised by the querist in paragraph 6 above and has not examined any other issue that may be contained in the Facts of the Case, such as, treatment of revenue from the disposal of ash evacuated from the ash dyke, accounting for the use to which the ash evacuated is put to, etc.

8. The Committee notes below paragraphs 12.1 and 23 of AS 10 referred by the querist in paragraph 2 above:

"12.1 Frequently, it is difficult to determine whether subsequent expenditure related to fixed asset represents improvements that ought to be added to the gross book value or repairs that ought to be charged to the profit and loss statement. Only expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity."

**"23. Subsequent expenditures related to an item of fixed asset should be added to its book value only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance."**

9. The Committee is of the view that expenditure on fixed assets subsequent to their installation may be categorised into (i) repairs and maintenance, and (ii) improvements or betterments. Repairs and maintenance, in the Committee's view, implies the restoration of a capital asset to its full productive capacity after damage, accident, or prolonged use, without increase in the previously estimated useful life or capacity. Expenditure on repairs and maintenance, including replacement cost necessary to maintain the previously assessed standard of performance, is expensed in the same period. On the other hand, in the view of the Committee, expenditures on improvements or betterments are expenditures that add new fixed asset unit, or that have the effect of improving the previously assessed standard of performance, e.g., an extension in the asset's useful life, an increase in its capacity, or a substantial improvement in the quality of output or a reduction in previously assessed operating costs. Such expenditures are capitalised.
10. From the above, the Committee is of the view that in the case of the company, it needs to be examined whether the capacity of the ash dyke was initially decided after taking into account the capacity that would be created by the evacuation of ash from the ash dyke and whether useful life of the dyke was decided on that basis. In other words, it needs to be examined whether the ash dyke constructed and subsequently raised by the company was intended to be emptied for further use of disposal of ash in the ash dyke. In case it was so intended, evacuation of ash from the ash dyke does not result in creation of additional capacity or in the extension of the useful life of the ash dyke. In such a case, the cost of evacuation of ash from the ash dyke is of the nature of repairs and maintenance and, therefore, should be expensed when incurred. However, in case the ash dyke was not intended to be emptied, i.e., the dyke was meant to be for single-use only and useful life thereof was decided on that basis, the expenditure incurred on evacuation of ash from the ash dyke results into creation of additional capacity for disposal of ash in the ash dyke. In such a case, the Committee is of the view that the expenditure incurred on evacuation of ash from the ash dyke is of the nature of improvement of fixed assets and, therefore, should be capitalised.

#### D. Opinion

11. On the basis of the above, the Committee is of the opinion that the proposed accounting treatment of capitalisation of expenditure incurred on evacuation of ash from fully raised ash dyke resulting in further creation of capacity for future disposal of ash as suggested in paragraph 5 above would be in accordance with paragraphs 12.1 and 23 of AS 10 provided the ash dyke when constructed and when further raised was not intended to be emptied for creation of further capacity for disposal of ash in the ash dyke and its useful life was determined on that basis. Please refer paragraph 10 above.

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](http://www.icai.org/category.html?c_id=146)

# XBRL Unleashing the Accounting Codes

**XBRL is not only a software language for technology professionals. It is much more than that and it is for us accountants to exploit and reap its benefits. There was an era when e-mail was used by a few before it became a necessity for everyone. It was not required to persuade people to use e-mail instead of snail mail, they themselves made a choice. XBRL is similarly going to be natural choice for people over other forms of financial statements. The article explores the concept of XBRL.**



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**X**BRL (eXtensible Business Reporting Language) is a language for electronic communication of business and financial data which is changing the face of business reporting around the world. It offers major benefits to all those who have to create, transmit, use or analyse such information. XBRL has been developed by XBRL International, a not-for-profit consortium of over 450 companies and organisations which is promoting its worldwide use. Government, businesses and business organizations are working together to exploit a new technology tool to improve business capacity and profitability.

## How XBRL Works

XBRL is likened to a bar code for the financial statements. In XBRL, financial data is tagged so that it can be easily understood by machines. Example <Sales>500</Sales>. The word Sales together with brackets <and> is known as a tag. XML distinguishes opening and closing tags by providing a </> for a closing tag. In between the tags there is a value. XBRL allows each element of a financial statement to carry certain properties with it so that when the reader of the financial statement reads an XBRL compliant financial statement he can read it along with the properties. The genesis of XBRL goes back to XML with which we are familiar, because of the hyper texts and the hyper links. XBRL is also XML-

based, it's an XML (Extensible Mark-up Language) dialect developed for business reporting purposes.

### **Benefits of XBRL**

XBRL is changing the way business reporting and analysis is carried out. The benefits are seen in automation, cost saving, faster, more reliable and more accurate handling of data, improved analysis and in better quality of information and decision-making. XBRL enables producers and consumers of financial data to switch resources away from time consuming and costly manual processes, typically involving comparison, assembly and re-entry of data. They are able to concentrate effort on analysis, aided by software which can validate and manipulate XBRL information. With XBRL it would just take a fraction of a second to obtain the requisite information.



**XBRL is changing the way business reporting and analysis is carried out. The benefits are seen in automation, cost saving, faster, more reliable and more accurate handling of data, improved analysis and in better quality of information and decision-making. XBRL enables producers and consumers of financial data to switch resources away from time consuming and costly manual processes, typically involving comparison, assembly and re-entry of data.**

Those who stand to benefit include all who collect business data, including governments, regulators, economic agencies, stock exchanges, financial information companies and the like, and those who produce or use it, including accountants, auditors, company managers, financial analysts, investors and creditors. Among those who can take advantage of XBRL include accountancy software vendors, the financial services industry, investor relations companies and the information technology industry.

### **An illustrative Example to Understand XBRL**

ABC Limited is required to file the following returns:

- Annual Financial Statements
- Tax Returns
- Returns to the Registrar of Companies

All these returns have some elements which are common, for example, Sales, Administrative expenses etc. If these elements could be tagged and

kept in a database, a mere re-arrangement of such elements could facilitate generation of different reports on a concurrent basis. XBRL facilitates financial data elements to be stored in a database and data from live financial statements can be linked to those elements to obtain an XBRL compliant instance document. This document can also be easily queried, retrieved sorted for financial analysis and research.

### **Common Misconceptions on Cost**

Resistance to adoption of XBRL often takes the form of cost or resource concerns. However, neither of these should be a valid concern as the only cost involved after developing the taxonomy should be out of pocket cost for a tagging software. Benefits received from reduction in filing cost and increased accuracy can overshadow these cost aspects.

### **Role of a Preparer of XBRL Financial Statements**

We as accountants need to understand how to interpret the taxonomy, which does not necessarily include understanding the XSD language and its semantics. As an accountant we should be able to appropriately

link each element of the financial statements to the relevant element in the taxonomy. In case suitable taxonomy elements are not available, company specific extensions have to be created within the taxonomy customized for the company. Generally softwares are available for facilitating the linking of financial statement items to the relevant elements in the taxonomy, which alleviates the need of hard coding by accountants. After tagging the financial statement items, the file is validated against a set of predefined XBRL validation rules and a XSD document is generated with a help of tagging software.

### **Demystifying Technical Jargons in XBRL**

XBRL defines data about data, which is the concept of meta data. A programmer explains to a computer the properties about the financial statement elements. In XBRL, each item in the financial statement gets attached to a unique

element which has some pre-defined properties. When an XBRL statement is extracted each tagged data item in the financial statement inherits those properties.

Typically taking the example of a liability we could state the common properties from an accounting parlance. From the rules of double entry accounting a liability account normally has a credit balance and they represent flow of resources during a period. From our accounting background we know the requisite characteristics which need to be embedded in XBRL for the machine also to recognise these properties.

In typical usage, XBRL consists of an instance document, containing primarily the business facts being reported, and a collection of taxonomies, which define metadata about these facts, such as what the facts mean and how they relate to one another.

## Taxonomy

An XBRL compliant excel or word document is called an instance document. Information on what Liabilities are and how a machine should read/treat them is provided in the taxonomy. Taxonomy is akin to a dictionary of elements with standardised properties arranged in a

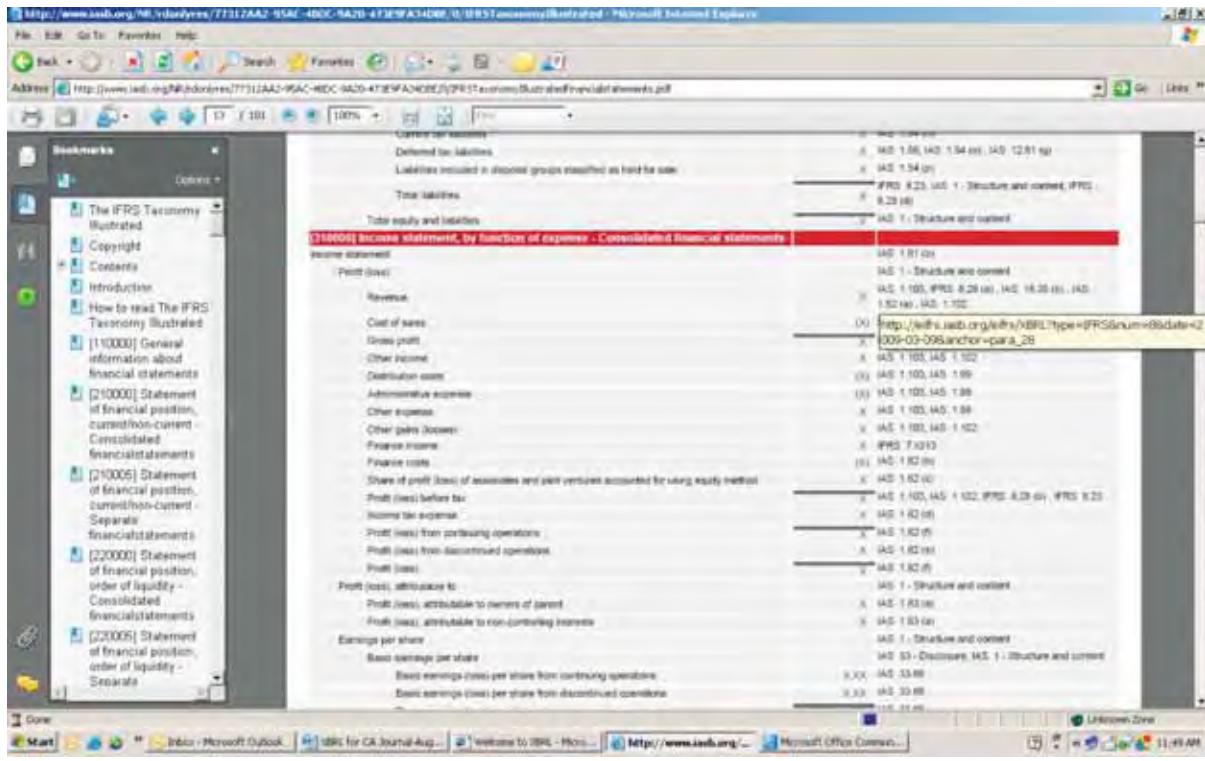
structured manner depicting inter-element relationships. The word taxonomy has obtained its origin from the Greek verb *tassein* which means to classify and the noun *nomos* which means law or science. The combination of the above can be interpreted as classification of some form of law. Frequently taxonomies are hierarchical in structure and form a network of relationships.

In XBRL, taxonomy consists of a core part which is known as the *Schema* and another part namely *Linkbases* which are like appendages. Schema is the part which contains the definition of all the elements (such as Liabilities) and the linkbases provide the relationships between the elements and references of the elements to external authoritative literature.

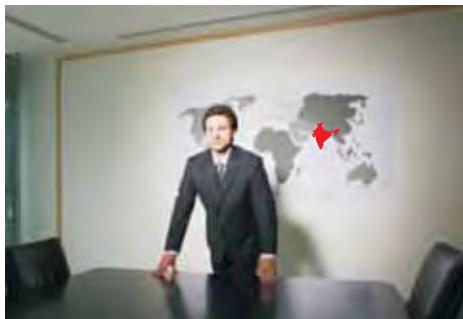
## World Taxonomies

- US Financial Reporting Taxonomy Framework:** It is a collection of taxonomies that can be used for building different financial reporting taxonomies, for different reporting purposes. The same are available at <http://www.xbrl.org>
- International Accounting Standards Committee Foundation (IASC) Foundation IFRS-taxonomy**  
<http://www.iasb.org/XBRL/IFRS+Taxonomy/Latest+Taxonomy/Latest+taxonomy.htm>

## Pictorial Representation of Taxonomy



(Source: <http://www.ica.org>)



**India has received a provisional jurisdiction status from XBRL International. XBRL India has been facilitated by the Institute of Chartered Accountants of India (ICAI). Members of XBRL India among others include regulators such as Reserve Bank of India (RBI), Insurance Regulatory and Development Authority (IRDA), Securities and Exchange Board of India (SEBI), Ministry of Corporate Affairs (MCA), stock exchanges like Bombay Stock Exchange Limited (BSE) and National Stock Exchange of India Limited (NSE), and some private sector companies.**

## Schema

An XBRL schema stores information about taxonomy elements, including their names, IDs and other characteristics. Schema consists of a set of unrelated elements. They usually are created using XML technology with an extension of .xsd. Schema together with Linkbases forms the taxonomy. Example would be elements like assets, liabilities, sales, depreciation all would be contained in a Schema.

Typically liability would be an element within the Schema. However as liability may be defined differently under various Generally Accepted Accounting Principles, Schemas are preceded by a Namespace. A Namespace looks like an Internet address. However, these are not Internet addresses and are unique in nature therefore appropriate in identifying the elements that are unique to the Schema.

## Elements

An element is a business concept (Assets, Liabilities, Revenues, Cost of Revenue etc.). Elements appear within the schema in accordance to a specific set of rules together with specific properties.

Example:

```
<element name='FixedDeposits' id='in-gaap-ci_FixedDeposits' abstract='false' substitutionGroup='xbrli:item' type='xbrli:monetaryItemType' xbrli:periodType='instant' xbrli:balance='credit' nillable='true'/>
```

*This implies the element Fixed Deposit on the Liability side has the following key characteristics:*

- **Concept name** = Fixed Deposits
- **Concept ID** = "Fixed Deposits"
- **Abstract concepts** are used as holders of the full set of child sets. Hence typically at the elements level the abstract concepts are false.
- **Period** = Instant as it reflects data for a particular point in time rather than for a period.

- **Balance** = Credit Balance being on the liability side of the Balance Sheet

## Linkbases

Linkbases provide the relationship between the elements and link those to defined external resources. The important functions performed by linkbases are the following:

1. Labelling the taxonomy in different languages to make it compatible for different countries
2. Referencing to external authoritative material for source information
3. Defining the calculation hierarchy between the different elements.

## Presentation Linkbase

Elements are typically linked to each other *vide* some pre-defined relationship flowing from authoritative standards. This relationship is stored within the Presentation Linkbase. These groupings can be formed in many ways. Generally a Balance Sheet would contain Assets, Liabilities and Equity. Assets would be segregated into Current and Non-current Assets. Current Assets would be further split into Cash and Bank Balances, Sundry Debtors, Inventories, etc. The presentation linkbases use parent-child relationships and organize elements in a tree like structure providing ease of reference to the users. A presentation linkbase, however, does not support a two dimensional structure like a Fixed Asset Schedule. We require specialized structures to contain two dimensional data.

## Calculation Linkbase

This linkbase contributes towards the accuracy of a XBRL compliant instance document. The calculation linkbase contains definitions of basic validation rules which apply to all instance documents referring to a particular taxonomy. A hierarchical calculation linkbase sorts all monetary items in a way such that the lower levels sums up or are subtracted from one another.

### Definition Linkbase

This linkbase allows the taxonomy developers to define different kinds of relationships within the elements. Generally four types of relationships are observable:

- General - Special relationships - Country specific concepts are linked to generic concepts accepted worldwide.
- Essence - Alias - These relationships are used by developers to indicate that two concepts have the same meaning.
- Requires - element- These are used by developers to make it mandatory for users to feed in data for one element if data is filled for another element.
- Similar - tuples- It is similar concept as essence-alias relationship but is applied to tuples. *Tuples* are facts holding multiple values.

### Reference Linkbase

All the financial concepts can be traced back to authoritative pronouncements and regulatory requirements. The reference linkbase presents relationships between elements and external regulations and standards. This facilitates the users to refer to the background pronouncement for the intended meaning and get a detailed understanding on the requirement.

### Label Linkbase

This linkbase allows all concepts to be labelled in different languages. In case a national jurisdiction is developing a taxonomy, it might not require multiple languages and choose to develop the taxonomy in its official national language.

### Instance Document

The instance document is a report compliant with XBRL rules. It begins with the <xbrl> root element. The XBRL instance document itself holds

the following information:

- *Business Facts* - facts can be divided into two categories
- *Items* are facts holding a single value. They are represented by a single XML element with the value as its content.
- *Tuples* are facts holding multiple values. They are represented by a single XML element containing nested Items or Tuples.

*Contexts:* *Contexts* define the entity (e.g. company or individual) to which the fact applies, the period of time the fact is relevant. In the design of XBRL, all item facts must be assigned a context.

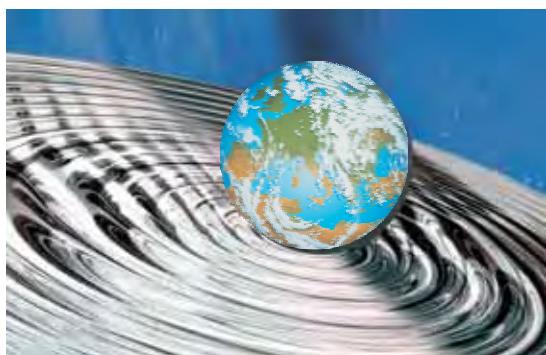
*Units* define the units used by numeric or fractional facts within the document, such as INR, shares, etc.

### XBRL Developments in India

India has received a provisional jurisdiction status from XBRL International. XBRL India is facilitated by the Institute of Chartered Accountants of India (ICAI). Members of XBRL India among others include regulators such as Reserve Bank of India (RBI), Insurance Regulatory and Development Authority (IRDA), Securities and Exchange Board of India (SEBI), Ministry of Corporate Affairs (MCA), stock exchanges like Bombay Stock Exchange Limited (BSE) and National Stock Exchange of India Limited (NSE), and some private sector companies. Provisional jurisdiction helps to get an acknowledgement for the draft taxonomies developed at the national level. Draft taxonomies have been made available for user review and comments. Details can be obtained at <http://www.xbrl.org/in>.

The primary objectives of the jurisdiction are:

- To promote and encourage the adoption of XBRL in India as the standard for electronic business reporting in India
- To facilitate education and marketing of XBRL



**XBRL is not meant to be restricted to financial reporting which is statutorily required. In fact the goal would be have a set of common taxonomies to stream line all reporting requirements of business and reduce their burden. That should include tax reporting, reporting of non-financial parameters, corporate law reporting and the other similar requirements. This reduction of compliance costs would provide an impetus to the nations globally to adopt interactive data and thereby standardised open taxonomies.**

- To develop and manage XBRL taxonomies
  - To keep the developed XBRL taxonomies updated with regard to international developments
  - To represent Indian interests within XBRL International
- To contribute to the international development of XBRL

Following the implementation of *Online Returns Filing System (ORFS)*, in October 2008 the Reserve Bank of India (RBI) launched *Basel II*, an XBRL reporting system to be used by commercial banks for all major filings. The decision follows the extensive 2007 pilot study overseen by the High Level Steering Committee, whose representatives included the RBI, the Institute of Chartered Accountants of India (ICAI), the Indian Banks' Association, commercial banks and the software industry.

In October 2008 XBRL India, under the leadership of the ICAI, published the final version of the *General Purpose Financial Reporting XBRL Taxonomy for Commercial and Industrial Companies (C&I)*. Based on Indian GAAP and the architecture of the IFRS Taxonomy 2006, this taxonomy was published as final in October 2008. XBRL India has a number of other initiatives: the update of the India Taxonomy C&I to the architecture of the latest IFRS taxonomy, and the development of a taxonomy for the financial sector. XBRL has already implemented at the two largest Indian stock exchanges (*Bombay* and *National*).

### **XBRL Developments in Asia**

In Asia, XBRL is being used by the capital markets. Stock exchanges in China, Japan, Singapore and South Korea all mandate XBRL data. Japan's Financial Services Agency required all public companies to submit financial statements in XBRL format beginning this year. Way back in 2004 Chinese capital markets had adopted XBRL. Along with public company reporting the Shanghai and Shenzhen stock exchanges have begun using XBRL for mutual funds information releases and expect to use the same for IPO as well. China is also continuing its efforts to incorporate key information in XBRL that

is not captured in US GAAP or IFRS, for example the key performance indicators and sustainability reporting.

XBRL filing was also made mandatory in Japan since April 2008 and since then over 3,000 Japanese listed companies have filed interactive data with the Financial Service Authority of Japan.

### **Developments of XBRL in Other Countries**

Recently US have mandated XBRL vide its final rule to all large public companies and also to other accelerated filers in a phased manner. This mandatory mass implementation of XBRL would bring to light the benefits of interactive data.

In Latin America, Chile, Colombia, Argentina, Mexico, Brazil, Ecuador and Venezuela have also initiated XBRL initiatives.

### **Unlimited Future in World of Interactive Data**

XBRL is simply structured data. Such a language does not have to be confined to Indian GAAP, IFRS or US GAAP, or to any national language, as nicely demonstrated by the Israeli "Manga" system that lets users simply toggle to see information in English. Today, XBRL taxonomies accommodate more than 30 regional languages.

XBRL is not meant to be restricted to financial reporting which is statutorily required. In fact the goal would be have a set of common taxonomies to streamline all reporting requirements of business and reduce their burden. That should include tax reporting, reporting of non-financial parameters, corporate law reporting and the other similar requirements. This reduction of compliance costs would provide an impetus to the nations globally to adopt interactive data and thereby standardised open taxonomies.

There are huge opportunities for gathering statistical data, or information in the health industry or for environmental pollution control compliance, resource management, oil and gas reserves, and more.

Thus the momentum has caught up and no nation can afford to ignore it anymore.

(Information sources acknowledged:  
<http://www.iasb.org>, <http://www.xbrl.org>, <http://www.xbrl.org/in>)



# XBRL to Revolutionise Financial Reporting and Analysis Globally

Financial reporting (accounting) was not the cause of the global financial crisis, but it has an important role to play in the resolution of the crisis. And XBRL has all the potential to revolutionise financial reporting and analysis. XBRL was developed just ten years ago, and for the past eight years, XBRL development has been on the agenda of the IASC Foundation to provide a framework to support adoption and implementation of International Financial Reporting Standards (IFRS). Today, XBRL is on the agenda of all 117 countries who have decided to adopt IFRS. This article examines XBRL in relation to IFRS and India's progress towards XBRL adoption.



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"On many an idle day have I grieved over lost time" (Lost Time, Rabindranath Tagore).

We often look to the past for inspiration and for solutions to the problems that we face today. And although it has been a long time since my university days, I often wonder how I would react and what I would learn from what is one of the most tumultuous financial situations to occur for over 50 years if I were a business science or economics student today. However, there is a concern among economists that in the 'rush' to restore 'normality' to the global economy, lessons may not be learnt and history may repeat itself again. Speaking at an international business forum in Malaysia, Paul Krugman – Nobel Prize

winner and professor at Princeton University – remarked that although "we seem to have avoided the Great Depression 2.0... we may have rescued the economy too soon before the political momentum for fundamental reform was strong enough to cause changes. Which means I worry this is all going to happen again in the not-too-distant future". However I believe that we can be optimistic and that this will not be the case.

The discussions of the top-most decision-makers (ie. the G20 nations) have focussed on not only the causes of and solutions to the 'crisis', but also on improvements to minimise the risk of such an event recurring. In particular, there has been great focus on how to improve the quality of information being exchanged between companies (usually called issuers) and receivers, those being regulators and supervisors, as well as investors, analysts and data aggregators. As part of this discussion the effectiveness of the International Accounting Standards Board (IASB) – and its oversight body, the International Accounting Standards Committee (IASC) Foundation – in addressing financial market concerns and also concerns surrounding the transparency of its governance has been called into question. However, it is largely accepted, in particular by the Financial Crisis Advisory Group – a committee of 18 members plus observers drawn from senior leaders throughout the world with broad experience of international financial markets – that financial reporting (accounting) was not the cause of the financial crisis, but that it has an important role to play in its resolution.

This was the message delivered by Sir David Tweedie (Chairman of the IASB) during his address at the Institute of Chartered Accountants of India (ICAI) Diamond Jubilee Conference in Agra in July, and this feeling was also echoed by other speakers. During my own conference address, I had the opportunity to share my own observations on the shared areas of commonality between the ICAI and the IASB/IASC Foundation –

both are independent organisations that foster accountability, operate with integrity, and aim to deliver excellence. Furthermore, both organisations are deeply involved with the emergence of a digital language called XBRL (eXtensible Business Reporting Language). XBRL is used to communicate information between businesses and other users of financial information. It is a license-free and data-rich version of XML (Extensible Markup Language) and like its most commonly-known sibling – HTML - XBRL involves the computerised tagging of data. Its most common function is financial reporting, but it can be used to support all standard tasks involving both financial and non-financial business data.

XBRL was developed just ten years ago, and for the past eight years, XBRL development has been on the agenda of the IASC Foundation to provide a framework to support adoption and implementation of International Financial Reporting Standards (IFRS). A taxonomy is a computer-readable dictionary of definitions of business reporting terms and the relationships between them, and the IASC Foundation is responsible for developing and maintaining the XBRL Taxonomy for IFRS – known as the IFRS Taxonomy – which is effectively the XBRL representation and translation of IFRS. The IFRS Taxonomy is recognised worldwide and is already in daily use in countries such as Australia, Belgium, Chile, France, South Africa and Spain for the purposes of securities regulation, banking supervision or statistical reporting. Today, XBRL is on the agenda of all 117 countries who have decided to adopt IFRS.

Many accountants are concerned that XBRL will have a negative impact on their business. However, most do not realise that XBRL was originally conceived by an American CPA and promoted by the American Institute of Certified Public Accountants (AICPA). However, that alone is not proof that it will benefit accountants

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therefore, let me share a story with you. Some years ago, I had a conversation with a very excited friend of mine who is head of an accounting office with 11 members of staff. What was the cause of his excitement? A disc he had received from his software vendor, containing an XBRL reference. Although he recalled our previous conversations on the subject of XBRL, he had never seen it 'in action' and was so excited when he finally installed a software upgrade with XBRL functionality and found that... nothing changed. Except that is, with the new XBRL functionality he could now complete filings for each of the companies whose accounts he held faster, more efficiently, with greater reliability and at lower cost.

The head of the companies filing system at the Belgian Central Bank recently revealed to me that on 15 July 2009, 98.3% of the 235,000 registered companies in Belgium are filing electronically using XBRL, and by 2010, all XBRL data will be made available on the Belgian Central Bank website (in both XBRL and PDF format) providing free and easy access to the financial statements of all Belgian companies to financial data consumers. Interestingly, one of the main reasons for the Belgian Central Bank's decision to adopt XBRL was to prepare for the eventual adoption of IFRS by non-listed and non-financial companies.

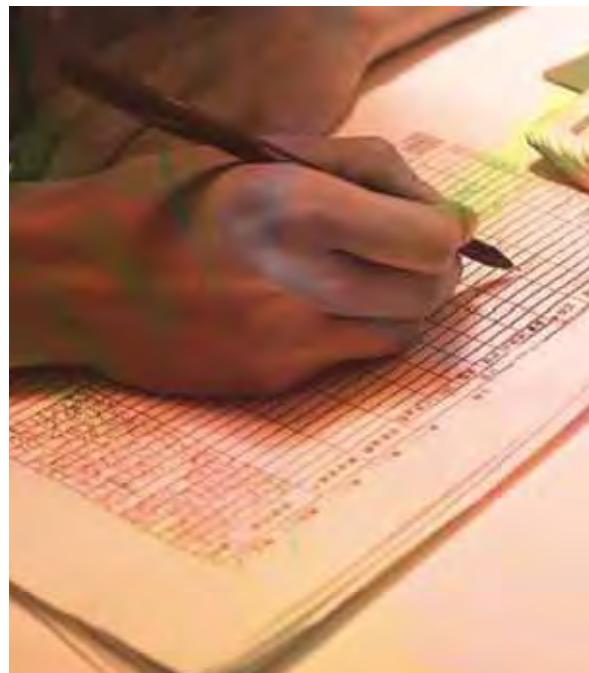
Examples of successful XBRL implementation around the world are numerous and the Belgian case is not unique. Since 15 June 2009 EDGAR, the filing system of the US Securities and Exchange Commission, has started receiving XBRL data on a daily basis, according to a ruling mandating XBRL-format filing for all listed companies on the US market. Though it has yet to be decided if and when IFRS will be adopted in the US, it is agreed that – as was the case in Belgium – successful implementation of XBRL will be a major driving factor in IFRS adoption in the US.

Closer to home to the ICAI, although XBRL is not yet an everyday reality as it is in Belgium, impressive progress is being made and it is certainly only a matter of time before the benefits of 'better, faster, cheaper' financial information are realised. Major developments include the release of the General Purpose Financial Reporting XBRL Taxonomy for Commercial and Industrial Companies and the launch of the Basel II XBRL reporting system by the Reserve Bank of India (RBI) in October 2008, and the recent recommendation in March from the High Level Committee on Estimation of Savings and Investment that the Ministry of Corporate Affairs (MCA) work with the ICAI to explore the possibility of using XBRL for its MCA21 database. Most recently, the launch of the XBRL India website and the initiatives introduced by ICAI to strengthen the ICAI's backbone (including the introduction of XBRL) is testimony to India's appetite for XBRL adoption.

This eagerness to embrace XBRL was echoed by the representatives of the RBI, the Securities and Exchange Board of India (SEBI) and both the Bombay and National Stock Exchanges whom I met during my recent visit to India, and it is this commitment and endorsement from high-level decision-makers that will result in the development of taxonomies and software solutions, all of which will make XBRL an accepted reality and non-issue in India, as it is around the world. And XBRL is a truly global effort, with working groups drawn from all countries and backgrounds contributing to the development of robust technical specifications so that all stakeholders, including software vendors and service providers, can implement XBRL via legacy system upgrades (in order to constrain costs). In the case of India, it is fascinating to see the speed with which the country is changing and improving, and also the role of chartered accountants (under the umbrella of the ICAI) in supporting this change.

While neither XBRL nor IFRS on their own are magical solutions to the current financial turmoil, when combined with the desire to improve and a willingness to embrace change – as I have witnessed in India – I believe that better, more transparent accounting and reporting is key to economic recovery and stability.

# eXtensible Business Reporting Language- An Overview



The idea behind eXtensible Business Reporting Language (XBRL) is simple. Instead of treating financial information as a block of text - as in a standard Internet page or a printed document - it provides an identifying tag for each individual item of data. The introduction of XBRL tags enables automated processing of business information by computer software, cutting out laborious and costly processes of manual re-entry and comparison. Companies can use XBRL to save costs and streamline their processes for collecting and reporting financial information. Consumers of financial data, including investors, analysts, financial institutions and regulators, can receive, find, compare and analyse data much more rapidly and efficiently if it is in XBRL format. The article provides an overview of XBRL in Indian context.



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**X**BRL is a technology language for the electronic communication of business and financial data which is revolutionising business reporting around the world. It provides major benefits in the preparation, analysis and communication of business information. It offers cost savings, greater efficiency and improved accuracy and reliability to all those involved in supplying or using financial data.

XBRL is being developed by an international non-profit consortium of approximately 450 major companies, organisations and government agencies. It is an open standard, free of licence fees. It is already being put to practical use in a number of countries and implementations of XBRL are growing rapidly around the world.

All types of organisations can use XBRL to save costs and improve efficiency in handling business and financial information. Because XBRL is extensible and flexible, it can be adapted to a wide variety of different requirements. All participants in the financial information supply chain can benefit, whether they are preparers, transmitters or users of business data

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### Benefits of XBRL

The XBRL reduces costs, increases productivity, improves data quality and extends data interoperability.

A single sell-side analyst might cover 30 separate stocks, many of which report earnings during the same one-week period. The moment a company's earnings release is issued, the analyst is in a race to update his/her model, correct any inconsistencies, interpret the results and report back to buy-side clients. Every minute is costly. With XBRL, information from the earnings announcement can be easily pulled into the analyst's model or centralized modelling system, thus eliminating manual data entry errors, saving time and increasing the accuracy of the final report.

For the buy-side firm, XBRL allows an easy extraction of data that can expedite analysis and make corporate data easier to manage. The relative uniformity of XBRL-tagged data also means that analysts can compare *as-reported* data from multiple companies with greater ease, rather than relying on normalized databases that often distort corporate financials.

XBRL will not make all corporate data perfectly comparable because that would require changing current accounting standards, but it does improve the ease with which companies can be contrasted and differences analyzed. You can create your own company-specific line items just as you do today—but your definition for a new line item will be bundled together with your XBRL documents making it easy for investors, regulators or other



users of your data to understand. And you can even create your own human readable labels for US GAAP line items, even if the underlying definition of that item is the same as it is for peer companies.

XBRL will also benefit internal financial reporting because XBRL-enabled data can be more easily searched, analyzed and converted into other documents. Similarly, XBRL will vastly improve the consolidation process for companies involved in a merger or acquisition.

The Securities Exchange Commission has already made it clear that it sees XBRL as the future of corporate reporting.

XBRL facilitates paper-less reporting. Prior to XBRL, financial information for reports was extracted from databases such as a general ledger. The extracted information was then needed to be processed several times depending upon the needs of the user. For example, a typical balance sheet would need to be individually processed for stock exchange filings, for placement in the annual report, for examination by external auditors and for analysis by management. Each process required an extra handling of the information to create the desired report. With XBRL, the information is coded once and ready for extraction electronically into reports for all information users. With the proper tools in place, the desired output for all uses of the balance sheet information can be transmitted electronically, without the need for a paper-based report.

Time savings from XBRL will come from several areas. First, multiple report preparations will take less time. XBRL-coded information can easily be fed into various instance documents to create customized output. Second, internal analysis of financial data will be quicker. This is because the data will already be in a format ready for analysis and will not have to be re-keyed. Third, financial analysts will be able to extract, analyze and process this information with software tools designed specifically for this purpose.

## How XBRL Works

XBRL is based on XML, a widely accepted standard, and has the ability to "tag" or code each element on a financial or business report with information such as description, units, currency, etc. so that it is easy to identify and understand for users of the information. All the elements are grouped together into a collection of financial and business reporting terms called "taxonomy". XBRL is extensible, meaning that the terms available for use can be customized so that companies using XBRL can create their own elements – called "extensions" – to describe a unique reporting situation.

XBRL is not an accounting standard and will not change what is reported but will change how it is reported. The XML tagging means that the information in a business report is computer-readable and can be more easily extracted, searched and analyzed by users of that information.

Interchangeability of data is facilitated by the use of XML-compatible coding. XBRL is fully compliant with the W3C's XML 1.0 recommendation. When an XBRL-coded file is created, the document does not make any assumptions about how the data will be used by the requestor (or client). In other words, the XBRL-coded information could be displayed in a Web browser, sent to a database, sent to a printer, used to create another XML document or even listened to as a sound document. The same document can be used by many different applications using the intelligence of the data to build powerful applications.

## What It Can Do

**XBRL allows for the creation of interactive, intelligent data:** Each piece of business information has detailed descriptive and contextual information wrapped around it, so that the data becomes machine-readable and can be

automatically processed and analyzed.

**XBRL allows business reporting information to be reused and repurposed:** A financial or business report created once can be used to create many documents in different formats— HTML, ASCII text, Microsoft Word or Excel— with no loss of accuracy or integrity.

**XBRL adds value to every step of an organization's business information reporting:** The entire reporting chain of business information — from data collection through internal reporting and external reporting — will be made more efficient and accurate and will contain more useful data.

**XBRL enhances the ability to compare information from one organization or entity to another:** This is because XBRL lays out a common set of definitions by which all organizations tag their data.

**XBRL allows for unique reporting situations:** This is because it can be extended by a single reporting entity by adding special elements that may be needed to best represent that company.

## Improving the Analytical Process with XBRL

Investors and analysts today are faced with increased pressure to reduce costs, analyze more companies, and provide better, more detailed analysis — all the more quickly and efficiently. XBRL, the technology standard for how business and financial information is reported, will provide an instant, accurate, unambiguous flow of information to the capital markets.

XBRL decreases the vulnerability of publicly disclosed financial information and reduces the likelihood of misinterpretation and misrepresentation. XBRL applies tags or codes to business data such as EPS, cash flow or even elements within the footnotes of public company financial statements, with information providing description, units, currency, etc., so that every element is easy to identify and compare. XBRL has



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been likened to “barcodes” for financial and business information. Using XBRL-formatted information to analyze companies will result in greater efficiency, improved accuracy and reliability and ultimately cost savings for those using financial data.

XBRL eliminates re-keying errors and misclassifications by third parties. Tags with established definitions remove ambiguity as to what a data point represents. Improvements in data quality translate into better analytics for your firm and for your clients.

### **Improving Communication with Investors through XBRL**

#### *Communicating with investors can be easier:*

Today, public companies are faced with reduced sell-side coverage, increased pressure to provide more information, faster, and little to no control over how their company is presented in thousands of financial databases available to investors.

As a new standard in how business information is reported, XBRL offers instant, accurate, unambiguous flow of information to the capital markets. XBRL decreases the vulnerability of publicly disclosed financial information and will combat misinterpretation and misrepresentation.

#### *Increased visibility:*

Business information can be translated into multiple languages by data consumers around the globe. Specific, pertinent pieces of information can be sought and extracted from lengthy reports, and financial data becomes easier for investors and analysts to examine. Organizations providing data in XBRL will likely enjoy broader and more in-depth consideration from investors.

#### *More efficient dialogue with the markets:*

Companies providing more accurate, up-to-date information to investors will gain increased access to new sources of capital, boosting awareness and thereby reducing the cost of

capital.

### **Data Collection and Reporting**

By using XBRL, companies and other producers of financial data and business reports can automate the processes of data collection. For example, data from different company divisions with different accounting systems can be assembled quickly, cheaply and efficiently if the sources of information have been upgraded to using XBRL. Once data is gathered in XBRL, different types of reports using varying subsets of the data can be produced with minimum effort. A company's finance division, for example, could quickly and reliably generate internal management reports, financial statements for publication, tax and other regulatory filings, as well as credit reports for lenders. Not only can data handling be automated, removing time-consuming, error-prone processes, but the data can also be checked by software for accuracy. Small businesses can benefit alongside large ones by standardising and simplifying their assembly and filing of information to the authorities.

### **Data Consumption and Analysis**

Users of data which is received electronically in XBRL can automate its handling, cutting out time-consuming and costly collation and re-entry of information. Software can also immediately validate the data, highlighting errors and gaps which can immediately be addressed. It can also help in analysing, selecting, and processing the data for re-use. Human effort can switch to higher, more value-added aspects of analysis, review, reporting and decision-making. In this way, investment analysts can save effort, greatly simplify the selection and comparison of data, and deepen their company analysis. Lenders can save costs and speed up their dealings with borrowers. Regulators and government departments can assemble, validate and review data much more efficiently and usefully than they have hitherto

been able to do.

The IASC Foundation (IASCF) has developed a high quality XBRL 'taxonomy' for IFRSs (in effect, a dictionary of data tags that explains what each tagged element is and how it should be treated under IFRSs) that will be maintained in line with the annual Bound Volume of IFRSs.

In November 2002, the XBRL International Steering Committee (ISC) issued the IAS Primary Financial Statements (PFS) Taxonomy as an XBRL Recommendation and also issued the IAS Explanatory Disclosures and Accounting Policies (EDAP) Taxonomy as a Public Working Draft. Both the PFS and EDAP taxonomies are available on the Internet from XBRL International's XBRL Resource Center.

The PFS Taxonomy includes XBRL representations of a classified balance sheet, an income statement, a statement of changes in equity, and a cash flow statement. The PFS Taxonomy encompasses the core financial statements that private sector and certain public sector entities typically report in annual, semi-annual, or quarterly financial disclosures as required by IAS 1.7 and IAS 34.8.

Significant accounting policies and other explanatory notes are modelled in a separate XBRL taxonomy, the Explanatory Disclosures and Accounting Policies (EDAP) taxonomy, which has been released as a public working draft.

### Exposure Draft of ICAI

ICAI has recently issued an exposure draft of general purpose financial reporting XBRL taxonomy for commercial and industrial companies.

Keeping in view the rising importance of XBRL and the advantages it has to offer, the Institute of Chartered Accountants of India constituted a Group on XBRL in January 2007. The main objective of the Group is to establish a forum for



the development of XBRL in India including its promotion and to develop taxonomy for XBRL-based reporting bearing in mind the peculiarities of the Indian Accounting Standards.

Recently, the ICAI group on XBRL has finalised the draft general purpose financial reporting XBRL taxonomy for commercial and industrial companies. This draft taxonomy covers the financial statements, viz., Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement and the related non-financial information. The draft taxonomy has been developed conforming to Indian Accounting Standards and Company Law while adapting the architectural features of the IFRS general purpose taxonomy 2006.

While building the taxonomy three broad reporting categories have been considered, taking into account the different reporting requirements. These are:

1. Commercial and Industrial
2. Banking Companies
3. Non-Banking Finance companies

All reporting entities would fall under any one of the above mentioned categories. The current version of ICAI XBRL taxonomy is a general purpose taxonomy, designed for Commercial and Industrial group (C&I), which would include trading entities, oil and gas companies, service providing entities, real estate and construction companies and all other commercially-operated entities.

The ICAI XBRL taxonomy has been constructed to conform to the Indian Accounting Standards and Company Law while adapting the architectural features of the IFRS XBRL taxonomy 2006.

The High Level Committee on Estimation of Savings and Investment submitted its report to the Government of India in New Delhi. The committee was appointed on 12<sup>th</sup> December 2007 to critically review the existing methodologies used to estimate saving and investment aggregates

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for the Indian economy and to suggest measures for improvement. The report included the recommendation that the Ministry of Corporate Affairs (MCA) work with the Institute of Chartered Accountants of India (ICAI) to explore the possibility of using XBRL for its MCA-21 database, an e-governance project to provide easy, secure access to MCA services. The ICAI led the development of the General Purpose Financial Reporting XBRL Taxonomy for Commercial and Industrial Companies (C&I) that was released in October 2008.

### Structure of the Taxonomy Files

The taxonomy for financial statements (GAAP elements) is covered in three different modules covering the Balance sheet, Income Statement and Cash Flow respectively. Each module contains a schema sheet as well as other sheets that depict, among other things, the relationships of the elements with each other (the linkbases). The non-GAAP module contains the taxonomy for the non-GAAP elements (mostly accounting policy and notes to accounts information). This module also has a schema sheet apart from other sheets that depict the presentation and calculation relationships as well as labels.

The schema (essentially a dictionary of all the elements that are there in the taxonomy) contains the XBRL attributes for each element as well as the reference to authoritative literature (the reference linkbase) and a short explanation (documentation) of each element. There are about 2400 odd concepts in this taxonomy across financial statements and non-GAAP information. Each module also contains the details of three linkbases, presentation, calculation and label. The presentation and calculation relationships are in multiple extended links (extended links are logical grouping of elements based on certain criteria).

Every sheet in a module is designed to contain a

specific extended link. The names of the extended link suggest the categorisation of the elements it contains which could be either a presentation or a calculation link. In the taxonomy for the Balance Sheet, all elements falling within a legal requirement such as the Accounting Standard or Schedule VI of the Companies Act are categorized as a specific extended link carrying the name 'Statutory'. This has both presentation and calculation sheets as extended links.

The calculation extended links contain weight in addition to the attributes defined in the schema file. Weights are assigned to the elements, in such a way that they add or subtract in order to arrive at their parent level concept. The label link-base contains period start labels, period end labels, positive labels and negative labels in addition to the standard labels, wherever required.

### Browsing the Taxonomy

To understand the elements and the interrelationship amongst them, it is preferable to start from the calculation relationship. The tree view or hierarchy is the best way to see the relationship; the elements at the top are known as parents of the elements appearing immediately below it. The elements under a parent are called child elements. In the calculation link-base, the child elements are either added or subtracted in order to arrive at the value of the parent level element. In order to identify which elements are to be added and which are to be subtracted the "weight" attribute is used. Elements having weight of +1 indicate that the element is added to derive value of its immediate parent, whereas weight of -1 indicate that the element is subtracted in order to arrive at the value of its immediate parent. The presentation link-base defines the format or the display pattern of elements. The label link-base includes all the types of labels that a particular item can hold.

## Taxonomy Design - Underlying Principles

The design and the structure are based on IFRS 2006-08-15 version, with the Indian regulatory requirements superseding in case of any discrepancy. The relationships between the elements are grouped into various extended links. The overall structure is defined in one extended link, while the detailed break up of elements is in separate extended links. For elements which have multiple interrelationships, separate extended link for each of the relationship has been defined. Consideration is given to the common reporting practices followed across the industries. Since varied reporting patterns are followed by companies, the most commonly followed practices have been modelled in the taxonomy. Many elements of the taxonomy have originated from the reporting practices and hence there may not be exact reference in any regulatory statute. Moreover, if elements are included only at a gross level, it will imply that the almost every time the taxonomy will have to be extended. In order to standardize the reporting patterns and reporting

elements, the most commonly reported elements are captured in the taxonomy.

IFRS XBRL Taxonomy

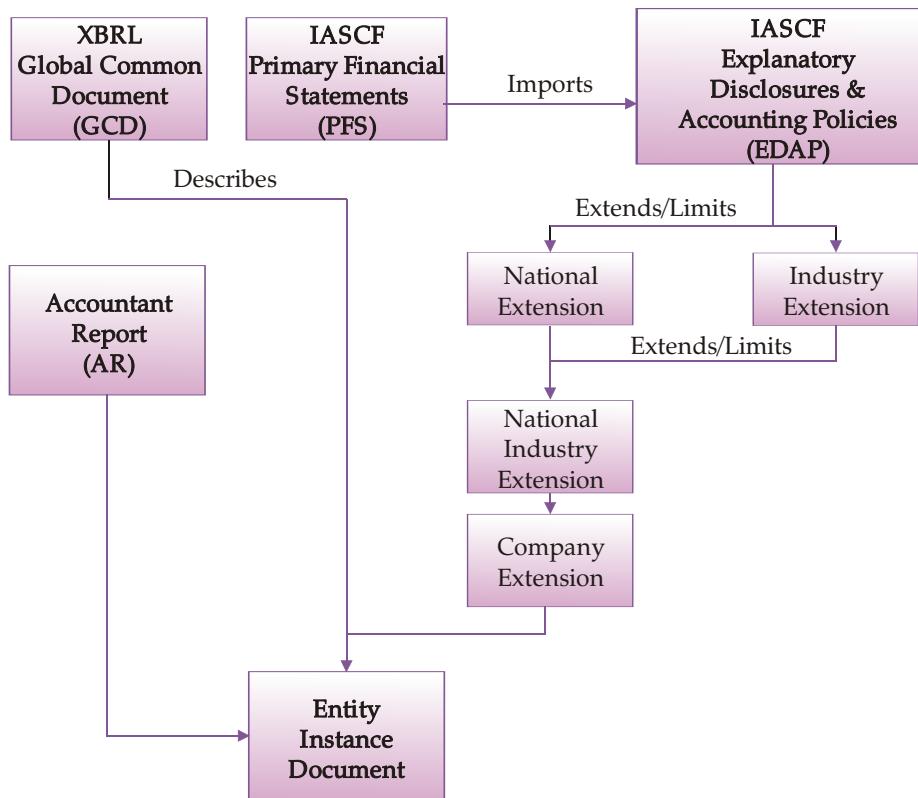
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Below is a graphical representation of the framework for preparing financial statements in accordance with International Accounting Standards, expressed using XBRL.



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### XML and Financial Community

The Internet is a wonderful tool for business. Over the last few years, businesses have flocked to the Internet to sell products, assist customer relations, exchange information and much more. As businesses woke up to the potential of the Internet, Web pages utilizing the hyper-text mark-up language (HTML) flourished. Businesses seeking to present information to customers and business partners found publishing HTML rendered Web pages significantly added to their ability to communicate. Detailed information was now available to customers and business partners

at the click of a mouse.

Financial departments seized the opportunity to present financial information directly on Web sites. Starting with the re-production of annual reports, publicly traded companies found new ways to communicate with their company's stakeholders.

Companies soon found that presenting annual report information on the company websites was a good idea. Stockholders, security analysts, and potential investors liked the convenience of using the Internet to look at information that previously was not available except in printed form.

# XBRL- A Dynamic Tool For Financial Reporting



The XBRL is an XML-based framework, which operates on the basis of specified standards, facilitates the preparation and publication of financial information in a wide variety of formats, reliable extraction and automatic exchange of information embedded in financial statements of listed companies. The XBRL model has the potential to effectively act as a positive agent for increasing the dynamism involved in financial reporting. However, a lot remains to be done in terms of sorting out the implementation issues. This article explores the concept of XBRL and the issues related to its implementation.



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**T**he financial reporting and analysis is a daunting task for organizations, be it in terms of scale of manpower involved, the deadlines to be met or the consequent incurrence of huge costs. For instance, the preparation of quarterly statements for listed companies consumes the majority of a finance department's resources during the reporting period. Similarly, it is found that equity analysts spend up to one-third of their time entering data into spreadsheet models and verifying that data for accuracy.

The primary challenge with analyzing financial information and generating reports for top management of a company is that the data needed to produce these items is locked in multiple disparate documents, and the data relies on those documents to give it context. For example, an individual number in an annual report would gain meaning only when supplemented with contextual information — company name, time period, or revenue — and thus be useful for multiple analysis. To use data locked in a document or spreadsheet, it must be manually entered, copied, and may need to be recalculated.

The following challenges underscore the need for a solution that helps

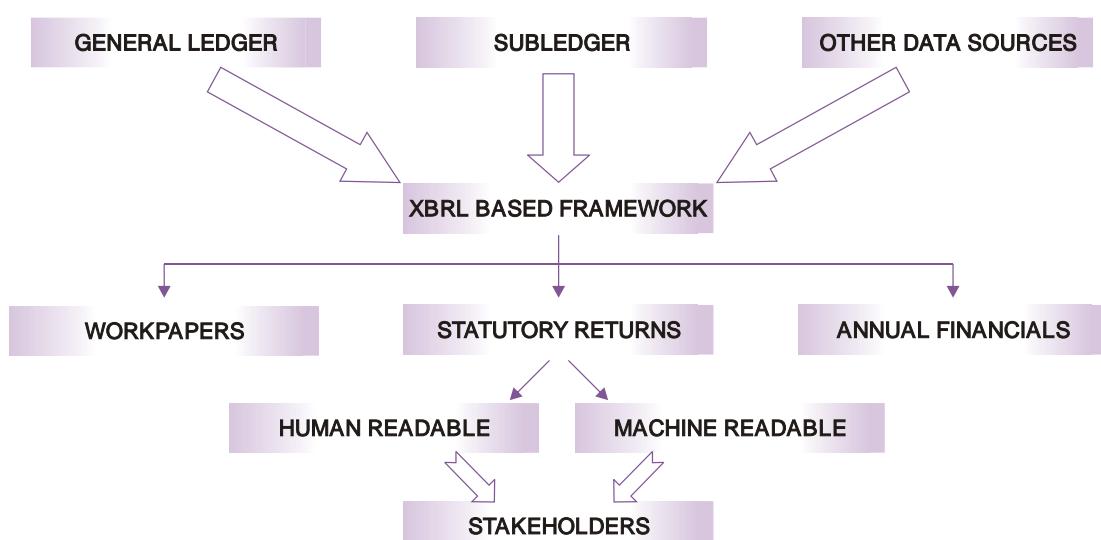
automate the way data is captured, shared, reported and analyzed:

- Preparing reports and analyzing data is costly, time-intensive, and error-prone because data must be manually entered from multiple sources.
- Sharing data across interested stakeholders is difficult because it is trapped in unstructured spreadsheets and documents with no automated means for retrieval.
- Verifying data accuracy is costly and time-intensive because data is manually validated

between a source and final document.

Consequently, the information generated has limited drill-down and analysis capabilities. Too much time is spent on producing the numbers and there is lack of timely information for decision-making.

With XBRL, the same piece of data can be automatically pulled into documents and spreadsheets, reducing or eliminating the need for manual re-entry and easing the data collection process.



### **XBRL-Concept**

XBRL (Extensible Business Reporting Language) is a freely available electronic language for financial reporting. An XML-based framework, which operates on the basis of specified standards, facilitates the preparation and publication of financial information in a wide variety of formats, reliable extraction and automatic exchange of information embedded in financial statements of listed companies.

Let us take a closer look at the definition of the term.

- *Extensible* – means that the user can extend the application of a particular business data beyond its original intended purpose and the major advantage is that the extended use can be determined even by users and not just the ones who merely prepare the business data. This is achieved by adding tags <> - which are both human and machine readable - describing what the data is.

- *Business* – means relevant to any type of business transaction. XBRL focus is on describing financial statements for both public and private companies.
- *Reporting* – the intention behind promoting use of XBRL is to have all companies report their financial statements in a consistent manner using the specified format.
- *Language* – XBRL is based on XML, which prescribes the manner in which data can be "marked-up" or "tagged" to make it meaningful to human readers as well as to computer-based system.

### **XBRL is Based on XML**

XML stands for Extensible Markup Language. What is being "marked" are the data that need to be exchanged (i.e. sent and retrieved from one system application to another both intra- and inter-organisationally). Marking means defining what the data is by attaching to it descriptions of

what it represents. These descriptions are called tags, and the tags can be any words so long as they are meaningful and follow the syntax of XML.

For instance, each item (depreciation expense/provision for bad debts) is tagged with information about its multiple attributes, such as financial year, audited/unaudited status, currency, etc.

Assuming that a particular company released its 10K using XBRL. One example of an XBRL tag is "US- APO-Net Income." This is the tag that a company would attach to its US GAAP net incomes figure for its "Asia-Pacific Operations" in its Consolidated Income Statement.

XBRL-tagged data can be read by any software that includes an XBRL processor and thus can be easily transferred between computers. The best part is that in order to create XBRL documents, the user is not required to take an XML computer programming course. Software is available to tag data for clients, submit tagged data to various recipients, and receive and analyse tagged data from other sources.

#### **What XBRL is NOT**

- It needs to be clearly understood that XBRL does not represent a set of accounting standards, which remain the prerogative of the regulatory standards bodies. XBRL is merely a platform on which reporting standards content will reside and be represented.
- XBRL is not a detailed universal chart of accounts. Formulation of a company's chart of accounts is an exercise conducted by its management with regard to its specific business intricacies. XBRL can facilitate the implementation of such structures through its ability to transport data between disparate software applications that might be used within an organisation's operational structure.
- XBRL is not a GAAP translator. It does not provide a mechanism for facilitating a drill-



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down of existing GAAP information into lower levels of information that would be necessary for translating financial statements from one GAAP to another. The business-reporting document contains the same GAAP information, be it in an XBRL format or a MS Word or PDF format.

- XBRL is not a proprietary technology. XBRL is freely licensed and available to the public. XBRL is XML-based and, therefore, is expected to be widely available in software applications.
- XBRL is not a Transaction Protocol. XBRL is designed to address issues related to generation and usage of information contained within business reports and begins at the accounting classification level. XBRL is about business reporting information, not about data capture at the transaction level.

#### **Advantages**

XBRL solves two significant problems through efficient preparation of financial statements in multiple forms and reliable extraction of specific detailed information.

- a) The first problem is that, in the current scenario, in the course of preparing the financial statements of a company for printing its annual report, for the investor relations section of its corporate web site, and for filing with regulatory authorities; the finance personnel would typically enter the same piece of information thrice in different formats. With XBRL, information would be entered only once and the same information will be "rendered" as a printed financial statement, an HTML document for a web site, an internal MIS report, a raw XML file, or a specialised reporting format such as periodic banking and other reports in prescribed formats to be submitted to the regulatory authorities.
- b) The second problem is that today, extracting specified detailed information from a financial statement, even an electronic financial state-

ment like a quarterly financial statement in SEBI format filed with the stock exchanges, is a manual process. For example, a company cannot tell a computer programme to trace out the depreciation expense for the year

1999 from an electronic financial statement. If a financial statement is prepared using XBRL, computer programs can easily extract every relevant piece of information in that statement.

*XBRL offers the following advantages:*

**Lower cost of generation of reports:** In most current financial systems, the data is stored in text format and must be re-entered in order to be used in other applications. XBRL not only increases the speed of handling of this financial data, but also reduces the chance of error and permits automatic checking of information and, hence, reduces the overall cost of production of reports significantly.

**Enhanced information sharing:** XBRL exponentially increases the timeliness and communication abilities between the major relevant parties interested in corporate information. Companies can disseminate a higher value stream of information about themselves to the owners. The information transmitted would remain the same but its utility would be greatly enhanced because of the manner in which it is structured.

### International Developments

XBRL has assumed critical importance across the globe as an increasing number of regulatory agencies are adopting it. The US Federal Reserve Board, the Office of the Comptroller of the Currency, the SEC and the UK Inland Revenue and Customs authority have already adopted XBRL as standard for their reporting requirements.

**Sarbanes Oxley Act & Securities Exchange Commission (USA):** The Sarbanes-Oxley Act affects all listed companies, whether US-based and international, whose stock is traded on United States exchanges. Failure to comply with it can result in high personal financial (up to US \$5 million) and criminal penalties (up to 20 years in prison) for CEO/CFO false certification. Two key sections of the law that have drawn the most attention are:

- Section 302: Requires executives to personally certify the validity of financial statements.
- Section 404: Requires complete documentation of financial controls and auditor attestation to management's evaluation.

Compliance with these sections presents some immediate challenges, which includes the following:

- Extensive documentation requirements.
- Inefficient and error-prone manual or semi-automatic process for tracking and auditing financial information.
- Lack of visibility over financial process and control documentation.
- Slow employee adoption of complex Sarbanes-Oxley processes and systems.
- Potential loss of focus on the core organisational mission while scoping, managing, and completing compliance activities.

Controlling such information would get easier and facilitate greater compliance when XBRL data tags uniquely identify individual items in a company's financial statement so that the internal auditors, can access business data, perform easier data analytics, improve profiling and risk assessments, and continually audit and monitor the business processes in a better fashion.

The current economic environment highlights the need for sustainable technology standards at the core of information governance. XBRL could be exploited for identifying and managing risks, ensuring oversight and enforcing corporate policies. In this extremely challenging economic climate, XBRL could be used for meeting the challenges of operational risk and compliance management.

In May 2008, the SEC had proposed an implementation schedule that would require that all US public companies using US GAAP with market capitalization greater than US \$ 5bn would need to start applying XBRL tags to their 10-Ks and 10-Qs filings for periods ending on or after 15<sup>th</sup> December 2008. The remaining companies using US GAAP would provide this disclosure over the following two years. Companies using IFRS as issued by the IASB would provide this disclosure for fiscal periods ending in late 2010.

SEC Chairman Christopher Cox, made the following statement in a press release dated 14<sup>th</sup> May 2008 as he unveiled the above-mentioned



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**The Institute has recently launched XBRL India website in the International Conference held at Agra from July 3-5, 2009. A taxonomy has been developed for general purpose financial statements for commercial and industrial sector with an exposure draft already been issued in this regard. The ICAI XBRL taxonomy has been constructed to conform to the Indian Accounting Standards and Company Law while taking into consideration the architectural features of IFRS XBRL taxonomy 2006.**

XBRL implementation schedule: "This is all about bringing better, faster, more meaningful information to investors about the companies they own. It would transform financial disclosure from a 1930s form-based system to a truly 21<sup>st</sup> century model that taps the power of technology for the benefit of investors." On 29<sup>th</sup> September 2008, the SEC announced a \$54 million investment to update its 20-year-old EDGAR database of corporate regulatory filings and turn it into an interactive database that uses XBRL.

**European Union (EU):** In the UK, momentum is gradually building behind the adoption of XBRL through advocates such as Lord Carter of Coles (a Labour Peer who has advised the UK Government on a wide range of issues and chaired a number of government reviews) who recommended in his review of Revenue & Customs online services that all UK companies be required to submit their Corporation Tax returns online using XBRL from 2010.

Other XBRL projects are also underway in Belgium, Denmark, Germany, Italy and Spain.

The Dutch government has committed itself to reducing the administrative burden for business by 25% in four years and several Dutch ministries, including finance, justice and economics are collaborating on XBRL taxonomy to carry financial data from businesses through the regulatory chain. Already the introduction of XBRL in the Netherlands has allowed multiple government parties to reduce 60,000 data elements down to just 5,000 through by using a common data dictionary.

The Netherlands Treasury Department has announced that several Dutch banks have joined its project to evaluate credit risk using XBRL data. The Committee of European Banking Supervisors (CEBS) has developed two XBRL-based taxonomies to enable interactive reporting by credit institutions and investment firms in the European Union.

- a) COREP (the Computerised Representation of the CEBS Common Solvency Reporting Framework) is primarily focused on regulatory own funds and the Basel II Pillar I capital requirements pertaining to credit risk, operational risk and market risk.
- b) Through FINREP (the Standardised Financial Reporting Framework), credit institutions would be in a position to use the same standardised data formats and data definitions and thus reduce their reporting burden.

**China:** In October 2008, China has established a provisional XBRL jurisdiction following strong interest in the use of XBRL by the Ministry of Finance, China Securities Regulatory Committee, Chinese Academy of Science and the Stock Exchanges. This new jurisdiction will provide XBRL training, host XBRL related conferences, promote XBRL adoption, enhance XBRL technology research, accelerate application development and perform other activities which will benefit XBRL developments in China. The official website of XBRL-China went operational on 13<sup>th</sup> October 2008.

### The Indian Scenario

#### *Initiatives by ICAI:*

Recognising the rising importance of XBRL as an effective means of communicating financial information and the inherent advantages, the Institute of Chartered Accountants of India (ICAI), constituted the XBRL Group in the year 2007 for undertaking the development and promotion of XBRL in India.

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Accounting Standards and Company Law while taking into consideration the architectural features of IFRS XBRL taxonomy 2006.

#### **Reserve Bank of India**

The RBI had, in October 2008, asked all banks to start preparing for submitting statements in the XBRL format complying with the Basel II mandate. Indian banks are now submitting their BASEL II-based "Return on Capital Adequacy (RCA2)" returns to RBI in the XBRL format.

Till date, RBI has converted five return files in the XBRL, and plans are in the offing to convert the rest (220 more returns) in a phased manner.

#### **XBRL in Indian bourses**

Both the leading stock exchanges of India, the BSE and NSE have migrated to XBRL from the paper-based model and have now on offer a unified electronic platform, popularly known as 'CorpFiling' system, which enables the companies listed in either or both of the exchanges to electronically file their disclosures.

Further, SEBI has introduced Clause 52 of the Listing Agreement, requiring listed companies to file information with the exchange only through the Corporate Filing and Dissemination System (CFDS). It is proposed that listed companies shall, in a phased manner, be required to file information with the stock exchange only through CFDS.

#### **Potential Areas of Impact**

##### **Fraud Prevention:**

A huge quantum of economic resources are being lost by organisations due to inefficient fraud prevention systems that do not provide real time information aggregated from major control points in its business operations.

In the same breadth, despite significant investment in transaction monitoring systems to provide the regulatory 'tick in the box' for anti-money laundering (AML) operations, the entire "transaction history" of many organisations still remains unaggregated and largely unused at the corporate level.

It is often found that point solutions for different types of fraud prevention and detection have been put in place but the information they hold is not shared in any meaningful way. Much manual intervention is required, if someone intends to conduct a deeper analysis from

multiple data sources and systems. Forensic auditors are often found compiling data from a myriad of accounting systems, manually mapping data sources and often manually re-entering data into multiple spreadsheets.

With XBRL, the company's management can have a realistic overview of the current state of their organisation and be confident that their information is both auditable and compliant.

With legislation such as the 3<sup>rd</sup> European Money Laundering Directive forcing financial organisations to implement processes around areas such as Know Your Customer (KYC), it is essential that these businesses understand the operational efficiencies that stem from using XBRL.

In the US, the umbrella agency for banking regulation, the Federal Financial Institutions Examination Council, found that a 90-day review cycle was reduced to 2-day affair when the data was filed under XBRL.

##### **Corporate Performance Management:**

XBRL offers manifold advantages for internal reporting as well, thus facilitating better management of corporate performance. By taking the appropriate GAAP taxonomy and extending it to link with management reporting structures, an organisation can bridge external statutory reporting systems and internal management reporting. This also can provide real time financial and management information that can be disseminated internally to any user at any level of the organisation, because XBRL handles the semantic complexity of aggregating financial data.

##### **Investment Analysis:**

While corporate results are now easily accessible online, the investor receiving such corporate results has to go through the time-consuming and laborious exercise of translation between the



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information a company reports and the information used by investors to analyse corporate results. It is the least standardised, least-automated link in the entire value chain of capital markets.

For example, discrete numbers on revenues and profitability have to be extracted from the latest financial statements and then this new data must be compared to historical data of the same as well as peer group companies to answer questions like growth rate of revenues/profit margins and relevant changes.

The investor is basically in the business of comparing one company to another. And yet, so much energy, time and intellect is consumed at the lowest level of transposing data from the stand-alone format in which the company reports to the comparative format that the investor needs. Consequently, little time is left for comparative analysis.

With XBRL, investors will have more time for analysis and insight, as less time is spent on translation and data entry. More companies will be used in investors' screening because the marginal cost of preparing data on additional companies for analysis will drop to zero.

### Implementation Issues

While XBRL standardises the way organisations collect, prepare, and share business information, organisations and internal auditors would have to become acquainted with the different control issues that might impact XBRL use and its effectiveness.

There are many risks organisations may face when using XBRL for financial reporting which are as follows:

#### (1) Risks of Errors:

Error risks would emerge around the accurate mapping of business information to tags and the use of appropriate taxonomies (i.e., XBRL dictionaries that define the specific tags for individual items of data). Hence, it is important to ensure that the mapping process attaches correct tags so that the data retrieved at a later stage is correct. Without an effective internal control structure to ensure accurate tagging, the data retrieved can represent invalid and inaccurate transactions. The impor-

tance of accurate tagging and mapping of information would increase when data is streamed in real time and automated.

#### (2) Control Issues:

XBRL control risks pertain to the use of appropriate taxonomies, tagging of data, and the integrity of the tagged data. It is important to ensure that a company has used the appropriate taxonomy in the creation of their filings or financial reports, as to whether the same is up-to-date with current business and reporting requirements and whether the taxonomy is applied correctly.

#### (3) Assurance Issues:

Different tools have slightly different approaches for tagging business reports with XBRL tags and preparers might have their own built-in validation processes, which may not be as rigorous as the tests conducted by other users.

#### (4) Data Security:

The risks, causing a major concern for management of companies filing under electronic filing and reporting systems relate primarily to information being incorrectly compiled or being altered by unauthorised persons, either before or after it is reported or during transmission.

### Costs Involved

Preparing the corporate accounting system for XBRL-based reporting can be a costly operation. Often, data resides in outdated systems. Some accounting departments still trust the old pencil and paper technique. This entire data, be it digital or paper, needs to be integrated from different sources into one shell application. Or it must be migrated to newly implemented applications that enable XBRL. However, once implemented properly, the costs would go down drastically.

As a participant in the SEC's XBRL pilot program, PepsiCo had filed four regulatory forms, spending \$5,000 in up-front costs for its first filing, which included outsourcing XBRL coding of its financials. For the second filing, the cost and labour hours involved "dropped dramatically," the company's CEO stated in a round table organised by SEC in the year 2008.

### Conclusion

The XBRL model has the potential to effectively act as a positive agent for increasing the dynamism involved in financial reporting. However a lot remains to be done in terms of sorting out the implementation issues. It remains to be seen as to how the same would be addressed before the idea gains its full momentum.

# Accounting for Intangible Assets and Depreciation in India

In the knowledge era it is well accepted that intangible assets are the key drivers of the organisation. Finance (No.2) Act, 1998, for the first time, provided for allowance of depreciation on 'intangible assets' under the Income-tax Act, 1961. Section 32(1)(ii) of the Act provides that any know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, acquired by an assessee on or after 1.4.1998 are eligible for depreciation. This article highlights the concept of intangible assets, their classification and provisions related with depreciation, various legal cases related with depreciation on intangible assets and other tax benefits for the promotion of research and development activities which will enhance intangible assets within the organisation.



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Innovative activities and capabilities are essential for economic growth and development of a country. A country can make good progress, if it spends a significant amount of its resources on various R&D activities. Similarly, at firm level also the R&D intensity is strongly correlated with sales growth, wealth creation, efficiency and market capitalisation. R&D activities are directly associated with creation of knowledge and knowledge base activities and they are creating intangible assets in the business. In the knowledge era it is well accepted that intangible assets are the key drivers of the organisation. The intangible assets such as brand, patents, franchises, software, research programmes, ideas, and expertise are having major role in growth and development in modern era for. Finance (No.2) Act, 1998, for the first time, provided for allowance of depreciation on 'intangible assets' under the Income-tax Act, 1961. Section 32(1)(ii) of the Act provides that any

**Peter Drucker (1993), the management guru, has rightly said “the factory of tomorrow will be organised around the information rather than automation”. The nature of intangible property makes the determination, recognition and measuring of intangible assets more difficult than it is in case of tangible assets. Most intangible assets are unique. Thus, the assessment of their value to the business and the period over which they may be expected to be available for use (their useful life) are rather problematic.**

know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, acquired by an assessee on or after 1.4.1998 are eligible for depreciation.

The profitability of a knowledge firm depends on its ability to leverage the learning ability of its professionals, and to enhance the reusability of their knowledge and expertise. During the early phase of industrialisation (from the 1840s to the early 1990s), a corporate's value was mainly driven by its tangible assets—values presented in the corporate balance sheet. The management of companies valued these resources and linked all their performance goals and matrices to these assets— Returns on Investment, capital turnover ratio, etc. The market capitalisation of companies also followed the value of tangible assets shown in the balance sheet with the difference rarely being above 25 per cent. In the later half of the 1990s, the relationship between market value and tangible asset value changed significantly. By early 2000, the book value of the assets represented less than 15% of the total market value<sup>1</sup>. In the present competitive scenario when every corporate in India is striving hard to maintain and, if possible, to increase its market share and building a good corporate image in the society, intangible assets have assumed a very important role in corporate accounting and reporting practices. But in the absence of any legal compulsion in this regard, the practice followed by the corporate world is not uniform and only a few of the companies deal with this subject in the annual reports published by them.

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measuring of intangible assets more difficult than it is in case of tangible assets. Most intangible assets are unique. Thus, the assessment of their value to the business and the period over which they may be expected to be available for use (their useful life) are rather problematic.

Intangible assets are those that create value beyond tangible assets. Typically, book values determine the value of hard assets of a particular business while the process of valuation of intangible assets would help determine other value creators such as the potential, and the ability to earn. Significantly, the computation of the true value of a company requires a comprehensive assessment of both tangible and intangible assets. An intangible asset is a claim to future benefits that does not have a physical (e.g. building or equipment) or financial (e.g. stock or bond) embodiment<sup>2</sup>. For example, patents, brand names, and unique organizational infrastructures that generate cost savings for companies can be defined as an intangible asset. Intangible assets have been defined by The Institute of Chartered Accountant of India as “an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.” The IAS-38 also defines “an intangible asset as an identifiable non-monetary asset without physical substance”<sup>3</sup>. On the basis of this definition the three important criteria that should be evaluated to describe any non-monetary asset as intangible are:

1. **Identifiability**— an intangible can be clearly identified separately when an enterprise can rent, sell, exchange or distribute specific future economic benefit attributable to the asset without disposing of the economic benefit that is to be derived from other assets.
2. **Control**— an enterprise controls an asset if the

<sup>1</sup> Infosys Annual Report 2007-08 pp 135.

<sup>2</sup> Lev, B. (2001) Intangibles: Management, Measurement, and Reporting, Washington, D C: The Bookings Institution.

<sup>3</sup> IAS-38 Para 8.

enterprise has the power to obtain the future economic benefits flowing from the underlying resource and it can also restrict any one else to enjoy that benefit.

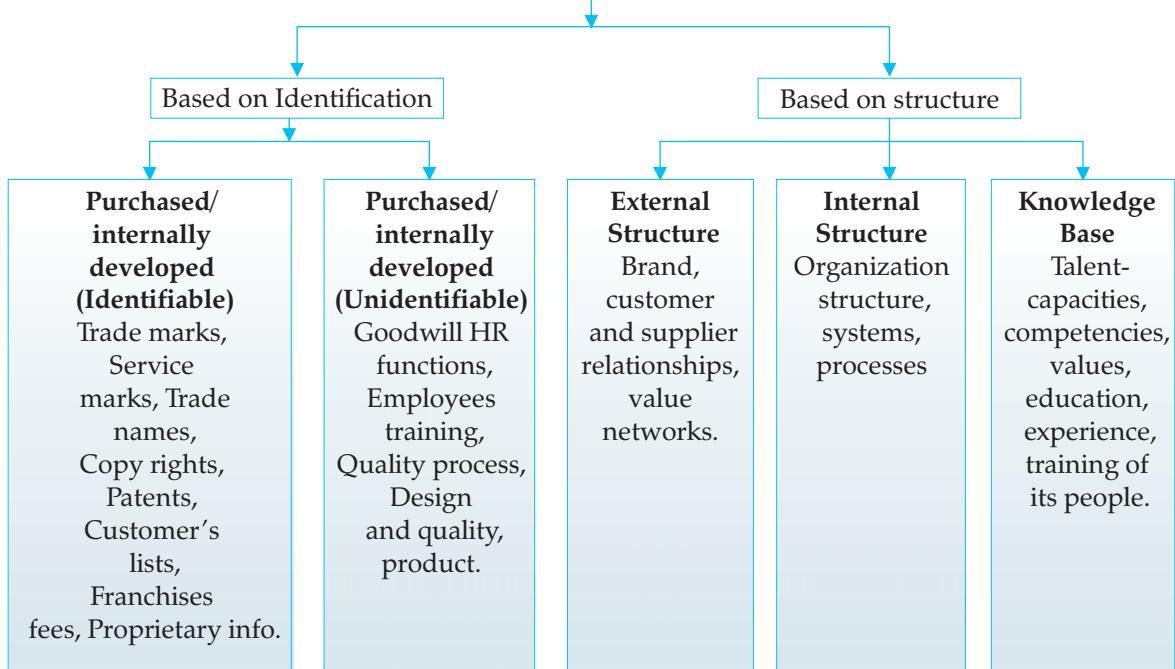
**3. Future economic benefits**— it includes revenue from sale of products or services and cost savings.

#### Exhibit I: Features of Intangible Assets

- Intangible assets are non-physical in nature with the specific rights of use several years.
- It increases the value when used and has strong network effects.
- It is possible for multiple uses at the same time.
- It is identifiable non-monetary asset and creates future value.
- It has limited ability to protect property rights and difficult to manage & control.
- Intangible asset cannot be owned except legal rights.
- Investment in intangible assets is typically more risky.
- It is not directly measurable and not subject to diminishing nature.

According to nature and legality, intangible assets are categorised in different ways. The first group of intangibles represents the property without physical presence which is subject to special legal protection such as transferable and non-transferable copyrights, patents, models, trademarks, know-how, etc. The protection is formalised by fixed procedures in some cases (e.g. patents, trademarks). Goodwill represents the second group of intangible assets. This category is particularly relevant for the tax and accounting area if arising on acquisition. It is described as any excess of the cost of the acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired as at the date of the exchange transaction. As per contemporary classification of intangible assets, there are Marketing-related intangible assets, Customers-related intangible assets, Artistic-related intangible assets, Contract-based intangible assets, Technologies-based intangible assets, etc. As per contract-based intangible assets franchise agreement is also treated as intangible assets. On the other hand, intangibles such as favorable government regulations, outstanding credit ratings, superior management and good labour relations are examples of unidentifiable intangible assets. Goodwill comprises the complete set of unidentifiable intangible assets held by the reporting entity.

#### Exhibit: II Kinds of Intangible Assets



## Intangible Assets & AS-26

The objective of Accounting Standard 26 (AS-26) relating to intangible assets is to prescribe the accounting treatment for intangible assets that are not covered specifically in another accounting standard. This standard is mandatory in nature and comes into effect in respect of expenditure incurred on intangible assets during accounting periods commencing on or after 1-4-2003. AS-26 defines an intangible asset as "*an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.*" According to this standard, intangible assets should be recognised only if, (a) it is probable that the future economic benefits that re-attributable to the assets will flow to the enterprise, and (b) The cost of the assets can be measured reliably. An intangible asset should be initially measured at cost and internally generated goodwill should not be recognised as an assets. Intangible assets arising from research should not be recognised. Expenditure on research should be recognised as an expense when it is incurred. Internally generated Brand, Published title, Customer's lists and items similar in substance should not be recognised as intangible assets.

According to the Para 63 of AS-26 the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of intangible assets will not exceed ten year from the date, when the asset is available for use. Amortisation should commence when the assets is available for use and the amortisation method used should be based on the pattern in which the assets' economic benefits are consumed by the enterprise. If the pattern of consumption of an intangible asset cannot be determined reliably, the straight line method should be used. Residual value of an intangible asset should be assumed to be zero unless (a) there is a commitment by a third party to purchase the assets at the end of the useful life, or (b) there is an active market for the asset and residual can be determined by reference to that market.

## Accounting Treatment

The valuation of intangibles is a complex issue although the main principles are the same as for tangible assets. The intangible asset is measured initially at cost in accounting, as for tangible assets. Besides that the accounting standards stress the importance of fair value accounting for intangible property. After the initial recognition the intangibles can be carried either at its cost less any accumulated amortisation and any accumulated impairment losses (cost model), or at a revalued amount being its

fair value at the date of the revaluation less any subsequent accumulated amortisation and impairment losses (revaluation model). IAS-38 also provides some more guidance on whether the increase of the value after the revaluation should be credited directly to equity or should be recognised in the profit or loss. In the absence of allowing corresponding deduction for high value intangibles, asseses are being forced to pay higher tax. It is in contradiction to the views of major accounting bodies, which have now permitted amortisation of such expenses in computing book profits.

## Intangible Assets and Depreciation

Depreciation allowance is granted to compensate the assessee for depreciation suffered by him in respect of specific assets. Depreciation is a measure of the effective life of an asset owing to use or obsolescence. Depreciation is one kind of notional loss, which arises due to physical wear and tear of the assets during production and manufacturing process. Deprecation allowance is provided for the replacement of assets after expiry of life and other side it is one of the tax shields, which will minimise the tax liability of the individuals or corporate assessee. Until 1998, depreciation was allowed only on tangible assets (L/B, P/M, furniture etc.) not for intangible assets. But, Finance (No.2) Act, 1998, for the first time, provided for allowance of depreciation on 'intangible assets' under the Income-tax Act, 1961. Section 32(1) (ii) of the Act provides that any know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature, acquired by the assessee on or after 1.4.1998, shall be eligible for depreciation allowance with effect from the assessment year 1999-2000. Sections 35A and 35AB, which earlier provided for amortisation of expenditure on patent rights, copyrights and know-how over a period of six years were also amended and such expenditure was to be treated as intangible assets, eligible for depreciation. Thus depreciation can now be claimed on intangible assets, acquired for a price, on the satisfaction of the following conditions namely: (1) the intangible assets are acquired by the assessee on or after 1.4.1998. (2) Such assets are owned by him either wholly or partly; and (3) such assets are used by him for the purposes of his business or profession during the previous year.

At present applicable rate of depreciation on intangible assets is @ 25 per cent. Now the question arises that their amortised value depends upon their performance and market demand or cost of acquisition less depreciation. When we are examining about depreciation on intangible assets we have to remember that in the case of *Bakliwal*

*Corporate's services ( P) ltd vs. ITO 302 ITR ( AT110)*, the bench pointed out that there are statutory conditions imposed by section 32 of income tax before the calculation of depreciation. They are: (a) The assets in question must be shown to be capable of diminishing value, (b) The assets must be owned by the assessee, and (c) The asset must be used for the purpose of business<sup>4</sup>.

Under Income-tax Act, 1961 definition of intangible assets are narrow. In this regard Supreme Court's observation in the *CIT, Kolkata vs. Hoogly Mills & Co Ltd*, case is significance for study. It was held that under section 32 of the act depreciation is allowable only in respect of building, machinery, plants or furniture being tangible assets and know-how, patents, copyrights, trademark's, licenses, franchise or other business or commercial rights of similar nature being intangible assets acquired on or after April 1, 1998. Recently in Delhi ITAT's ruling involving *Guruji Entertainment Network 108 TTJ 180*, the assessee, is doing the business of production and telecasting of serials, acquired a firm with all rights and liabilities including copyrights, business & commercial rights of its stock of serials. In the opinion of The ITAT that intangible assets in the nature of copyright, trademark, patent, licences etc. are depreciable and since assessee acquired copyright and related commercial and business interests, the same is depreciable. Thus, the assessee was entitled to depreciation on the cost representing the value of intangible assets except goodwill.

### Goodwill as Intangible Assets and Depreciation

Goodwill is an intangible asset, probably the most intangible of all intangible assets, hard to measure and even more difficult to account for. Goodwill today constitutes a much larger part of acquisition prices than it did previously, resulting in a much greater impact on financial statements. Goodwill is also a main part of intangible assets, but due to lack of clarity in the Income tax act and in accounting standards in many cases depreciation was not allowed by the taxation authorities on goodwill as intangible assets. In case of *BC Srinivasa Setty 128 ITR 294* the Supreme Court, in a landmark judgment, ruled that it is not possible to evaluate the cost of goodwill, as it is a self-generated asset. To overcome this judicial interpretation, Section 55(2) (a) was amended by the Finance Act, 1987, to state that the cost of acquisition in case of goodwill would be the purchase price and in case of *self-generated goodwill it will be Nil*. Thus purchased goodwill is now specifically recognised as a capital asset. Specially,

M&A transactions usually result in the transferee company paying a consideration higher than the value of the assets taken over, which is accounted as 'Goodwill'. An unresolved point from an income-tax perspective is whether such goodwill, being an 'intangible asset', would be eligible for tax depreciation. Another important observation in case of *Bharatbhai J. Vyas v. ITO 97 ITD 248* (Ahmedabad Tribunal) held that depreciation is allowable only in respect of intangible assets specified in the provisions of the Act and depreciation on goodwill is not allowable as it is not covered under the definition of specific assets.

*There is not a clear provision for depreciation on certain known intangible assets such as, goodwill, employees' contracts, vendor/customer contracts, distributorship rights, non-compete rights, customer lists, service process flows, knowledge databases, brands, etc. which are creating and generating more and more revenue in the present competitive environment.*

The key issues in respect of depreciation of such unspecified intangible assets, mentioned above, is whether they can be regarded as business or commercial rights of a nature 'similar' to know-how, patents, etc. The Supreme Court in *Nat Steel v. CCE (1988 AIR 631)* has held that the expression 'similar' means 'corresponding to or resembling to in many respects'. In this regard another case is also significant, in the case of *CIT v. Raffiuddin (242 ITR 57)* Madras High Court has observed that goodwill is inseparable from business. It may not be possible to acquire goodwill on a standalone basis, separate from the business, unlike know-how, patents, etc. similarly in another case of *Khushal Shah v. Khorshed Boatwalla (AIR1970SC1147)* the Supreme Court made an observation that goodwill of a business is an intangible asset being the whole advantage of the reputation and connections formed with the customers together with the circumstances that make the connection durable. However, intangible assets, such as goodwill, non-compete fees, etc. may lack specific legal enforceability.

But another opinion has been given by the Calcutta High Court in *Bird and Co. (108 ITR 253)* wherein the court observed that depreciation in the value of goodwill had to be taken into account either as business expenditure or purely as a capital loss. It is now well accepted that the amounts capitalised as goodwill, etc. have to be amortized in the books of accounts over a period, to know the true and fair profits. In this regard another judgment is also important in the case of *CIT v. Alps Theatre (65 ITR 377)*, one may demand for the amortisation/depreciation on amounts paid as goodwill, etc. is not only a legal but a necessary

<sup>4</sup> The Hindu Business Line (2008): Deprecation allowance for intangibles assets dated 2 August

**At present applicable rate of depreciation on intangible assets is @ 25 per cent. Now the question arises that their amortised value depends upon their performance and market demand or cost of acquisition less depreciation. When we are examining about depreciation on intangible assets we have to remember that in the case of *Bakliwal Corporate's services (P) Ltd vs. ITO 302 ITR (AT110)*, the bench pointed out that there are statutory conditions imposed by section 32 of income tax before the calculation of depreciation.**



charge for arriving at the assessable profits.

Goodwill is also a part of intangible assets like other intangible assets copyrights, patents, models, trademarks, know-how, etc. But there have been many instances when depreciation on goodwill was not allowed by the assessing officer. In this regard, the case of *R.G. Keswani v. ACIT (2009) 116 ITD 133 (Mum)* is significant. The assessee had purchased a running business from M/s R.G. Keswani & Engrep. At the time of acquiring the business, the assessee had paid certain amount in respect of trade name, goodwill and for all other business and commercial rights and claimed depreciation on said amount. The Assessing Officer rejected the assessee's claim holding that goodwill could not be treated as intangible asset and, therefore, not depreciable.

After all these analyses it is clear that there are huge gaps in the accounting & treatment of goodwill and also in the treatment of goodwill from the taxation point of view. There are many instances when rules under accounting standard were not followed by the income tax authorities because such provisions are not the part of tax laws.

**Depreciation on Non-Compete Fees:** A Non-compete fee is another unique intangible asset which is popular in acquisition deals and is generally paid to eliminate competition in certain region or geographical area. There are many judgments that have held that sums paid as compensation towards non-compete results in enduring benefit and, therefore, cannot be allowed as revenue expenditure. In this scenario, the assessee generally argue that non-compete fee should be allowed to be written off over a number of years in the form of tax depreciation. However, courts in India have, on several occasions, disallowed the claim of depreciation on the grounds that non-compete fee cannot be construed as an asset which the assessee could use like royalty, franchise, etc. for its business. It is a payment made to ward off the competitor for specified number of years and it only confers a right to sue in case of a breach. There is a case for simpler regimes which allows the non-compete fee payment as revenue expenditure or allows

depreciation on the same based on duration of the non-compete period as intangible assets.

Indian companies such as Ranbaxy Ltd. Dr Reddy's lab Ltd. are having non-compete fee as intangible assets in their annual reports. In case of Ranbaxy Ltd. non-compete fee is capitalised and amortised on a straight-line basis over the term of the non-compete agreement, similarly in Dr Reddy's Ltd. their non-compete fees amortising within 1.5 to 10 years according to the agreement. But In case of Hero Honda, a new intangible assets known as model fees exist as intangible assets in their financial statements.

In this regard another case under US law is important. The Supreme Court of the United States recently held in *Newark Morning Ledger Co. v. United States* that customer-based intangible assets, such as newspaper subscription lists, can be depreciated for federal tax purposes. In a 5-4 decision, the court held that an intangible asset is depreciable if two conditions are met: (i) the asset has a limited life that can be reasonably estimated; and (ii) the asset can be valued.

### Intangible Assets and Other Tax Benefits

Under Income-tax Act, 1961, apart from depreciation on intangible assets many other incentives are given to assessee for the research and development activities, through which they are generating intangible assets/ intellectual capital. An innovative industry in India can gain competitive advantage in the market if it develops the necessary expertise and skills in developing and manufacturing new products, which are patented. The following incentives would be extremely useful in promoting the culture of innovation and intellectual property protection in industries, academic and R&D institutions:

- Weighted tax deduction on R&D expenditure:** Under section 35(2AB) of the Income-tax Act, 1961 weighted tax deduction @ 150% on R&D expenditure is available (except land and building) to companies engaged in the manufacturing or production of drugs, computers, biotechnology, or the business of manufacture or production of drugs, pharmaceuticals, electronic equipment, telecommunication equipment, automobiles



chemicals and manufacture of aircraft and helicopters. Now this deduction is available up to 31<sup>st</sup> March 2012 (earlier it was available up to 31<sup>st</sup> March 2008).

**2. Accelerated depreciation allowance:** Depreciation allowance at a higher rate is available in respect of plant and machinery installed for manufacturing goods based on indigenous technology developed in recognised in-house R&D units, Government R&D institutions, National laboratories and Scientific and Industrial Organisations (SIRO).

**3. Tax holiday to R&D companies:** Under section 80IB(8A) of the Income-tax Act, 1961 tax holiday is available to approved companies engaged in scientific and industrial R&D activities on commercial lines for 10 consecutive assessment years. This incentive is applicable to any commercial company that has its main objective and activities in the area of scientific and industrial R&D. This would be applicable to companies approved after March 31, 2000 but before 31<sup>st</sup> March 2005.

**4. Income tax relief on R&D expenditure:** Under Section 35(1)(i) of the Income-tax Act 1961, the revenue expenditure on scientific research, by recognised R&D units, on activities related to the business of the company is allowed full deduction. Under Section 35(1)(iv) expenses of a capital nature could be deducted totally from the income of the year in which the expenses have been incurred (other than land and building).

**5. Tax deduction for sponsoring research:** Section 35(2AA) of the Income-tax Act 1961 provides for a weighted tax deduction of 125% for expenses on sponsoring research programmes at National laboratories functioning under ICAR, CSIR, ICMR, DRDO, Department of Biotechnology, Department of Atomic Energy, Department of Electronics; IIT and universities.

### Intangible Assets and Indian Companies

Now-a-days there are many reasons for disclosing information by the companies related with intangible assets. It contributes to reducing

the information irregularity between management, shareholders and investors. Several fast growing Indian companies, particularly in information technology sector, are fully dependent upon the intangible assets rather than tangible assets. The average overall contribution of intangible assets in information technology sector has been 85.8 per cent during the last five years and the companies in this sector very much interested about the depreciation on intangible assets. Similarly in Pharmaceutical industry, intangible assets contribute more than the tangibles. Firms like Lupin, Cipla, Ranbaxy, Dr Reddy's, Pfizer and Nicholas pharma are some leading companies where creation of intangibles assets has been 80 per cent during the last five years. In FMCG industry Dabur, HUL, Colgate Palmolive, Britannia, ITC, Nestle are some major companies which provide marginal information related to intangible assets and their reporting. Automobile industry is another fast growing industry during the last two decade but only few companies in this sector are interested about the disclosure of intangible assets in their reporting system.

### Conclusion

Now-a-days intangible assets are very important in knowledge-based companies. As contribution of service-oriented industry increase in our economy (52.8% of GDP), intangible assets are having a greater importance in earning as well as wealth creation for the shareholders. But, unfortunately current accounting and reporting practices not cover all the intangible assets in annual reporting statements and because of this some of the companies cannot claim depreciation on such intangible assets and have loss of revenue by way of higher tax liability. For instance Infosys client base is an important intangible asset for the company while in case of Britannia its strong brand continuously earns more and more money for it. The most valuable intangible assets for HUL are its brand and channel partners (both form the external structure). The market value of Dr. Reddy's is a factor of the quality of their knowledge base, the investment in R&D, the quality of their leadership (internal structure and employees' knowledge). There are many more effective intangible assets which cannot be recognised by the firm in the current definition and practice due to unstable nature and continuous changes in their structure. To avoid court cases and unnecessary legal proceedings, CBDT has to take initiative to clarify and re-structure all the intangible assets from the depreciation and taxation point of view.

<sup>5</sup> Finance Act 2006

# Taxation Aspects of Film Producer



Movies are the most popular form of entertainment for us. In addition to this, vast cultural diversity of the Indian population has been instrumental in making India the biggest producer of films in the world (India Brand Equity Foundation Report). The Indian Entertainment & Media (E&M) industry has out-performed the Indian economy and is one of the fastest growing sectors. The Indian media and entertainment industry broadly consists of five segments viz Films, Television, Music, Radio, and Print (primarily Newspapers & Magazines).

This article discusses how the income of film producer is computed primarily in respect of deduction of cost of production from the revenue generated by the film



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**T**he Indian economy has been growing at a fast pace over the last few years, and the income levels too have been experiencing a high growth rate. The rise in disposable income is faster than the growth in total income. This results in the expenditure on leisure and entertainment being high. One of the known Global Entertainment and Media Outlook has ranked India as the fastest growing market in the world for the expenditure on entertainment and media in the next five years. The E&M industry has significantly benefited from liberal foreign investment regime. Foreign Direct Investment (FDI) in all film related activities such as film financing, production distribution, exhibition, marketing, etc is permitted up to 100% for all companies under the automatic route. India's demographic profile, which makes it one of the

youngest nations in the world, is another significant driver of growth for the E&M industry.

### Film Production

The film production process starts with the conceptualization of the idea by the production house which then decides on the artistes and technicians and approaches the distribution house, the music company and the laboratory. Depending on the standing of the production house, the story line, artists and technicians involved the film gets sold in advance to each of these parties at various stages depending on the category/ quality of the film.

### Revenue Sources

The major sources of revenue in this industry are:

1. Domestic Theatrical Sales
2. Satellite Rights and Home Video Segment
3. Overseas Rights (Both Theatrical and Satellite)
4. Music Rights
5. Video and CD Rentals
6. Corporate Sponsorship and Merchandising
7. Internet Rights and Merchandising
8. Ring Tone Rights

### Cost of Production

Rule 9A of the Income-tax Act, 1961 (herein after referred to as "the Act" unless otherwise specified) deals with the allowability of cost of production for films and related aspects.

Explanation (ii) to Rule 9A (1) defines cost of production as:

"Cost of production" in relation to a feature film means the expenditure incurred on the production of the film, not being:-

- (a) the expenditure incurred for the preparation of the positive prints of the film; and
- (b) the expenditure incurred in connection with the advertisement of the film after it is certified for release by the Board of Film Censors.

The cost of production of a film may spread over a period of time and sometimes beyond a year. Typically, till the production is complete, the cost is accumulated and carried forward as 'work-in-progress' in the Balance sheet and not written off in the profit and loss account. The major expenditure is in the form of artistes' fees, technicians' expenses, studio charges, and production and promotion expenses. Similarly, when the film is released or rights therein are sold,

the revenues streams may flow over a period of times and may often flow-in even after years of production.

As per Rule 9A, the cost of production does not include the expenditure on making of positive prints, and on advertisement after the Censor Board certifies the film for release. As held in *CIT vs. Prasad Productions (P) Ltd. [1989] 76 CTR (Madras) 173*, production cost does not include any type of post-production expenses such as expenses for multiple prints, advertisement, commission etc. Such post-production expenditures are not subject to the restrictions contained in the rules and therefore allowable in the same year in which they are incurred as per Section 37.

### Basic Conditions

As far as the production expenses are concerned, the accepted principle as laid down in the income tax rules is that, being eligible for deduction the film should be certified by the Board of Film Censor [constituted under the Cinematograph Act, 1952 (37 of 1952)] in previous year [sub-rule (1)].

The deduction under this rule shall not be allowed unless the amount realized by the film producer from exhibition of film and / or selling of rights of exhibition including minimum amount guaranteed, if any, are credited in the books of accounts maintained by him in respect of the year in which the deduction is admissible [sub-rule (5)].

The income tax rules link the allowability of production costs to the exhibition or sale of rights in film. The sale of the rights of exhibition of a feature film includes the lease of such rights or their transfer on minimum guarantee basis. As per Rule 9A (7) (ii) the exhibition rights of a feature film are considered as sold only on the date when:

- i) the positive prints of the film are delivered by the film producer to the purchaser of such rights, or
- ii) the negative of the film is delivered by the film producer to the film distributor if the positive prints are to be made by the film distributor.

### Allowability of Production Cost [Sub- rule 3, 4, 5]

The basis of allowance of cost of production can be explained as follows;

- A. Where a feature film is certified for release by the Board of Film Censor in any previous year and in such previous year, the film producer sells all

**Where a feature film is certified for release by the Board of Film Censor in any previous year and in such previous year, the film producer sells all rights of exhibition of the film, the entire cost of production of the films shall be allowed as a deduction in computing the profits and gains of such previous year.**



rights of exhibition of the film, the entire cost of production of the films shall be allowed as a deduction in computing the profits and loss of such previous year.

B. Where the film producer either himself exhibits the film on a commercial basis in all or some of the areas or sells the rights of exhibition of the film in respect of some of the areas or himself exhibit the film on a commercial basis in certain areas and sells the rights of exhibition of film in respect of all or some of the remaining areas, and the film is released for exhibition on a commercial basis at least ninety days before the end of such previous year, then entire cost of production of the film shall be allowed as a deduction in computing the profits and gains of such previous year.

Otherwise the cost of the production of the film in so far as it does not exceed the amount realized by the film producer by exhibiting the film on a commercial basis or the amount for which the rights of exhibition are sold, as the case may be, the aggregate of the amounts realized by the film producer by exhibiting the film and by the sale of the rights of exhibition, shall be allowed as deduction and the balance, if any, shall be carried forward to the next following previous year and allowed as deduction in that year.

Thus, if a film is released in last 90 days of the year and production costs are less than collections, entire cost is allowed as deduction.

In this situation, the requirement is not that the film should be released at least for 90 days period, but merely that it should be released 90 days prior to year end. Therefore, if a film is released by January 1<sup>st</sup> even for a day, full deduction would be allowed, but if a film is released for less than 90 days (after 1<sup>st</sup> January), only deduction to the extent of collections would be allowed. The tax treatment does not appear to be fair but that is law. Further it is held in the case of

*V. Varghese vs. Dy. CIT (No. 2) [1994] 210 ITR 526 (Karnataka)* that Rule 9A is not ultra vires the provisions of the Act.

For Example if cost of production is 80 crores as against the collection of Rs. 70 crores and the film is released at least 90 days prior to year end, the full cost of Rs. 80 crores is allowed. If the film is released in last 90 days of the year, deduction upto the collection i.e. Rs. 70 crores is allowed in the same previous year and balance Rs. 10 crores will be allowed in subsequent previous year.

C. Further, even after the feature film is certified for release by the Censor Board in a particular year, and if the film producer neither himself exhibit the film on a commercial basis nor sell the rights of exhibition of the film (i.e. neither A nor B above), no deduction shall be allowed in respect of the cost of the production of the film in computing the profits and loss of such year.



The above all three situations can be summarized in a tabular form as follows:

Situation A	Situation B		Situation C
Film certified by Censor Board and all rights sold	Film Certified by Censor Board and film is exhibited or partly exhibited and/or partly rights sold Film released at least 90 days before the end of the year		Film certified by Censor Board but neither rights are sold nor film is exhibited
100% Deduction	100% Deduction	Deduction to the extent of collection and remaining amount is carried forward and allowed in subsequent previous year, if any	No Deduction in previous year. The cost is carried forward and allowed in subsequent previous year whether film is exhibited/rights are sold or not in subsequent year

### Similarity of Rule 9A and Rule 9B

Further, Rule 9B is in same line with Rule 9A. Rule 9B deals with cost of acquisition, which applies to both film distributor and sub-distributor.

### Frequently Asked Questions

#### What is the treatment of production cost for an uncertified film?

Certification by Censor Board is prerequisite for allowability of production cost. That means if any film is not certified by Censor Board, expenses related to cost of production can not be allowed in computing the income as per this rule. In author's view, assessee may claim the same as per normal provisions of the Act.

#### How the subsidy is taxed?

The cost of production of a feature film shall be reduced by the subsidy received by the film producer under any scheme framed by the Government, where such amount of subsidy has not been included in computing the total income of the assessee for any assessment year.

Subsidy received by producers of regional feature films should not be treated as revenue receipt – see circular No. 541, dated 25-7-1989 as amended by circular No. 544, dated 15-9-1989.

Further as held in *Jagapathy Art Pictures vs. CIT [1999] 240 ITR 625 (Mad)*, cash subsidy received from state government by producer of film after certification by Central Board of Film Censor is not an amount paid to assist assessee to make film but to encourage the producers to produce the film in that state. Accordingly, the same was revenue receipt and taxable as such.

#### What is the treatment of Depreciation?

Generally, producers do not use substantial

assets owned by them for the purpose of production of film. Therefore, depreciation would relate mainly to non-production assets or the assets used for general administrative / office purpose. Such depreciation not being in the nature of production cost would not be governed by the aforesaid Rule 9A. Therefore, in author's view such depreciation would be allowed as a deduction in the respective year of use of assets. If any capital asset is acquired and used for film production, the depreciation would have to be computed in normal manner in accordance with the applicable rules and be given same treatment as of production expenses by amortizing it over one or two years as the case may be.

#### Whether disallowances under section 43B, 40A(2), 40A(3) of the Act etc. will be applicable or Rule 9A will override other provisions of section 29 to 44D of the Act?

A question may arise that whether due to application of this rule, Section 40A(2), 40A(3), 43B, etc. would be applicable to compute taxable business income or whether one can say that Rule 9A is a self contained code which simply provides for amortizing the film production costs and





**Generally, producers do not use substantial assets owned by them for the purpose of production of film. Therefore, depreciation would relate mainly to non-production assets or the assets used for general administrative / office purpose. Such depreciation not being in the nature of production cost would not be governed by the Rule 9A.v**

would override other provisions of section 29 to 44D.

A view has been expressed that since the film production expenses are claimed as per Rule 9A and not under section 37, no further disallowance can be made. Similar view has been held by the Tribunal in the case of *K.R. Films 31 ITD 482 (Mum.)* in similar other context.

However, as per other view, rules cannot override the Act, and therefore Rule 9A would come into play only after the income has been computed applying all the normal provisions including all the disallowances. This view is based on the principle that Rule 9A provides for additional restrictions over and above those in the specific sections disallowing certain expenses, and that the rule only touches upon the manner of amortization of film production cost over a number of years and does not deal with the allowability or disallowance of any expenditure as such.

#### **What is the treatment of finance cost/interest?**

An obvious question may arise that whether finance cost / interest would be a part of production cost? In practice, producers claim deduction of this cost either as expenses in the year in which it is incurred or as a part of production costs under Rule 9A depending on what suits them. If film is under production or is not released, and the producer has profits from other films released previously, it would be advantageous to write off the interest cost as a common overhead not relating to production in the year in which it is incurred. Otherwise it may be advantageous to carry it forward as production costs. The rule is silent on this issue. In author's view following the

normal accounting principles, and Accounting Standard 2 issued by ICAI, one should capitalize interest cost also if the nexus of borrowals and utilization for the project is clear. If however, the borrowing is for common overheads or working capital of the entity and not for any specific film, the same should be treated as cost for that period.

#### **Is it possible to deviate from the methodology laid out in Rule?**

The question may arise as to whether it is possible for the film producer to claim production cost and value inventories as per prudent accounting policies which may deviate from the methodology laid out in Rule 9A.

Now-a-days, this has become relevant due to mandatory requirement of the Companies Act, 1956 to follow accrual system of accounting and accounting standards. It is not open for the tax authorities to challenge the valuation method based on sound accounting principle even if the same is contrary to Rule 9A [Tribunal – *Ram Gopal 21 TTJ 235 (Bom.) and Samantha Enterprises 22 TTJ 590 (Bom.)*]

As per Sub-rule (6) of Rule 9A, Where the Assessing officer is of opinion that –

- the rights of exhibition of the feature film have been transferred by the film producer by a mode not covered by the provisions of this rule
- having regards to the facts and circumstances of any case, it is not practicable to apply the provisions of this rule to such case, deduction in respect of the cost of production of the film may be allowed by the Assessing Officer in such other manner as he may deem suitable.

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# TDS/ TCS Compliances/ ITRs Filing– An Overview

CBDT has issued Notification No. 31 dated March 25, 2009 bringing out several changes in TDS compliance. The notification amends/ substitutes various rules like Rules 30, 31, 31A and 31AA of Income Tax Rules, 1962 w.e.f 1-4-2009. Further, notification no. 28 dated 16/3/2009 and notification no. 30 dated 25/3/2009 have also been issued for change in credit of TDS rules and new revised forms for TDS compliances on payment to non-residents respectively. Further on 6<sup>th</sup> July 2009, Finance Minister announced the proposals for changes in various TDS rates. Along with amendments in TDS/ TCS compliances, CBDT has also notified ITR-1 to ITR-8 for the assessment year 2009-10 with a change in the procedure of submitting ITR-V (acknowledgement of various ITRs). This article provides an overview of these amendments and changes.



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## TDS/TCS Compliances

CBDT has issued Notification No. 31 dated March 25, 2009 bringing out several changes in TDS compliance. The notification amends/ substitutes various rules like Rules 30, 31, 31A and 31AA of Income Tax Rules, 1962 w.e.f 1-4-2009. By this notification, CBDT has substituted old challan no. 281 for depositing TDS / TCS with the new challan no. 17 which requires deductee / collector-wise details of TDS / TCS. A new quarterly return/statement in from no. 24C has been notified while all previous quarterly returns will have to be submitted annually on or before 15<sup>th</sup> June of next year.

In addition to the above mentioned notification, notification no. 28 dated 16/3/2009 and notification no. 30 dated 25/3/2009 have also been issued for change in credit of TDS rules and new revised

**Postponing again and again the applicability of notification no. 31 reveals that CBDT has not yet completed its home-work to accept the new challans, forms and returns. However, the new revised forms no. 15CA and 15CB for compliance of TDS on payment to non-residents (referred in notification no. 30 dated 25/03/2009) have been made applicable w.e.f 1<sup>st</sup> July 2009.**



forms for TDS compliances on payment to non-residents respectively.

But department did not upload the new challan no. 17 on the income tax website in April '09. Thereafter CBDT came out with a press release no. 402/92/2006-MC (11 of 2009) on 11<sup>th</sup> April 2009 postponing the compliances of new amended rules from 1<sup>st</sup> July 2009 instead of 1<sup>st</sup> April 2009.

Again CBDT further decided and issued a Press Release no.402/92/2006-MC (14 of 2009), dated 30-6-2009 that the notification no. 31 of 2009 dated 25.3.2009 shall be kept in abeyance for the time being and the date from which the notification no. 31 / 2009 shall become applicable shall be notified by the Central Board of Direct Taxes subsequently. By that time, all deductors/ collectors of TDS / TCS may continue to deposit their TDS / TCS and file their quarterly TDS / TCS returns as per procedure existing prior to issuance of notification no. 31 / 2009 dated 25.3.2009. Postponing again and again the applicability of notification no. 31 reveals that CBDT has not yet completed its home-work to accept the new challans, forms and returns. However, the new revised forms no. 15CA and 15CB for compliance of TDS on payment to non-residents (referred in notification no. 30 dated 25/3/2009) have been made applicable w.e.f 1<sup>st</sup> July 2009.

Further on 6<sup>th</sup> July 2009, Finance Minister announced the proposals for changes in various TDS rates which have also been incorporated in this article and then Finance (No. 2) Act 2009 has been assented by Hon. President of India on 19. 8.2009 although changes in TDS rates will be applicable w.e.f. 1.10.2009.

### E-Filing of ITRs

Along with amendments in TDS/ TCS compliances, CBDT has also notified ITR-1 to ITR-8 for the assessment year 2009-10 with a change in the procedure of submitting ITR-V (acknowledgement of various ITRs). Now ITR-V (in case of submission of ITRs without digital

signature) has to be sent to CPC, IT Department, Bangalore within 60 days from the date of electronic submission of ITRs or up to 30<sup>th</sup> September 2009, whichever is later (Press Release dated 12/08/2009). In turn, CPC Bangalore shall send a confirmatory e-mail of submission of ITR-V. Earlier it had to be submitted with the A.O. having jurisdiction over the assessee within 15 days. Under the proposed new guidelines, since ITR-V is to be sent by post to Bangalore City Post Office, there is no acknowledgment for the acceptance of the same, except the e-mail communication. Further, assessee would not be able to sent his ITR-V by registered post as the address given refers to a Post Box Number and no registered post is accepted where the letters are addressed to Post Box No. To assist taxpayers, a limited call centre service with two agents has been established at ITD-CPC, Bangalore. Taxpayer queries on status of ITR-V receipt at CPC, Bangalore will be answered on 080-43456700 between 9:30 AM to 6 PM from Monday to Friday. The service will be available in English, Hindi and Kannada.

The changes which affect various aspects of TDS/TCS compliance are summarized below:

#### A. *Challan Format:*

- a. New TDS Challan, Form No. 17 has been introduced in place of earlier Form No. 281.
- b. Challan is section independent i.e. deductor can prepare a single challan at the end of the month for all his TDS deductions (including Salaries and Non Salaries).
- c. This additionally contains, information of the Bank Account No./ Card No. of the deductor.
- d. The earlier fields Surcharge and Cess break-ups are not necessary in new challan.
- e. The deductor/collector will electronically submit the challan in Form No. 17 which will be submitted on or before the due date of making deposit of TDS/TCS. In Form No. 17, the deductor will submit deductee-wise break-up of TDS (Name, PAN of the

deductee) and collectee-wise break-up of TCS.

- f. Immediately after uploading Form No. 17, a 'Transaction Reference Number' for the challan and a 'Unique Transaction Number' for each deductee/collectee will be created.

**Note:** New Form No. 17 will be applicable only for payment of TDS or TCS on or after the date which will be notified subsequently by CBDT. "In respect of any TDS or TCS made before that date, the payment will continue to be made to the credit of the Central Government by using the challan in Form No 281, the old challan form."

#### B. Payment:

a. Electronic Payment [e-Payment] of TDS has been made mandatory to all. No TDS/TCS Payments would be accepted directly at Bank Branches.

b. The system for acceptance of e-Payment would be ready by end of April in accordance to Form-17.

c. An entry form would be provided similar to Form 17 format.

d. Credit & debit card payment acceptance is likely to happen.

e. The old system of e-Payment may remain for challan payments of earlier years.

#### C. Acknowledgement:

a. The deductee records under that challan have to be entered online [if less than 10] or have to be uploaded through a file if it is more than 10.

b. On successful payment, an acknowledgement would be generated in Form 17 format, which validates [Yes/No] for each PAN of the deductee and generates a Unique Transaction Number [UTN] for each deductee record.

#### D. Due Date for TDS Payment:

(a) Within two months from the end of the month in which the amount is credited by the payer to the account of the payee, if the crediting is on the date up to which the accounts of the payer are made; and

(b) In any other case within one week from the end of the month in which the deduction is made.

**Note:** Joint Commissioner, on prior request through AO, can approve for quarterly payment of TDS under certain sections.

**Note:** Due date as mentioned in clause-(a) is not applicable for TDS on salary, dividend, winning from horserace, crossword puzzles, lottery, etc.

#### E. Changes in TDS Return filing:

##### 1. Earlier Forms:

a. Earlier quarterly returns namely, Form 24Q (Salary), 26Q (Payment other than salary to a resident), 27Q (for payment other than salary to a non-resident) and 27EQ (TCS) remain as it is, with a little change in formats.

i. UTN has to be mentioned against each deduction.

b. Quarterly due dates for all the forms have been removed and annual due date of 15<sup>th</sup> June has been introduced.

c. These forms have to be prepared quarterly and can be filed once at the end of the year, before 15<sup>th</sup> June.

##### 2. New Form:

a. New Quarterly return, Form 24C has been introduced with following contents.

b. With the *deductor information*, Form 24C should contain Details of TDS Compliances for 3 months separately and the *Challan Identification Numbers/Amounts in that quarter*.

c. Details of TDS compliances should contain the section-wise (all) information of total payment, total amount eligible for deduction, total amount considered for TDS at full rate, amount of TDS at full rate, total amount considered for TDS at lesser rate, amount of TDS at lesser rate, total TDS.

d. To be submitted quarterly on or before July 15, October 15, January 15 and June 15

e. Form No. 24C shall be submitted electronically by every person who has been allotted a tax deduction/collection number (TAN). In case, no tax has been deducted or collected during a quarter, then NIL return should be submitted in Form No. 24C.

#### F. Changes in TDS Certificates:

1. New formats of Form No. 16 and 16A.

2. These formats may be applicable for FY 2009-10 and above:

a. For 2008-09, the same earlier formats may continue as the data for new formats would be less. However, a confirmation circular is expected from CBDT.

3. The forms should contain the information of UTN against each payment shown in TDS certificate.

a. UTN has to be mentioned, along with gross amount paid and TDS amount.

b. Date of Payment is not required. That means if a party payment is shown consolidated in

monthly challan, a yearly Form 16A contains only 12 entries.

c. TDS Certificate no. has been introduced as internal reference no. to be given by the deductor – as an optional.

4. Form 16A is section independent. It can contain multiple section related deductions.

#### **G. TDS on Payment to Non-Residents:**

Tax is deductible at source under section 195 in respect of payment/credit to non-resident. The person making the remittance is required to furnish an undertaking in Form No. 15CA addressed to the Assessing Officer accompanied by a certificate from a chartered accountant in Form No. 15CB. This undertaking and certificate is submitted to the Reserve Bank of India or its authorized dealers who, in turn, are required to forward a copy to the Assessing Officer.

Form No. 15CA shall be furnished electronically to the website designated by the Income-tax Department and thereafter signed printout of the said form shall be submitted prior to remitting the payment. The electronic version of Form No. 15CA is available on the website of income tax department and tin-nsdl w.e.f. 1<sup>st</sup> July 2009.

#### **H. If income is taxable in the hands of some other person:**

When income on which tax is deducted at source is assessable in the hands of a person other than the deductee, credit will be available in respect of TDS to the other person in whose hands the income is chargeable to tax. However, this facility will be available only when the following conditions are satisfied:-

(i) Income is taxable in the hands of a person other than deductee because of the following –

(a) the income of the deductee is assessable in the hands of other person by virtue of section 60, section 61, section 64, section 93 or section 94;

(b) income of AOP / Trust assessable in the hands

**Tax is deductible at source under section 195 in respect of payment/credit to non-resident. The person making the remittance is required to furnish an undertaking in Form No. 15CA addressed to the Assessing Officer accompanied by a certificate from a chartered accountant in Form No. 15CB. This undertaking and certificate is submitted to the Reserve Bank of India or its authorized dealers who, in turn, are required to forward a copy to the Assessing Officer.**

of members/ trustees, as the case may be;

(c) the income from an asset of a partner of a firm or a *karta* of a Hindu Undivided Family, is assessable in the hands of firm, or Hindu Undivided Family, as the case may be;

(d) the income from a property, deposit, security, unit or share held in the name of a deductee is owned jointly by the deductee and other persons and the income is assessable in their hands in the same proportion as their ownership of the asset.

(ii) The deductee should file a declaration to the deductor on a plain paper. The declaration should contain the name, address, permanent account number of the person to whom credit is to be given, payment or credit in relation to which credit is to be given and reasons for giving credit to such person.

(iii) After the receipt of declaration from the deductee, the deductor will report the tax deduction in the name of the other person. The 'Unique Transaction Number' will be generated in the name of the other person.

(iv) The deductor shall keep the declaration in safe custody and issue Form No. 16 or 16A in the name of the other person.

(v) The other person will include the income in his income-tax return and give the information in Schedule SPI TDS-1 and TDS-2 of ITR.

#### **I. If income is assessable in the hands of deductee in different years:**

Credit for TDS shall be given for the assessment year for which such income is assessable. Where tax has been deducted at source and deposited and the income is assessable over a number of years, credit for tax deducted at source shall be allowed across those years in the same proportion in which the income is assessable to tax.

In such a case, the credit would be available on the basis of income reported in the income-tax return and the information which is submitted in Schedule TDS-2 (Column 7) of different ITRs.



<i>Situation 1 – TDS on salary u/s192 Form No 16</i>	By April 30 after the end of the financial year
<i>Situation 2 - When tax is deducted at the time of passing credit entry on the last day of the accounting year</i>	Within one week from the date of deposit of TDS
<i>Situation 3 - When prior approval is taken from the Assessing Officer to quarterly deposit tax deducted under section 192, 194A, 194D or 194H</i>	Within 14 days from the date of deposit of TDS
<i>Situation 4 - When deductee requests the payer to issue consolidated TDS certificate (applicable only when more than one TDS certificate is required to be given to the deductee)</i>	By April 30 after the end of the financial year
<i>Situation 5 - Any other case (also for TCS)</i>	Within one month from the end of the month in which tax is deducted

**J. Issuance of Certificate in Form No 16/16A**  
**- Time limit:**

**K. Amendments Proposed by the Union Budget 2009**

**1) TDS Rates:**

(a) The provisions relating to tax deducted at source will be rationalised from 1<sup>st</sup> October, 2009. Surcharge and Education cess is not applicable on any TDS other than salary. On TDS on salary, surcharge will not be applicable but education cess will be levied.

(b) The difference between payments to contractor & sub-contractors and advertising & other contracts has been eliminated.

(c) In case of payments to Contractors being individuals & HUF, the single rate of TDS @ 1% will be applicable.

(d) In case of payments to contractors other than Individual & HUF, the single rate of TDS @ 2% will be applicable.

(e) In case of Sec. 194A, rate of TDS on interest on other than securities has been reduced to 10% from existing 20% in case of domestic companies.

(f) The new rates of TDS on rent are:

Rent Payments (Sec. 194-I)	Old Rates	New Rates
(i) For Plant, Machinery or Equipment	10%	2%
(ii) For Land, Building, Furniture & Fittings	15 & 20%	10%

(g) No TDS will be applicable on payment to

transport contractors if he furnishes a valid PAN to the deductor and in turn the deductor shall furnish the detail of such transport contractors with PAN to Income Tax Department.

- If PAN is not quoted by the transporters, the rate will be 1% for an individual/HUF transporters and 2% for other transporters up to 31.03.2010.

(h) If however, PAN is not quoted by the deductee, the rate of TDS will be higher of 20% or applicable rates, in all the cases, with effect from 1<sup>st</sup> April, 2010

(i) No TDS will be deducted on any payment made to New Pension Scheme Trust.

(j) TDS will not be deducted on work of manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person other than such customer as such a contract is a contract for 'sale'. If material is purchased from such customer then TDS is applicable on non-material part of invoice (if separately mentioned) otherwise on full invoice value. (w.e.f.1.10.2009)

**2) TDS Return Processing & Assessment:**

(a) New section 200A has been inserted to provide for processing of TDS return and intimation of processing of TDS return to be sent within one year from end of financial year in which return is filed.

(b) No TDS assessment order shall be passed after the expiry of 2 years from the end of financial year in which TDS return is filed or 4 years from the end of the financial year in which payment is made where such return is not filed.

# Taxability of Principal Amount of Loan Waived Under One Time Settlement Scheme (O.T.S)

**Under the Government's popular One Time Settlement Scheme that has helped reduce the non-performing assets of various banks and financial institutions substantially, the principal amount as well as the interest outstanding due to the bank or to the financial institution could be waived partially subject to the borrower settling the balance amount in one lump sum or installments. But is the waiver of such principal amount of loan and interest outstanding is taxable under the Income tax Act either under section 28(IV) or under section 41(1) of the Income tax Act? This article discusses the issue.**



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We are all aware of the fact that with a view to reduce the alarming non-performing assets (NPA), the Government has come out with a scheme popularly known as OTS. Under this scheme, in appropriate cases, the principal amount as well as the interest outstanding due to the bank or to the financial institution could be waived partially subject to the borrower settling the balance amount in one lump sum or installments. Many constituents took advantage of this scheme whereby the government was also able to reduce substantially the non-performing assets of various banks and financial institutions. The issue discussed in this article is whether



the waiver of such principal amount of loan and interest outstanding is taxable under the Income tax Act either under section 28(IV) or under section 41(1) of the Income tax Act.

The I.T. Department relied upon the decision of Supreme Court in *CIT Vs. M/s. T.V. Sundaram Iyenger & Sons reported in 222 ITR 344*. In that case, the company treated the unpaid sundry creditors as income by taking into Profit and Loss Account. On those facts, the apex court held that such amount tantamount to income. It is to be borne in mind that all these sundry creditors were deposits from customers, who were mostly dealers and had gone out of business.

But as far as the issue for discussion is concerned, no doubt the principal amount of the loan waived under the O.T.S. scheme will not be taxable under section 41(1), since in order to invoke this section, the amount remitted should have been allowed as a deduction in computing the income of earlier years. This is not so. As far as the bank interest is concerned, definitely, the provisions of section 41(1) are applicable if such interest waived has been allowed as a deduction in computing the income of the earlier years. If such interest has been disallowed by virtue of the provision of section 43B in any of the earlier years, section 41(1) will not be applicable.

Now we come to the question of the taxability of the principal amount waived under section 28(IV) which reads as under:-

*The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;*

By a scheme promulgated by Reserve Bank of India (RBI), banks were authorized to waive the principal amount due from the borrowers under a one time settlement scheme (OTS). This was basically intended to enable the banks to reduce their non-performing assets, namely advances which have become overdue or which have been

defaulted in payment. When the appellant also defaulted payment over a period of time, the bank demanded full repayment of the loan as this was becoming non-performing asset affecting the liquidity of the bank. As the financial condition of the company was not sound, the bank authorities had several rounds of discussions and waived a portion of the principal amount in terms of the guidelines issued by the RBI in this regard subject to the payment of the balance amount immediately. In the case of the company, there was a partial waiver of bank loan liability, (capital in nature) and there was no remission or cessation of any trading liability. Section 28 of the Income-tax Act, 1961 Act deals with the profits and gains of business and clause (4) thereof says that the value of any benefit or perquisite, whether converted into money or not, arising from the business or the exercise of profession, shall be chargeable as income under the head Profit and Gains of business. In the appellant's case, they were engaged in the manufacture and export of marine products and they had not carried on business of obtaining loan to hold that waiver by the bank was a benefit arising from such business. In short, this waiver cannot be taxed under section 28(IV) as income and it cannot be stated to be a benefit of perquisite. It must be arising from the business. Reliance is also placed on the decision of the Bombay High Court in the case of *M/s. Mahendra & Mahendra vs. CIT*, reported in 261 ITR 501 and the decision of the High Court of Gujarat in the case of *CIT vs. Chetan Chemicals Pvt Ltd.* reported in ITR 770.

In view of the above referred facts and legal position, it can be seen that the loan taken by the company from the bank does not amount to trading liability and the amount of the principal loan waived by the bank does not constitute income assessable under section 41(1) or under section 28(iv) of the Income-tax Act, 1961. The waiver of the loan amount also cannot be considered as non-recurring receipt as there is no actual receipt but only waiver. Subsequent to the above decision, the Bombay High Court in the case reported in 308 ITR 417 in the case of *M/s. Solid Containers Ltd. vs. DCIT* has held that waiver of loan taken for business purpose and transferred to the Profit & Loss account is assessable as income. In this judgment, the court referred to the decision of the apex court in *M/s. T.V. Sundaram Iyenger & Sons Ltd.* and also

the Bombay High Court in *M/s. Mahindra & Mahindra Ltd.* case. Here again, the decision does not alter the issue. In principle, in the subsequent decision, the Bombay High Court has approved the ratio of the judgment in the case of *Mahindra & Mahindra Ltd. vs. CIT 261 ITR 501*. To quote their Lordship, the present case can hardly derive any advantage from the case of *M & M Ltd. vs. CIT 261 ITR 501*. In that case the real fact was recorded that the assessee continued to pay interest @ 6% for a period of 10 years and the agreement for purchase of toolings was entered into much prior to the approval of the loan arrangement given by the RBI. Secondly, the consideration related to the capital assets for manufacture of heavy vehicles and plant and machinery. As such, the waiver could not constitute business. As far as the present case is concerned, this is entirely different in as much as it was a loan taken for trading activities and ultimately upon waiver, the loan was retained in business by the assessee.

It is a trite law that the nomenclature given by an assessee to a particular account in its books of accounts is not the sole test to decide the real character of that account. The court of appeals, in the case of *Grafton Hotel Ltd. – 1942 (1) All ER 675-682*, has observed that accountancy is a matter of taste. One assessee may be conservative because of outlook and may well decide the debt payments of Revenue account that they are in their nature proper to be debited to capital account. The Supreme Court in the case of *Hoshiarpur Electric Supply Co. vs. CIT – 41 ITR 608* has observed that the assessee may credit to revenue account what should otherwise have been credited correctly to capital account. Again the Supreme Court in the case of *Punjab Distilling Industries Ltd. V. CIT – 35 ITR 519* has observed that an assessee may credit an amount to capital account what should have otherwise been credited to revenue account. Therefore, it is to be seen that the treatment given to a transaction by an assessee in his books of accounts or his Profit & Loss Account is not decisive of the true nature of the transactions as held by the Supreme Court in the case of *Delhi Stock Exchange Association Ltd. vs. CIT – 41 ITR 495*. The Supreme Court has held in the case of *Kedarnath Jute Mfg. Co. Ltd. vs. CIT – 82 ITR 363* that bad accounting effects neither in favour of the assessee nor against the Revenue. Therefore, the fact that the assessee has credited loan waiver amount in its general reserve does not influence

the process of determining the exact nature of the issue.

The question is the reduction in the liability availed by the assessee on the basis of One Time Settlement Scheme in respect of its outstanding term loans, whether to be treated as taxable income under section 28(iv) or under section 41(1) of the Act. Section 28(iv) seeks to charge the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession, as profits and gains of business or profession. Therefore, what is to be examined is whether the waiver of loan would amount to a perquisite so as to be taxable as such under section 28 of the Act. The Bombay High Court in the case of *Mahindra and Mahindra Ltd. vs. CIT – 261 ITR 501* has considered the very same issue. While rejecting the Revenue's stand, the court explained that section 28(iv) seeks to charge the value of any benefit or perquisite, meaning thereby that the benefit must be in kind whereas the waiver of loan was in cash. Hence, clause (iv) of section 28 was not attracted at all. While arriving at that conclusion, the Bombay High Court in fact referred to the decision of the Gujarat High Court in the case of *CIT vs. Alchemic Pvt. Ltd. – 130 ITR 168*. The Gujarat High Court in the said case has held that the benefit or perquisite arising from business as construed in section 28(iv) would not include cash receipt. The court observed that it is only if the benefit or perquisite is not in cash or money, that section 28(iv) would apply and the question of including the value of such benefit or perquisite as income from business would ever arise. Agreeing with the above ratio laid down by the Gujarat High Court, the Bombay High Court in the case of *Mahindra and Mahindra Ltd. vs. CIT – 261 ITR 501* held that waiver of loan is in respect of money transaction and, therefore, would not be in the nature of any benefit or perquisite as construed in section 28(iv). The court further observed that the loan amount was utilized by the assessee to



purchase machinery and, therefore, it was on capital account and waiver of such capital account liability cannot be treated as on revenue account and cannot be brought to tax, as only the receipts on revenue account would partake the character of income.

In the case of *Mahindra and Mahindra Ltd. vs. CIT* – 261 ITR 501, the assessee was a manufacturer of jeeps. In June 1964, it entered into an agreement with an American company, which agreed to sell to the assessee dyes, welding equipment and dye models, toolings for production of special types of jeeps by the assessee in India. The Government of India approved the import of toolings. Since the assessee could not secure foreign exchange, the American company agreed to provide loan amount to finance the purchase, which was repayable after ten years in installments with interest. Consequently in terms of the approval granted by the Central Government, the assessee received the loan for securing the toolings from the American company. Later on the American company was taken over and as a term thereof it had been agreed to waive the principal amount of loan advanced to the assessee. The assessing authority came to the conclusion that with the waiver of the loan, the credits represented income and not a liability and therefore liable for taxation under section 28 of the Income-tax Act, 1961. The Tribunal held that section 28(iv) was not applicable because benefit of waiver was not received by the assessee in kind. The Tribunal also took the view that even section 41(1) of the Act was not applicable because there was no cessation of trading liability. The findings of the Tribunal have been upheld by the High Court in the above case.

In a recent judgment of the Bombay High Court in the case of *Solid Containers Ltd. Vs. Dy. CIT and Another* – 308 ITR 417 it was held that even the waiver of loan would amount to taxable under section 28 (iv). In that case, the assessee had taken a loan for business purposes, which was written back and thereafter credited to the reserve account as a result of the consent terms arrived at in a suit. The assessee claimed the amount as capital receipt, even though it had offered the interest on the said loan as its income by crediting the same to its Profit



& Loss Account. Dismissing the plea of the assessee, the Tribunal held that loan was taken for trading activity and ultimately upon waiver the amount was retained in the business of the assessee and in substance the amount has become assessee's income, which was assessable. The above decision of the Bombay High Court in the case of *Solid Containers Ltd. vs. Dy. CIT and Another* – 308 ITR 417 is the latest decision when compared to the decision of the same court in the case of *Mahindra and Mahindra Ltd. vs. CIT* – 261 ITR 501. The Bombay High Court in the case of *Solid Containers Ltd. vs. Dy. CIT and Another* – 308 ITR 417 has in fact relied on the decision of the Supreme Court in the case of *CIT vs. T.V. Sundaram Iyengar and Sons Ltd.* – 222 ITR 344.

But it should not be lost sight that the court while delivering its judgment in the case of Solid Containers Ltd. has also considered the earlier decision of the Bombay High Court in the case of *Mahindra and Mahindra Ltd. vs. CIT* – 261 ITR 501, which squarely covered the case discussed. The Bombay High Court took a view different from the view taken in the case of *Mahindra and Mahindra Ltd. vs. CVIT* – 261 ITR 501, after distinguishing the facts of the case in Solid Containers Ltd. In respect of that, the court held as follows:

“ ..... Secondly, the purchase consideration related to capital assets. The toolings were in the nature of dyes and the assessee was a manufacturer of heavy vehicles. The import was that of plant and machinery and the waiver would not constitute business. The facts of the present case are entirely different inasmuch it was a loan taken for trading activity and ultimately, upon waiver the amount was retained in business by the assessee.”

Therefore, it is clear that the High Court while delivering its judgment in the case of Solid Containers Ltd. 308 ITR 417 has not dissented in any way from the earlier decision in the case of *Mahindra and Mahindra Ltd. vs. CIT* – 261 ITR 501. On the other hand, the court further reiterated the ratio laid down in the judgment of Bombay High Court in the case of *Mahindra and Mahindra Ltd. vs.*



*CIT – 26 ITR 501*, that the loan availed for acquiring capital assets, when waived, cannot be treated as assessable income. Therefore, it is not possible to hold that as far as the loan waiver of capital account is concerned, the decision of the Bombay High Court in the case of Solid Containers Ltd. – 308 ITR 417, clashes with the judgment of the same court in the case of *Mahindra and Mahindra Ltd. vs. CIT – 261 ITR 501*.

Now, secondly, one has to examine whether section 41(1) operates against the contentions of the assessee or not. The Supreme Court in the case of *Polyflex (India) Pvt. Ltd. vs. CIT* 257 ITR 2343 has examined the constitution of section 41(1). The court has pointed out that section 41(1) consists of two main ingredients, (a) loss or expenditure and (b) trading liability. The two ingredients of section 41(1), the court held, have to be read independently. As the first ingredient relates to loss or expenditure and the second ingredient relates to remission or cessation of trading liability, the court has categorically ruled that the words "remission or cessation thereof" shall apply only to a trading liability.

Obviously, it is again to be stated that the term loan availed by an assessee on capital account was not in the nature of any loss or expenditure. The Delhi High Court in the case of *CIT vs. Phool Chand Jiwan Ram* (1981) 131 ITR 37 and Bombay High Court in the case of *Mahindra and Mahindra Ltd. vs. CIT – 261 ITR 501* have held that section 41(1) would be applied only if the assessee has obtained any deduction or allowance in respect of any expenditure or loss. If the assessee has not obtained any such allowance or deduction,

section 41(1) would not be attracted at all. The assessee never had the benefit of deduction of the term loan availed by it from the banks on capital account. Therefore, section 41(1) has no application to the facts of the present case.

The High Court of Kerala in the case of *CIT vs. Cochin Co. Ltd.* – 81 CTR 115 has specially held that payments on loan taken to purchase cannot be reduced from the cost of machinery as remission or loss will not amount to remission of depreciation within the meaning of section 41(1). It means remission of capital liability cannot be brought under the purview of section 41(1). In addition to the judgment of the Bombay High Court in the case of *Mahindra and Mahindra*, the decision in the case of *Solid Containers Ltd. vs. DCIT* as well has upheld this position that waiver of amount availed for the purchase of capital assets could not be treated as an item coming under section 41(1).

In the Madras High Court in the case of *CIT vs. Aries Advertising Pvt. Ltd.* – 255 ITR 510, the assessee had transferred unclaimed credits to the general reserve. The credit balances considered by the court in that case were not in the nature of term loans availed for the capital purposes. It is in that circumstances, the court has relied on the judgment of the Supreme Court in the case of *T.V. Sundaram Iyengar and Sons Ltd.* – 222 ITR 344 and held that the credit balances written off and transferred to general reserve could be chargeable as profit under section 41(1). The said decision in no way is applicable.

The decision of the Apex Court in the case of *T.V. Sundaram Iyengar and Sons Ltd.* – 222 ITR 344 – is distinguishable on facts. The decision in the case of *Solid Containers Ltd. vs. DCIT* – 308 ITR 417 is also not applicable to the present case for the reason that the said decision does not differ from the ratio laid down in the decision of the Bombay High Court in the case of *Mahindra and Mahindra vs. CIT – 261 ITR 501*.

### Conclusion

It is submitted that the taxability of the waiver of principal amount of the loan depends on the facts and circumstances of each case. It should be a benefit derived from the business and directly attributable to it. If it is for acquisition of capital assets, then this will be in the nature of capital receipt not liable to tax.

# M&A Deal Documents and Certain Key Deal Covenants

Merger & Acquisition (M&A) deal documents are drafted by legal advisors to the transaction. However, the implications of these documents need to be well understood by a financial advisor to the transaction. Each transaction document has a unique purpose. Further, as an advisor to his client he needs to ensure that the transaction documents best safeguard the interests of his client and are least restrictive in nature. Though the language may be best left to the legal advisors, the essence of each document needs to be sourced from the financial advisors. This article discusses certain important transaction documents and the key clauses that a financial advisor should be aware of.



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**T**oday a Chartered Accountant, as a financial advisor or an investment banker, plays a key role in supporting a Merger & Acquisition (M&A) deal. His role in supporting an M&A transaction starts from identifying an opportunity to successfully executing and completing a successful transaction. Advising a client on the transaction/deal documents is an important part of deal support advisory. The word M&A is used here to include, mergers, acquisition and strategic as well as financial investments by private equity funds.

## Deal Documents

Following is a chronological flow of documents that are executed during a deal:

### Deal Documents

- MoU	- Share purchase agreement	Transfer deeds
- LoI	- Shareholders agreement	Letters/ Agreements to record satisfaction of CPs
- Term sheet	- Business purchase agreement - Transitory agreement	



The above list of documents is not exhaustive. At the same time, not all documents are executed during the lifetime of a deal. The type of document to be executed at execution stage would depend on the structure, tax risks, negotiation and legal requirements and would vary from deal to deal.

Every transaction document is unique to a particular transaction. However, the genesis of each transaction document would be uniform irrespective of the deal.

### I. MoU/LoI/Term Sheet

Memorandum of Understanding, Letter of Intent and Term Sheet are documents entered into when a transaction is initiated. For ease of reference, these set of documents is referred to as 'term sheet' hereinafter. The term sheet is a formal document which details the initial understanding between the parties on the basis of which the transaction is pursued. One of the primary motives of this document is to ensure exclusivity for a predefined time frame. The provisions of a term sheet are non-binding in nature except for the confidentiality which generally is binding in nature. The term sheet is a precursor to the Share Purchase Agreement (SPA).

A term sheet would typically include –

1. **Transaction rationale** – The purpose why the buyer/investor is pursuing the transaction and the end use of the funds. Often this may not be directly expressed in clear words, but the transaction rationale can be deduced from a term sheet.

2. **Tentative deal structure & valuation** – The investment instruments i.e. debt/preferred stock/equity and the exercise price. Sometimes a term sheet may be entered into after the price has been fixed and is binding. In such cases, the price is only subject to any due diligence findings. Exit options are also detailed in the term sheet i.e. whether the exit will be through an IPO and by which year, failing which what rights will be available to the investor, etc.

3. **Equity stake** – Proceeds that would be transferred to the seller/infused in the company and the resultant equity transferred to the buyer/investor. The equity stake could also be pegged to a formulae i.e. based on profits/operational parameters, etc. in which case the formula is clearly mentioned.

4. **Rights & Obligations of the parties** – Voting rights, right of first refusal, drag along rights, tag along rights etc. This clause will detail representations made by the parties.

5. **Exclusivity** – The target company (i.e. acquired/investee company) agrees not to pursue any other potential investor/buyer during the agreed 'exclusivity period'.

6. **Conditions of closing** – This part details the way forward viz. consultants to be hired, documents to be executed, compliances to be obtained and any other material conditions to be satisfied prior to closing the transaction.

The term sheet is an indicator of the seriousness of the investor/buyer and the investee/seller. Hence, once a term sheet is signed, the proposed investor/ buyer would undertake a financial, business, tax, and legal due diligence on the investee/target company. Sometimes the due diligence starts even before the conclusion of the term sheet. If subsequent to the due diligence, the investor decides to go ahead with the investment, then the terms agreed upon in the term sheet would form the basis of the share subscription agreement or a share purchase agreement.

### II. Share Purchase Agreement (SPA)

The SPA is a definitive agreement to the transaction. It is a binding document that prevails over all other documents that the parties would have entered into, including the term sheet. The SPA is an indicator of closure of negotiations between the parties to the transaction. The SPA is a culmination of the entire negotiation that takes place between the parties and is prepared with

respect to advice/recommendations from various consultants on the deal.

The SPA, among other items, would typically include the following –

1. *The subject of the transaction & the structure* – what is it that is transferred? The SPA will, in clear terms, indicate what is being sold and what is being purchased i.e. sale of shares, sale of certain assets, trademarks, etc.
2. *Consideration* – this is the final price that is payable to the target company/seller.
3. *Payment mechanism* – including the mode of payment i.e. whether the payment will be made in cash, or shares or in kind, etc. This clause also covers earn-outs, escrow, contingent payments, etc.
4. *Representations/Warranties/Indemnities (RW&I)* – The SPA details the RW&Is made by each of the parties. This is a vital section of the SPA. This section generates most of the negotiation points before the SPA is finalized. This is a culmination of a 'give & take' between the parties. Each of the parties negotiates hard to ensure that this section is least restrictive on them. These terms are elaborated later in this article.
5. *Conditions precedent* – these are conditions that need to be satisfied after the SPA is executed but before the consideration is paid/funds are infused/business is transferred.
6. *Conditions subsequent* – these are conditions that need to be satisfied subsequent to execution of the SPA and after the funds are infused/consideration is paid/business is transferred.
7. *Exit mechanism (in case of an investment deal)* – This clause in clear words details the exit options that the investor can exercise while also mentioning the investment horizon. Generally there is a lock-in period, post which the investor has the option to sell his stake.
8. *Other clauses* – include non-compete, specific disclosures, etc.

Thus the SPA is a binding document, which

**Memorandum of Understanding, Letter of Intent and Term Sheet** are documents entered into when a transaction is initiated. These are formal documents which detail the initial understanding between the parties on the basis of which the transaction is pursued. One of the primary motives of these documents is to ensure exclusivity for a predefined time frame.

exhaustively details the understanding between the buyer/investor and target/ investee company.

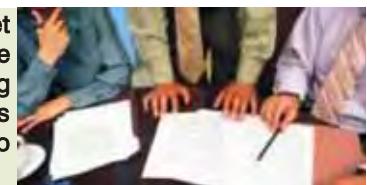
### III. Other Deal Documents

Apart from the term sheet and SPA, there are other documents which are also entered into –

1. ***Shareholders agreement*** – It enlists the rights and duties of the new shareholders post the transaction. This is similar to a SPA and is used in case of new joint ventures or equity investments.
2. ***Business Purchase Agreement (BPA)*** – Business Purchase agreement is similar to a SPA except that a BPA is entered into when a business unit/division of the company with its assets and liabilities is sold. An SPA is executed where there is a stake sale instead of an entire business sale.
3. ***Asset Purchase Agreement (APA)*** – Asset Purchase agreements are entered into when only a part of the business i.e. a group of assets is transferred/sold to the buyer. This document is also used instead of a BPA, where the transaction has been specifically structured as an 'asset sale' instead of a 'business sale' to be more tax efficient.
4. ***Transitory Agreement*** – This agreement is specifically entered into in case of carve-outs where only part of the company is carved out and transferred under the transaction. This agreement primarily includes the support that the carved out entity would be provided by the parent entity with respect to management, common assets, etc. during a specified period referred to as the 'transition period'.
5. ***Transfer Documents*** – These are the documents executed to transfer assets, licenses, registrations, technology, trademarks, copyrights, etc. to the buyer. These are registered documents evidencing the transfer of ownership of assets from the seller to the buyer.

### Key Deal Covenants / Terms

There are certain key covenants/terms that find





**The Share Purchase Agreement (SPA)** is a definitive agreement to the transaction. It is a binding document that prevails over all other documents that the parties would have entered into including the term sheet. The SPA is an indicator of closure of negotiations between the parties to the transaction. The SPA is a culmination of the entire negotiation that takes place between the parties and is prepared with respect to advice/recommendations from various consultants on the deal.

place in the deal documents above. It is essential that a financial advisor is aware of these covenants and the implications that they have on the transaction. These covenants are an important and integral part of any deal. Their usage in a deal document depends on the negotiating skills of either party to the transaction. These covenants are briefly explained below -

#### 1. Debtfree Cash free

This term is generally used as a condition to transfer of business/company. It indicates that the transferor/seller will assume the entire debt and cash of the business/company so that it is transferred without any debt obligation (including the related encumbrances) or cash. It indicates that the exiting shareholders will assume the debt and cash or it will be cleared from available resources of the business/company, before the business/company is transferred/sold.

#### 2. TagAlong Rights

These are a contractual obligation used to protect a minority shareholder. Basically, if a majority shareholder sells his stake, then the minority shareholder has the right to join the transaction and sell its minority stake in the company. It is also referred to as "co-sale rights". Tag-alongs effectively oblige the majority shareholder to include the holdings of the minority holder in the negotiations in order to facilitate the possibility that a tag-along right is exercised. This enables the minority shareholder to sell its stake on the same terms which are available to the majority shareholder for its stake sale, which otherwise would not have been possible for the minority shareholder to negotiate given his smaller size of stake.

#### 3. Drag Along Rights

These are the rights that enable a shareholder (majority or a minority with special rights) to force another shareholder to join in the sale of a company. This is a right provided to a

shareholder to drag along the other shareholders so that the intending purchaser can acquire a controlling stake in the company. The owner doing the dragging must give the other shareholder the same price, terms, and conditions as any other seller.

In case of a buyer who proposes to have complete control of a company, drag-along rights help to eliminate minority owners and sell 100% of a company's securities to the buyer.

#### 4. Non-Compete

'Non-compete' clause, or 'covenant not to compete', is a term under which one party (usually the seller/exiting key management) agrees to not pursue a similar profession or trade in competition against another party (usually the buyer) for a specified period. This is used wherein the existing promoters/management exit the transferred/sold business/company. This right protects the interest of the buyer against any competing business that the exiting promoter/management may start. 'Non-compete' clause may relate to a geography or business vertical or product or specific time period.

#### 5. Right of First Refusal

Right of first refusal (ROFR) is a contractual right that gives the holder of the right an option – before any others – to accept or reject an offer to buy shares held by another shareholder. For example, in case of a joint venture, each of the co-venturers may have a right of first refusal against the other for any future stake sale to a third party.

#### 6. Closing Date

Closing date is the date of the final event to complete the transaction, at which time the business/shares is/are transferred and funds are transferred subject to a set of conditions. It may/may not be the date on which all the legal documents are signed. In case of a business sale, the assets and liabilities are deemed to be transferred on the closing date.

## 7. Signing Date

Signing date is the date on which all the definitive agreements (including the SPA) that signify the transfer of business/shares are signed.

## 8. Conditions Precedent

An event which must take place before the title (or right) to the business is transferred i.e. before the closing date. Generally, the key terms of the agreement are not enforceable before the conditions precedent are satisfied. This would include, among other things, the transfer of certain licences/trademarks in the name of the buyer, physical verification of assets, etc.

## 9. Conditions Subsequent

It is an event which must take place within a specified period after the title (or right) to the business is transferred i.e. after the closing date. This would include intimation to stock exchange in case a listed entity is involved, appointment of management personnel, etc.

## 10. Representations

Representation is a statement of fact (not intention) made by one party to another, such that they enter into a contract placing reliance on these facts. There are various sets of representations made by the buyer/investor and seller/target company to each other, which are documented as basis to the transaction. For example, the seller may represent to the buyer that the financials used for the purpose of valuation are prepared under generally accepted accounting procedures.

## 11. Disclosure Schedule/Disclosures

The Schedule of Exceptions, or Disclosure Schedule, is a document that enlists disclosures in terms of documents, facts, representations, warranties, etc. This is to protect the issuer against subsequent recriminations and litigation.

## 12. Indemnities

Indemnity is the right to receive compensation from another for a loss paid. Indemnity permits the indemnified to effectively escape the

burden of paying for the liability incurred. For example, the seller may indemnify the buyer for any claim with respect to undisclosed past disputes that may have to be settled by the buyer.

## 13. Warranties

A warranty is a contractual statement by one party to the other party that certain facts or conditions are true or will happen; the other party is permitted to rely on that assurance and seek some type of remedy if it is not true or followed. For example, in a business sale the seller may warrant to the buyer that all receivables are good and collectible.

## 14. Earn Out

It is an arrangement where a part of the purchase consideration is calculated by reference to the future performance of the business being purchased/invested in. This is commonly referred to as a management incentive where owner-managed businesses are sold/invested in and the managers continue to work in the business following the sale/investment. This earn out structure ensures that the owner/management interests are tied to the performance of the business. This structure is widely followed where the new buyer may extensively rely on the owner/ management for the performance of the company in the near future. The earn out is spread over the transition period, so that the exiting owner/management gets the entire purchase consideration when the new buyer is ready to manage the company independently.

## 15. Hold Back

An arrangement where a part of the purchase consideration is only paid by the buyer to the seller upon the occurrence of a contingency or the fulfilment of a condition or conditions in a contract. In case the condition is not fulfilled or the contingency does not happen, the consideration is not payable. For example, part of the consideration may be held back in an asset sale transaction, till it is technically established that all assets are in working condition.

**It is essential that a financial advisor is aware of these covenants and the implications that they have on the transaction. These covenants are an important and integral part of any deal. Their usage in a deal document depends on the negotiating skills of either party to the transaction. These covenants include 'debt free Cash free', 'tag along rights', 'non-compete clause', 'right of first refusal', etc.**





The universe of deal covenants cannot be delineated. As the deal structures get more exotic, more and more deal covenants find place in the deal documents. Many a time the structure of the deal also decides the binding deal document to be used. Sometimes the transaction may be structured as an 'Asset sale' rather than a 'Business sale' to make it more tax efficient.

## 16. Escrow

Escrow is a legal arrangement in which the consideration for the transfer of business/shares is delivered to a third party (called an escrow agent) to be held in trust pending a contingency or the fulfilment of a condition or conditions in a contract. Upon that event occurring, the escrow agent will deliver the consideration to the proper recipient, otherwise the escrow agent is bound by his or her fiduciary duty to maintain the escrow account.

Few circumstances where this structure is used include (i) deals where there are certain conditions precedents which need to be complied and the purchase consideration is kept in escrow until these conditions are fulfilled; (ii) deals where there are perceived outflows/losses in the nature of undisclosed past liabilities or bad debts, etc. which are adjusted from the purchase consideration; or (iii) deals where earn out or hold back structures are followed.

## 17. Completion Accounts

These are accounts of the target company drawn up at or shortly after completion of the acquisition which will form the basis for determining the final amount of consideration payable under the share or asset purchase agreement.

They may take the form of a full profit and loss account and balance sheet, a balance sheet alone, a net assets statement or just a valuation of a specific asset. The seller and buyer generally set out in a schedule to the acquisition agreement the principles on which the accounts are to be drawn up and also specify who should prepare them, who should bear the cost of their preparation and how to resolve any disputes.

## Conclusion

The covenants mentioned above are only inclusive and not exhaustive. Covenants with

respect to valuation, price consideration computation, multiples, etc. do not find a mention above. The universe of deal covenants cannot be delineated. As the deal structures get more exotic, more and more deal covenants find place in the deal documents. Many a time the structure of the deal also decides the binding deal document to be used. Sometimes the transaction may be structured as an 'Asset sale' rather than a 'Business sale' to make it more tax efficient.

When the parties sit across the table there are various covenants that get added and various covenants that get dropped before the SPA is finalised. The usage of covenants would depend on the negotiating skills of the parties represented by their financial advisors.

Hence, it is very important that a financial advisor is aware of most of the deal covenants that can be used in a deal document. Negotiation on the deal documents is a very time consuming process and various versions of the understanding between the parties in the form of deal documents are exchanged before the final deal documents are agreed upon and signed.

The financial advisor needs to use his knowledge about the deal and advice received from various consultants to ensure that his client's interest is always protected when framing the deal documents. There are certain clauses that are relevant at the time of an exit viz. tag along and drag along rights. The implications of these exit covenants may be difficult to comprehend at the time of the investment. Hence, it is important for the financial advisor to be extremely clear as to the client's transaction rationale.

Not all buyers/investors are savvy when it comes to comprehending the implications of certain key clauses in the deal document. That is when a financial advisor needs to simplify and decode the implication of a covenant for his client.

A clear and comprehensive deal document lays a sound foundation for a good investor – investee relationship on a go forward basis.

# Feasibility Study— A Widening Approach



A well-researched and well-written feasibility study uncovers the information related to "Go/No Go" decisions regarding entry into new businesses. Now, when the world economy is reeling under the impact of financial crisis, the world stock markets have fallen, large financial institutions have collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems, the role of financial analyst and business consultants has become more complex and widened towards risk assessment and risk management during feasibility study of any upcoming project in any industry. The article explores the concept.



**CA. Anjusha Gupta**

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In today's complex business environment, a feasibility study before entering any business assumes paramount importance. Such a study is crucial in arriving at "Go/No Go" decisions. If a proposed venture is seen to be feasible from the results of the study, the next logical step is to proceed with it.

On the conventional side, the feasibility studies had a short term vision. It was concentrating only on the current scenarios to check the financial viability of the proposed venture with very limited scope for sensitivity analysis. For example, when the world economy was booming and sensex was touching new heights every day with oil prices hovering over \$135 per barrel, developing a real estate project was an excellent leveraged investment and a most feasible project but now it has been proved to be an investment bubble only.

Now, when the world economy is reeling under the impact of financial crisis, the world stock markets have fallen, large financial institutions have collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems, the role of financial analyst and

business consultants has become more complex and widened towards risk assessment and risk management during feasibility study of any upcoming project in any industry.

Together with their experience and analysis of current trends, the analysts should guide through the steps of understanding the environment in which a business operates, identifying, analyzing and evaluating risks, and finally providing options to overcome the related risks. They should include all the possible identified risks in the study to provide a probability as to how much the project is feasible in all variable situations, what the business strategy for all identified risks would be and how much it will be cost effective. In this way, the feasibility study will work as a ready - reckoner for all identified risks. Financial projections and sensitivity analysis of key factors should provide a base line or budget for the project.

Risk is inherent in life. Everything we do involves a risk. A business owner chooses to take risks through opening a new venture or extension of existing project. The more complex the business, the more important it is to identify risks. But it is also relevant to say that risk identification and management is not simply a one-time exercise which could be completed at the time of business planning only: it is an ongoing journey towards better business practice and for success of the business venture that help businesses in realizing its potential and in managing them in order to minimize adverse outcomes and maximize positive outcomes.

A complete feasibility study identifies in advance all the possible risks and contingencies and the types of risks. The likelihood and consequences of an unwanted outcome from those risks vary with the circumstances and have an impact on the business decision as to whether to go ahead for the project or not.

*"The first step in the risk management process is to acknowledge the reality of risk. Denial is a common tactic that substitutes deliberate ignorance for thoughtful planning." —Charles Tremper*

In general, while preparing a feasibility study, consultants should identify the risk in following areas:

### PESTEL Risk Analysis

There are many factors in the macro-environment that affect the viability of any proposed venture. Tax changes, new laws, trade barriers, demographic change and government

policy changes are all examples of macro change. An analyst should analyze these factors using the PESTEL model.

For some such as pharmaceutical companies, government regulation may be critical. If the project is related with alcohol industry and in future if government policy changes towards the industry then project will not be feasible even if there is demand. An export-oriented project is feasible only if there is political stability in the country. Thus analysts should have a good insight into the economy and the possible effects of economic change on an upcoming project. These must be considered in the light of other macro and micro factors that influence a project's feasibility decisions and success.

### Industry Risk Analysis

Industry risk analysis begins by focusing on the status of an industry or an industrial sector. Here, the analysts should take an in-depth look into the industry in which the particular project will work and point out the direction of industry-specific resources.

The primary area that the feasibility study needs to address is potential market opportunities for the product or service. If an adequate level of demand does not exist for the product and the businessman does not know how to differentiate its product so that it can compete with established industry players, then the proposed venture should not be pursued.

Through intensive research activities such as market surveys primarily related with the specific industry, analysts should develop realistic estimates of the projected demand for the proposed



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**Through intensive research activities such as market surveys primarily related with the specific industry, an analyst should develop realistic estimates of the projected demand for the proposed product for the first several years of operation. Based on this projected demand, he can determine its anticipated level of business volume, which is needed in order to design the processing facilities. If the projected business volume is not large enough to justify a processing facility, then the project is not feasible.**



product for the first several years of operation. Based on this projected demand, they can determine its anticipated level of business volume, which is needed in order to design the processing facilities. If the projected business volume is not large enough to justify a processing facility, then the project is not feasible.

### Competitors Risk Analysis

This section of the feasibility study was initially intended to have a look at the number, size, and position of competitors that already exist in the market and how the new project will plan to position its business for success. But in current scenario, visionary analysts should identify the risk to the business from a new upcoming local competitor also. If the analysts are doing a feasibility study for a big hotel then they should consider the risk of opening another hotel in the same strategic location.

"Make your product easier to buy than your competition, or you will find your customers buying from them, not you" --MarkCuban

This process is found to be extremely difficult. Generally, hundreds of competitors already exist in the market. Particularly, the challenge of identifying the risk from new upcoming competitors is not an easy task. It is important to study that if a new competitor emerges in the market, how the proposed venture will market its product to up-sell and cross-sell opportunities to grow existing customers to achieve sustainable and profitable growth in a recessionary economy.

### Trend Risk Analysis

"At a time, when all the other builders were selling homes with basements but without

carports, we would sell homes without basements and with carports. This allowed us to provide a more appealing product at a lower price. In other words, we felt we would be giving customers greater value." --Eli Broad

Trend Risk Analysis is based on customers' purchasing habits. When the fall-out of the recession becomes more visible in 2009 and 2010 the way we do business with our customers or consumers of our service will change forever.

Analysts will have to examine that the proposed venture will transact their business by following only the existing prevailing trends or will they adopt very new strategies to win consumer confidence. To win life-time loyalty of customers for guaranteed survival will be more than a challenge. Analysts need to think about the factors which are most likely to change and which ones will have the greatest impact on them.

Behaviour texts are now out of date. The economy needs a much bigger shift to ignite the circular flow of income from customers to suppliers of services and goods. Consumption changes with tastes, trends, fads and emotions. Businessmen should be aware that there are key emotions that drive customer loyalty and purchasing decisions. This is true whether you are opening a candy bar or developing a high profile real estate property.

It does not matter which area of the industry analysts are studying. They must note that changes in the consumption of food, leisure services, basic retail goods, white goods and automotive products is changing and will keep changing forever.

### Company Analysis

Moving forward, during the company analysis, analysts should review the promoters' background, their past experience towards running the industry, their past successful ventures, their capabilities, capital requirements, source of capital, availability of raw material, labour, etc.

Each business has the key factors in their own internal environment. In a more widening approach, analysts must identify those key factors which are most likely to change and which ones will have the greatest impact on the viability of the proposed venture.

If a project requires some technical know-how and only one partner of the business has this technical knowledge then that partner is the key factor for the business. Feasibility of the project will solely depend on that partner. Analysts should not

ignore the fact that if the partner quits from the business then the proposed venture will be able to sustain its existence.

For firms that are going to borrow heavily, interest rate changes may be a huge issue. An analyst must decide on the relative importance of various factors and one way of doing this is to rank or score the likelihood of a change occurring and also rate the impact if it did. The higher the likelihood of a change occurring and the greater the impact of any change the more significant this factor will be to the success of proposed venture.

### Conclusion

Even with a positive detailed look at the risk analysis, analysts should not be positive about the prospect of the projects' succeeding in the marketplace. Businessmen should remember that there are going to be bumps



along the way. It is very important to make this discovery at the start-up point in the development. With this additional research, however, they will be able to identify potential roadblocks and create a plan in advance to deal with them.

*Take calculated risks. That is quite different from being rash"—General George S. Patton*

**Even with a positive detailed look at the risk analysis, an analyst should not be positive about the prospect of the projects' succeeding in the marketplace. A businessman should remember that there are going to be bumps along the way. It is very important to make this discovery at the start-up point in the development. With this additional research, however, the businessman will be able to identify potential roadblocks and create a plan in advance to deal with them.**

### ICAI NEWS

## Payment of Annual Membership/Certifacate of Practice Fee for the Year 2009-10

The annual Membership and Certificate of Practice fees (if member holds certificate of practice) became due and payable on 1<sup>st</sup> April, 2009. Circulars advising members to pay the membership/certificate of practice fee were sent to individual members in the month of April, 2009 followed by a reminder in August 2009. An announcement to this effect was published in May, 2009 and August 2009 issues of the Journal and also hosted on website [www.icai.org](http://www.icai.org).

Attention of all those members who have still not paid the annual membership fee/certificate of practice fee by 31<sup>st</sup> August, 2009 is invited to pay the fees immediately so as to reach the concerned Regional Office before 30<sup>th</sup> September, 2009.

The non-payment of annual membership/certificate of practice fee will have the following consequences:

- i) The member will not be eligible to use designatory letters 'CA.' as a prefix to the

name and 'ACA'/'FCA' and designation 'Chartered Accountant'.

- ii) A member in practice will cease his right to practise as a Chartered Accountant.
- iii) Such a member will not be eligible to train articled/audit assistant already receiving training under him.
- iv) The member will not be eligible to train any new articled/audit assistant.
- v) Such a member will not be eligible to carry out audit/certificate/attest and other functions in view of (i) & (ii) above.

For, any other clarification, members are advised to contact the concerned Decentralized Offices of the Region.

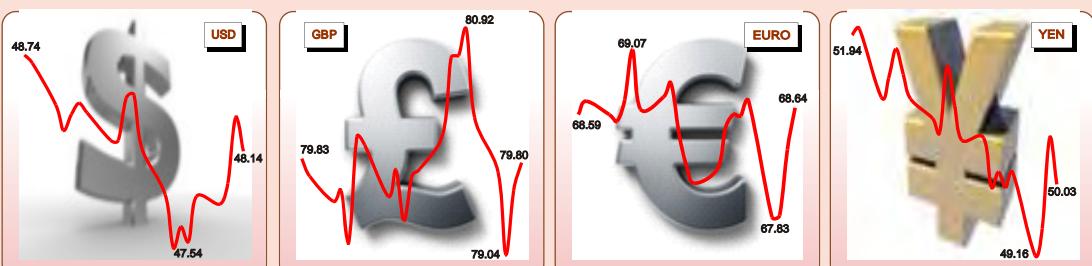
Please pay your membership fee and avoid unwanted removal of your name.

**"HELP US TO SERVE YOU BETTER"**

# Economic Indicators



Indian Rupee vs. Major Foreign Currencies (July 16, 2009 to August 13, 2009)



## Stock Markets



## Selected Indicators

Item	Unit/Base	2008		2009					
		July 25	June 19	June 26	July 3	July 10	July 17	July 24	
Cash Reserve Ratio	per cent	8.75	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	12.75-13.25	11.00-12.25	11.00-12.25	11.00-12.00	11.00-12.00	11.00-12.00	11.00-12.00	
Deposit Rate	Per cent per annum	8.75-9.00	6.50-8.00	6.50 - 8.00	6.50 - 8.00	6.50 - 8.00	6.50 - 8.00	8.50 - 8.00	
Call Money Rate (Low/High)	Per cent per annum	5.80/10.25	1.00/3.35	1.00/3.40	1.00/3.35	1.25/3.30	1.50/3.35	1.75/3.30	

Note: Readers are Invited to contribute write-ups or any relevant and interesting piece of information for this feature at [eboard@icai.org](mailto:eboard@icai.org).

# ACCOUNTANT'S BROWSER

## "PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE"

**Index of some useful articles taken from Periodicals received during July-August 2009 for the reference of Faculty/Students & Members of the Institute.**

### **1. ACCOUNTING**

Generating Good Profitability Information: Accounting Systems Can Reveal the True State of Electricity Profits by P. V. Dunmore etc. *Chartered Accountants Journal*, July 2009, pp.36-39.

Linking Accounting Systems With Business Valuation by K.E. Dow etc. *Journal of Information Systems*, Spring 2009, pp.119-136.

Structural Shifts in the Current Account of India's Balance of Payments by Bhupal Singh. *Margin*, Vol.3/2, 2009, pp.133-171.

The Value Relevance & Reliability of Reported Goodwill & Identifiable Intangible Assets by Firas N. Dahmash etc. *The British Accounting Review*, Vol.41, 2009, pp.120-137.

### **2. AUDITING**

Fraud Catcher: Forensic Accounting Experts Expect Already Record Corporate Fraud Levels to Rise as the Economic Downturn continues to Bite by Michael Laurence. *Intheblack*, July 2009, pp.22-25.

Internal Audit: A Comfort Provider to the Audit Committee by Gerrit Sarens etc. *The British Accounting Review*, Vol.41, 2009, pp.90-106.

Investigation of Factors Influencing the Use of Computer-Related Audit Procedures by Diane Janvrin etc. *Journal of Information Systems*, Spring 2009, pp.97-118.

Peer Review – Audit of Auditors Work? by B.K. Patel. *ACAJ* 2009, pp.134-139.

Protection for Auditors – An Impossible Dream? *Accountancy*, May 2009, pp.26-27.

Tax Evasion or Fraud: Same Difference? by Vern Krishna. *CGA Magazine*, July-August 2009, pp.54.

### **3. ECONOMICS**

Higher Education Policy in India: Emerging Dichotomies in an Era of International Economic Crisis by K.S. Chalam. *University News*, July 27 to Aug. 02, 2009, pp.1-4.

Quick Estimates of National Income, 2007-08 & Revised Estimates of National Income, 2008-09: A Review.

RBI Bulletin, July 2009, pp.1123-1140.

Risk-Based Capital for Life Insurers Implications for India by Ashvin Parekh. *IRDA Journal*, July 2009, pp.14-16.

Special Economic Zones (SEZs): Boon or Bane? by B. Mohan & P.V. Narasaiah. *Banking Finance*, July 2009, pp.21-23.

### **4. INVESTMENT**

The Agency Cost Effects of Unionization on Firm Value by Vic Naiker etc. *Journal of Management Accounting Research*, Vol.20, 2008, pp.133-152.

Corporate Brand Valuation – A Global Perspective by M. Yadagiri & R. Sridhar. *The Management Accountant*, July 2009, pp.545-549.

Dubious Role of Credit Rating Agencies by J.P. Sharma. *Chartered Secretary*, July 2009, pp.911-918.

Effects of Expanded Independent Assurance on the use of Firm-Initiated Disclosures by Investors with Limited Business Knowledge by Robert Pinsker & Patrick Wheeler. *Journal of Information Systems*, Spring 2009, pp.25-49.

Effects of Inter-Firm Cost Correlation, IT Investment, & Product Cost Accuracy on Production Decisions & Firm Profitability by Carolyn M. Callahan etc. *Journal of Information Systems*, Spring 2009, pp.51-78.

Knowledge Management Valuation by Ashvine Kumar etc. *PR Communication Age*, July 2009, pp.5-10.

Securities Laws: Foreign Institutional Investors & Role of SEBI by Rahim Ubwani. *SEBI & Corporate Laws*, July 20-26, 2009, pp.63-70.

### **5. LAW**

Confirmation of Minutes Not Necessary – Affirms Supreme Court by S.D. Israni. *Chartered Secretary*, July 2009, pp.898-904.

Consumer Protection Act & the Legal Profession by Ashish Kumar Goel. *Company Law Journal*, Vol.3, 2009, pp.22-26.

Evolution & Justification of Patent Regime in India by M.K. Matolli. *CLC*, Vol.7, 2009, pp.292-296.

Independent Directors – Corporate Governance in Challenging

Times by Deepak Ghaisas. *BCAJ*, July 2009, pp.13-16.

International Competition Agreement: Analysis of Relevance & Existence by Karn Gupta. *CLC*, Vol.7, 2009, pp.257-283.

Right to Education Act: A Comment by Vimala Ramachandran. *Eco. & Pol. Weekly*, July 11, 2009, pp.155-156.

### **6. MANAGEMENT**

Business Process & Improving Knowledge Work Processes by Hafiz Faruqi. *Accountants Today*, July 2009, pp.18-21.

Ethical Exposure in Practical Training by M.M. Saat & R.A.R. Ahmad. *Accountants Today*, July 2009, pp.14-16.

Management Accounting Research in a Changing World by Anthony G. Hopwood. *Journal of Management Accounting Research*, Vol.20, 2008, pp.3-13.

Performance Measurement System Design in Joint Strategy Settings by Anne M. Lillis & Paula M.G.V. Veen-Diks. *Journal of Management Accounting Research*, Vol.20, 2008, pp.25-57.

Relating Supply Chain Management & Information & Communication Technology: Challenges by D. Ghose. *The Management Accountant*, July 2009, pp.537-541.

Top Business Tips for Tough Times by Gavan Ord. *Intheblack*, July 2009, pp.36-43.

Update on Small Business & Financial Reporting Committees by Linda Devonish-Mills. *Strategic Finance*, July 2009, pp.17-18+63.

What Every CEO Should Know About Creating New Businesses by David A. Garvin. *Business Today*, July 26, 2009, pp.100-104.

### **7. TAXATION & FINANCE**

Service Tax is Not Applicable to Chit Fund Business by Jose Pottokaran. *Service Tax Today*, July 24-30, 2009, pp.79-86.

Taxes in Troubled Times: Explore Strategies That Can Help Ease the Pain of the Down Economy. *Journal of Accountancy*, April 2009, pp.36-38.

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

#### ► 'Cut-off Date for Resolving I-T Issues Arbitrary'

The Bombay High Court has ruled that the cut-off date for resolving matters of tax evasion and complex tax transactions before the Settlement Commission was arbitrary. About 500 applicants had moved the court challenging the provision of the Finance Act 2007. According to the provision, the Commission had to resolve matters that were pending till July 1, 2007, by March 31, 2008. The Commission also had the power to grant immunity from prosecution and penalty to such applicants. The Finance Act, 2007, however, to streamline the proceedings before the Commission, imposed a deadline for issues to be resolved failing which the pending cases would become redundant.

**Source:** <http://economictimes.indiatimes.com>

#### ► Law to Tax Companies Routing Investments via Tax Havens

The Government is mulling new laws to bring into the tax net domestic companies which deliberately route their overseas investments through tax havens to avoid paying taxes at home. The inclusion of new provisions in the existing tax laws, called Controlled Foreign Corporation (CFC) laws, was also suggested by the Kelkar Task Force on tax reforms, said a senior finance ministry officer. In view of a spurt in overseas investment by Indian companies, it has become necessary to frame CFC laws to prevent loss to the exchequer, the official said, adding that several developed countries such as the US, the UK and Germany have similar laws. India, however, is still debating on the modality of the CFC, though the Kelkar report, submitted to the Government six years ago, had recommended "introduction of anti-abuse provisions in the domestic law, enacting of CFC regulations and the law relating to thin capitalisation." The advantage of having CFC laws, the official said, is that it will not be affected by the Double Taxation Avoidance Agreement (DTAA).

**Source:** <http://www.hindustantimes.com>

#### ► Payment to MDs Not to Attract Service Tax: CBEC

The government has clarified that payments made to Managing Directors and Directors of companies would not call for service tax. "Remunerations paid to the Managing Directors/ Directors of companies whether whole-time or independent when being compensated for their performance as Managing Director/ Director would not be liable to service tax," the Central Board of Excise and Customs has said in a circular. Meanwhile, the circular also clarified on the consultancy and advisory services given by the MDs of companies.

**Source:** <http://www.timesofindia.com>

#### ► Tax Shadow on Foreign Arms' Dividend

Undistributed dividends of foreign corporations controlled or owned by Indian companies will be taxed in the near future, said income tax (I-T) department sources. Most countries have Controlled Foreign Corporation (CFC) laws that enable authorities to levy such taxes. These laws effectively check the governments' revenue loss due to the transfer of undistributed dividends to offshore tax havens like Isle of Man, Cayman Islands and Mauritius. Indian tax authorities, for long, have maintained that there is a need to have a similar law here. Tax experts say it will be difficult for the government to refrain from introducing such a legislation as there is a substantial flow of outbound investments from India. "We should tax the undistributed dividend of the foreign corporations owned by Indian companies. It does not matter if the dividends are brought to India or not. Tax for this has to be paid here since the resources for making these cross-border acquisitions are mobilised from India," said a senior I-T department official, who asked not to be named.

**Source:** <http://www.ca-india.org>

#### ► Industrial Capex to Grow Despite Slowdown: CRISIL

Aggregate industrial investments would continue to grow at a moderate pace over the next three years, with total investments projected at Rs 10,500 billion. This growth is notwithstanding the current economic slowdown and expectations of relatively muted GDP growth, according to a CRISIL (Credit Rating Information Services of India Limited) study.

**Source:** <http://economictimes.indiatimes.com/News/>

#### ► Tax Exemption Cost the Govt. Rs 4.2 Lakh Crore in 2008-09

The government lost a whopping Rs 4.2 lakh crore in 2008-09 as revenue foregone on account of various tax exemptions, a sum almost equivalent to the budget deficit for the current financial year. This probably forms the basis of the proposed withdrawal of tax incentives as recommended in the Direct Tax Code released by the Finance Ministry.

**Source:** <http://timesofindia.indiatimes.com/>

### ► Financial Instruments Round Tables

In September 2009, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) will hold joint round-table discussion in North America, Asia and Europe on their proposals for financial instruments. Round tables will be held in North America, Asia and Europe. The IASB and the FASB have been separately considering the appropriate model for classification and measurement of financial instruments with an ultimate goal of achieving a common outcome. The round tables will discuss the alternative approaches proposed by the IASB and the FASB. An audio of the discussions will be made available on the website after each round table.

**Source:** <http://www.iasb.org/News/>

### ► IASB Publishes Proposals on the Classification of Rights Issues

The (IASB) has published for public comment proposals on the classification of rights issues. The proposals seek to clarify the accounting treatment when rights issues are denominated in a currency other than the functional currency of the issuer. Introducing the exposure draft, the Chairman of the IASB said, "the IASB continues to give priority to its work related to the global financial crisis." The proposals in the exposure draft *Classification of Rights Issues* are open for comment until September 7, 2009, on [www.iasb.org](http://www.iasb.org). After considering comments, the IASB plans to issue the final amendment before the end of 2009.

**Source:** <http://www.iasb.org/News/>

### ► IFRIC on Settling Financial Liabilities with Equity Instruments

The International Financial Reporting Interpretations Committee (IFRIC) has published for public comment a draft Interpretation, IFRIC D25 (IFRIC) *Extinguishing Financial Liabilities with Equity Instruments*. The IFRIC was asked for guidance on how an entity should account for such transactions in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 32 *Financial Instruments: Presentation*. According to the proposal, the entity's equity instruments are part of any 'consideration paid' to extinguish the financial liability, and the equity instruments are measured at either their fair value or the fair value of the financial liability extinguished, whichever is more reliably determinable. This draft Interpretation is freely available on the IASB website and is open for comment until October 5, 2009.

**Source:** <http://www.iasb.org/News/>

### ► Financial Crisis Advisory Group Publishes Review of Standard-Setting Activities Following Global Financial Crisis

The Financial Crisis Advisory Group (FCAG), a group having experience in international financial markets, has published its recommendations related to accounting standard-setting activities, and other changes to the international regulatory environment following the global financial crisis. The FCAG was formed at the request of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) to consider financial reporting issues arising from the crisis. The report of the FCAG has addressed on effective financial reporting, limitations of financial reporting, convergence of accounting standards and standard-setters' independence and accountability.

**Source:** <http://www.iasb.org/News/>

### ► IAASB's Q&As for Auditors' Implementation of Clarified ISAs

To assist auditors worldwide in implementing the clarified International Standards on Auditing (ISAs), the International Auditing and Assurance Standards Board (IAASB) has developed a new question-and-answer publication, *Applying ISAs Proportionately with the Size and Complexity of an Entity*. The publication will be of particular help to those who audit or oversee the audits of small- and medium-sized entities (SMEs). James Gunn, IAASB Technical Director, said, "SMEs are an important sector of national economies and one that is sensitive to significant changes in standards." The publication explains how the design of the ISAs enables them to be applied in a manner that is proportionate to the specific characteristics of the entity subject to audit. The publication is available for free download from the IFAC website.

**Source:** <http://www.ifac.org/MediaCenter/>

### ► IFAC Publication on Linkage of Costing and Decision-Making

The Professional Accountants in Business (PAIB) Committee of the International Federation of Accountants (IFAC) has released a guide, *Evaluating and Improving Costing in Organizations*, which establishes six fundamental principles that can help accountants and their organizations evaluate and improve their approach to costing. It recognizes the importance of distinguishing between the purposes and information needs of cost accounting to meet the demands of external reporting, cost measurement, and reporting for internal decision support. The companion publication, *Costing Levels Maturity Model*, has been published to help accountants decide the level of costing sophistication. These publications are available for free and can be downloaded from IFAC website.

**Source:** <http://www.ifac.org/MediaCenter/>

### ► IFAC G20 Accountancy Summit Issues Renewed Mandate for Adoption of Global Standards

The International Federation of Accountants' (IFAC's) G20 Accountancy Summit was held in London to achieve consensus by the profession on a series of recommendations to be made to the G20 leaders prior to their meeting in September on issues related to the financial crisis. They suggested that governments and regulators need to step up initiatives to promote convergence to global accountancy and auditing standards and they need to do so quickly, and agreed unanimously that the public interest would best be served by a single set of high-quality, principles-based financial reporting and auditing standards for listed and public interest entities. World Bank highlighted the urgent need to develop and strengthen the profession in developing and emerging economies as a key step in achieving financial stability, and announced that the World Bank and IFAC will work together to develop a new initiative in this area.

**Source:** <http://www.ifac.org/MediaCenter/>

# ICAI Green Initiative



## ICAI Green Initiative - Goals

Consistent with our Institute's approach to social responsibility, the ICAI is going Green. The Institute's green policy has two primary goals:

1. To lessen the Institute's impact on environment and
2. To create a sense of responsibility and accountability in the members, students, various stake holders and the society at large towards the environment and the natural resources.

## Endeavour

The Institute is committed to the prevention of pollution and enhancement of the environment through its direct actions, recognizing its position of responsibility in moving towards, demonstrating and sensitizing its stakeholders (students, members, industry associations, vendors, policy makers etc) on sustainable practices. To achieve this, the Institute is making an earnest endeavor to work towards:

- Developing, implementing and maintaining an environmental management system within which clear objectives and targets are set with the aim of:
- Conservation of resources (or manage and conserve energy and water efficiently within all its premises)
- Prevention of pollution/Reduction of greenhouse gases emissions
- Consider appropriate environmental criteria when purchasing products and services
- Incorporate environmental practice into the design of construction projects
- Ensure that this policy and all reports and reviews of environmental performance are communicated to all stakeholders and are available to the public

Promoting awareness and understanding of environmental issues among students, members, industry associations, vendors, policy makers and the external community

Comply with all relevant environmental legislation and take such additional environmental protection measures as it considers necessary

Implementing IT Solutions such that members and students get online solutions obviating the need for travel/paper work – Online Helpdesk, Online Information, Online Payments, eLearning, Online Forms

As a part of this green initiative, the Institute seeks to change attitudes and influence action towards environment at grassroots level. The Institute shall take up 'Green Campaigns' to spread awareness about environment amongst its members & students community and also the office bearers. These 'Green Campaigns' will be spread to all branches of the ICAI across the country.

## **Office 'Green Committees'**

A key component to our Green Initiative will be the formation of 'Green Committees' at every branch office. The Green Committee will be responsible for promoting, implementing, monitoring and reporting the status and progress of each Branch's Green Initiative to the head office on a quarterly basis.

## **ICAI Green Initiatives**

We have taken up several initiatives to neutralize our impact on the environment:

**Water Management:** Portable water is a depleting resource. The Institute offices would earnestly endeavor to harvest rainwater and consistently endeavor reduce the use of fresh water.

**Energy Reduction and Conservation:** ICAI uses energy responsibly by measuring its utilization across all locations through energy audits, analyzing data and measure the effectiveness of this initiatives.

**Waste Management:** Waste is recycled scientifically. We reduce waste, segregate it at the source and dispose it.

**Educational and Volunteer Opportunities:** By partnering with organizations that spread awareness about climate changes, ICAI seeks to offer its members and students opportunities that promote energy and natural resource conservation for both office and home.

ICAI seeks volunteers from the members and students community to participate actively in the Green ICAI initiative to make this a success.

**Eco Construction:** Materials used for construction frequently cause some environmental pollution during their construction. ICAI will strive to reduce the use of such materials for construction of new offices, campuses of the Institute. Initiatives like; compulsory provision for water harvesting, water treatment plants at our major campuses, use of less energy consuming lighting systems at our premises.

## **Technology for Green ICAI**

- Restrictions/pass codes for printers used in ICAI offices monitoring the paper consumption.
- Encourage use of Laptop, soft copies in various meetings, seminars instead of printed material.
- Enable email IDs for all members & students making provision for use of electronic communication instead of communication through post/ courier which consume paper.
- Automation of all correspondence/returns/forms filings by members/students
- Online payment facility for payment of various fees by members & students
- All our official documents are being digitized, reducing the paper consumption.
- **Green Branches & Campuses:** ICAI will strive towards having a Green look at all its branches & campuses. We propose to plant as many trees/plants as possible to offset the carbon footprint of the Institute.
- **Communications:** Green ICAI will manage internal & external communications about sustainability efforts and foster information sharing among stakeholders with the help of our offices/branches in various cities & towns.
- **Culture Change:** Promote culture change by developing nationwide outreach and education campaigns, programs and incentives.
- **Support:** Support members and students in the development and implementation sustainability plans and programs.

## ICAI Awards for Excellence in Financial Reporting Invitation to Participate in the Competition for the year 2008-09

**Last date for receipt of entries: 15<sup>th</sup> October, 2009**

### **Objective**

To recognise and encourage excellence in the preparation and presentation of financial information with the mission of greater accountability and well-informed decision making.

### **Categories of the Awards**

#### **Category I**

**Manufacturing and Trading enterprises** (including Processing, Mining, Plantations, Oil and Gas enterprises)

#### **Category II**

**Banking and Financial Institutions** (including NBFCs, Mutual Funds, Unit Trust of India, Investment Bankers, HFCs etc.)

#### **Category III**

**Service sector** (including Hotels, Consultancy, Transport, Stock Exchanges, R&D, Private Hospitals)

#### **Category IV**

**Insurance Sector**

#### **Category V**

**Information Technology, Communication and Entertainment enterprises**

#### **Category VI**

**Infrastructure & Construction sector** (including Power generation and supply, Port Trusts, Metro, Roads)

#### **Category VII**

**Others** (Section 25 companies, Educational Institutions, NGOs, Charitable hospitals and other organisations)

In a case, where an organisation is engaged in more than one business, the dominant source of revenue will determine the category to which the organisation belongs.

### **Awards to be distributed**

Hall of fame to be awarded to the entity that has been winning the first prize under the same category continuously in the last five years, if any. One Gold Shield and one Silver Shield will be awarded in each category for the best entry and the next best entry, respectively. Apart from the above-mentioned awards, Plaques will be awarded for commendable entries.

### **Conditions for Entry**

I The Annual Report for entry to the 2008-09 Com-

petition should relate to the financial year ending on any day between 1st April, 2008 and 31st March, 2009 (both days inclusive).

II Ten copies of the following documents should be sent:

(a) Annual Report

(b) Quarterly/Half-yearly Financial Results published during the year (specifically mentioning their date of publication) alongwith the Limited Review/Audit Report, where applicable.

III The following documents (or such other similar documents as are prepared by the organisation concerned) should form part of the Annual Report:

(a) Balance Sheet

(b) Profit and Loss Account

(c) Directors' Report

(d) Chairman's statement or speech at the Annual General Meeting. If a copy of the statement or speech of the Chairman was circulated to the shareholders along with the Annual Accounts, specific mention of this fact may be made.

IV The entry to the Competition should be accompanied by a declaration that the Annual Reports submitted are the same that have been circulated to the common shareholders.

V No fee is payable.

VI Cyclostyled copies of the Annual Report and Accounts will not be accepted. This condition, however, does not apply to entities covered by Category VII.

VII In all matters concerning the Competition, the decision of the panel of judges appointed by the Institute will be final.

Entries to the Competition for the year 2008-09 should be submitted in the duly filled entry form (available on the Institute's Website [www.icai.org](http://www.icai.org) under the link [http://www.icai.org/resource\\_file/16823icai\\_awards\\_efr.pdf](http://www.icai.org/resource_file/16823icai_awards_efr.pdf)) with relevant enclosures and sent to:

The Secretary, Research Committee, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002; E-mail: [research@icai.org](mailto:research@icai.org)

# Looking for accounting resources tailormade to your company's needs?



Welcome to  
**ICAI's**  
**Campus Placement Programme 2009**  
for Newly Qualified Chartered Accountants

Over the years, ICAI has set new benchmarks of excellence in the sphere of developing world-class Chartered Accounting professionals for the corporate world. Through CMII, the Institute provides an opportunity to employers to interact with newly qualified Chartered Accountants and makes all arrangements at its centres, thereby offering a cost effective mode of recruiting newly qualified Chartered Accountants. Organizations and firms of Chartered Accountants from all over the country can participate in one or more centres.

The next Campus Placement Programme for Newly Qualified Chartered Accountants will be held at 17 centres nationwide.

**The schedule for Campus Interview August-September, 2009**

Centre	Dates
Mumbai and New Delhi	8th-12th September,2009
Bangalore, Chennai and Kolkata,	8th-11th September,2009
Ahmedabad, Hyderabad and Pune	23rd -24th September 2009
Chandigarh, Coimbatore, Ernakulam, Indore, Jaipur, Kanpur, Ludhiana, Nagpur and Surat	23rd September 2009

**For further details and enquiries log on to [www.cmii.icai.org](http://www.cmii.icai.org)**  
or contact at placements@icai.org, chairmancmii@icai.org

Committee for Members in Industry  
**The Institute of Chartered Accountants of India**  
(ICAI - Set up by an Act of Parliament)  
[www.icai.org](http://www.icai.org), [www.cmii.icai.org](http://www.cmii.icai.org)

## Amendment to SQC 1 - Retention Period for Engagement Documentation (Working Papers)

**P**aragraph 83 of the Standard on Quality Control (SQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements*, states as follows:

### "83. The needs of the firm for retention

.....  
.....

*In the specific case of audit engagements, the retention period ordinarily is **no shorter than ten years** from the date of the auditor's report, or, if later, the date of the group auditor's report." (emphasis added)*

The Council of the Institute of Chartered Accountants of India, at its 289<sup>th</sup> meeting held on August 19, 2009 at New Delhi, pursuant to the provisions of Rule 12 of the Chartered Accountants (Procedures of Investigations of Professional and

Other Misconduct and Conduct of Cases) Rules, 2007, has decided to amend paragraph 83 of the SQC 1 as follows:

### "83. The needs of the firm for retention

.....  
.....

*In the specific case of audit engagements, the retention period ordinarily is **no shorter than seven years** from the date of the auditor's report, or, if later, the date of the group auditor's report." (emphasis added)*



## Launch of ISA Course eLearning

**T**he Committee on Information Technology, ICAI has launched eLearning facility for the Post Qualification Course on Information Systems Audit. To begin with, the first module on "Network Security – An Introduction" has been introduced. More and more such modules are proposed to be introduced from time to time.

ISA eLearning is a value added facility for members pursuing the Post Qualification Course on Information Systems Audit. Members who have qualified ISA or are pursuing the ISA Course can access this facility free of charge by logging in to the Committee Portal at <http://cit.icai.org> with their ISA Number and Password (already provided).

### Topics Covered in Network Security eLearning Module:

- Trend of Network Security.
- Network Security Threats
- Network Attacks.
- Firewall
- Intruder Prevention System
- Antivirus
- Encryption
- Content Filtering
- Network Admission Control

Network security comprises a large amount of activity and it is the most critical part of the entire information security gamut. In fact when a system is added in the network the actual threat starts and it has potential to create huge disaster if we do not take proactive preventive actions in time. This module takes the learners through the possible threats and remedies in Network Security.



**Committee on Information Technology  
The Institute of Chartered Accountants of India**  
Phone: 011-3021 0619/621. E-mail: [cit@icai.org](mailto:cit@icai.org)  
Web: <http://cit.icai.org>

# Anytime - Anywhere Professional Development



## Recent ICAI Initiatives

### ICAI Webcast Channel

<http://webcast.icai.org>

- Join Events and Webcasts lead by leading experts
- Keep abreast with latest developments and challenges facing the profession
- Join Live Webcasts, View recordings or re-visit important aspects at your convenience (time and place)
- Agra International Conference Event & two Webcasts currently available for view
- Experience Technology at Work for you
- Free Access - Currently

### ICAI e-Learning Portal

<http://elearn.icai.org>

- Learn/ develop competencies in emerging professional areas
- Well structured standardised content pan India & abroad
- On-Demand training at your doorstep
- Service Tax e-Learning course @ Rs.500/-, 6 CPE Hours
- IFRS e-Learning course Rs.5,000/-, 20 CPE Hours
- Register online at <http://www.icai.org/ccm.html>
- CPE Hours

### IT Committee Portal

<http://cit.icai.org>

- Courses - ISA PQC, ERP Courses SAP, MS Dynamics NAV, Finacle Auditors Training Programme, Forensic Accounting & Fraud Detection using IT & CAATs, Computer Appreciation Course for Members, Practical Workshops, IT Conferences ...
- Publications & Technical Guides
- e-Learning Courses
- e-Learning Course on IS Security, Cyber Threats & Review - Free
- RSS - Feeds on New Items
- Online Helpdesk & Forms



Committee on Information Technology  
The Institute of Chartered Accountants of India  
ICAI Bhawan, Plot No. 52-54, Vishwas Nagar  
Shahadara, Delhi – 110 032, India

e-Mail: [cit@icai.org](mailto:cit@icai.org), [elearn@icai.org](mailto:elearn@icai.org)  
Web: <http://cit.icai.org> | [www.icai.org](http://www.icai.org)  
Phone: 011-30210621/ 619.

## Formation of Industry Specific Groups of Members in Industry

CAI has achieved recognition as a premier accounting body in India and globally as well, for its contribution in the fields of education, professional development, maintenance of high accounting, auditing and ethical standards. It is always the endeavour of ICAI to update its members about the changes taking place in various statutes, share the knowledge on various new techniques and sharpen their skills on various professional matters. Similarly ICAI has been maintaining close inter-actions with its stakeholders in the overall interest of the economic development of the Country.

Committee for Members in Industry is one of the Committees of the Institute. The Committee encourages and enhances close links between the Institute and the Chartered Accountants working in industries in various capacities so as to provide for them, a base of reference in terms of knowledge, expertise and skills. There has been a felt need that the ICAI should maintain close links with its members in specific Industries, focusing, *inter alia*, to identify Accounting, Auditing issues relating to specific industries apart from identifying the help or assistance which a particular industry can provide to the Institute. Committee for Members in Industry (CMII) understood this necessity and took a step forward in this direction by setting up Industry Specific Study Groups for Members In Industry in order to have better two way communication of the Institute with the Members in Industry who are occupying senior positions in the specific Industries.

### **Terms of Reference of the Group shall be:**

1. To identify Accounting Issues relating to Particular Specific Industry.
2. To identify Auditing Issues relating to Particular Specific Industry.
3. To identify the role that the Institute can play for the Particular Industry.
4. To identify the help or the assistance which the Particular Industry can provide to the Institute.
5. To identify the faculty in the Particular Industry for the CPE programmes meant for the members and the students of the Institute.
6. Any other issue which the group may consider appropriate.

**So far Industry-Specific Groups of Members in Industry have been formed for the following**

### **industries:**

1. Insurance Sector
2. Hospitality Sector
3. Retail Sector

### **The CMII intends to form Industry-Specific Groups for the following Industries:**

- Banking
- Business Process Outsourcing
- Cement
- Constructions
- Hotels & Hospitality
- Education, Training & Research
- Fertilizers
- Financial Services
- Housing Finance
- Iron & Steel
- Mutual Funds
- Non-Banking Financial Service
- Petrochemicals
- Power, Generation & Distribution
- Shipping
- Steel & Metal Manufacturing
- Telecommunications
- Travel & Tourism
- Oil & Gas Exploration



### **Invitation to Senior Members in Industry to volunteer to form Industry-Specific Groups:**

Members occupying senior positions in specific industries and others who can contribute on the Terms of Reference are invited to send the following details by email to [cmii@icai.in](mailto:cmii@icai.in) to enable the CMII to consider and form Industry-Specific Group:

1. Name
2. Correspondence Address with Residence Telephone No.
3. Complete Official Address with Designation
4. Office Phone No.
5. Fax No.
6. Mobile No.
7. Specific Industry in which the Organisation belongs
8. Experience in the relevant Industry

**For further assistance, Members may get in touch with the Secretary of the CMII at [tparamasivan@icai.org](mailto:tparamasivan@icai.org)/9350799934/011-30110491.**

## Invitation for Research Proposals

**R**esearch Committee invites applications for Research Projects from members and others for carrying out research in the field of accounting and other affiliated fields, for e.g. accounting for chain departmental stores, accounting in health care industry, accounting for electricity generation and distribution companies, accounting in aviation industry, accounting for shipping companies, management control systems, approaches to social cost-benefit analysis in the Indian context, etc. The Committee would provide financial support for the approved Research Projects.

### The Eligibility Criteria

- (a) The applicant must be a member of the Institute of Chartered Accountants of India with a research aptitude having at least 10 years of post-qualification experience either in the practice of the profession or as an employee with a reputed manufacturing/service organisation; or
- (b) The applicant must be holding a post-graduate degree from a recognised University or an institute of national repute and must have at least 10 years research and/or teaching experience;

Applications from persons having an experience less than as stated above may also be considered on the basis of merit.

### The Evaluation Criteria

Only those research proposals will be accepted that result in formulation of guidance material in the form of Technical Guide, Studies, Monographs for the members of the Institute in accounting and allied areas, such as the following:

- the issues on which no accounting standards are available or

- the issues that may arise in the implementation of accounting standards and other pronouncements in the industry-specific situations.

### Duration

The duration of research project should not exceed 3 months from the date of the approval of the research proposal unless a longer period is otherwise justified.

### Documents to be Submitted with the Research Proposal

The proposal should be accompanied by a

- ❖ Complete bio-data including experience in the relevant field of interest.
- ❖ Synopsis of the project explicitly specifying the objective, scope and issues that would be addressed in the final proposed document. It should also contain a justification for the proposal and the detailed chapter plan.

The proposal should also indicate the estimated expenditure and expected honorarium for this purpose. The amounts in this regard would be remitted on the final acceptance of the draft by the Research Committee.

Research proposals complete in all respects should be sent to the Secretary, Research Committee, at the following address:

The Institute of Chartered Accountants of India,  
ICAI Bhawan  
Post Box No.7100,  
Indraprastha Marg,  
New Delhi 110 002  
E-mail: [research@icai.org](mailto:research@icai.org)



## Campus Placement Programme for Newly Qualified Chartered Accountants - August-September, 2009

The Committee for Members in Industry of the Institute organises Campus Placement Programme for newly qualified Chartered Accountants at various centres all over India. The scheme has been evolved to provide an opportunity both to employing organisations as well as the young professional aspirants to meet and explore the possibility of taking up positions in Industry.

It has been decided to organise Campus Placement Programme at 17 centres, viz., Ahmedabad, Bangalore, Chandigarh, Chennai, Coimbatore, Ernakulam, Hyderabad, Indore, Jaipur, Kanpur, Kolkata, Ludhiana, Mumbai, Nagpur, New Delhi, Pune & Surat in August-September, 2009. As earlier, a large number of leading organisations are expected to participate.

The schedule of the Campus Placement Programme is as below:

Centre	Dates
Mumbai and New Delhi	8 <sup>th</sup> September 2009 - 12 <sup>th</sup> September, 2009
Bangalore, Chennai and Kolkata	8 <sup>th</sup> September 2009 - 11 <sup>th</sup> September, 2009
Ahmedabad, Hyderabad and Pune	23 <sup>rd</sup> September 2009 - 24 <sup>th</sup> September, 2009
Chandigarh, Coimbatore, Ernakulam, Indore, Jaipur, Kanpur, Ludhiana, Nagpur and Surat	23 <sup>rd</sup> September, 2009

### Eligibility for appearing in Campus Placement Programme to be held in August-September, 2009

The candidates who fulfil the following criteria are eligible to appear in the Campus Placement Programme to be held in August-September, 2009:

Sl. No.	Criteria		
	Clearance of Final Examination of Chartered Accountancy Course	Completion of GMCS Course	Completion of Articledship
1	May 2009	31 <sup>st</sup> October, 2009	31 <sup>st</sup> October, 2009
2	November 2008	Between 1 <sup>st</sup> June, 2009 and 31 <sup>st</sup> October, 2009	Between 1 <sup>st</sup> June, 2009 and 31 <sup>st</sup> October, 2009
3	May 2008		



### INVITATION TO EMPLOYERS

The Committee for Members in Industry of the Institute provides opportunity to the employers to interact with newly qualified Chartered Accountants and makes all arrangements at its centres, thereby providing a cost effective mode of recruiting newly qualified Chartered Accountants.

Organisations intending to recruit newly qualified Chartered Accountants through the above said scheme of Campus Placement Programme are requested to get in touch with Dr. T. Paramasivan, Secretary, Committee for Members in Industry, Indraprastha Marg, New Delhi - 110 002, Tel. No. (011) 3011 0450/491 E-mail: [placements@icai.org](mailto:placements@icai.org), [tparamasivan@icai.org](mailto:tparamasivan@icai.org); Fax- +91(11) 3011 0583 (or) Mr. Ajeet Nath Tiwari, Placement Co-ordinator at Tel +91(11) 3011 0450.

An organisation can also participate in one or more centres, as per its requirements. Firms of Chartered Accountants are also welcome to join. For further details please log on to [www.cmii.icai.org](http://www.cmii.icai.org) or [www.icai.org](http://www.icai.org).

Chairman  
Committee for Members in Industry

## Committee on Economic and Commercial Laws Empanelment of Resource Persons to act as Faculty for the Workshops/Seminars and Preparation of Background Material



**W**hile appreciating the need of the Economic and Commercial world in the Competitive globalised era and to empower the profession, the Committee on Economic and Commercial Laws of the Institute of Chartered Accountants of India has decided to hold the Workshops/Seminars and to develop the background material in various fields of Economic and Commercial Laws including the following:

1. Special Economic Zones Act, 2005
2. Arbitration and Conciliation Act, 1996
3. Competition Act, 2002
4. Foreign Exchange Management Act, 1999 and Foreign Direct Investment
5. Foreign Contribution(Regulation) Act, 1976 and Trust Laws
6. RTI Act, 2005
7. Drafting and Conveyancing
8. Consumer Protection Act, 1986
9. Securitisation Laws
10. Insolvency Laws, Debt Recovery and Allied Laws



The Institute is having its Headquarters at New Delhi and has five Regional Councils at Mumbai, Chennai, Kolkata, New Delhi and Kanpur and 119 Branches across the country. The Institute has also its Chapters outside India. The Institute has more than 1,57,000 members.

The Committee is presently preparing a panel of Experts/Resource persons to act as Faculty for the Workshops/Seminars and for Preparation of Background Material on priority basis and in a prescribed time frame. The Remuneration would be paid as per rules of the Institute. Chartered Accountants, Company Secretaries, Cost Accountants, Advocates, Management Experts, Eminent Academician having multi disciplinary experience & expertise in the above fields may send their Resume at the following address:-

The Secretary,  
Committee on Economic and Commercial Laws,  
The Institute of Chartered Accountants of India,  
ICAI Bhawan, A-94/4, Sector-58,  
Noida - 201301  
Phone No. (0120) 3045955  
E-Mail: [cecl@icai.in](mailto:cecl@icai.in), [susanta.sahu@icai.in](mailto:susanta.sahu@icai.in)

## Announcement



**C**MII has released its first issue of eNewsletter 'Corporate Communique' on 11<sup>th</sup> July 2009 in the august hands of Hon'ble Shri. K. Rehman Khan, Deputy Chairman, Rajyasabha.

- The newsletter can be viewed at : <http://www.cmii.icai.org/imgs/E-Newsletter.pdf>
- We invite technical contributions (articles of interest to Members of ICAI in Industry) which may be sent to [cmii@icai.org](mailto:cmii@icai.org).

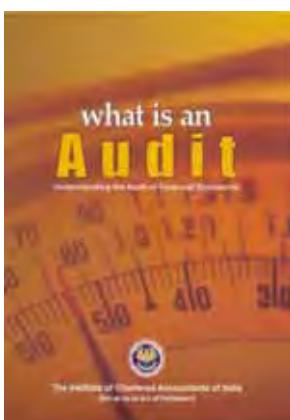
The screenshot shows the first page of the 'Corporate Communique' eNewsletter. At the top is the ICAI logo and the title 'CORPORATE COMMUNIQUE'. Below is a photo of Shri. K. Rehman Khan, the President. The main content includes a 'President's Message' and a 'Message' from Mr. Virendra Singh. The layout is clean with blue and white colors.

## New Publications

### FROM THE AUDITING AND ASSURANCE STANDARDS BOARD

**What is an Audit – Understanding the Audit of Financial Statements (2<sup>nd</sup> edition)**  
 (Pages: 32 + 4 initial pages+ 4 cover pages)

Significant features of the What is an Audit – Understanding the Audit of Financial Statements are:



- Reduces the perceived expectation gap between the auditor and the users of the financial statements.
- Discusses in a very simple and lucid manner important topics, such as, genesis of audit, importance of financial reporting, need for audit, myths relating to an audit of financial statements, inherent limitations of an audit, detection of frauds by auditors, role of auditing standards, understanding the audit report, the different types of opinions given by the auditor, why audit report is a seal of trust, the disciplinary mechanism to which the auditors are subject and importantly what the auditors expect from the users of financial statements and the accompanying audit report.
- Clarifies some misconceptions of the society about the auditing, such as, an audit is a guarantee as to the future viability of an entity or the efficiency and efficacy with which the affairs of the entity have been carried out by its management.

This is a non-priced publication of the Institute. In case the members would like to have a copy of the Brochure, they can write to the AASB Secretariat at [aasb@icai.org](mailto:aasb@icai.org). The Brochure is also freely downloadable from the URL: [http://www.icai.org/post.html?post\\_id=4845](http://www.icai.org/post.html?post_id=4845)

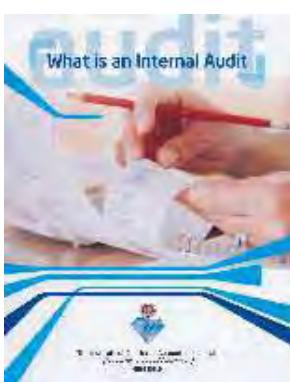
Members are advised to share this publication with all concerned such as government officials, independent directors, media etc., and particularly with those who do not belong to the audit profession as such.

### FROM THE INTERNAL AUDIT STANDARDS BOARD

#### **What is an Internal Audit**

(Pages: 18 + 6 initial pages+ 4 cover pages)

Significant features of "What is an Internal Audit" – an informative and concise booklet are:



- Highlights the evolving role of internal audit function in modern organisations.
- Briefly touches upon important aspects of internal audit, viz., evolution of internal audit, need for internal audit, defining internal audit, internal audit in Indian scenario, value addition made by internal audit in an organisation, basic elements of internal audit report, basic principles governing internal audit, etc. Discusses relationship of internal auditor with audit committee, management and external auditor.
- Simple and useful tool for the readers in understanding and appreciating the value internal auditors brings to organisations everywhere and also about the criticality of the internal audit safety net.

This easy-to-read booklet is a non-priced publication of the Institute. In case, the members would like to have a copy of the same, they can write to the IASB Secretariat at [cia@icai.org](mailto:cia@icai.org). The booklet is also freely downloadable from the URL: [http://www.icai.org/resource\\_file/16670Annexure%204.pdf](http://www.icai.org/resource_file/16670Annexure%204.pdf)

## For kind attention of all members of the Chartered Accountants Benevolent Fund

No. CABF/AGM/49/2009

August 10, 2009

This is to inform you that as required under Rule 28 of the Chartered Accountants Benevolent Fund Rules and Regulations, the 49<sup>th</sup> Annual General Meeting of the Fund will be held at 11:00 A.M. on 23<sup>rd</sup> September, 2009 in the office of the Institute of Chartered Accountants of India, ICAI Bhawan, Indraprastha Marg, New Delhi. In compliance with Rule 29 of the said Rules and Regulations, agenda for the meeting together with the report of the Managing Committee and statement of Accounts for the year ending 31<sup>st</sup> March, 2009 will be placed on the table at the time of meeting.

**Note:** I wish to add that under Rule 38 of the said Rules and Regulations, no member is entitled to any fee or travelling expenses or other allowances for attending the meeting whether annual or special.

You are requested to make it convenient to attend the meeting.

Sd/-  
(CAN.D.Gupta)  
Member Secretary  
CABF

(Details of Agenda, Report of Managing Committee and Financial Statements are available on Institute's website at [www.icai.org](http://www.icai.org))



## For kind attention of all members of the S. Vaidyanath Aiyar Memorial Fund

No. SVAMF/AGM/48/2009

August 10, 2009

This is to inform you that as required under Rule 27 of the S.Vaidyanath Aiyar Memorial Fund Rules and Regulations, the 47<sup>th</sup> Annual General Meeting of the Fund will be held at 11:30 A.M. on 23<sup>rd</sup> September, 2009 in the office of the Institute of Chartered Accountants of India, ICAI Bhawan, Indraprastha Marg, New Delhi. In compliance with Rule 28 of the said Rules and Regulations, agenda for the meeting together with the report of the Managing Committee and statement of Accounts for the year ending 31<sup>st</sup> March, 2009 will be placed on the table at the time of meeting.

**Note:** I wish to add that under Rule 37 of the said Rules and Regulations, no member is entitled to any fee or travelling expenses or other allowances for attending the meeting whether annual or special.

You are requested to make it convenient to attend the meeting.

Sd/-  
(CA S.C. Vasudeva)  
Member Secretary  
SVAMF

(Details of Agenda, Report of Managing Committee and Financial Statements are available on Institute's website at [www.icai.org](http://www.icai.org))



## Invitation for Expression of Interest: Services of Marketing Agencies for ICAI Job Portal and Campus Placement Programme

### **Background of the Committee for Members in Industry**

The Committee for Members in Industry of the Institute of Chartered Accountants of India is meant to encourage and enhance close links between the Institute and the Chartered Accountants working in industries, so as to provide for them, a base of reference in terms of knowledge, expertise, skills and assistance in individual career growth through the development of extensive and intensive relationship with organizations, agencies of the Government, Departments and Ministries of the Central and State Government to provide the maximum possible exposures to the world of trade, commerce, industry and Governance, simultaneously pursuing the goal of providing maximum employment opportunities.

The Committee for Members in Industry has been conducting Campus Placement Programme for more than a decade for newly qualified Chartered Accountants (CAs) that has proved to be a beneficial service to the Companies and Students and is being carried out successfully all over the country twice a year.

As the Committee for Members in Industry is committed to provide world class placement services to the Members a new initiative has been taken to launch ICAI Job Portal. The ICAI Job Portal is primarily for Experienced Chartered Accountants and Accounting Technicians. In order to broad base the reach of this amongst each and every possible recruiting entity for newly qualified CAs and Experienced CAs /Accounting Technicians – both in India and abroad, the Institute would like to empanel reputed / experi-

enced agencies for marketing the **ICAI Job Portal and Campus Placement Programme**.

### **Invitation for Expression of Interest**

Expressions of interest are invited from reputed/experienced agencies having relevant experience containing the following details.

- Profile of the Organisation.
- Details of Management personnel and their brief details.
- Relevant experience justifying their empanelment with ICAI for marketing the **ICAI Job Portal or Campus Placement Programme**.
- Retainership/honorarium structure anticipated.
- Technical bid containing the details of the organization and the technology to be adopted for marketing.
- Any other detail, which will enhance the candidature of the organization for the proposed purpose.

ICAI reserves the right to reject the tenders without assigning any reasons or to award the contract to any agency even if it has not responded to this announcement.

If you have any further clarification, you may get in touch with Dr. T. Paramasivan, Sr. Deputy Director or Mr. Ajeet Nath Tiwari, Placement Co-ordinator, Committee for Members in Industry, The Institute of Chartered Accountants of India, 'ICAI BHAWAN', Indraprastha Marg, New Delhi - 110 002, Tel - 011 – 30110450/491, e-mail. [tparamasivan@icai.org](mailto:tparamasivan@icai.org), [placements@icai.org](mailto:placements@icai.org).

The Committee for Members in Industry  
The Institute of Chartered Accountants of India  
New Delhi



# HEALTH TIPS



## Ponder over for "Soul Cleansing"

We are not creatures of circumstance; we are creators of circumstance. A circumstance is created either by **fear of loss** of what is possessed or by **desire of getting** what is not possessed (may be status or wealth or health or a relation or may be anything). So learn to enjoy what you do or have; rather than do or have what you enjoy.

*Contributed by CA R. S. Agrawal, Mumbai  
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## JALA NETI—a yogic technique of nasal cleansing:

Cleansing techniques and Jala Neti	Steps for Jala Neti	Healing benefits of Jala-Neti
<p>The ancient Yogis developed a wide range of methods for body and mind cleansing. In performing such things, it was only ever their aim to purify and balance the elements of human structure to the highest level for the highest purposes. These amazing ways of external and internal cleansing were not just for health, but in preparation for the higher states of meditation so as to be able to attain enlightenment, self transcendence and immortality. Some of these techniques are:</p> <ul style="list-style-type: none"> <li>• Jala Neti - Nasal Cleansing</li> <li>• Dhauti - Cleansing the Alimentary Canal &amp; Sense Organs of the Head</li> <li>• Nauli - Abdominal Purification Through Self Massage and Churning</li> <li>• Basti - Colon Cleansing</li> <li>• Kapalbhati - Frontal Brain Purification</li> <li>• Trataka - Concentrated Gazing to Purify the Optic and Psychic Faculties</li> </ul> <p><b>Jala Neti</b>, using warm salty water, is a very ancient technique which has been passed on for thousands of years by the Yogis for both physical as well as deeper spiritual benefits. Now is possibly a time of the greatest need for such a practice by modern people.</p> <p>Ordinary fine salt will do for Jala Neti.</p> <p>Jala Neti is advised twice a day—in the morning and before going to bed.</p>	<p>Fill up a special Neti Patra (Pot) with warm, slightly salted water;</p> <ul style="list-style-type: none"> <li>• Insert the nose cone of Jala Neti Patra into right nostril;</li> <li>• Adjust the position of the head and Patra to allow the water to flow out of the left nostril; (Now slowly bend forward from the waist so that the tip of the nose is the lowest point of the head; and then tilt/roll the head to the right, so that the left nostril is now the lowest point of the nose. Tilt slowly so that water doesn't run out the top of the pot onto your face. Keep the nose cone fully sealed into the right nostril so that it doesn't leak)</li> <li>• <b>Must breathe gently through the mouth whilst the water is flowing</b> through the nasal passages;</li> <li>• Just wait a few seconds and the water should run out the left nostril;</li> <li>• Keep breathing slowly and gently through the mouth;</li> <li>• Try not to sniff, swallow, laugh, talk or have any movement of air through the nose whilst the water is flowing through;</li> <li>• After the water begins to run, wait about 30 seconds for about half a pot to flow right to left;</li> <li>• Now reverse water flow i.e. from left nostril to right nostril after half a pot has flowed in right to left direction;</li> <li>• When the water in the pot is finished, the nose must be dried well.</li> </ul> <p>The technique is not as hard or uncomfortable as one may at first think. Once learned, the practice can be done in about 3-5 minutes, and like showering and cleaning the teeth, Jala Neti is easily integrated into one's daily routine of body cleansing.</p>	<ul style="list-style-type: none"> <li>• <b>Removes all the dirt and bacteria filled mucus from within the nose;</b></li> <li>• Helps to drain the sinus <b>cavities</b>;</li> <li>• Beneficial in <b>respiratory illnesses</b> such as <b>asthma</b> and <b>bronchitis</b>;</li> <li>• Has a <b>cooling and soothing effect on the brain</b> by drawing out excessive heat, and is therefore beneficial for <b>headaches, migraine, epilepsy, temper tantrums, hysteria, depression and general mental tension</b>;</li> <li>• Great benefit for problems associated with the <b>eyes</b> and <b>ear disorders</b>;</li> <li>• Improves sensitivity of the olfactory nerves, helping to restore <b>lost sense of smell</b>, and thereby benefits the relationship with taste and the digestive processes;</li> <li>• Has <b>subtle effects on the pineal and pituitary glands</b> which control the hormonal system;</li> <li>• Affects the psychic centre known as <b>Ajna Chakra</b> which helps in awakening higher states of meditation;</li> <li>• Helps to stimulate better powers of visualization and concentration and gives a feeling of <b>lightness and clarity to the mind</b>.</li> <li>• In short, in the opinion of the author, it improves every condition because <b>it definitely improves respiratory system-&gt; healthy breathing-&gt;increases oxygen level -&gt; purifies blood-&gt; maintains all the 7 dhatus (according to Ayurveda, from intakes, body produces 7 dhatus fluid, blood, flesh, fat, bone, marrow and semen) in good order.</b></li> </ul>



*The author will be pleased to give demonstration, if desired, of Jala Neti and gift a Jala Neti Patra to the interested persons who are residents of Mumbai.*

### 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.*

# Chief Experience Officer (CExO)

Business rules are changing faster than amendments in our constitutions. These rules are not notified but learned and experienced. From product to service to experience. Things have changed manifold during last one decade. New generation of entrepreneurs is here to create memorable experience for stakeholders. Creating memorable experience is their passion. Business is no longer license-driven or machine-driven. It is experience-driven and top management is taking highest interest in their customers and other stakeholders. Boardrooms not in touch with ground realities and comprising only members having compliance mind are slowly but surely writing their obituary. Read on to know why in experience economy experience creation is top of the agenda for the top management.



**CA. Sunil Gandhi**

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**W**hy multiplex theatres are commanding double the price than normal theaters even though movies shown are the same? Jumbo vadapav(a Maharashtrian dish easily available on the streets) can command premium over local street vadapav. Annual report by Infosys creates different level of reporting standards. Virgin Airlines' slogan says "We are in entertainment industry @ 25000 feet height". In today's attention deficit economy, getting attention of customers is very difficult as, for that matter, all stakeholders are very critical. It is said that your customers can kick you out of business simply by spending somewhere else.



**Author duo of the book, *The Experience Economy*, Joe Pine and Jim Gilmore write that 'Work is a theatre and every business a stage.'** Imagine this, for a second, for product companies which can also add spice of entertainment in their dealings. It is not about service or product, but it's more about mindset.

### Experience Economy

Everybody is looking for unforgettable experience in whatever they do. Shopping, commuting, banking, or, snacking in a restaurant, whatever one does, entertainment in dealing is the key differentiating factor for consumers in selecting their service or product providers. It is not just entertainment companies that are in entertainment business but every other company doing business has to have some element of entertainment in their offerings. How do your stakeholders view you as a company offering truly world-class experience in their dealings with you? This is the question all business owners, governing boards and CEOs must ask themselves every morning. It is not just about customers' experience. Their own employees, suppliers and shareholders are equally important too.

Getting right people to work for their companies requires creating stimulating internal atmosphere. Excitement, challenges, fairness and innovation will attract finest talents to any company. In the absence of the above even the leading companies will find it difficult to attract and retain employees. Similarly, this applies to other stakeholders too.

### World of Experience

'Satisfied customers' is the phrase for the last generation entrepreneurs. Now it is time for '*dramatic or fabulous customer's experience*' which applies to both service and product companies. Author duo of the book, *The Experience Economy*, Joe Pine and Jim Gilmore write that 'Work is a theatre and every business a stage.' Imagine this, for a second, for product companies which can also add spice of entertainment in their dealings. It is not about service or product, but it's more about mindset. Product companies can play with their product offering so that customers using those products will have scintillating experience. In every product there is an element of service these days. Innovations at the point of sale and after sales, new product updates can engage customers

more.

World over, companies like Sony, Starbucks, HP, McDonalds, or Ferrari are experience creators. In India companies like Kingfisher Airlines, Super Malls, Maruti, Amul, etc., are creators of experience. To have clear idea of what I mean by experience, visualize your experience against the names given on the left and against those on the right:

**Table:1**

Edward Theater Vs Fame Cinema
Indian Airlines Vs Kingfisher Airlines
Shankar Vilas Tea Vs Barista
Udipi Restaurant Vs McDonalds
Offline Share Trading Vs Online Share Trading
Municipality Hospitals Vs Asian Heart Institute

Names on the right are experience creators. Does your company qualify to be on the right side for all your stakeholders? If no, your business obituary will be written soon. I mean it. Just watch the names on the left and check their business standing. All our sensory organs are looking for experience everywhere. How we capture our stakeholders' experience organs will decide the future of our business. I am referring all stakeholders and not just customers as any weak link will have adverse impact on the business sooner than expected. Rosenbluth says, 'customers come second'.

Experience can be created at all touch points. A touch point is defined as, all of the communication, human and physical interactions your stakeholders experience during their relationship life cycle with your organization. Select list is given in Table:2

### Experience Creation

There are companies who think differently. They are not in business to earn just money. They are passionate about what they do. Unfortunately there are not many Indian companies that are

creators of world-class experience. Companies have started writing mission and vision statements but hardly they revisit them once they are written. What is the fun in life without fun in business? Companies are made up of people it employs. Why best of the talents would work with your company? No idea! What if hospital staffs are trained like an airline crew? Imagine the experience it can create for the patients. What if banks are floor-managed like five-star hotels? What if railway platforms are created and maintained like those of airports?

Experience Creation is a full-time job. Unless top leadership is committed to this cause, these initiatives will not last. Chief Experience Officer responsible to create memorable experience for all stakeholders directly reporting to the CEO is the minimum need.

Recently I was at a musical programme. It started late by half an hour against its schedule. There was no announcement and the viewers were not allowed to enter the auditorium. Secondly, stage was not set to suit the eyes in terms of its colour combination. Anchor duo didn't do proper home work and they were baffling. Finally all singers were fabulous & choices of songs were great. But how was the overall experience? Lacklustre. Despite the great main products, songs and singers, peripheral experiences averaged the overall effect.

Point I am trying to convey is even if we have great product or service if overall delivery and after sales are not equally passionately delivered, the whole efforts are considered average. If I want to reach today's hi-tech bank customer relations executives, I have to wait on call for few minutes and then press number of buttons with all chances of line getting disconnected. When I visit branch 20 people are waiting ahead of me. So no way I can get my things done at my priority and time. Banks have resorted to home banking. But I think total re-imagination is call of the day the way branch banking has been done. Mr. V.W. Hill, president, founder and chairman of the US-based Commerce

**Chief Experience Officer is responsible for understanding present experience status of all stakeholders. Total corporate experience mapping is very important. Imagine cool products, low prices but unhappy customers! In surplus economy, we find ourselves where all our stakeholders have multiple choices.**

Bank, declares 'though he is a trained banker he is not a banker. They are growth retailers.' (Quote from *The Mavericks at Work*)

Another experience worth sharing is about my computer service company. Person picking up the call will know by name who I am, from which company I am calling and what my last problem was. What does hi-tech mean to me? My experience with the product or service will make me decide whom I have to deal with Period. Bank may have the best of the model promoting its brand, but for me it is worthless.

### Engaging Top Management

Time when the economy is looking for rejuvenation and business confidence is at a record low, passionate business owners will tread the offbeat path. Yes, true innovation can come through world-class experience creation. One can create experience-focused organization by igniting passion in the human resource. Train and retrain human resource to align with new business realities and passion at the top. Usually initial fires fizzle down once everything becomes routine and obvious. It is the responsibility of the top management to keep fires alive within every employee.

Chief Experience Officer is responsible for understanding present experience status of all stakeholders. Total corporate experience mapping is very important. Imagine cool products, low prices but unhappy customers! In surplus economy, we find ourselves where all our stakeholders have multiple choices. Real challenge is not just to produce more and more, but to make compelling offers to customers who already have enough and have multiple choices. Stakeholders are taking clues about the company from various sources. So if one believes that annual reports are for shareholders or lenders, they are mistaken. Today even suppliers and employees go through the annual reports keenly to know the future of their money and job respectively. All companies may not afford to engage full-time CExOs unless



**Companies have audit and remuneration committees because it is statutory to have them. How about committees on internal innovation, customer experience and future business? No Clue! Creating experience requires innovative and seriously non-routine thinking at the top.**



they see full-time value creating role for them. These companies, however, must have internal champions working closely with external experience consultant.

So, starting point is to know present experience status, that is by way of closely scrutinizing feedback forms obtained from all stakeholders about their dealing with the company. Designing feedback forms is very crucial if top managements want to know the results of their decisions and actions. Unfortunately feedback forms are not in vogue in most of the industries and these forms are rarely seen by people at the top. If carefully designed and seriously considered, these forms can give valuable guidance to the management to know the status of their performance on regular basis. Feedback is not only giving insight into what is happening at ground level but most important is direction to the future and idea for the new products. Tom Peters says "Dull Customers = Dull Company, Dull Board = Dull Company, Dull Suppliers = Dull Company". I would say instead of daily MIS, daily feedback can give idea of the shape of things to come.

Companies, when they grow in size, unfortunately lose focus on the objective of their existence. Observe their agendas of meetings. Hardly any agenda ever focuses on stakeholders' needs. Companies engage independent directors because SEBI/BSE clause 49 requires them to do so. What about their business interest? Lawyers, solicitors & CAs are occupying these posts. Though they play an important role, but top managements do not think of hiring management thinkers, cross-industry specialists, customer-insight champions, professors at universities, renowned artists, magicians, architects or simply women who can form part of the board to add new dimensions to the board. Routine, rhetoric, or, obvious works are so solidly practiced that there is hardly any scope for thinking differently and innovation.

Our regulators ask us to engage independent directors so public companies follow them in letter but hardly in spirit. Private companies are not supposed to have them on board so they don't engage them. I fail to understand if they are not in

business. Why can't private entrepreneurs and family-managed companies have board with mix of expertise from diverse fields? Companies have audit and remuneration committees because it is statutory to have them. How about committees on internal innovation, customer experience and future business? No Clue! Creating experience requires innovative and seriously non-routine thinking at the top. Unless there is a dramatic change of thinking at the top, no company can create memorable experience for their stakeholders. I would say if you have delighted your customers instead of simply satisfying them, you are probably in a monopoly business. No competition can stop you.

Ignore the scheme of experience creation if you dare. Surprise and delight your stakeholders at every touch points every time. Tom Peters says, 'It is the foremost responsibility of our generation to re-imagine our enterprise and institutions, public and private.' In the present economic turmoil this seems to be more relevant.

**Caution:** The above changing rules are applicable to every product & service company whether dealing directly with retail consumer or not.



**Table:2**

Board of Directors					
Chief Executive Officer					
Chief Experience Officer	CMO	COO	CFO	COO	???
Function Head	Marketing Head	HR	CS	Purchase	???
	CRM Head	Administration	Finance & Accounts	Quality	???
	Sales Head	Supervisor		SCM	???
Stake-holders Touch Points					
Stake Holders	Customer	Employees	Investors/ Share Holders	Suppliers	Society
1	Website	Interview	Annual Report	Inquiry	Environment
2	Promotional Campaign	Appointment	AGM/EGM	Quotation	CSR
3	Inquiry	Office/ Factory Premise	Dividend Distribution	Purchase Order	Taxes
4	Retail Counter/ Point of Sales	Salary & Increment	Periodic Updates	Delivery from Suppliers	Business Practices
5	Actual usage of product or service	Promotion	Annual/Semi Annual Data Submission at Banks	Quality Report Rejections	
6	Packaging of Product /Service Providers	Appreciation	Renewal of Loan at Banks	Invoice & Payments	
7	Product Usage Support	Non Monetary Benefits	Daily Transactions at Banks	Respective Dept. handling in case of service providers	
8	After Sales Inquiry/ Complaint	Immediate Boss	Ad Hoc Requests	Advance Feedback for future need/ improvements	
9	Resolution of Complaint	Newsletter & Updates	Follow up Issues	Annual Suppliers Conference	
10	Newsletter/ Updates	Annual Best Employees Award Function		Reminder/ Follow-up	
11	Promotions & Referrals				
12	Feedback Forms				
13	Customer Events				

\* List is not exhaustive

# Standard on Auditing (SA) 200\* (Revised)

## Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing

Your comments on the Exposure Draft should reach us by **October 30, 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 – 201301.**

Comments can also be e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

### Introduction

#### *Scope of this SA*

1. This Standard on Auditing (SA) establishes the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with SAs. Specifically, it sets out the overall objectives of the independent auditor, and explains the nature and scope of an audit designed to enable the independent auditor to meet those objectives. It also explains the scope, authority and structure of the SAs, and includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the SAs. The independent auditor is referred to as "the auditor" hereafter.

2. SAs are written in the context of an audit of financial statements by an auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

#### *An Audit of Financial Statements*

3. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion. (Ref: Para. A1)

4. The financial statements subject to audit are those of the entity, prepared and presented by management of the entity with oversight from those charged with governance. SAs do not impose responsibili-

ties on management or those charged with governance or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with SAs is conducted on the premise that management and, where appropriate, those charged with governance have responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of those responsibilities. (Ref: Para. A2-A11)

5. As the basis for the auditor's opinion, SAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. (Ref: Para. A28-A52)

6. The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.<sup>1</sup> In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgments about materiality are made in the light of surrounding circum-

stances, and are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both. The auditor's opinion deals with the financial statements as a whole and therefore the auditor is not responsible for the detection of misstatements that are not material to the financial statements as a whole.

7. The SAs contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The SAs require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things:

- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
- Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.
- 8. The form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable laws or regulations. (Ref: Para. A12-A13)
- 9. The auditor may also have certain other communication and reporting responsibilities to users, management, those charged with governance, or parties outside the entity, in relation to matters arising from the audit. These may be established by the SAs or by applicable laws or regulations<sup>2</sup>.

\* Presently, there are two Standards on Auditing (SAs), i.e., SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" corresponding to Standard on Auditing (SA) 200 (Revised). Now both the SAs are merged in one Standard, i.e., SA 200 (Revised).

<sup>1</sup> SA 320 (Revised), "Materiality in Planning and Performing an Audit" and SA 450, "Evaluation of Misstatements Identified during the Audit".

<sup>2</sup> See, for example, SA 260 (Revised), "Communication with Those Charged with Governance"; and paragraph 43 of SA 240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements".

**Effective Date**

10. This SA is effective for audits of financial statements for periods beginning on or after .....  
.....

**Overall Objectives of the Auditor**

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 SAs, in accordance with the auditor's findings.
12. In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the SAs require that the auditor disclaim an opinion or withdraw from the engagement, where withdrawal is legally permitted.

**Definitions**

13. For purposes of the SAs, the following terms have the meanings attributed below:

- (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.

- (b) Audit evidence – Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. For purposes of the SAs:
  - (i) Sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.
  - (ii) Appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.
- (c) Audit risk – The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.
- (d) Auditor – "Auditor" is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an SA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "auditor" is used. "Engagement partner" and "firm" are to be read as referring to their public sector equivalents where relevant.
- (e) Detection risk – The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.
- (f) Financial statements – A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement.
- (g) Historical financial information – Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
- (h) Management – The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.
- (i) Misstatement – 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. Misstatements can arise from error or fraud. When the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgment, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.
- (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 SAs. 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 SAs.

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".

- (k) Professional judgment – The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.
- (l) Professional skepticism – An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
- (m) Reasonable assurance – In the context of an audit of financial statements, a high, but not absolute, level of assurance.
- (n) Risk of material misstatement – The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:
  - (i) Inherent risk – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
  - (ii) Control risk – The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.
- (o) Those charged with governance – The person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive

members of a governance board of a private or public sector entity, or an owner-manager.

## Requirements

### Ethical Requirements Relating to an Audit of Financial Statements

14. The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. (Ref: Para. A14-A17)

### Professional Skepticism

15. The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A18-A22)

### Professional Judgment

16. The auditor shall exercise professional judgment in planning and performing an audit of financial statements. (Ref: Para. A23-A27)

### Sufficient Appropriate Audit Evidence and Audit Risk

17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: Para. A28-A52)

### Conduct of an Audit in Accordance with SAs

#### Complying with SAs Relevant to the Audit

18. The auditor shall comply with all SAs relevant to the audit. An SA is relevant to the audit when the SA is in effect and the circumstances addressed by the SA exist. (Ref: Para. A53-A57)

19. The auditor shall have an understanding of the entire text of an SA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A58-A66)

20. The auditor shall not represent compliance with SAs in the auditor's report unless the auditor has complied with the requirements of this SA and all other SAs relevant to the audit.

#### Objectives Stated in Individual SAs

21. To achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit, having regard to the interrelationships among the SAs, to: (Ref: Para. A67-A69)

- (a) Determine whether any audit procedures in addition to those required by the SAs are necessary in pursuance of the objectives stated in the SAs; and (Ref: Para. A70)

- (b) Evaluate whether sufficient appropriate audit evidence has been obtained. (Ref: Para. A71)

#### Complying with Relevant Requirements

22. Subject to paragraph 23, the auditor shall comply with each requirement of an SA unless, in the circumstances of the audit:

- (a) The entire SA is not relevant; or
- (b) The requirement is not relevant because it is conditional and the condition does not exist. (Ref: Para. A72-A73)

23. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an SA. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement. (Ref: Para. A74)

#### Failure to Achieve an Objective

24. If an objective in a relevant SA cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the SAs, to modify the auditor's opinion or withdraw from the engagement. Failure to achieve an objective represents a significant matter requiring documentation in accordance with SA 230 (Revised).<sup>3</sup> (Ref: Para. A75-A76)

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## Application and Other Explanatory Material

### An Audit of Financial Statements

#### Scope of the Audit (Ref: Para. 3)

A1. The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some cases, however, the applicable laws and regulations may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the SAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

#### Preparation of the Financial Statements (Ref: Para. 4)

A2. An audit in accordance with SAs 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

<sup>3</sup> SA 230 (Revised), "Audit Documentation", paragraph 8(c).

- 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.
- A4. The financial statements may be prepared in accordance with a financial reporting framework designed to meet:
- The common financial information needs of a wide range of users (i.e., "general purpose financial statements"); or
  - The financial information needs of specific users (i.e., "special purpose financial statements").
- A5. The applicable financial reporting framework often encompasses financial reporting standards established by an authorised or recognised standards setting organisation, or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial reporting standards established by an authorised or recognised standards setting organisation and legislative or regulatory requirements. Other sources may provide direction on the application of the applicable financial reporting framework. In some cases, the applicable financial reporting framework may encompass such other sources, or may even consist only of such sources. Such other sources may include:
- The legal and ethical environment, including statutes, regulations, court decisions, and professional ethical obligations in relation to accounting matters;
  - Published accounting interpretations of varying authority issued by standards setting, professional or regulatory organisations;
  - Published views of varying authority on emerging accounting issues issued by standards setting, professional or regulatory organisations;
  - General and industry practices widely recognized and prevalent; and
  - Accounting literature.
- Where conflicts exist between the financial reporting framework and the sources from which direction on its application may be obtained, or among the sources that encompass the financial reporting framework, the source with the highest authority prevails.
- A6. The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficient broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.
- A7. Some financial reporting frameworks are fair presentation frameworks, while others are compliance frameworks. Financial reporting frameworks that encompass primarily the financial reporting standards established by an organisation that is authorised or recognised to promulgate standards to be used by entities for preparing and presenting general purpose financial statements are often designed to achieve fair presentation.
- A8. The requirements of the applicable financial reporting framework also determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the state of affairs, results of operations and cash flows of an entity. For such frameworks, a complete set of financial statements would include a balance sheet; statement of profit and loss; a cash flow statement; and related notes. For some other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements:
- For example, normally, in government departments and local bodies, the primary financial statement is a statement of cash receipts and payments.
  - Other examples of a single financial statement, each of which would include related notes, are:
    - Balance sheet.
    - Statement of profit & loss.
    - Statement of cash flows.
    - Statement of operations by product lines.
- A9. SA 210 (Revised) establishes requirements and provides guidance on determining the acceptability of the applicable financial reporting framework<sup>4</sup>. SA 800 deals with special considerations when financial statements are prepared in accordance with a special purpose framework<sup>5</sup>.
- A10. Because of the significance of the premise to the conduct of an audit, the auditor is required to obtain agreement from management and, where appropriate, those charged with governance that they acknowledge and understand their responsibilities set out in paragraph A2 as a precondition for accepting the audit engagement.<sup>6</sup> The auditor is also required to obtain written representations about whether management and, where appropriate, those charged with governance have fulfilled those responsibilities<sup>7</sup>.
- Considerations Specific to Central/State Government and Related Government Entities**
- A11. The mandates for audits of the financial statements of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of such an entity is conducted may include additional responsibilities, such as, the responsibility for the execution of transactions and events in accordance with legislation or proper authority.
- Form of the Auditor's Opinion** (Ref: Para. 8)
- A12. The opinion expressed by the auditor is on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The form of the auditor's opinion, however, will depend upon the applicable financial reporting framework and any applicable laws or regulations. Most financial reporting frameworks include requirements relating to the presentation of the financial statements; for such frameworks, preparation of the financial statements in accordance with the applicable financial reporting framework includes presentation.

<sup>4</sup> SA 210 (Revised), "Agreeing the Terms of Audit Engagements," paragraph 6(a).

<sup>5</sup> [Proposed] SA 800, "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks", paragraph 8 of the Exposure Draft of the SA 800. The Exposure Draft of SA 800 is published elsewhere in this issue of the Journal.

<sup>6</sup> SA 210 (Revised), paragraph 6(b).

<sup>7</sup> SA 580 (Revised), "Written Representations," paragraphs 10-11.

A13. Where the financial reporting framework is a fair presentation framework, as is generally the case for general purpose financial statements, the opinion required by the SAs is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view. Where the financial reporting framework is a compliance framework, the opinion required is on whether the financial statements are prepared, in all material respects, in accordance with the framework. Unless specifically stated otherwise, references in the SAs to the auditor's opinion cover both forms of opinion.

**Ethical Requirements Relating to an Audit of Financial Statements** (Ref: Para.14)

A14. The auditor is subject to relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics issued by the Institute of Chartered Accountants of India.

A15. The Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements and provides a conceptual framework for applying those principles;

- (a) Integrity;
- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behaviour.

A16. In the case of an audit engagement it is in the public interest and, therefore, required by the Code of Ethics, that the auditor be independent of the entity subject to the audit. The Code describes independence as comprising both independence of mind and independence in appearance. The auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.

A17. Standard on Quality Control (SQC) 1 sets out the responsibilities of the firm for establishing policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence.<sup>8</sup> Proposed Revised SA 220 sets out the engagement partner's responsibilities with respect to relevant ethical requirements. These include evaluating whether members of the engagement team have complied with relevant ethical requirements, determining

the appropriate action if matters come to the engagement partner's attention that indicate that members of the engagement team have not complied with relevant ethical requirements, and forming a conclusion on compliance with independence requirements that apply to the audit engagement.<sup>9</sup> Proposed Revised SA 220 recognises that the engagement team is entitled to rely on a firm's systems in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless information provided by the firm or other parties suggests otherwise.

**Professional Skepticism** (Ref: Para.15)

A18. Professional skepticism includes being alert to, for example:

- Audit evidence that contradicts other audit evidence obtained.
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- Conditions that may indicate possible fraud.
- Circumstances that suggest the need for audit procedures in addition to those required by the SAs.

A19. Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of:

- Overlooking unusual circumstances.
- Over generalising when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

A20. Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

A21. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence.<sup>10</sup> In cases of doubt about the reliability of information or indications of possible fraud (for example, if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may

have been falsified), the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter<sup>11</sup>.

A22. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less-than-persuasive audit evidence when obtaining reasonable assurance.

**Professional Judgment** (Ref: Para.16)

A23. Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the SAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:

- Materiality and audit risk.
- The nature, timing, and extent of audit procedures used to meet the requirements of the SAs and gather audit evidence.
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor.
- The evaluation of management's judgments in applying the entity's applicable financial reporting framework.
- The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

A24. The distinguishing feature of the professional judgment expected of an auditor is that it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments.

A25. The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, such as that required by Proposed

<sup>8</sup> Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements".

<sup>9</sup> Presently SA 220 (AAS 17), "Quality Control for Audit Work" is in force. The Standard is being revised in the light of the corresponding International Standard on Auditing (ISA) 220 (Redrafted), "Quality Control for an Audit of Financial Statements".

<sup>10</sup> SA 500 (Revised), "Audit Evidence," paragraphs 7-9.

<sup>11</sup> SA 240 (Revised), paragraph 13; SA 500 (Revised), paragraph 11; and Proposed SA 505 (Revised), "External Confirmations," paragraphs 10-11, and 16.

Revised SA 220<sup>12</sup>, assist the auditor in making informed and reasonable judgments.

A26. Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of auditing and accounting principles and is appropriate in the light of, and consistent with, the facts and circumstances that were known to the auditor up to the date of the auditor's report.

A27. Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented. In this regard, the auditor is required to prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the significant professional judgments made in reaching conclusions on significant matters arising during the audit<sup>13</sup>. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate audit evidence.

#### *Sufficient Appropriate Audit Evidence and Audit Risk* (Ref: Para. 5 and 17)

#### *Sufficiency and Appropriateness of Audit Evidence*

A28. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit<sup>14</sup>) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

A29. The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher

the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

A30. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

A31. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. SA 500 (Revised) and other relevant SAs establish additional requirements and provide further guidance applicable throughout the audit regarding the auditor's considerations in obtaining sufficient appropriate audit evidence.

#### *Audit Risk*

A32. Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

A33. For purposes of the SAs, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant. Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

#### *Risks of Material Misstatement*

A34. The risks of material misstatement may exist at two levels:

- The overall financial statement level; and
- The assertion level for classes of transactions, account balances, and disclosures.

A35. Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.

A36. Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk. Auditors use various approaches to accomplish the objective of assessing the risks of material

misstatement. For example, the auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an acceptable level of detection risk. Some auditors find such a model to be useful when planning audit procedures.

A37. The risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements.

A38. Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations or for accounts consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterised by a large number of business failures.

A39. Control risk is a function of the effectiveness of the design, implementation and maintenance of internal control by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal control. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. The SAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures to be performed<sup>15</sup>.

A40. The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement." However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material

<sup>12</sup> See footnote 9.

<sup>13</sup> SA 230 (Revised), paragraph 8.

<sup>14</sup> SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", paragraph 9.

<sup>15</sup> SA 330, "The Auditor's Responses to Assessed Risks", paragraphs 7-17.

misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

A41. SA 315 establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

#### *Detection Risk*

A42. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

A43. Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. Matters such as:

- adequate planning;
- proper assignment of personnel to the engagement team;
- the application of professional skepticism; and
- supervision and review of the audit work performed,

assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results.

A44. SA 300 (Revised)<sup>16</sup> and SA 330 establish requirements and provide guidance on planning an audit of financial statements and the auditor's responses to assessed risks. Detection risk, however, can only be reduced, not eliminated, because of the inherent limitations of an audit. Accordingly, some detection risk will always exist.

#### *Inherent Limitations of an Audit*

A45. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:

- The nature of financial reporting;
- The nature of audit procedures; and

- The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

#### *The Nature of Financial Reporting*

A46. The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures. For example, this is often the case with respect to certain accounting estimates. Nevertheless, the SAs require the auditor to give specific consideration to whether accounting estimates are reasonable in the context of the applicable financial reporting framework and related disclosures, and to the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments<sup>17</sup>.

#### *The Nature of Audit Procedures*

A47. There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

- There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.
- Fraud may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
- An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

#### *Timeliness of Financial Reporting and the Balance between Benefit and Cost*

A48. The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. This is recognised in certain financial reporting frameworks (see, for example, the "Framework for the Preparation and Presentation of Financial Statements" issued by the Institute of Chartered Accountants of India (ICAI)). Therefore, there is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognising that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

A49. Consequently, it is necessary for the auditor to:

- Plan the audit so that it will be performed in an effective manner;
- Direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and
- Use testing and other means of examining populations for misstatements.

A50. In light of the approaches described in paragraph A49, the SAs contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

- Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities<sup>18</sup>; and
- Use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population<sup>19</sup>.

#### *Other Matters that Affect the Inherent Limitations of an Audit*

A51. In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are

<sup>16</sup> SA 300 (Revised), "Planning an Audit of Financial Statements".

<sup>17</sup> SA 540 (Revised), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", and Proposed SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", paragraph 12 of the Exposure Draft of revised SA 700. The same has been published in the June, 2009 issue of the Journal.

<sup>18</sup> SA 315, paragraphs 5-10.

<sup>19</sup> SA 330 ; SA 500 (Revised); Proposed SA 520 (Revised), "Analytical Procedures"; and SA 530 (Revised), "Audit Sampling".

particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion. See SA 240 (Revised)<sup>20</sup> for further discussion.
- The existence and completeness of related party relationships and transactions. See SA 550 (Revised)<sup>21</sup> for further discussion.
- The occurrence of non-compliance with laws and regulations. See SA 250 (Revised)<sup>22</sup> for further discussion.
- Future events or conditions that may cause an entity to cease to continue as a going concern. See SA 570 (Revised)<sup>23</sup> for further discussion.

Relevant SAs identify specific audit procedures to assist in mitigating the effect of the inherent limitations.

A52. Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with SAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence. Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

#### *Conduct of an Audit in Accordance with SAs*

##### *Nature of the SAs* (Ref: Para.18)

A53. The SAs, taken together, provide the standards for the auditor's work in fulfilling the overall objectives of the auditor. The SAs deal with the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific topics.

A54. The scope, effective date and any specific limitation of the applicability of a specific SA is made clear in the SA. Unless otherwise stated in the SA, the auditor is permitted to apply an SA before the effective date specified therein.

A55. In performing an audit, the auditor may be required to comply with legal or regulatory requirements in addition to the SAs. The SAs do not override laws and regulations that govern an audit of financial statements. In the event that those laws and regulations differ from the SAs, an audit conducted only in accordance with laws and regulations will not automatically comply with SAs.

A57. The SAs are also relevant to engagements in case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions). The auditor's responsibilities of those entities, however, may be affected by the audit mandate, or by obligations on those entities arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature, which may encompass a broader scope than an audit of financial statements in accordance with the SAs. These additional responsibilities are not dealt with in the SAs. They may be dealt with in the relevant laws and regulations in which the entities are operating.

#### *Contents of the SAs* (Ref: Para.19)

A58. In addition to objectives and requirements (requirements are expressed in the SAs using "shall"), an SA contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the SA, and definitions. The entire text of an SA, therefore, is relevant to an understanding of the objectives stated in an SA and the proper application of the requirements of an SA.

A59. Where necessary, the application and other explanatory material provides further explanation of the requirements of an SA and guidance for carrying them out. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover.
- Include examples of procedures that may be appropriate in the circumstances.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an SA. The application and other explanatory material may also provide background information on matters addressed in an SA.

A60. Appendices form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related SA or within the title and introduction of the appendix itself.

A61. Introductory material may include, as needed, such matters as explanation of:

- The purpose and scope of the SA, including how the SA relates to other SAs.
- The subject matter of the SA.
- The respective responsibilities of the auditor and others in relation to the subject matter of the SA.
- The context in which the SA is set.

A62. An SA may include, in a separate section under the heading "Definitions", a description of the meanings attributed to certain terms for purposes of the SAs. These are provided to assist in the consistent application and interpretation of the SAs, and

are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout the SAs. The Proposed Glossary of Terms relating to Engagement and Quality Control Standards issued by the Auditing and Assurance Standards Board contains a complete listing of terms defined in the SAs. It also includes descriptions of other terms found in SAs to assist in common and consistent interpretation.

A63. When appropriate, additional considerations specific to audits of smaller entities and to certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), are included within the application and other explanatory material of an SA. These additional considerations assist in the application of the requirements of the SA in the audit of such entities. They do not, however, limit or reduce the responsibility of the auditor to apply and comply with the requirements of the SAs.

#### *Considerations Specific to Smaller Entities*

A64. For purposes of specifying additional considerations to audits of smaller entities, a "smaller entity" refers to an entity which typically possesses qualitative characteristics such as:

- (a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and
- (b) One or more of the following:
  - (i) Straightforward or uncomplicated transactions;
  - (ii) Simple record-keeping;
  - (iii) Few lines of business and few products within business lines;
  - (iv) Few internal controls;
  - (v) Few levels of management with responsibility for a broad range of controls; or
  - (vi) Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.

A65. The considerations specific to smaller entities included in the SAs have been developed primarily with unlisted entities in mind. Some of the considerations, however, may be helpful in audits of smaller listed entities.

A66. The SAs refer to the proprietor of a smaller entity who is involved in running the entity on a day-to-day basis as the "owner-manager".

<sup>20</sup> SA 550 (Revised), "Related Parties".

<sup>21</sup> SA 250 (Revised), "Consideration of Laws and Regulations in an Audit of Financial Statements".

<sup>22</sup> SA 570 (Revised), "Going Concern".

**Objectives Stated in Individual SAs (Ref: Para. 21)**

A67. Each SA contains one or more objectives which provide a link between the requirements and the overall objectives of the auditor. The objectives in individual SAs serve to focus the auditor on the desired outcome of the SA, while being specific enough to assist the auditor in:

- Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and
- Deciding whether more needs to be done to achieve them in the particular circumstances of the audit.

A68. Objectives are to be understood in the context of the overall objectives of the auditor stated in paragraph 11 of this SA. As with the overall objectives of the auditor, the ability to achieve an individual objective is equally subject to the inherent limitations of an audit.

A69. In using the objectives, the auditor is required to have regard to the interrelationships among the SAs. This is because, as indicated in paragraph A53, the SAs deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this SA requires the auditor to adopt an attitude of professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each SA. At a more detailed level, SA 315 and SA 330 contain, among other things, objectives and requirements that deal with the auditor's responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An SA dealing with specific aspects of the audit (for example, SA 540 (Revised)) may expand on how the objectives and requirements of such SAs as SA 315 and SA 330 are to be applied in relation to the subject of the SA but does not repeat them. Thus, in achieving the objective stated in SA 540 (Revised), the auditor has regard to the objectives and requirements of other relevant SAs.

**Use of Objectives to Determine Need for Additional Audit Procedures (Ref: Para. 21(a))**

A70. The requirements of the SAs are designed to enable the auditor to achieve the objectives specified in the SAs, and thereby the overall objectives of the auditor. The proper application of the requirements of the SAs by the auditor is therefore expected to provide a sufficient basis for the auditor's achievement of the objectives.

However, because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the SAs, the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of the SAs and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that require the auditor to perform audit procedures in addition to those required by the SAs to meet the objectives specified in the SAs.

**Use of Objectives to Evaluate Whether Sufficient Appropriate Audit Evidence Has Been Obtained (Ref: Para. 21(b))**

A71. The auditor is required to use the objectives to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If as a result the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph 21(b):

- Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other SAs;
- Extend the work performed in applying one or more requirements; or
- Perform other procedures judged by the auditor to be necessary in the circumstances. Where none of the above is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by the SAs to determine the effect on the auditor's report or on the auditor's ability to complete the engagement.

**Complying with Relevant Requirements****Relevant Requirements (Ref: Para. 22)**

A72. In some cases, an SA (and therefore all of its requirements) may not be relevant in the circumstances. For example, if an entity does not have an internal audit function, nothing in SA 610 (Revised)<sup>23</sup> is not relevant.

A73. Within a relevant SA, there may be conditional requirements. Such a requirement is relevant when the circumstances envisioned in the requirement apply and the condition exists. In general, the conditionality of a requirement will either be explicit or implicit, for example:

- The requirement to modify the auditor's opinion if there is a limitation of scope<sup>24</sup> represents an explicit conditional requirement.
- The requirement to communicate significant deficiencies in internal control

identified during the audit to those charged with governance,<sup>25</sup> which depends on the existence of such identified significant deficiencies; and the requirement to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework,<sup>26</sup> which depends on that framework requiring or permitting such disclosure, represent implicit conditional requirements.

**Departure from a Requirement (Ref: Para. 23)**

A74. SA 230 (Revised) establishes documentation requirements in those exceptional circumstances where the auditor departs from a relevant requirement.<sup>27</sup> The SAs do not call for compliance with a requirement that is not relevant in the circumstances of the audit.

**Failure to Achieve an Objective (Ref: Para. 24)**

A75. Whether an objective has been achieved is a matter for the auditor's professional judgment. That judgment takes account of the results of audit procedures performed in complying with the requirements of the SAs, and the auditor's evaluation of whether sufficient appropriate audit evidence has been obtained and whether more needs to be done in the particular circumstances of the audit to achieve the objectives stated in the SAs. Accordingly, circumstances that may give rise to a failure to achieve an objective include those that:

- Prevent the auditor from complying with the relevant requirements of an SA.
- Result in its not being practicable or possible for the auditor to carry out the additional audit procedures or obtain further audit evidence as determined necessary from the use of the objectives in accordance with paragraph 21, for example due to a limitation in the available audit evidence.

A76. Audit documentation that meets the requirements of SA 230 (Revised) and the specific documentation requirements of other relevant SAs provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor. While it is unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor's evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor.

<sup>23</sup> SA 610 (Revised), "Using the Work of Internal Auditors".

<sup>24</sup> Proposed SA 705, "Modifications to the Opinion in the Independent Auditor's Report", paragraph 13 of the Exposure Draft of SA 705. The same has been published in the June, 2009 issue of the Journal.

<sup>25</sup> SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", paragraph 9.

<sup>26</sup> Currently SA 501 (AAS 34), "Audit Evidence—Additional Considerations for Specific Items" is in force. The Standard is being revised in the light of the corresponding International Standard on Auditing (ISA) 501 (Redrafted), "Audit Evidence—Specific Considerations for Selected Items".

<sup>27</sup> SA 230 (Revised), paragraph 12.

## **Material Modifications vis-a-vis ISA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing"**

### **Deletion**

Paragraph A11 of ISA 200 deals with the additional responsibilities for the execution of transactions and events in accordance with legislation or proper authority in case of public sector entities. Further, paragraph A57 of ISA 200 deals with the auditor's additional responsibility arising out of the mandatory or obligatory laws or regulations applicable to that public sector entity. These additional responsibilities are not dealt by the SAs but dealt by the laws or regulations under which the public sector entity operates. Also, paragraph A63 of ISA 200 deals with the inclusion of the paragraph specific to public sector entities in the application and explanatory material section. Since as mentioned in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

Further, it is also possible that such a specific situation may exist in case of Central/State governments or related government entities, pursuant to a requirement under the statute or regulation under which they operate. Accordingly, the spirit of erstwhile A11, A57 and A63, highlighting such fact, has been retained.

## **Limited Revision Consequential to the issuance of Proposed Standard on Auditing (SA) 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"**

The amendments to the following have been shown in track change mode.

### **Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Preface)**

#### **Standards issued by AASB Under the Authority of the Council of ICAI**

3. The following Standards issued by the Auditing and Assurance Standards Board under the authority of the Council are collectively known as the Engagement Standards:

.....

(c) Standards on Assurance Engagements (SAEs), to be applied in assurance engagements dealing with subject matters other than audits or reviews of historical financial information.

### **Standards on Auditing**

5. The Standards on Auditing (SAs) referred to in Paragraph 3(a) above are formulated in the context of an audit of financial statements by an independent auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. The authority of SAs is set out in Proposed SA 200 (Revised)<sup>18</sup>....

6.—The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. It is undertaken to enhance the degree of confidence of intended users in the financial statements. The Standards on Auditing, taken together, provide the standards for the auditor's work in fulfilling this objective.

7.—In conducting an audit, the overall objective of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to report on the financial statements in accordance with the auditor's findings. However, owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs. In all cases, when this overall objective has not been or cannot be achieved, the SAs require the auditor to modify the auditor's opinion accordingly or withdraw from the engagement as may be appropriate, depending upon the facts and circumstances of each case.

8.—The auditor applies each Standard on Auditing (SA) relevant to the audit. An SA is relevant when the SA is in effect and the circumstances addressed by the SA exist.

9.—The SAs deal with the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific areas. An SA contains objectives and requirements together with related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context to a proper understanding of the SAs; and

definitions. It is, therefore, necessary to consider the entire text of an SA to understand and apply its requirements.

### **Objectives**

10.—Each SA contains an objective or objectives, which provide the context in which the requirements of the Standards on Auditing are set. Any limitation of the applicability of a specific Standard is made clear in the Standard itself. An individual Standard should be read in the context of the objective stated in the Standard as well as this Preface. The auditor aims to achieve these objectives, having regard to the interrelationships amongst the SAs. For this purpose, the auditor uses the objectives to judge whether, having complied with the requirements of the SAs, sufficient appropriate audit evidence has been obtained in the context of the overall objective of the auditor. Where an individual objective has not been or cannot be achieved, the auditor considers whether this prevents the auditor from achieving his overall objective.

### **Requirements<sup>19</sup>**

11.—The requirements of each SA are contained in a separate section and expressed using the word "shall". The auditor applies the requirements in the context of the other material included in the Standard.

12.—The auditor complies with the requirements of an SA in all cases where they are relevant in the circumstances of the audit. In exceptional circumstances, however, the auditor may judge it necessary to depart from a relevant requirement by performing alternate audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective.

13.—When a situation envisaged in paragraph 12 above arises, the auditor is required to document how alternative procedures performed achieve the aim of the requirement, and, the reasons for the departure. Further, his report also should draw attention to such departures. However, a mere disclosure in his report does not absolve an auditor from complying with the applicable Standard(s).

14.—A requirement is not relevant only in the cases where the SA is not relevant, or the circumstances envisioned do not apply because the requirement is conditional and

<sup>18</sup> Proposed SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing".

<sup>19</sup> The International Auditing and Assurance Standards Board, pursuant to its Clarity Project, has adopted a new format for presentation of the International Standards on Auditing (ISAs) issued by it. As per the new format, an ISA is divided into two sections, one, the requirements section and second, the application and other explanatory material section. Accordingly, the practice of presenting the standard portion (i.e., the principles enunciated) in **bold** lettering and the application/explanatory guidance in plain lettering has been done away with. The entire text of the Standard, whether the requirements section or the application and other explanatory material section are presented in plain lettering.

In so far as the Auditing and Assurance Standards (AASs) issued by the Institute are concerned, in the AASs issued prior to December 1997, the entire text of the Standard is presented in the plain lettering, whereas in case of the AASs issued subsequent to that date, the standard portion/ principles enunciated are given in **bold** lettering whereas the explanatory/ application guidance is given in plain lettering. The presentation of the Standards on Auditing, issued subsequent to the date this Preface comes into effect, would be in line with that adopted by the IAASB for its ISAs pursuant to the Clarity Project. In the due course, the existing Standards would also be brought in line with the abovementioned convention.

the condition does not exist. The auditor is not required to comply with a requirement that is not relevant in the circumstances of the audit and this does not constitute a departure from the requirement. However, the auditor should document the steps undertaken by him to satisfy himself that the process adopted in the circumstances of the audit assisted him in achieving his overall objective.

#### *Application and Other Explanatory Material*

15. The application and other explanatory material contained in an SA is an integral part of the SA as it provides further explanation of, and guidance for carrying out, the requirements of an SA, along with the background information on the matters addressed in the SA. It may include examples of procedures, some of which the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement.

16. Appendices, which form part of the application and other explanatory material, are an integral part of an SA. The purpose and intended use of an appendix are explained in the body of the related Standard or within the title and introduction of the appendix itself.

#### *Introductory Material and Definitions*

17. Introductory material may include, as needed, such matters as explanation of the purpose and scope of the Standard, including how the SA relates to other SAs, the subject matter of the SA, specific expectations from the auditor and others, and the context in which the SA is set.

18. A Standard on Auditing may include, in a separate section under the heading 'Definitions', a description of the meanings attributed to certain terms for purposes of the SAs. These are provided to assist in the consistent application and interpretation of the SAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Unless otherwise indicated, these terms will carry the same meanings throughout the SAs.

#### *Standards on Quality Control*

19. SQCs are written to apply to firms<sup>50</sup> in respect of all their services falling under the Engagement Standards issued by the AASB of ICAI. The authority of SQCs is set out in the introduction to the SQCs.

### **SA 230 (Revised), "Audit Documentation"**

#### *Nature and Purposes of Audit Documentation*

2. Audit documentation that meets the requirements of this SA and the specific documentation requirements of other relevant SAs provides:

- (a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
- (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements...

#### *Documentation of Significant Matters and Related Significant Professional Judgments* (Ref: Para. 8(c))

A11. The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes the significant matters identified during the audit and how they were addressed, or that includes cross-references to other relevant supporting audit documentation that provides such information. Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist the auditor's consideration of the significant matters. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant SA objective that the auditor cannot achieve has not met or is unable to meet that would prevent the auditor from achieving the overall objectives of the auditor's overall objective...

#### *Departure from a Relevant Requirement* (Ref: Para. 12)

A18. The objectives and requirements of the SAs are designed to enable the auditor to achieve the objectives specified in the SAs, and thereby support the achievement of the overall objectives of the auditor.<sup>51</sup> Accordingly, other than in exceptional circumstances, the SAs call for compliance with each requirement that is relevant in the circumstances of the audit.

A19. The documentation requirement applies only to requirements that are relevant in the circumstances. A requirement is not relevant<sup>52</sup> only in the cases where:

- (a) The entire SA is not relevant [for example, if an entity does not have an internal audit function in a continuing

engagement, nothing in Proposed SA 610.510(Revised)<sup>53</sup> is relevant]; or

- (b) The circumstances envisioned do not apply because—the requirement is conditional and the condition does not exist (for example, the requirement to modify the auditor's opinion where there is an inability to obtain sufficient appropriate audit evidence, and there is no such inability).

### **SA 240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"**

#### *Responsibilities of the Auditor*

5. An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. As described in SA 200, "Objective and General Principles Governing an Audit of Financial Statements," owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

6. As described in Proposed SA 200 (Revised)<sup>54</sup>, the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

<sup>50</sup> The term "firm" refers to a sole practitioner/proprietor, partnership, or any such entity of professional accountants, as may be permitted by law.

<sup>51</sup> Proposed SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", paragraph 11.

<sup>52</sup> Refer paragraph 23-24 of ISA 200 (Revised and Redrafted), SA 200 (AAS 1), "Basic Principles Governing an Audit" and SA 200A (AAS 2), "Objective and Scope of the Audit of Financial Statements". The Standards are being revised in the light of the corresponding International Standard.

<sup>53</sup> Refer paragraph 22-23 of Proposed ISA 200 (Revised and Redrafted).

<sup>54</sup> The Exposure Draft of SA 510.610 (Revised), "Initial Audit Engagements—Opening Balances Using the Work of Internal Auditors", has been published in the October, 2008 August, 2009 issue of the Journal.

<sup>55</sup> Presently, AAS 1 (Renumbered as SA 200), "Basic Principles Governing an Internal Audit" and AAS 2 (Renumbered as SA 200A), "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200. Both the AASs are currently being revised in the light of the ISA 200.

Post this revision, the principles covered by AAS 1 and AAS 2 will be merged into one Standard i.e., SA 200.

<sup>56</sup> Proposed SA 200 (Revised), paragraph A51.

7. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

8. When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.....

#### *Professional Skepticism*

12. In accordance with Proposed SA 200 (Revised)<sup>5</sup>, the auditor shall maintain an attitude of professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance. (Ref: Para. A7-A8)

A7. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. Maintaining an attitude of professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance where relevant. Due to the

characteristics of fraud, the auditor's attitude of professional skepticism is particularly important when considering the risks of material misstatement due to fraud.

A8. Although the auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance, the auditor's attitude of professional skepticism is particularly important in considering the risks of material misstatement due to fraud because there may have been changes in circumstances.....

### **SA 260 (Revised), "Communication with Those Charged with Governance"**

#### *Definitions*

6. For purposes of the SAs, the following terms have the meanings attributed below:

(a) **Those charged with governance** – The person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector undertakings or an owner-manager. In some cases, those charged with governance are responsible for approving<sup>6</sup> the entity's financial statements (in other cases management has this responsibility). For discussion of the diversity of governance structures, see paragraphs A5-A12.

(b) **Management** – The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance, for example, executive members of a

governance board, or an owner-manager. Management is responsible for the preparation of the financial statements, overseen by those charged with governance, and in some cases management is also responsible for approving<sup>7</sup> the entity's financial statements (in other cases those charged with governance have this responsibility).

#### *Those Charged with Governance*

(Ref: Para.7)

As. Governance structures may vary reflecting different size and ownership characteristics. For example:

- In most of the entities, those charged with governance hold positions that are an integral part of the entity's legal structure, for example, company directors. In others, for example, some government undertakings a body that is not part of the entity is charged with governance.
- In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons
- In some cases, those charged with governance are responsible for approving<sup>8</sup> the entity's financial statements (in other cases management has this responsibility).....

### **All Final SAs**

#### *Phrases*

"attitude of professional skepticism"

- SA 250(Revised), paragraph 8.
- SA 540(Revised), paragraph A40.
- SA 550(Revised), paragraph A9.

"affected by the inherent limitations of inherent to internal control"

- SA 315, paragraph A42.

<sup>5</sup> Proposed SA 200 (Revised), paragraph 15.

<sup>6</sup> As described at paragraph [A43] of [proposed] SA 700, (hitherto known as AAS 28) "The Independent Auditor's Report on General Purpose Financial Statements". The Standard is being revised in the light of the corresponding International Standard.

<sup>7</sup> See footnote 3.

<sup>8</sup> As described at paragraph [to be inserted] of Proposed SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", having responsibility for approving in this context means having the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared.

### ICAI NEWS

### CORRIGENDUM

The readers may kindly note that the author of the article titled '**Economic Melt-down and Impact on India**' published on page no. 47 in July 2009 issue of The Chartered Accountant journal is Prof. Atul Sarma and not as printed in the credit line in the article. The typographical error is regretted.

# Standard on Auditing (SA) 710 (Revised)\* Comparative Information—Corresponding Figures and Comparative Financial Statements

Your comments on the Exposure Draft should reach us by **October 30, 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 e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

**Proposed Standard on Auditing (SA) 710 (Revised), “Comparative Information—Corresponding Figures and Comparative 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”.**

## Introduction

### Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibilities regarding comparative information in an audit of financial statements. When the financial statements of the prior period have been audited by a predecessor auditor or were not audited, the requirements and guidance in SA 510 (Revised)<sup>3</sup> regarding opening balances also apply.

### The Nature of Comparative Information

2. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures<sup>4</sup> and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.

3. The essential audit reporting differences between the approaches are:

- (a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas
- (b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

This SA addresses separately the auditor's reporting requirements for each approach.

### Effective Date

4. This SA is effective for audits of financial statements for periods beginning on or after

## Objectives

5. The objectives of the auditor are:
  - (a) To obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework; and
  - (b) To report in accordance with the auditor's reporting responsibilities.

## Definitions

6. For purposes of the SAs, the following terms have the meanings attributed below:
  - (a) Comparative information – The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.
  - (b) Corresponding figures – Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as “current period figures”). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.
  - (c) Comparative financial statements – Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are

referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

For purposes of this SA, references to “prior period” should be read as “prior periods” when the comparative information includes amounts and disclosures for more than one period.

## Requirements

### Audit Procedures

7. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:
  - (a) The comparative information agrees with the amounts and other disclosures presented in the prior period; and
  - (b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.
8. If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor had audited the prior period's financial statements, the auditor

\* Earlier known as SA 710 (AAS 25), “Comparatives”.

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> Presently, SA 200, “Basic Principles Governing an Audit” and SA 200 A, “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. The Exposure Draft of Revised SA 200 has been published elsewhere in this issue of the Journal.

<sup>3</sup> SA 510 (Revised), “Initial Audit Engagements—Opening Balances”.

<sup>4</sup> Typically, financial reporting frameworks in India use the corresponding figures approach for general purpose financial statements.

shall also follow the relevant requirements of SA560 (Revised)<sup>5</sup>.

9. As required by SA 580 (Revised)<sup>6</sup>, the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss. (Ref: Para. A1)

#### Audit Reporting

##### Corresponding Figures

10. When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the circumstances described in paragraphs 11, 12, and 14. (Ref: Para. A2)

11. If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

(a) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or  
(b) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures. (Ref: Para. A3-A5)

12. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein. (Ref: Para. A6)

##### Prior Period Financial Statements Audited by a Predecessor Auditor

13. If the financial statements of the prior period were audited by a predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report:

(a) That the financial statements of the prior period were audited by the predecessor auditor;  
(b) The type of opinion expressed by the predecessor auditor and, if the opinion

was modified, the reasons therefore; and

(c) The date of that report. (Ref: Para. A7)

##### Prior Period Financial Statements Not Audited

14. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements<sup>7</sup>.

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#### Application and Other Explanatory Material

##### Audit Procedures

##### Written Representations (Ref: Para. 9)

A1. In the case of comparative financial statements, the written representations are requested for all periods referred to in the auditor's opinion because management needs to re-affirm that the written representations it previously made with respect to the prior period remain appropriate. In the case of corresponding figures, the written representations are requested for the financial statements of the current period only because the auditor's opinion is on those financial statements, which include the corresponding figures. However, the auditor requests a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.

##### Audit Reporting

##### Corresponding Figures

No Reference in Auditor's Opinion (Ref: Para. 10)

A2. The auditor's opinion does not refer to the corresponding figures because the auditor's opinion is on the current period financial statements as a whole, including the corresponding figures.

##### Modification in Auditor's Report on the Prior Period Unresolved (Ref: Para. 11)

A3. When the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

A4. When the auditor's opinion on the prior period, as previously expressed, was modified, the unresolved matter that gave rise to the modification may not be relevant to the current period figures. Nevertheless, a qualified opinion, a disclaimer of opinion, or an adverse opinion (as applicable) may be required on the current period's financial statements because of the effects or possible effects of the unresolved matter on the comparability of the current and corresponding figures.

A5. Illustrative examples of the auditor's report if the auditor's report on the prior period included a modified opinion and the matter giving rise to the modification is unresolved are contained in Examples A and B of the Appendix.

<sup>5</sup> SA 560 (Revised), "Subsequent Events", paragraphs 14-17.

<sup>6</sup> SA 580 (Revised), "Written Representations", paragraph 14.

<sup>7</sup> SA 510 (Revised), paragraph 6.

<sup>8</sup> SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", paragraph 8 of the Exposure Draft of SA 706. The same has been published in the June, 2009 issue of the Journal.

<sup>9</sup> SA 510 (Revised), paragraph 6.

**Misstatement in Prior Period Financial Statements**(Ref: Para.12)

A6. When the prior period financial statements that are misstated have not been amended and an auditor's report thereon has not been issued in accordance with the requirements of SA 560 (Revised), "Subsequent Events", but the corresponding figures have been properly dealt with as required under the applicable financial reporting framework and the appropriate disclosures have been made in the current period financial statements, the auditor's report may include an Emphasis of Matter paragraph describing the circumstances and referring to, where relevant, disclosures that fully describe the matter that can be found in the financial statements (see SA 706).

**Prior Period Financial Statements Audited by a Predecessor Auditor**(Ref: Para.13)

A7. An illustrative example of the auditor's report if the prior period financial statements were audited by a predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures is contained in Example C of the Appendix.

**Prior Period Financial Statements Not Audited**(Ref: Para.14)

A7a. Where prior period financial statements were not audited, the auditor should request the Management to disclose this fact on the face of the current period financial statements with respect to the corresponding figures.

**Comparative Financial Statements**

**Reference in Auditor's Opinion**(Ref: Para.15)

A8. Because the auditor's report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, or include an Emphasis of Matter paragraph with respect to one or more periods, while expressing a different auditor's opinion on the financial statements of the other period.

A9. An illustrative example of the auditor's report if the auditor is required to report on both the current and the prior period financial statements in connection with the current year's audit and the prior period included a modified opinion and the matter giving rise to the modification is unresolved, is contained in Example D of the Appendix.

**Opinion on Prior Period Financial Statements Different from Previous Opinion**(Ref: Para.16)

A10. When reporting on the prior period financial statements in connection with the current period's audit, the opinion expressed on the prior period financial statements may be different from the opinion previously expressed if the auditor becomes aware of circumstances or events that materially affect the financial statements of a prior period during the course of the audit of the current period. In some circumstances, the auditor may have additional reporting responsibilities designed to prevent future reliance on the auditor's previously issued report on the prior period financial statements.

**Prior Period Financial Statements Audited by a Predecessor Auditor**(Ref: Para.18)

A11. The predecessor auditor may be unable or unwilling to revise the auditor's report on the prior period financial statements. An Other Matter paragraph of the auditor's report may indicate that the predecessor auditor reported on the financial statements of the prior period before amendment. In addition, if the auditor is engaged to audit and obtains sufficient appropriate audit evidence to be satisfied as to the appropriateness of the amendment, the auditor's report may also include the following paragraph:

As part of our audit of the 20X2 financial statements, we also audited the adjustments described in Note X that were applied to amend the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 20X1 financial statements of the company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 20X1 financial statements taken as a whole.

**Material Modifications vis-a-vis ISA 710, "Comparative Information— Corresponding Figures and Comparative Financial Statements"**

**Deletions**

1. Paragraphs 9 and 12 of ISA 710 deal with the restatement of the prior period financial statements. Since in India, Accounting Standard (AS) 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that prior period items should be separately disclosed in the Statement of Profit and Loss in a manner that their impact on the current profit or loss can be perceived, the restatement of the prior period financial statements does not exist in the Indian scenario. Hence, to align with the requirements of AS 5, the requirement of restatement of prior period items has been replaced with the requirement to disclose the prior period items in the current year's Statement of Profit & Loss. Corresponding changes have also been made at the relevant places of the Standard.

2. Paragraph 17 of ISA 710 deals with the situation wherein the predecessor auditor reissue his audit report. Since in India, the nomenclature, "Reissue" is not used for the reissuance of the audit report by an auditor, the same has been replaced with the word, "Revised". Corresponding changes have also been made at the relevant places of the Standard.

**Appendix**

**Example Auditors' Reports**

**Example A - Corresponding Figures**(Ref: Para. A5)

**Report illustrative of the circumstances described in paragraph 11(a), as follows:**

- The auditor's report on the prior period, as

previously issued, included a qualified opinion.

- The matter giving rise to the modification is unresolved.
- The effects or possible effects of the matter on the current period's figures are material and require a modification to the auditor's opinion regarding the current period figures.

**INDEPENDENT AUDITOR'S REPORT**

**To the Members of ABC Company Limited**

**Report on the Financial Statements<sup>10</sup>**

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, 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 and presentation of these financial statements that give a true and fair view of the state of affairs, results of operations 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 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 (ICAI). 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 entity's preparation of the financial statements that give a true and fair view 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 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.

<sup>10</sup> The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

**Basis for Qualified Opinion**

As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements which constitutes a departure from the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This is the result of a decision taken by management at the start of the preceding financial year and caused us to qualify our audit opinion on the financial statements relating to that year. Based on the straight-line method of depreciation and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by Rs. XXX in 20X1 and Rs. XXX in 20X0, property, plant and equipment should be reduced by accumulated depreciation of Rs. XXX in 20X1 and Rs. XXX in 20X0, and the accumulated loss should be increased by Rs. XXX in 20X1 and Rs. XXX in 20X0.

**Qualified Opinion**

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of affairs of the Company as of March 31, 20X1, and of its results of operations and its cash flows for the year then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

**Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member Signing the Audit Report)  
(Designation)  
Membership Number

Place of Signature  
Date

**Example B - Corresponding Figures** (Ref: Para. A5)

**Report illustrative of the circumstances described in paragraph 11(b), as follows:**

- The auditor's report on the prior period, as previously issued, included a qualified opinion.
- The matter giving rise to the modification is unresolved.
- The effects or possible effects of the matter on the current period's figures are immaterial but require a modification to the auditor's opinion because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

**INDEPENDENT AUDITOR'S REPORT****To the Members of ABC Company Limited**  
**Report on the Financial Statements<sup>12</sup>**

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, 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 and presentation of these financial statements that give a true and fair view of the state of affairs, results of operations 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 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 (ICAI). 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 entity's preparation and presentation of the financial statements that give a true and fair view 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 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**

Because we were appointed auditors of the Company during 20X0, we were not able to observe the counting of the physical inventories at the beginning of that period or

satisfy ourselves concerning those inventory quantities by alternative means. Since opening inventories affect the determination of the results of operations, we were unable to determine whether adjustments to the results of operations and opening retained earnings might be necessary for 20X0. Our audit opinion on the financial statements for the year ended 31 March, 20X0 was modified accordingly. Our opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures and the corresponding figures.

**Qualified Opinion**

In our opinion, except for the possible effects on the corresponding figures of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of affairs of the Company as of March 31, 20X1, and of its results of operations and its cash flows for the year then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

**Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member Signing the Audit Report)  
(Designation)  
Membership Number

Place of Signature  
Date

**Example C - Corresponding Figures:** (Ref: Para. A7)

**Report illustrative of the circumstances described in paragraph 13, as follows:**

- The prior period's financial statements were audited by a predecessor auditor.
- The auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so.

**INDEPENDENT AUDITOR'S REPORT****To the Members of ABC Company Limited**  
**Report on the Financial Statements<sup>13</sup>**

We have audited the accompanying financial statements of ABC Company Ltd. ("the Company"), which comprise the balance sheet as at March 31, 20X1, 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.

<sup>11</sup> Partner or Proprietor, as the case may be.

<sup>12</sup> The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

<sup>13</sup> Partner or Proprietor, as the case may be.

<sup>14</sup> The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and presentation of these financial statements that give a true and fair view of the state of affairs, results of operations 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 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 (ICAI). 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 entity's preparation and presentation of the financial statements that give a true and fair view 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 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, the financial statements give a true and fair view of the state of affairs of the Company as of March 31, 20X1, and of its results of operations and its cash flows for the year then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

#### **Other Matters**

The financial statements of the Company for the year ended March 31, 20X1, were audited by another auditor who expressed an unmodified opinion on those statements on June 30, 20X1.

#### **Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>16</sup>)  
Membership Number

Place of Signature  
Date

#### **Example D-Comparative Financial Statements:** (Ref: Para. A9)

#### **Report illustrative of the circumstances described in paragraph 15, as follows:**

- Auditor is required to report on both the current period financial statements and the prior period financial statements in connection with the current year's audit.
- The financial reporting framework used in preparing the financial statements is other than accounting principals generally accepted in India. However, the audit is performed in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India.
- The auditor's report on the prior period, as previously issued, included a qualified opinion.
- The matter giving rise to the modification is unresolved.
- The effects or possible effects of the matter on the current period's figures are material to both the current period financial statements and prior period financial statements and require a modification to the auditor's opinion.

#### **INDEPENDENT AUDITOR'S REPORT**

#### **To the Members of ABC Company Limited**

#### **Report on the Financial Statements<sup>17</sup>**

We have audited the accompanying financial statements of ABC Company Ltd. ("the Company"), which comprise the balance sheets as at March 31, 20X1 and 20X0, and the statements of profit & loss, and cash flow statements for the years 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 and presentation of these financial statements that give a true and fair view of the state of affairs, results of operations 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 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 audits. We conducted our audits in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). 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 entity's preparation and presentation of the financial statements that give a true and fair view 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 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 in our audits is sufficient and appropriate to provide a basis for our qualified audit opinion.

#### **Basis for Qualified Opinion**

As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements which constitutes a departure from the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). Based on the straight-line method of depreciation and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by Rs. XXX in 20X1 and Rs. XXX in 20X0, property, plant and equipment should be reduced by accumulated depreciation of Rs. XXX in 20X1 and Rs. XXX in 20X0, and the accumulated loss should be increased by Rs. XXX in 20X1 and Rs. XXX in 20X0.

#### **Qualified Opinion**

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of affairs of the Company as of March 31, 20X1 and 20X0 and of its results of operations and its cash flows for the years then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

#### **Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member  
Signing  
the Audit Report)  
(Designation<sup>17</sup>)  
Membership Number

Place of Signature  
Date

<sup>16</sup> Partner or Proprietor, as the case may be.

<sup>17</sup> The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

<sup>17</sup> Partner or Proprietor, as the case may be.

# Standard on Auditing (SA) 800

## Special Considerations — Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks

Your comments on the Exposure Draft should reach us by **October 30, 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 – 201301.**

Comments can also be e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

**Proposed Standard on Auditing (SA) 800, “Special Considerations — Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks”** 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”.

### Introduction

#### Scope of this SA

1. The Standards on Auditing (SAs) in the 100-700 series apply to an audit of financial statements. This SA deals with special considerations in the application of those SAs to an audit of financial statements prepared in accordance with a special purpose framework.
2. This SA is written in the context of a complete set of financial statements prepared in accordance with a special purpose framework. SA 805<sup>3</sup>, 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.
3. This SA does not override the requirements of the other SAs; nor does it purport to deal with all special considerations that may be relevant in the circumstances of the engagement.

#### Effective Date

4. This SA is effective for audits of financial statements for periods beginning on or after \_\_\_\_\_.

### Objective

5. The objective of the auditor, when applying SAs in an audit of financial statements prepared in accordance with a special purpose framework, is to address appropriately the special considerations that are relevant to:

- (a) The acceptance of the engagement;

- (b) The planning and performance of that engagement; and
- (c) Forming an opinion and reporting on the financial statements.

### Definitions

6. For purposes of the SAs, the following terms have the meanings attributed below:
  - (a) Special purpose financial statements – Financial statements prepared in accordance with a special purpose framework. (Ref: Para.A4)
  - (b) Special purpose framework – A financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.<sup>4</sup> (Ref: Para.A1-A4)

7. Reference to “financial statements” in this SA means “a complete set of special 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.

### Requirements

#### Considerations When Accepting the Engagement

#### Acceptability of the Financial Reporting Framework

8. SA 210 (Revised) requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements.<sup>5</sup> In an audit of special purpose financial statements, the auditor shall obtain an understanding of: (Ref: Para.A5-A8)

- (a) The purpose for which the financial statements are prepared;
- (b) The intended users; and
- (c) The steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

#### Considerations When Planning and Performing the Audit

9. Proposed SA 200 (Revised) requires the auditor to comply with all SAs relevant to the audit.<sup>6</sup> In planning and performing an audit of special purpose financial statements, the auditor shall determine whether application of the SAs requires special consideration in the circumstances of the engagement. (Ref: Para.A9-A12)

10. SA 315 requires the auditor to obtain an understanding of the entity's selection and application of accounting policies.<sup>7</sup> In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements. An interpretation is significant when adoption of another reasonable interpretation would have produced a material difference in the

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> 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. The Exposure Draft of Revised SA 200 has been published elsewhere in this issue of the Journal.

<sup>3</sup> Proposed SA 805, “Special Considerations- Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statements”.

<sup>4</sup> Proposed SA 200 (Revised), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing,” paragraph 13(a) of the Exposure Draft of revised SA 200.

<sup>5</sup> SA 210 (Revised), “Agreeing the Terms of Audit Engagements,” paragraph 6 (a).

<sup>6</sup> SA 200 (Revised), paragraph 18 of the Exposure Draft of revised SA 200.

<sup>7</sup> SA 315, “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment”, paragraph 11(c).

information presented in the financial statements.

#### *Forming an Opinion and Reporting Considerations*

11. When forming an opinion and reporting on special purpose financial statements, the auditor shall apply the requirements in proposed SA 700 (Revised).<sup>8</sup> (Ref: Para. A13)

#### *Description of the Applicable Financial Reporting Framework*

12. Proposed SA 700 (Revised) requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.<sup>9</sup> In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall evaluate whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based.

13. Proposed SA 700 (Revised) deals with the form and content of the auditor's report. In the case of an auditor's report on special purpose financial statements:

- (a) The auditor's report shall also describe the purpose for which the financial statements are prepared and, if necessary, the intended users, or refer to a note in the special purpose financial statements that contains that information; and
- (b) If management has a choice of financial reporting frameworks in the preparation of such financial statements, the explanation of management's responsibility for the financial statements shall also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

#### *Alerting Readers that the Financial Statements Are Prepared in Accordance with a Special Purpose Framework*

14. The auditor's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. The auditor shall include this paragraph under an appropriate heading. (Ref: Para. A14-A15)

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#### **Application and Other Explanatory Material**

##### *Special Purpose Frameworks*<sup>10</sup> (Ref: Para. 6)

A1. Examples of special purpose frameworks are:

- The cash receipts and disbursements basis of accounting for cash flow

information that an entity may be requested to prepare for creditors;

- The financial reporting provisions established by a regulator to meet the requirements of that regulator; or
- The financial reporting provisions of a contract, such as a bond indenture, a loan agreement, or a project grant.

A2. There may be circumstances where a special purpose framework is based on a financial reporting framework established by an authorised or recognised standards setting organisation or by law or regulation, but does not comply with all the requirements of that framework. An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of the Financial Reporting Standards of Jurisdiction X. When this is acceptable in the circumstances of the engagement, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply full compliance with the financial reporting framework established by the authorised or recognised standards setting organisation or by law or regulation. In the above example of the contract, the description of the applicable financial reporting framework may refer to the financial reporting provisions of the contract, rather than make any reference to the Financial Reporting Standards of Jurisdiction X.

A3. In the circumstances described in paragraph A2, the special purpose framework may not be a fair presentation framework even if the financial reporting framework on which it is based is a fair presentation framework. This is because the special purpose framework may not comply with all the requirements of the financial reporting framework established by the authorised or recognised standards setting organisation or by law or regulation that are necessary to achieve fair presentation of the financial statements.

A4. Financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements in those circumstances, the financial statements are still considered to be special purpose financial statements for purposes of the SAs. The requirements in paragraphs 13-14 are designed to avoid misunderstandings about the purpose for which the financial statements are prepared.

#### *Considerations When Accepting the Engagement*

##### *Acceptability of the Financial Reporting Framework* (Ref: Para. 8)

A5. In the case of special purpose financial statements, the financial information needs of the intended users are a key factor in determining the acceptability of the financial reporting framework applied in the preparation of the financial statements.

A6. The applicable financial reporting framework may encompass the financial reporting standards established by an organisation that is authorised or recognised to promulgate standards for special purpose financial statements. In that case, those standards will be presumed acceptable for that purpose if the organisation follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. In some jurisdictions, law or regulation may prescribe the financial reporting framework to be used by management in the preparation of special purpose financial statements for a certain type of entity. For example, a regulator may establish financial reporting provisions to meet the requirements of that regulator. In the absence of indications to the contrary, such a financial reporting framework is presumed acceptable for special purpose financial statements prepared by such entity.

A7. Where the financial reporting standards referred to in paragraph A6 are supplemented by legislative or regulatory requirements, SA 210 (Revised) requires the auditor to determine whether any conflicts between the financial reporting standards and the additional requirements exist, and prescribes actions to be taken by the auditor if such conflicts exist<sup>11</sup>.

A8. The applicable financial reporting framework may encompass the financial reporting provisions of a contract, or sources other than those described in paragraphs A6 and A7. In that case, the acceptability of the financial reporting framework in the circumstances of the engagement is determined by considering whether the framework exhibits attributes normally exhibited by acceptable financial reporting frameworks as described in Appendix 2 of SA 210 (Revised). In the case of a special purpose framework, the relative importance to a particular engagement of each of the attributes normally exhibited by acceptable financial reporting frameworks is a matter of professional judgment. For example, for purposes of establishing the value of net assets of an entity at the date of its sale, the vendor and the purchaser may have agreed that very prudent estimates of allowances

<sup>8</sup> Proposed SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements".

<sup>9</sup> SA 700 (Revised), paragraph 15 of the Exposure Draft of revised SA 700. The same has been published in the June, 2009 issue of the Journal.

<sup>10</sup> In India, financial statements prepared for filing with income tax authorities are considered to be general purpose financial statements. Attention of the readers are also invited to the announcement published in "The Chartered Accountant", August 1994 (page 224) which states that: "It is hereby clarified that the mandatory accounting standards also apply in respect of financial statements audited under section 44AB of the Income Tax Act, 1961. Accordingly, members should examine compliance with the mandatory accounting standards when conducting such audit".

<sup>11</sup> SA 210 (Revised), paragraph 18.

for uncollectible accounts receivable are appropriate for their needs, even though such financial information is not neutral when compared with financial information prepared in accordance with a general purpose framework.

#### *Considerations When Planning and Performing the Audit* (Ref: Para. 9)

A9. Proposed SA 200 (Revised) requires the auditor to comply with (a) relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements, and (b) all SAs relevant to the audit. It also requires the auditor to comply with each requirement of an SA unless, in the circumstances of the audit, the entire SA is not relevant or the requirement is not relevant because it is conditional and the condition does not exist. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement<sup>12</sup>.

A10. Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor. For example, in SA 320 (Revised), judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group<sup>13</sup>. In the case of an audit of special purpose financial statements, however, those judgments are based on a consideration of the financial information needs of the intended users.

A11. In the case of special purpose financial statements, such as those prepared in accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 (Revised) for purposes of planning and performing the audit of the special purpose financial statements.

A12. Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility; for example, when the financial information is prepared solely for management's use. In such cases, the requirements of SA 260 (Revised)<sup>14</sup> may not be relevant to the audit of the special purpose financial statements, except when

the auditor is also responsible for the audit of the entity's general purpose financial statements or, for example, has agreed with those charged with governance of the entity to communicate to them relevant matters identified during the audit of the special purpose financial statements.

#### *Forming an Opinion and Reporting Considerations* (Ref: Para. 11)

A13. The Appendix to this SA contains illustrations of auditors' reports on special purpose financial statements.

#### *Alerting Readers that the Financial Statements Are Prepared in Accordance with a Special Purpose Framework* (Ref: Para. 14)

A14. The special purpose financial statements may be used for purposes other than those for which they were intended. For example, a regulator may require certain entities to place the special purpose financial statements on public record. To avoid misunderstandings, the auditor alerts users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and, therefore, may not be suitable for another purpose.

#### *Restriction on Distribution or Use* (Ref: Para. 14)

A15. In addition to the alert required by paragraph 14, the auditor may consider it appropriate to indicate that the auditor's report is intended solely for the specific users. Depending on the law or regulation of the particular jurisdiction, this may be achieved by restricting the distribution or use of the auditor's report. In these circumstances, the paragraph referred to in paragraph 14 may be expanded to include these other matters, and the heading modified accordingly.

#### **Material Modifications vis-a-vis ISA 800, "Special Considerations — Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks"**

##### *Deletion*

Paragraph A1 of ISA 800 deals with the examples of special purpose frameworks, which also includes a tax basis of accounting for a set of financial statements that accompany an entity's tax return. Since in India, financial statements prepared for filing with income tax authorities are considered to be general purpose financial statements and as per the announcement issued under the authority of the Council of the Institute of Chartered Accountants of India (ICAI) in August, 1994, the mandatory accounting standards should also be applied in respect of financial statements audited under section 44AB of the Income Tax Act, 1961, an example, "A tax basis of accounting for a set of financial statements that accompany an entity's tax return" has been deleted.

## Appendix

(Ref: Para. A13)

### **Illustrations of Auditors' Reports on Special Purpose Financial Statements**

Illustration 1: An auditor's report on a complete set of financial statements prepared in accordance with the financial reporting provisions of a contract (for purposes of this illustration, a compliance framework).

Illustration 2: An auditor's report on a complete set of financial statements prepared in accordance with the financial reporting provisions established by a regulator (for purposes of this illustration, a fair presentation framework).

#### *Illustration 1:*

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with the financial reporting provisions of a contract (i.e., a special purpose framework) to comply with the provisions of that contract. Management does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a compliance framework.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210 (Revised).
- Distribution and use of the auditor's report are restricted.

### INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying financial statements of ABC Company Ltd., which comprise the balance sheet as at March 31, 20X1, 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. The financial statements have been prepared by management of ABC Company Ltd. based on the financial reporting provisions of section/clause Z of the contract dated July 1, 20X0 between ABC Company and DEF Company Ltd. ("the contract").

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation of these financial statements in accordance with the financial reporting provisions of section/clause Z of the contract; this 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.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on

<sup>12</sup> Proposed SA 200 (Revised), paragraphs 14, 18 and 22-23 of the Exposure Draft of revised SA 200.

<sup>13</sup> SA 320 (Revised), "Materiality in Planning and Performing an Audit", paragraph 2.

<sup>14</sup> SA 260 (Revised), "Communication with Those Charged with Governance".

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 (ICAI). 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 entity'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 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, the financial statements of ABC Company Ltd. for the year ended March 31, 20X1 are prepared, in all material respects, in accordance with the financial reporting provisions of section/clause Z of the contract.

#### *Basis of Accounting and Restriction on Distribution and Use*

Without modifying our opinion, we draw attention to Note X to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist ABC Company Ltd. to comply with the financial reporting provisions of the contract referred to above. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for ABC Company Ltd. and DEF Company Ltd. and should not be distributed to or used by parties other than ABC Company Ltd. or DEF Company Ltd.

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>15</sup>)  
Membership Number

Place of Signature  
Date

<sup>15</sup> Partner or Proprietor, as the case may be.  
<sup>16</sup> Partner or Proprietor, as the case may be.

#### **Illustration 2:**

**Circumstances include the following:**

- **The financial statements have been prepared by management of the entity in accordance with the financial reporting provisions established by a regulator (i.e., a special purpose framework) to meet the requirements of that regulator.**
- **Management does not have a choice of financial reporting frameworks.**
- **The applicable financial reporting framework is a fair presentation framework. The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210 (Revised).**
- **Distribution or use of the auditor's report is not restricted.**
- **The Other Matter paragraph refers to the fact that the auditor has also issued an auditor's report on financial statements prepared by ABC Company Ltd. for the same period in accordance with a general purpose framework.**

#### INDEPENDENT AUDITOR'S REPORT

##### [Appropriate Addressee]

We have audited the accompanying financial statements of ABC Company Ltd., which comprise the balance sheet as at March 31, 20X1, 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. The financial statements have been prepared by management based on the financial reporting provisions of Section Y of Regulation Z.

#### *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 state of affairs, results of operations and cash flows of the Company in accordance with the financial reporting provisions of Section Y of Regulation Z; this 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 Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). 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 entity'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 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 a true and fair view of the state of affairs of ABC Company Ltd. as at March 31, 20X1, and of its results of operations and its cash flows for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z.

#### *Basis of Accounting*

Without modifying our opinion, we draw attention to Note X to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist ABC Company Ltd. to meet the requirements of Regulator DEF. As a result, the financial statements may not be suitable for another purpose.

#### *Other Matter*

ABC Company Ltd. has prepared a separate set of financial statements for the year ended March 31, 20X1 in accordance with the Accounting Standards referred to in subsection (3C) of Section 211 of the Companies Act, 1956 ("the Act") on which we issued a separate auditor's report to the shareholders of ABC Company Ltd. dated June 30, 20X1.

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>16</sup>)  
Membership Number

Place of Signature  
Date

# Standard on Auditing (SA) 805

## Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement

Your comments on the Exposure Draft should reach us by **October 30, 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 e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

**Proposed Standard on Auditing (SA) 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement"** should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services<sup>1</sup>," 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"<sup>2</sup>.

### Introduction

#### Scope of this SA

- The Standards on Auditing (SAs) in the 100-700 series apply to an audit of financial statements and are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. This SA deals with special considerations in the application of those SAs to an audit of a single financial statement or of a specific element, account or item of a financial statement. The single financial statement or the specific element, account or item of a financial statement may be prepared in accordance with a general or special purpose framework. If prepared in accordance with a special purpose framework, SA 800<sup>3</sup> also applies to the audit. (Ref: Para. A1-A4)
- This SA does not apply to the report of a component auditor, issued as a result of work performed on the financial information of a component at the request of a group engagement team for purposes of an audit of group financial statements (see Proposed SA 600)(Revised)<sup>4</sup>).
- This SA does not override the requirements of the other SAs; nor does it purport to deal with all special considerations that may be relevant in the circumstances of the engagement.

#### Effective Date

- This SA is effective for audits of single

financial statements or of specific elements, accounts or items for periods beginning on or after ..... In the case of audits of single financial statements or of specific elements, accounts or items of a financial statement prepared as at a specific date, this SA is effective for audits of such information prepared as at a date on or after .....

### Objective

- The objective of the auditor, when applying SAs in an audit of a single financial statement or of a specific element, account or item of a financial statement, is to address appropriately the special considerations that are relevant to:
  - The acceptance of the engagement;
  - The planning and performance of that engagement; and
  - Forming an opinion and reporting on the single financial statement or on the specific element, account or item of a financial statement.

### Definitions

- For purposes of this SA, reference to:
  - "Element of a financial statement" or "element" means an "element, account or item of a financial statement";
  - "Financial Reporting Standards" 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; and

- A single financial statement (for example, a cash flow statement) or to a specific element of a financial statement (for example, cash and bank balances) includes the related notes. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information relevant to the financial statement or to the element.

### Requirements

#### Considerations When Accepting the Engagement

##### Application of SAs

- Proposed SA 200 (Revised) requires the auditor to comply with all SAs relevant to the audit<sup>5</sup>. In the case of an audit of a single financial statement or of a specific element of a financial statement, this requirement applies irrespective of whether the auditor is also engaged to audit the entity's complete set of financial statements. If the auditor is

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> 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. The Exposure Draft of Revised SA 200 has been published elsewhere in this issue of the Journal.

<sup>3</sup> Proposed SA 800, "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks". The Exposure Draft of SA 800 has been published elsewhere in this issue of the Journal.

<sup>4</sup> Currently, SA 600 (AAS 10), "Using the Work of Another Auditor" is in force. The Standard is being revised in the light of the corresponding International Standard on Auditing (ISA) 600 (Revised and Redrafted), "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)".

<sup>5</sup> Proposed SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", paragraph 18 of the Exposure Draft of revised SA 200.

not also engaged to audit the entity's complete set of financial statements, the auditor shall determine whether the audit of a single financial statement or of a specific element of those financial statements in accordance with SAs is practicable. (Ref: Para.A5-A6)

#### **Acceptability of the Financial Reporting Framework**

8. SA 210 (Revised) requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements.<sup>6</sup> In the case of an audit of a single financial statement or of a specific element of a financial statement, this shall include whether application of the financial reporting framework will result in a presentation that provides adequate disclosures to enable the intended users to understand the information conveyed in the financial statement or the element, and the effect of material transactions and events on the information conveyed in the financial statement or the element. (Ref: Para. A7)

#### **Form of Opinion**

9. SA 210 (Revised) requires that the agreed terms of the audit engagement include the expected form of any reports to be issued by the auditor<sup>7</sup>. In the case of an audit of a single financial statement or of a specific element of a financial statement, the auditor shall consider whether the expected form of opinion is appropriate in the circumstances. (Ref: Para. A8-A9)

#### **Considerations When Planning and Performing the Audit**

10. Proposed SA 200 (Revised) states that SAs are written in the context of an audit of financial statements; they are to be adapted as necessary in the circumstances when applied to audits of other historical financial information<sup>8</sup>. In planning and performing the audit of a single financial statement or of a specific element of a financial statement, the auditor shall adapt all SAs relevant to the audit as necessary in the circumstances of the engagement. (Ref: Para. A10-A14)

#### **Forming an Opinion and Reporting Considerations**

11. When forming an opinion and reporting on a single financial statement or on a specific element of a financial statement, the auditor shall apply the requirements in Proposed SA 700 (Revised)<sup>9</sup>, adapted as necessary in the circumstances of the engagement. (Ref: Para. A15-A16)

#### **Reporting on the Entity's Complete Set of Financial Statements and on a Single Financial Statement or on a Specific Element of Those Financial Statements**

12. If the auditor undertakes an engagement

to report on a single financial statement or on a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, the auditor shall express a separate opinion for each engagement.

13. An audited single financial statement or an audited specific element of a financial statement may be published together with the entity's audited complete set of financial statements. If the auditor concludes that the presentation of the single financial statement or of the specific element of a financial statement does not differentiate it sufficiently from the complete set of financial statements, the auditor shall ask management to rectify the situation. Subject to paragraphs 15 and 16, the auditor shall also differentiate the opinion on the single financial statement or on the specific element of a financial statement from the opinion on the complete set of financial statements. The auditor shall not issue the auditor's report containing the opinion on the single financial statement or on the specific element of a financial statement until satisfied with the differentiation.

*Modified Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor's Report on the Entity's Complete Set of Financial Statements*

14. If the opinion in the auditor's report on an entity's complete set of financial statements is modified, or that report includes an Emphasis of Matter paragraph or an Other Matter paragraph, the auditor shall determine the effect that this may have on the auditor's report on a single financial statement or on a specific element of those financial statements. When deemed appropriate, the auditor shall modify the opinion on the single financial statement or on the specific element of a financial statement, or include an Emphasis of Matter paragraph or an Other Matter paragraph in the auditor's report, accordingly. (Ref: Para. A17)

15. If the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set of financial statements as a whole, Proposed SA 705 does not permit the auditor to include in the same auditor's report an unmodified opinion on a single financial statement that forms part of those financial statements or on a specific element that forms part of those financial statements<sup>10</sup>. This is because such an unmodified opinion would contradict the adverse opinion or disclaimer of opinion on the entity's complete set of financial statements as a whole. (Ref: Para. A18)

16. If the auditor concludes that it is necessary to express an adverse opinion or

disclaim an opinion on the entity's complete set of financial statements as a whole but, in the context of a separate audit of a specific element that is included in those financial statements, the auditor nevertheless considers it appropriate to express an unmodified opinion on that element, the auditor shall only do so if:

- (a) The auditor is not prohibited by law or regulation from doing so;
- (b) That opinion is expressed in an auditor's report that is not published together with the auditor's report containing the adverse opinion or disclaimer of opinion; and
- (c) The specific element does not constitute a major portion of the entity's complete set of financial statements.

17. The auditor shall not express an unmodified opinion on a single financial statement of a complete set of financial statements if the auditor has expressed an adverse opinion or disclaimed an opinion on the complete set of financial statements as a whole. This is the case even if the auditor's report on the single financial statement is not published together with the auditor's report containing the adverse opinion or disclaimer of opinion. This is because a single financial statement is deemed to constitute a major portion of those financial statements.

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#### **Application and Other Explanatory Material**

##### **Scope of this SA** (Ref: Para. 1)

A1. Proposed SA 200 (Revised) defines the term "historical financial information" as information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past<sup>11</sup>.

A2. Proposed SA 200 (Revised) defines the term "financial statements" as a structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework<sup>12</sup>.

A3. SAs are written in the context of an audit of financial statements<sup>13</sup>; they are to be adapted as necessary in the circumstances when applied to an audit of other historical financial information, such as a single financial statement or a specific element of a

<sup>6</sup> SA 210 (Revised), "Agreeing the Terms of Audit Engagements," paragraph 6 (a).

<sup>7</sup> SA 210 (Revised), paragraph 10 (e).

<sup>8</sup> Proposed SA 200 (Revised), paragraph 2 of the Exposure Draft of revised SA 200.

<sup>9</sup> Proposed SA 200 (Revised), paragraph 13(f) of the Exposure Draft of revised SA 200, explains that the term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework.

<sup>10</sup> Proposed SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements".

<sup>11</sup> Proposed SA 705, "Modifications to the Opinion in the Independent Auditor's Report", paragraph 15 of the Exposure Draft of SA 705. The same has been published in the June, 2009 issue of the Journal.

<sup>12</sup> Proposed SA 200 (Revised), paragraph 13(g) of the Exposure Draft of revised SA 200.

<sup>13</sup> Proposed SA 200 (Revised), paragraph 13(f) of the Exposure Draft of revised SA 200.

<sup>14</sup> Proposed SA 200 (Revised), paragraph 2 of the Exposure Draft of revised SA 200.

financial statement. This SA assists in this regard. (Appendix 1 lists examples of such other historical financial information.)

A4. A reasonable assurance engagement other than an audit of historical financial information is performed in accordance with Proposed Standard on Assurance Engagements (SAE) 3000<sup>16</sup>.

#### *Considerations When Accepting the Engagement*

##### *Application of SAs* (Ref: Para. 7)

A5. Proposed SA 200 (Revised) requires the auditor to comply with (a) relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements, and (b) all SAs relevant to the audit. It also requires the auditor to comply with each requirement of an SA unless, in the circumstances of the audit, the entire SA is not relevant or the requirement is not relevant because it is conditional and the condition does not exist. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement<sup>17</sup>.

A6. Compliance with the requirements of SAs relevant to the audit of a single financial statement or of a specific element of a financial statement may not be practicable when the auditor is not also engaged to audit the entity's complete set of financial statements. In such cases, the auditor often does not have the same understanding of the entity and its environment, including its internal control, as an auditor who also audits the entity's complete set of financial statements. The auditor also does not have the audit evidence about the general quality of the accounting records or other accounting information that would be acquired in an audit of the entity's complete set of financial statements. Accordingly, the auditor may need further evidence to corroborate audit evidence acquired from the accounting records. In the case of an audit of a specific element of a financial statement, certain SAs require audit work that may be disproportionate to the element being audited. For example, although the requirements of SA 570 (Revised)<sup>18</sup> are likely to be relevant in the circumstances of an audit of a schedule of accounts receivable, complying with those requirements may not be practicable because of the audit effort required. If the auditor concludes that an audit of a single financial statement or of a specific element of a financial statement in accordance with SAs may not be practicable, the auditor may discuss with management whether another type of engagement might be more practicable.

#### *Acceptability of the Financial Reporting Framework* (Ref: Para. 8)

A7. A single financial statement or a specific element of a financial statement may be prepared in accordance with an applicable financial reporting framework that is based on a financial reporting framework established by an authorized or recognized standards setting organization for the preparation of a complete set of financial statements (e.g., Financial Reporting Standards). If this is the case, determination of the acceptability of the applicable framework may involve considering whether that framework includes all the requirements of the framework on which it is based that are relevant to the presentation of a single financial statement or of a specific element of a financial statement that provides adequate disclosures.

#### *Form of Opinion* (Ref: Para. 9)

A8. The form of opinion to be expressed by the auditor depends on the applicable financial reporting framework and any applicable laws or regulations.<sup>19</sup> In accordance with Proposed SA 700 (Revised):<sup>20</sup>

- (a) When expressing an unmodified opinion on a complete set of financial statements prepared in accordance with a fair presentation framework, the auditor's opinion, unless otherwise required by law or regulation, uses one of the following phrases:
  - (i) the financial statements present fairly, in all material respects, in accordance with [the applicable financial reporting framework]; or
  - (ii) the financial statements give a true and fair view in accordance with [the applicable financial reporting framework]; and
- (b) When expressing an unmodified opinion on a complete set of financial statements prepared in accordance with a compliance framework, the auditor's opinion states that the financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework].
- A9. In the case of a single financial statement or of a specific element of a financial statement, the applicable financial reporting framework may not explicitly address the presentation of the financial statement or of the element. This may be the case when the applicable financial reporting framework is based on a financial reporting framework established by an authorized or recognized standards setting organization for the preparation of a complete set of financial statements (e.g., Financial Reporting Standards). The auditor therefore considers

whether the expected form of opinion is appropriate in the light of the applicable financial reporting framework. Factors that may affect the auditor's consideration as to whether to use the phrases "presents fairly, in all material respects," or "gives a true and fair view" in the auditor's opinion include:

- Whether the applicable financial reporting framework is explicitly or implicitly restricted to the preparation of a complete set of financial statements.
- Whether the single financial statement or the specific element of a financial statement will:
  - Comply fully with each of those requirements of the framework relevant to the particular financial statement or the particular element, and the presentation of the financial statement or the element include the related notes.
  - If necessary to achieve fair presentation, provide disclosures beyond those specifically required by the framework or, in exceptional circumstances, depart from a requirement of the framework.

The auditor's decision as to the expected form of opinion is a matter of professional judgment. It may be affected by whether use of the phrases "presents fairly, in all material respects," or "gives a true and fair view" in the auditor's opinion on a single financial statement or on a specific element of a financial statement prepared in accordance with a fair presentation framework is generally accepted in the particular jurisdiction.

#### *Considerations When Planning and Performing the Audit* (Ref: Para. 10)

A10. The relevance of each of the SAs requires careful consideration. Even when only a specific element of a financial statement is the subject of the audit, SAs such as SA 240 (Revised)<sup>21</sup>, SA 550 (Revised)<sup>22</sup> and SA 570 (Revised) are, in principle, relevant. This is because the element could be misstated as a result of fraud, the effect of related party transactions, or the incorrect application of the going concern assumption under the applicable financial reporting framework.

A11. Furthermore, SAs are written in the context of an audit of financial statements; they are to be adapted as necessary in the circumstances when applied to the audit of a single financial statement or of a specific element of a financial statement<sup>23</sup>. For example, written representations from management about the complete set of financial statements would be replaced by written representations about the presentation of the financial statement or the element in accordance with the applicable financial reporting framework.

<sup>16</sup> Presently, there is no corresponding SAE corresponding to ISAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information." The Standard is being formulated in the light of the corresponding International Standard.

<sup>17</sup> Proposed SA 200 (Revised), paragraphs 4, 18 and 22-23 of the Exposure Draft of revised SA 200.

<sup>18</sup> SA 570 (Revised), "Going Concern".

<sup>19</sup> Proposed SA 200 (Revised), paragraph 8 of the Exposure Draft of revised SA 200.

<sup>20</sup> Proposed SA 700 (Revised), paragraphs 35-36 of the Exposure Draft of revised SA 700. The same has been published in the June, 2009 issue of the Journal.

<sup>21</sup> SA 240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements".

<sup>22</sup> SA 550 (Revised), "Related Parties".

<sup>23</sup> Proposed SA 200 (Revised), paragraph 2 of the Exposure Draft of revised SA 200.

A12. When auditing a single financial statement or a specific element of a financial statement in conjunction with the audit of the entity's complete set of financial statements, the auditor may be able to use audit evidence obtained as part of the audit of the entity's complete set of financial statements in the audit of the financial statement or the element. SAs, however, require the auditor to plan and perform the audit of the financial statement or element to obtain sufficient appropriate audit evidence on which to base the opinion on the financial statement or on the element.

A13. The individual financial statements that comprise a complete set of financial statements, and many of the elements of those financial statements, including their related notes, are interrelated. Accordingly, when auditing a single financial statement or a specific element of a financial statement, the auditor may not be able to consider the financial statement or the element in isolation. Consequently, the auditor may need to perform procedures in relation to the interrelated items to meet the objective of the audit.

A14. Furthermore, the materiality determined for a single financial statement or for a specific element of a financial statement may be lower than the materiality determined for the entity's complete set of financial statements; this will affect the nature, timing and extent of the audit procedures and the evaluation of uncorrected misstatements.

#### *Forming an Opinion and Reporting Considerations* (Ref: Para.11,14)

A15. Proposed SA 700 (Revised) requires the auditor, in forming an opinion, to evaluate whether 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<sup>33</sup>. In the case of a single financial statement or of a specific element of a financial statement, it is important that the financial statement or the element, including the related notes, in view of the requirements of the applicable financial reporting framework, provides adequate disclosures to enable the intended users to understand the information conveyed in the financial statement or the element, and the effect of material transactions and events on the information conveyed in the financial statement or the element.

A16. Appendix 2 of this SA contains illustrations of auditors' reports on a single financial statement and on a specific element of a financial statement.

#### *Modified Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor's Report on the Entity's Complete Set of Financial Statements* (Ref: Para. 14-15)

A17. Even when the modified opinion on the entity's complete set of financial statements, Emphasis of Matter paragraph or Other

Matter paragraph does not relate to the audited financial statement or the audited element, the auditor may still deem it appropriate to refer to the modification in an Other Matter paragraph in an auditor's report on the financial statement or on the element because the auditor judges it to be relevant to the users' understanding of the audited financial statement or the audited element or the related auditor's report (see Proposed SA 706)<sup>34</sup>.

A18. In the auditor's report on an entity's complete set of financial statements, the expression of a disclaimer of opinion regarding the results of operations and cash flows, where relevant, and an unmodified opinion regarding the state of affairs is permitted since the disclaimer of opinion is being issued in respect of the results of operations and cash flows only and not in respect of the financial statements as a whole<sup>35</sup>.

#### **Material Modifications vis-a-vis ISA 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement"**

##### *Addition*

Paragraph 6(b) of ISA 805 defines the meaning of the International Financial Reporting Standards (IFRS). 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 6(b) has, accordingly, been changed. Corresponding changes have also been made at the relevant places of the Standard.

#### **Appendix 1**

(Ref: Para. A3)

#### **Examples of Specific Elements, Accounts or Items of a Financial Statement**

- Accounts receivable, allowance for doubtful accounts receivable, inventory, the liability for accrued benefits of a private pension plan, the recorded value of identified intangible assets, or the liability for "incurred but not reported" claims in an insurance portfolio, including related notes.
- A schedule of externally managed assets and income of a private pension plan, including related notes.

- A schedule of net tangible assets, including related notes.
- A schedule of disbursements in relation to a lease property, including explanatory notes.
- A schedule of profit participation or employee bonuses, including explanatory notes.

#### **Appendix 2**

(Ref: Para. A16)

#### **Illustrations of Auditors' Reports on a Single Financial Statement and on a Specific Element of a Financial Statement**

- Illustration 1: An auditor's report on a single financial statement prepared in accordance with a general purpose framework (for purposes of this illustration, a fair presentation framework).
- Illustration 2: An auditor's report on a single financial statement prepared in accordance with a special purpose framework (for purposes of this illustration, a fair presentation framework).
- Illustration 3: An auditor's report on a specific element, account or item of a financial statement prepared in accordance with a special purpose framework (for purposes of this illustration, a compliance framework).

##### *Illustration 1:*

*Circumstances include the following:*

- Audit of a balance sheet (i.e., a single financial statement).
- The balance sheet has been prepared by management of the entity in accordance with the requirements of the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") relevant to preparing a balance sheet.
- The applicable financial reporting framework is a fair presentation framework designed to meet the common financial information needs of a wide range of users.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210 (Revised).
- The auditor has determined that it is appropriate to use the phrase "presents a true and fair view", in the auditor's opinion.

#### **INDEPENDENT AUDITOR'S REPORT**

[Appropriate Addressee]

We have audited the accompanying balance sheet of ABC Company Ltd. as at March 31, 20X1 and a summary of significant accounting policies and other explanatory information (together "the financial statement").

<sup>33</sup> Proposed SA 700 (Revised), paragraph 13(e) of the Exposure Draft of revised SA 700. The same has been published in the June, 2009 issue of the Journal.

<sup>34</sup> Proposed SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", paragraph 6 of the Exposure Draft of SA 706. The same has been published in the June, 2009 issue of the Journal.

<sup>35</sup> SA 510 (Revised), "Initial Audit Engagements—Opening Balances", paragraph A5, and Proposed SA 705, paragraph A16 of the Exposure Draft of SA 705. The same has been published in the June, 2009 issue of the Journal.

### **Management's<sup>26</sup> Responsibility for the Financial Statement**

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the requirements of the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"), relevant to preparing such a financial statement. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement 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 accounting estimates, if any, made by management, as well as evaluating the overall presentation of the financial statement.

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, the financial statement presents a true and fair view of the state of affairs of ABC Company Ltd. as at March 31, 20X1 in accordance with those requirements of the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"), relevant to preparing such a financial statement.

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>27</sup>)  
Membership Number

Place of Signature  
Date

### **Illustration 2:**

Circumstances include the following:

- Audit of a statement of cash receipts and disbursements (i.e., a single financial statement).
- The financial statement has been prepared by management of the entity in accordance with the cash receipts and disbursements basis of accounting to respond to a request for cash flow information received from a creditor. Management has a choice of financial reporting frameworks.
- The applicable financial reporting framework is a fair presentation framework designed to meet the financial information needs of specific users<sup>28</sup>.
- The auditor has determined that it is appropriate to use the phrase "true and fair view" in the auditor's opinion.
- Distribution or use of the auditor's report is not restricted.

### **INDEPENDENT AUDITOR'S REPORT**

#### **[Appropriate Addressee]**

We have audited the accompanying statement of cash receipts and disbursements of ABC Company Ltd. for the year ended March 31, 20X1 and a summary of significant accounting policies and other explanatory information (together "the financial statement"). The financial statement has been prepared by management using the cash receipts and disbursements basis of accounting described in Note X.

### **Management's<sup>29</sup> Responsibility for the Financial Statement**

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the cash receipts and disbursements basis of accounting described in Note X; this includes determining that the cash receipts and disbursements basis of accounting is an acceptable basis for the preparation of the financial statement in the circumstances, and the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's

judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement 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 accounting estimates, if any, made by management, as well as evaluating the overall presentation of the financial statement.

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, the financial statement presents a true and fair view of the cash receipts and disbursements of ABC Company Ltd. for the year ended March 31, 20X1 in accordance with the cash receipts and disbursements basis of accounting described in Note X.

#### **Basis of Accounting**

Without modifying our opinion, we draw attention to Note X to the financial statement, which describes the basis of accounting. The financial statement is prepared to provide information to XYZ Creditor. As a result, the statement may not be suitable for another purpose.

For XYZ and Co.  
Chartered Accountants  
Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>29</sup>)  
Membership Number

Place of Signature

Date

### **Illustration 3:**

Circumstances include the following:

- Audit of the liability for "incurred but not reported" claims in an insurance portfolio (i.e., element, account or item of a financial statement).
- The financial information has been prepared by management of the entity in accordance with the financial reporting provisions established by a regulator to meet the requirements of that regulator. Management does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a compliance framework designed to meet the financial information needs of specific users<sup>30</sup>.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210 (Revised).
- Distribution of the auditor's report is restricted.

<sup>26</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>27</sup> Partner or Proprietor, as the case may be.

<sup>28</sup> SA 800 contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

<sup>29</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>30</sup> Partner or Proprietor, as the case may be.

<sup>31</sup> SA 800 contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

## INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the accompanying schedule of the liability for "incurred but not reported" claims of ABC Insurance Company as of March 31, 20X1 ("the schedule"). The schedule has been prepared by management based on [describe the financial reporting provisions established by the regulator].

***Management's<sup>32</sup> Responsibility for the Schedule***

Management is responsible for the preparation of the schedule in accordance with [describe the financial reporting provisions established by the regulator]; this includes the design, implementation and maintenance of internal control relevant to the preparation of the schedule that is free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

Our responsibility is to express an opinion on the schedule based on our audit. We conducted our audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI). Those standards require that we comply with

ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the schedule is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the schedule 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 accounting estimates made by management, as well as evaluating the overall presentation of the schedule.

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, the financial information in the schedule of the liability for "incurred but not

reported" claims of ABC Insurance Company as of March 31, 20X1 is prepared, in all material respects, in accordance with [describe the financial reporting provisions established by the regulator].

***Basis of Accounting and Restriction on Distribution***

Without modifying our opinion, we draw attention to Note X to the schedule, which describes the basis of accounting. The schedule is prepared to assist ABC Insurance Company to meet the requirements of Regulator DEF. As a result, the schedule may not be suitable for another purpose. Our report is intended solely for ABC Insurance Company and Regulator DEF and should not be distributed to parties other than ABC Insurance Company or Regulator DEF.

For XYZ and Co.  
Chartered Accountants  
Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>33</sup>)  
Membership Number

Place of Signature  
Date

<sup>32</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>33</sup> Partner or Proprietor, as the case may be.

# Standard on Auditing (SA) 810

## Engagements to Report on Summary Financial Statements

Your comments on the Exposure Draft should reach us by **October 30, 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 e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

**Proposed Standard on Auditing (SA) 810, "Engagements to Report on Summary 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".<sup>2</sup>**

### Introduction

#### Scope of this SA

- This Standard on Auditing (SA) deals with the auditor's responsibilities when undertaking an engagement to report on summary financial statements derived from financial statements audited in accordance with SAs by that same auditor.

#### Effective Date

- This SA is effective for engagements for periods beginning on or after.....

### Objectives

- The objectives of the auditor are to:

- (a) Determine whether it is appropriate to accept the engagement to report on summary financial statements;
- (b) Form an opinion on the summary financial statements based on an evaluation of the conclusions drawn from the evidence obtained; and
- (c) Express clearly that opinion through a written report that also describes the basis for that opinion.

### Definitions

- For purposes of this SA, the following terms have the meanings attributed below:
- (a) Applied criteria – The criteria applied by management in the preparation of the summary financial statements.
  - (b) Audited financial statements – Financial statements<sup>3</sup> audited by the auditor in accordance with SAs, and from which the summary financial statements are derived.
  - (c) Summary financial statements – Historical financial information that is derived from financial statements but that contains less detail than the financial

statements, while still providing a structured representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time<sup>4</sup>. Different jurisdictions may use different terminology to describe such historical financial information.

preparation of the summary financial statements, to describe that law or regulation in the summary financial statements); and

- iii. To include the auditor's report on the summary financial statements in any document that contains the summary financial statements and that indicates that the auditor has reported on them.

- (c) Agree with management the form of opinion to be expressed on the summary financial statements (see paragraphs 9–11).

- 7. If the auditor concludes that the applied criteria are unacceptable or is unable to obtain the agreement of management set out in paragraph 6(b), the auditor shall not accept the engagement to report on the summary financial statements, unless required by law or regulation to do so. An engagement conducted in accordance with such law or regulation does not comply with this SA. Accordingly, the auditor's report on the summary financial statements shall not indicate that the engagement was conducted in accordance with this SA. The auditor shall include appropriate reference to this fact in the terms of the engagement. The auditor shall also determine the effect that this may have on the engagement to audit the financial statements from which the summary financial statements are derived.

#### Nature of Procedures

- 8. The auditor shall perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor's opinion on the summary financial statements:

- (a) Evaluate whether the summary financial

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> 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. The Exposure Draft of Proposed Revised SA 200 has been published elsewhere in this issue of the Journal.

<sup>3</sup> Proposed SA 200(Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing," paragraph 13(f) of the Exposure Draft of Revised SA 200, defines the term "financial statements".

<sup>4</sup> SA 200(Revised), paragraph 13(f) of the Exposure Draft of Revised SA 200.

- statements adequately disclose their summarised nature and identify the audited financial statements.
- (b) When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:
- From whom or where the audited financial statements are available; or
  - The law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements.
- (c) Evaluate whether the summary financial statements adequately disclose the applied criteria.
- (d) Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be re-calculated from the related information in the audited financial statements.
- (e) Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.
- (f) Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.
- (g) Evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty, unless law or regulation provides that they need not be made available and establishes the criteria for the preparation of the summary financial statements. (Ref: Para. A8)

#### *Form of Opinion*

9. When the auditor has concluded that an unmodified opinion on the summary financial statements is appropriate, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases: (Ref: Para. A9)
- The summary financial statements are consistent, in all material respects, with the audited financial statements, in accordance with [the applied criteria]; or
  - The summary financial statements are a fair summary of the audited financial statements, in accordance with [the applied criteria].
10. If law or regulation prescribes the wording of the opinion on summary financial statements in terms that are different from those described in paragraph 9, the auditor shall:
- Apply the procedures described in paragraph 8 and any further procedures necessary to enable the auditor to

- express the prescribed opinion; and
- Evaluate whether users of the summary financial statements might misunderstand the auditor's opinion on the summary financial statements and, if so, whether additional explanation in the auditor's report on the summary financial statements can mitigate possible misunderstanding.
  - If, in the case of paragraph 10(b), the auditor concludes that additional explanation in the auditor's report on the summary financial statements cannot mitigate possible misunderstanding, the auditor shall not accept the engagement, unless required by law or regulation to do so. An engagement conducted in accordance with such law or regulation does not comply with this SA. Accordingly, the auditor's report on the summary financial statements shall not indicate that the engagement was conducted in accordance with this SA.

#### *Timing of Work and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements*

- The auditor's report on the summary financial statements may be dated later than the date of the auditor's report on the audited financial statements. In such cases, the auditor's report on the summary financial statements shall state that the summary financial statements and audited financial statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements that may require adjustment of, or disclosure in, the audited financial statements. (Ref: Para. A10)
- The auditor may become aware of facts that existed at the date of the auditor's report on the audited financial statements, but of which the auditor previously was unaware. In such cases, the auditor shall not issue the auditor's report on the summary financial statements until the auditor's consideration of such facts in relation to the audited financial statements in accordance with SA 560 (Revised)<sup>4</sup> has been completed.

#### *Auditor's Report on Summary Financial Statements*

##### *Elements of the Auditor's Report*

- The auditor's report on summary financial statements shall include the following elements:<sup>5</sup> (Ref: Para. A15)
  - A title clearly indicating it as the report of an independent auditor. (Ref: Para. A11)
  - An addressee. (Ref: Para. A12)
  - An introductory paragraph that:
    - Identifies the summary financial statements on which the auditor is reporting, including the title of each statement included in the summary financial statements; (Ref: Para. A13)
    - Identifies the audited financial statements;
    - Refers to the auditor's report on the audited financial statements, the date of that report, and, subject to paragraphs 17-18, the fact that an unmodified opinion is expressed on the audited financial statements;
- If the addressee of the summary financial statements is not the same as the addressee of the auditor's report on the audited financial statements, the auditor shall evaluate the appropriateness of using a different addressee. (Ref: Para. A12)
- The auditor shall date the auditor's report on the summary financial statements no earlier than: (Ref: Para. A14)
  - The date on which the auditor has obtained sufficient appropriate evidence on which to base the opinion, including evidence that the summary financial statements have been prepared and those with the recognised authority have asserted that they have taken responsibility for them; and
  - The date of the auditor's report on the audited financial statements.

#### *Modifications to the Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor's Report on the Audited Financial Statements* (Ref: Para. A15)

- When the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter paragraph, but the auditor is

<sup>4</sup> SA 560 (Revised), "Subsequent Events".

<sup>5</sup> Published in the July, 2007 issue of the Journal.

satisfied that the summary financial statements are consistent, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, the auditor's report on the summary financial statements shall, in addition to the elements in paragraph 14:

- (a) State that the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter paragraph; and
- (b) Describe:
  - (i) The basis for the qualified opinion on the audited financial statements, and that qualified opinion; or the Emphasis of Matter or the Other Matter paragraph in the auditor's report on the audited financial statements; and
  - (ii) The effect thereof on the summary financial statements, if any.

18. When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor's report on the summary financial statements shall, in addition to the elements in paragraph 14:

- (a) State that the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion;
- (b) Describe the basis for that adverse opinion or disclaimer of opinion; and
- (c) State that, as a result of the adverse opinion or disclaimer of opinion, it is inappropriate to express an opinion on the summary financial statements.

#### **Modified Opinion on the Summary Financial Statements**

19. If the summary financial statements are not consistent, in all material respects, with or are not a fair summary of the audited financial statements, in accordance with the applied criteria, and management does not agree to make the necessary changes, the auditor shall express an adverse opinion on the summary financial statements. (Ref: Para. A15)

#### **Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting**

20. When distribution or use of the auditor's report on the audited financial statements is restricted, or the auditor's report on the audited financial statements alerts readers that the audited financial statements are prepared in accordance with a special purpose framework, the auditor shall include a similar restriction or alert in the auditor's report on the summary financial statements.

#### **Comparatives**

21. If the audited financial statements contain comparatives, but the summary financial statements do not, the auditor shall determine whether such omission is reasonable in the circumstances of the engagement. The auditor shall determine the effect of an unreasonable omission on the auditor's report on the summary financial statements. (Ref: Para. A16)

22. If the summary financial statements contain comparatives that were reported on

by another auditor, the auditor's report on the summary financial statements shall also contain the matters that Proposed SA 710 (Revised) requires the auditor to include in the auditor's report on the audited financial statements<sup>7</sup>. (Ref: Para. A17)

#### **Unaudited Supplementary Information Presented with Summary Financial Statements**

23. The auditor shall evaluate whether any unaudited supplementary information presented with the summary financial statements is clearly differentiated from the summary financial statements. If the auditor concludes that the entity's presentation of the unaudited supplementary information is not clearly differentiated from the summary financial statements, the auditor shall ask management to change the presentation of the unaudited supplementary information. If management refuses to do so, the auditor shall explain in the auditor's report on the summary financial statements that such information is not covered by that report. (Ref: Para. A18)

#### **Other Information in Documents Containing Summary Financial Statements**

24. The auditor shall read other information included in a document containing the summary financial statements and related auditor's report to identify material inconsistencies, if any, with the summary financial statements. If, on reading the other information, the auditor identifies a material inconsistency, the auditor shall determine whether the summary financial statements or the other information needs to be revised. If, on reading the other information, the auditor becomes aware of an apparent material misstatement of fact, the auditor shall discuss the matter with management. (Ref: Para. A19)

#### **Auditor Association**

25. If the auditor becomes aware that the entity plans to state that the auditor has reported on summary financial statements in a document containing the summary financial statements, but does not plan to include the related auditor's report, the auditor shall request management to include the auditor's report in the document. If management does not do so, the auditor shall determine and carry out other appropriate actions designed to prevent management from inappropriately associating the auditor with the summary financial statements in that document. (Ref: Para. A20)

26. The auditor may be engaged to report on the financial statements of an entity, while not engaged to report on the summary financial statements. If, in this case, the auditor becomes aware that the entity plans to make a statement in a document that refers to the auditor and the fact that summary financial statements are derived from the financial statements audited by the auditor, the auditor shall be satisfied that:

- (a) The reference to the auditor is made in the context of the auditor's report on the audited financial statements; and
- (b) The statement does not give the impression that the auditor has reported

on the summary financial statements.

If (a) or (b) are not met, the auditor shall request management to change the statement to meet them, or not to refer to the auditor in the document. Alternatively, the entity may engage the auditor to report on the summary financial statements and include the related auditor's report in the document. If management does not change the statement, delete the reference to the auditor, or include an auditor's report on the summary financial statements in the document containing the summary financial statements, the auditor shall advise management that the auditor disagrees with the reference to the auditor, and the auditor shall determine and carry out other appropriate actions designed to prevent management from inappropriately referring to the auditor. (Ref: Para. A20)

\*\*\*

#### **Application and Other Explanatory Material**

##### **Engagement Acceptance** (Ref: Para. 5-6)

A1. The audit of the financial statements from which the summary financial statements are derived provides the auditor with the necessary knowledge to discharge the auditor's responsibilities in relation to the summary financial statements in accordance with this SA. Application of this SA will not provide sufficient appropriate evidence on which to base the opinion on the summary financial statements if the auditor has not also audited the financial statements from which the summary financial statements are derived.

A2. Management's agreement with the matters described in paragraph 6 may be evidenced by its written acceptance of the terms of the engagement.

##### **Criteria** (Ref: Para. 6(a))

A3. Management is responsible for the determination of the information that needs to be reflected in the summary financial statements so that they are consistent, in all material respects, with or represent a fair summary of the audited financial statements. Because summary financial statements by their nature contain aggregated information and limited disclosure, there is an increased risk that they may not contain the information necessary so as not to be misleading in the circumstances. This risk increases when established criteria for the preparation of summary financial statements do not exist.

A4. Factors that may affect the auditor's determination of the acceptability of the applied criteria include:

- The nature of the entity;
- The purpose of the summary financial statements;
- The information needs of the intended users of the summary financial statements; and
- Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances.

A5. The criteria for the preparation of summary financial statements may be established by an authorised or recognised standards setting organisation or by law or

<sup>7</sup> Proposed SA 710 (Revised), "Comparative Information—Corresponding Figures and Comparative Financial Statements".

regulation. Similar to the case of financial statements, as explained in SA 210 (Revised)<sup>8</sup>, in many such cases, the auditor may presume that such criteria are acceptable.

A6. Where established criteria for the preparation of summary financial statements do not exist, criteria may be developed by management, for example, based on practice in a particular industry. Criteria that are acceptable in the circumstances will result in summary financial statements that:

- (a) Adequately disclose their summarised nature and identify the audited financial statements;
- (b) Clearly describe from whom or where the audited financial statements are available or, if law or regulation provides that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements, that law or regulation;
- (c) Adequately disclose the applied criteria;
- (d) Agree with or can be re-calculated from the related information in the audited financial statements; and
- (e) In view of the purpose of the summary financial statements, contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.

A7. Adequate disclosure of the summarised nature of the summary financial statements and the identity of the audited financial statements, as referred to in paragraph A6(a), may, for example, be provided by a title such as "Summary Financial Statements Prepared from the Audited Financial Statements for the Year Ended March 31, 20X1".

#### *Evaluating the Availability of the Audited Financial Statements* (Ref: Para. 8(g))

A8. The auditor's evaluation whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty is affected by factors such as whether:

- The summary financial statements describe clearly from whom or where the audited financial statements are available;
- The audited financial statements are on public record; or
- Management has established a process by which the intended users of the summary financial statements can obtain ready access to the audited financial statements.

#### *Form of Opinion* (Ref: Para. 9)

A9. A conclusion, based on an evaluation of the evidence obtained by performing the procedures in paragraph 8, that an unmodified opinion on the summary financial statements is appropriate enables the auditor to express an opinion containing one of the phrases in paragraph 9. The auditor's decision as to which of the phrases to use may be

affected by generally accepted practice in the particular jurisdiction.

#### *Timing of Work and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements* (Ref: Para. 12)

A10. The procedures described in paragraph 8 are often performed during or immediately after the audit of the financial statements. When the auditor reports on the summary financial statements after the completion of the audit of the financial statements, the auditor is not required to obtain additional audit evidence on the audited financial statements, or report on the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements since the summary financial statements are derived from the audited financial statements and do not update them.

#### *Auditor's Report on Summary Financial Statements*

##### *Elements of the Auditor's Report*

###### *Title* (Ref: Para. 14(a))

A11. A title indicating the report is the report of an independent auditor, for example, "Report of the Independent Auditor", affirms that the auditor has met all of the relevant ethical requirements regarding independence. This distinguishes the report of the independent auditor from reports issued by others.

###### *Addressee* (Ref: Para. 14(b), 15)

A12. Factors that may affect the auditor's evaluation of the appropriateness of the addressee of the summary financial statements include the terms of the engagement, the nature of the entity, and the purpose of the summary financial statements.

###### *Introductory Paragraph* (Ref: Para. 14(c)(i))

A13. When the auditor is aware that the summary financial statements will be included in a document that contains other information, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the summary financial statements are presented. This helps readers to identify the summary financial statements to which the auditor's report relates.

###### *Date of the Auditor's Report* (Ref: Para. 14(h), 16)

A14. The person or persons with recognized authority to conclude that the summary financial statements have been prepared and take responsibility for them depend on the terms of the engagement, the nature of the entity, and the purpose of the summary financial statements.

###### *Illustrations* (Ref: Para. 14, 17-18, 19)

A15. The Appendix to this SA contains illustrations of auditors' reports on summary financial statements that:

- (a) Contain unmodified opinions;
- (b) Are derived from audited financial statements on which the auditor issued modified opinions; and
- (c) Contain a modified opinion.

#### *Comparatives* (Ref: Para. 21-22)

A16. If the audited financial statements contain comparatives, there is a presumption that the summary financial statements also would contain comparatives. Comparatives in the audited financial statements may be regarded as corresponding figures or as comparative financial information. Proposed SA 710 (Revised) describes how this difference affects the auditor's report on the financial statements, including, in particular, reference to other auditors who audited the financial statements for the prior period.

A17. Circumstances that may affect the auditor's determination whether an omission of comparatives is reasonable include the nature and objective of the summary financial statements, the applied criteria, and the information needs of the intended users of the summary financial statements.

#### *Unaudited Supplementary Information Presented with Summary Financial Statements* (Ref: Para. 23)

A18. Proposed SA 700 (Revised)<sup>9</sup> contains requirements and guidance to be applied when unaudited supplementary information is presented with audited financial statements that, adapted as necessary in the circumstances, may be helpful in applying the requirement in paragraph 23.

#### *Other Information in Documents Containing Summary Financial Statements* (Ref: Para. 24)

A19. SA 720<sup>10</sup> contains requirements and guidance relating to reading other information included in a document containing the audited financial statements and related auditor's report, and responding to material inconsistencies and material misstatements of fact. Adapted as necessary in the circumstances, they may be helpful in applying the requirement in paragraph 24.

#### *Auditor Association* (Ref: Para. 25-26)

A20. Other appropriate actions the auditor may take when management does not take the requested action may include informing the intended users and other known third-party users of the inappropriate reference to the auditor. The auditor's course of action depends on the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

#### *Material Modifications vis-a-vis ISA 810, "Engagements to Report on Summary Financial Statements"*

##### *Additions*

1. Paragraph 14 of ISA 810 deals with the elements of the summary financial statements that also include the auditor's address. Since the proposed Revised SA 700, "Forming an Opinion and Reporting on Financial Statements" 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.
2. Paragraph 14 of ISA 810 deals with the

<sup>8</sup> SA 210 (Revised), "Agreeing the Terms of Audit Engagements", paragraphs A3 and A8-A9.

<sup>9</sup> SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", paragraphs 46-47 of the Exposure Draft of SA 700. The same has been published in the June, 2009 issue of the Journal.

<sup>10</sup> SA 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements".

elements of the summary financial statements that also include auditor's signature. Since as per the proposed Revised SA 700, "Forming an Opinion and Reporting on Financial Statements", 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 14 (g) of proposed SA 810.

### Appendix

(Ref: Para. A15)

#### Illustrations of Reports on Summary Financial Statements

- Illustration 1: An auditor's report on summary financial statements prepared in accordance with established criteria. An unmodified opinion is expressed on the audited financial statements. The auditor's report on the summary financial statements is dated later than the date of the auditor's report on the financial statements from which summary financial statements are derived.
- Illustration 2: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. An unmodified opinion is expressed on the audited financial statements.
- Illustration 3: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. A qualified opinion is expressed on the audited financial statements.
- Illustration 4: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. An adverse opinion is expressed on the audited financial statements.
- Illustration 5: An auditor's report on summary financial statements prepared in accordance with established criteria. An unmodified opinion is expressed on the audited financial statements. The auditor concludes that it is not possible to express an unmodified opinion on the summary financial statements.

#### Illustration 1:

*Circumstances include the following:*

- An unmodified opinion is expressed on the audited financial statements.

- **Established criteria for the preparation of summary financial statements exist.**
- **The auditor's report on the summary financial statements is dated later than the date of the auditor's report on the financial statements from which the summary financial statements are derived.**

Signature  
 (Name of the Member Signing the  
 Audit Report)  
 (Designation)  
 Membership Number

Place of Signature  
 Date

#### Illustration 2:

*Circumstances include the following:*

- **An unmodified opinion is expressed on the audited financial statements.**
- **Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.**

#### REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS [Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated May 15, 20X1. Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements. The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") [applied in the preparation of the audited financial statements of ABC Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

#### *Management's Responsibility for the Summary Financial Statements*

Management is responsible for the preparation of a summary of the audited financial statements in accordance with [Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") and accounting principles generally accepted in India].

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Audit (SA) 810, "Engagements to Report on Summary Financial Statements", issued by the Institute of Chartered Accountants of India.

#### *Opinion*

In our opinion, the summary financial statements derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1 are a fair summary of those financial statements, in accordance with [Accounting Standards referred to in sub-section (3C) of Section 211 of the Companies Act, 1956 ("the act") and accounting principles generally accepted in India].

For XYZ and Co.  
 Chartered Accountants

Signature

(Name of the Member Signing the  
 Audit Report)

(Designation)

Membership Number

Place of Signature  
 Date

#### Illustration 2:

*Circumstances include the following:*

- **An unmodified opinion is expressed on the audited financial statements.**
- **Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.**

#### REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS [Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated May 15, 20X1<sup>11</sup>.

The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") [applied in the preparation of the audited financial statements of ABC Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

#### *Management's Responsibility for the Summary Financial Statements*

Management is responsible for the preparation of a summary of the audited financial statements on the basis described in Note X.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Audit (SA) 810, "Engagements to Report on Summary Financial Statements", issued by the Institute of Chartered Accountants of India.

#### *Opinion*

In our opinion, the summary financial statements derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1 are a fair summary of those financial statements, on the basis described in Note X.

For XYZ and Co.  
 Chartered Accountants

Signature

<sup>11</sup> Partner or Proprietor, as the case may be.

<sup>12</sup> When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements".

(Name of the Member Signing the  
Audit Report)  
(Designation<sup>18</sup>)  
Membership Number

Place of Signature  
Date

#### **Illustration 3:**

*Circumstances include the following:*

- A qualified opinion is expressed on the audited financial statements.
- Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.

#### **REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS** [Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1<sup>19</sup>. We expressed a qualified audit opinion on those financial statements in our report dated May 15, 20X1 (see below).

The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") [applied in the preparation of the audited financial statements of ABC Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

#### **Management's Responsibility for the Summary Financial Statements**

Management is responsible for the preparation of a summary of the audited financial statements on the basis described in Note X.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

#### **Opinion**

In our opinion, the summary financial statements derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1 are a fair summary of those financial statements, on the basis described in Note X.

However, the summary financial statements are misstated to the equivalent extent as the

audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1.

The misstatement of the audited financial statements is described in our qualified audit opinion in our report dated May 15, 20X1. Our qualified audit opinion is based on the fact that the company's inventories are carried in the balance sheet in those financial statements at Rs. XXX. Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost, which constitutes a departure from the Accounting Standard (AS) 2, "Valuation of Inventories". 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 realizable 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. Our qualified audit opinion states that, except for the effects of the described matter, those financial statements give a true and fair view of the state of affairs of ABC Company Ltd. as of March 31, 20X1, and (of) its results of operations and its cash flows for the year then ended in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act").

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>15</sup>)  
Membership Number

Place of Signature  
Date

#### **Illustration 4:**

*Circumstances include the following:*

- An adverse opinion is expressed on the audited financial statements.
- Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.

#### **REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS** [Appropriate Addressee]

The accompanying summary financial statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1<sup>16</sup>.

The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") [applied in the preparation of the audited financial statements of ABC Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

#### **Management's Responsibility for the Summary Financial Statements**

Management is responsible for the preparation of a summary of the audited financial statements on the basis described in Note X.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810, "Engagements to Report on Summary Financial Statement" issued by the Institute of Chartered Accountants of India.

#### **Denial of Opinion**

In our report dated May 15, 20X1, we expressed an adverse audit opinion on the financial statements of ABC Company Ltd. for the year ended March 31, 20X1. The basis for our adverse audit opinion was [describe basis for adverse audit opinion]. Our adverse audit opinion stated that [describe adverse audit opinion].

Because of the significance of the matter discussed above, it is inappropriate to express an opinion on the summary financial statements of ABC Company Ltd. for the year ended March 31, 20X1.

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>17</sup>)  
Membership Number

Place of Signature  
Date

#### **Illustration 5:**

*Circumstances include the following:*

- An unmodified opinion is expressed on the audited financial statements.
- Established criteria for the preparation of summary financial statements exist.
- The auditor concludes that it is not possible to express an unmodified opinion on the summary financial statements.

#### **REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS** [Appropriate Addressee]

The accompanying summary financial

<sup>18</sup> Partner or Proprietor, as the case may be.

<sup>19</sup> When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements".

<sup>15</sup> Partner or Proprietor, as the case may be.

<sup>16</sup> When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements."

<sup>17</sup> Partner or Proprietor, as the case may be.

statements, which comprise the summary balance sheet as at March 31, 20X1, the summary statement of profit & loss, and summary cash flow statement for the year then ended, and related notes, are derived from the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated May 15, 20X1<sup>18</sup>.

The summary financial statements do not contain all the disclosures required by the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") [applied in the preparation of the audited financial statements of ABC Company Ltd.]. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of ABC Company Ltd.

#### *Management's Responsibility for the Summary Audited Financial Statements*

Management is responsible for the preparation of a summary of the audited financial statements in accordance with [Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") and accounting principles generally accepted in India].

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Standard on Auditing (SA) 810, "Engagements to Report on Summary Financial Statements" issued by the Institute of Chartered Accountants of India.

#### *Basis for Adverse Opinion*

[Describe matter that caused the summary financial statements not to be a fair summary of the audited financial statements, in accordance with the applied criteria.]

#### *Adverse Opinion*

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the summary financial statements referred to above are not a fair summary of the audited financial statements of ABC Company Ltd. for the year ended March 31, 20X1, in accordance with [Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act") and accounting principles generally accepted in India].

For XYZ and Co.  
Chartered Accountants

Signature  
(Name of the Member Signing the Audit Report)  
(Designation)  
Membership Number

Place of Signature  
Date

<sup>18</sup> When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements".

\* Partner or Proprietor, as the case may be.

#### ICAI NEWS

## Online Registration Form for Empanelment as a Resource Person in the Committee on Accounting Standards for Local Bodies

**(For Chartered Accountants who are having experience in the Local Bodies including Panchayats are only to be registered.)**

The Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India (ICAI) is in the process of developing a database of the members as Resource Persons having experience in the ongoing accounting reforms in Local Bodies. The main objective of this database is to develop a platform wherein the members across the country can discuss various issues concerning the accrual accounting reforms in Local Bodies. Seminars/ Conferences/ Round Table meetings may also be organised for resource persons to discuss the matters pertaining to the accounting reforms in Local Bodies and equip the profession to develop as per the expectations of the stakeholders.

The members listed in the database would also be consulted on contemporary accounting matters concerning the accrual accounting reforms in Local Bodies so as to develop a pool of Chartered Accountants which would enable the profession to move forward and gain insight in the ongoing accounting reforms in the Local Bodies in India.

For registration, members may kindly log on to Institute's website i.e., <http://www.icai.org/empanelment.html>.



For any further queries, kindly contact to the Secretary to the Committee on Accounting Standards for Local Bodies (CASLB) at [caslb@icai.in](mailto:caslbcaslb@icai.in) or [caslb@icai.org](mailto:caslbcaslb@icai.org).

# Standard on Auditing (SA) 210 (Revised)

## Agreeing the Terms of Audit Engagements

(Effective for all audits relating to accounting periods beginning on or after April 1, 2010)

**Standard on Auditing (SA) 210 (Revised), "Agreeing the Terms of Audit Engagements" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services<sup>1</sup>," 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"<sup>2</sup>.**

### Introduction

#### Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, responsibility for which rests with management and, where appropriate, those charged with governance, are present. Proposed SA 220 (Revised)<sup>3</sup> deals with those aspects of engagement acceptance that are within the control of the auditor. (Ref: Para. A1)

### Effective Date

2. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

appropriate, those charged with governance of the terms of the audit engagement.

### Objective

3. The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

- (a) Establishing whether the preconditions for an audit are present; and
- (b) Confirming that there is a common understanding between the auditor and management and, where

### Definitions

4. For purposes of the SAs, the following term has the meaning attributed below:  
**Preconditions for an audit –** The use by management of an acceptable financial reporting framework<sup>4</sup> in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise<sup>5</sup> on which an audit is conducted.  
 5. For the purposes of this SA, references

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> 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.

<sup>3</sup> Currently, SA 220 (AAS 17), "Quality Control for Audit Work", issued in July 1999 by the Institute of Chartered Accountants of India (ICAI) is in force. The Standard is being revised in the light of the corresponding Revised International Standard on Auditing (ISA) 220, "Quality Control for an Audit of Financial Statements".

<sup>4</sup> ISA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with International Standards on Auditing", paragraph 13 (a) defines the applicable financial reporting framework as follows:

"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".

Presently, SA 200, "Basic Principles Governing an Audit", issued in April 1985 and SA 200A, "Objective and Scope of an Audit of Financial Statements", issued in April 1985, correspond to the 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 (Revised).

<sup>5</sup> Paragraph 13 (j) of ISA 200 defines the Premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted as follows:

"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".

to "management" should be read hereafter as "management and, where appropriate, those charged with governance".

### Requirements

#### *Preconditions for an Audit*

6. In order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and (Ref: Para. A2-A9)
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility: (Ref: Para A10-A13, A19)
  - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation; (Ref: Para. A14)
  - (ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and (Ref: Para. A15-A18)
  - (iii) To provide the auditor with:
    - a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
    - b. Additional information that the auditor may request from management for the purpose of the audit; and
    - c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

#### *Limitation on Scope Prior to Audit Engagement Acceptance*

7. If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

### *Other Factors Affecting Audit Engagement Acceptance*

8. If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement:

- (a) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable, except as provided in paragraph 19; or
- (b) If the agreement referred to in paragraph 6(b) has not been obtained.

#### *Agreement on Audit Engagement Terms*

9. The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. (Ref: Para. A20)

10. Subject to paragraph 11, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include: (Ref: Para. A21-A24)

- (a) The objective and scope of the audit of the financial statements;
- (b) The responsibilities of the auditor;
- (c) The responsibilities of management;
- (d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- (e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

11. If law or regulation prescribes in sufficient detail the terms of the audit engagement referred to in paragraph 10, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities as set out in paragraph 6(b). (Ref: Para. A21, A25-A26)

12. If law or regulation prescribes responsibilities of management similar to those described in paragraph 6(b), the auditor may determine that the law or regulation includes responsibilities that, in the auditor's judgment, are equivalent in effect to those set out in that paragraph. For such responsibilities that are equivalent, the auditor may use the wording of the law or regulation to describe them in the written agreement.

For those responsibilities that are not prescribed by law or regulation such that their effect is equivalent, the written agreement shall use the description in paragraph 6(b). (Ref: Para. A25)

#### *Recurring Audits*

13. On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. (Ref: Para. A27)

#### *Acceptance of a Change in the Terms of the Audit Engagement*

14. The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so. (Ref: Para. A28-A30)

15. If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so. (Ref: Para. A31-A32)

16. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

17. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

- (a) Withdraw from the audit engagement where possible under applicable law or regulation; and
- (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

#### *Additional Considerations in Engagement Acceptance*

#### *Financial Reporting Standards<sup>6</sup> Supplemented by Law or Regulation*

18. If financial reporting standards established by an authorised or recognised standards setting organization are supplemented by law or regulation, the auditor shall determine whether there are any conflicts between the financial reporting standards and the additional requirements. If such conflicts exist, the auditor shall discuss with management the nature of the additional requirements and shall agree whether:

- (a) The additional requirements can be

<sup>6</sup> Accounting Standards promulgated by Accounting Standards Board (ASB) of the 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 ICAI, as may be applicable.

- met through additional disclosures in the financial statements; or
- (b) The description of the applicable financial reporting framework in the financial statements can be amended accordingly.

If neither of the above actions is possible, the auditor shall determine whether it will be necessary to modify the auditor's opinion in accordance with SA 705 (Revised)<sup>7</sup>. (Ref: Para. A33)

#### **Financial Reporting Framework Prescribed by Law or Regulation – Other Matters Affecting Acceptance**

19. If the auditor has determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation, the auditor shall accept the audit engagement only if the following conditions are present: (Ref: Para. A34)

- (a) Management agrees to provide additional disclosures in the financial statements required to avoid the financial statements being misleading; and
- (b) It is recognised in the terms of the audit engagement that:
- (i) The auditor's report on the financial statements will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures, in accordance with SA 706 (Revised)<sup>8</sup>; and
  - (ii) Unless the auditor is required by law or regulation to express the auditor's opinion on the financial statements by using the phrases "present fairly, in all material respects", or "give a true and fair view" in accordance with the applicable financial reporting framework, the auditor's opinion on the financial statements will not include such phrases.

20. If the conditions outlined in paragraph

19 are not present and the auditor is required by law or regulation to undertake the audit engagement, the auditor shall:

- (a) Evaluate the effect of the misleading nature of the financial statements on the auditor's report; and
- (b) Include appropriate reference to this matter in the terms of the audit engagement.

#### **Auditor's Report Prescribed by Law or Regulation**

21. In some cases, the law or regulation applicable to the entity prescribes the layout or wording of the auditor's report in a form or in terms that are significantly different from the requirements of SAs. In these circumstances, the auditor shall 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<sup>9</sup>.

If the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor shall not accept the audit engagement, unless required by law or regulation to do so. An audit conducted in accordance with such law or regulation does not comply with SAs. Accordingly, the auditor shall not include any reference within the auditor's report to the audit having been conducted in accordance with SAs<sup>10</sup>. (Ref: Para. A35-A36)

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#### **Application and Other Explanatory Material**

##### **Scope of this SA** (Ref: Para. 1)

A1. Assurance engagements, which include audit engagements, may only be accepted when the practitioner considers that relevant ethical requirements such as independence and professional competence will be satisfied, and when the engagement exhibits certain

characteristics". The auditor's responsibilities in respect of ethical requirements in the context of the acceptance of an audit engagement and in so far as they are within the control of the auditor are dealt with in proposed SA 220 (Revised)<sup>12</sup>. This SA deals with those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

##### **Preconditions for an Audit**

##### **The Financial Reporting Framework** (Ref: Para. 6(a))

A2. A condition for acceptance of an assurance engagement is that the criteria referred to in the definition of an assurance engagement are suitable and available to intended users<sup>13</sup>. Criteria are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Suitable criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. For purposes of the SAs, the applicable financial reporting framework provides the criteria the auditor uses to audit the financial statements, including where relevant their fair presentation.

A3. Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements and the auditor does not have suitable criteria for auditing the financial statements. In many cases the auditor may presume that the applicable financial reporting framework is acceptable, as described in paragraphs A8-A9.

##### **Determining the Acceptability of the Financial Reporting Framework**

A4. Factors that are relevant to the auditor's determination of the acceptability of the financial reporting framework to be applied in the preparation of the

<sup>7</sup> At present, there is no separate Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 705, "Modifications to the Opinion in the Independent Auditor's Report". However, the concept of modified audit report has been discussed in SA 700, "The Auditor's Report on Financial Statements", issued by ICAI in January 2003. The Auditing and Assurance Standards Board (AASB) has issued the Exposure Drafts of Revised SA 700, "Forming an Opinion and Reporting on Financial Statements"; SA 705, "Modifications to the Opinion in the Independent Auditor's Report"; and SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", corresponding to the ISA 700, ISA 705 and ISA 706. These Exposure Drafts are published in the June, 2009 issue of the Journal and are also hosted on the website of ICAI.

<sup>8</sup> At present, there is no separate Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report". However, the concept of 'emphasis of matter paragraph' has been discussed in SA 700, "The Auditor's Report on Financial Statements", issued by ICAI in January 2003. The Auditing and Assurance Standards Board (AASB) has issued the Exposure Drafts of Revised SA 700, "Forming an Opinion and Reporting on Financial Statements"; SA 705, "Modifications to the Opinion in the Independent Auditor's Report"; and SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", corresponding to the ISA 700, ISA 705 and ISA 706. These Exposure Drafts are published in the June, 2009 issue of the Journal and are also hosted on the website of ICAI.

<sup>9</sup> See foot note No. 7.

<sup>10</sup> See paragraph 43 of the Exposure Draft of Revised SA 700, "Forming an Opinion and Reporting on Financial Statements". The Exposure Draft has been published in June, 2009 issue of the Journal of ICAI.

<sup>11</sup> "Framework for Assurance Engagements," paragraph 16.

<sup>12</sup> See foot note No. 3.

<sup>13</sup> "Framework for Assurance Engagements," paragraph 16(b)(ii).

financial statements include:

- The nature of the entity (for example, whether it is a business enterprise, or a not for profit organization);
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users or the financial information needs of specific users);
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement); and
- Whether law or regulation prescribes the applicable financial reporting framework.

A5. Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. While all the information needs of specific users cannot be met, there are financial information needs that are common to a wide range of users. Financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users are referred to as general purpose financial statements.

A6. In some cases, the financial statements will be prepared in accordance with a financial reporting framework designed to meet the financial information needs of specific users. Such financial statements are referred to as special purpose financial statements. The financial information needs of the intended users will determine the applicable financial reporting framework in these circumstances. Proposed SA 800 discusses the acceptability of financial reporting frameworks designed to meet the financial information needs of specific users.<sup>14</sup>

A7. Deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable may be encountered after the audit engagement has been accepted. When use of that

framework is prescribed by law or regulation, the requirements of paragraphs 19-20 apply. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, as required by paragraph 16, new terms of the audit engagement are agreed to reflect the change in the framework as the previously agreed terms will no longer be accurate.

#### General purpose frameworks

A8. At present, there is no objective and authoritative basis that has been generally recognised globally for judging the acceptability of general purpose frameworks. In the absence of such a basis, financial reporting standards established by organisations that are authorised or recognised to promulgate standards to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared by such entities, provided the organizations follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders. Examples of such financial reporting standards include:

- Accounting Standards promulgated by Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) and/ or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards) Rules, 2006, as may be applicable;
- Accounting Standards for Local Bodies promulgated by Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India (ICAI);
- International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board; and
- International Public Sector Accounting Standards (IPSAs) promulgated by the International

#### Public Sector Accounting Standards Board.

These financial reporting standards are often identified as the applicable financial reporting framework in law or regulation governing the preparation of general purpose financial statements.

#### Financial reporting frameworks prescribed by law or regulation

A9. In accordance with paragraph 6(a), the auditor is required to determine whether the financial reporting framework, to be applied in the preparation of the financial statements, is acceptable. Appendix 2 contains guidance on determining the acceptability of the financial reporting framework. In case of some entities, law or regulation may prescribe the financial reporting framework to be used in the preparation of general purpose financial statements. In the absence of indications to the contrary, such a financial reporting framework is presumed to be acceptable for general purpose financial statements prepared by such entities. In the event that the framework is not considered to be acceptable, paragraphs 19-20 apply.

#### *Agreement of the Responsibilities of Management (Ref: Para. 6(b))*

A10. An audit in accordance with SAs is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph 6(b)<sup>15</sup>. In case of certain entities, such responsibilities may be specified in the applicable law or regulation. In others, there may be little or no legal or regulatory definition of such responsibilities. SAs do not override law or regulation in such matters. However, the concept of an independent audit requires that the auditor's role does not involve taking responsibility for the preparation of the financial statements or for the entity's related internal control, and that the auditor has a reasonable expectation of obtaining the information necessary for the audit in so far as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of

<sup>14</sup> At present, there is no corresponding SA issued by ICAI on the subject. The AASB has, however, already initiated a project on formulation of SA corresponding to International Standard on Auditing (ISA) 800, "Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks". Meanwhile, attention of the readers is also drawn to the "Guidance Note on Audit Reports and Certificates for Special Purposes" issued by ICAI in March, 1984.

<sup>15</sup> Paragraph A2 of ISA 200 provides as follows:

"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."

an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and recording the terms of the audit engagement in paragraphs 9-12.

A11. The way in which the responsibilities for financial reporting are divided between management and those charged with governance will vary according to the resources and structure of the entity and any relevant law or regulation, and the respective roles of management and those charged with governance within the entity. In most cases, management is responsible for execution while those charged with governance have oversight of management. In some cases, those charged with governance will have, or will assume, responsibility for approving the financial statements or monitoring the entity's internal control related to financial reporting. In larger or public entities, a subgroup of those charged with governance, such as an audit committee, may be charged with certain oversight responsibilities.

A12. SA 580 (Revised) requires the auditor to request management to provide written representations that it has fulfilled certain of its responsibilities<sup>16</sup>. It may therefore be appropriate to make management aware that receipt of such written representations will be expected, together with written representations required by other SAs and, where necessary, written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

A13. Where management will not acknowledge its responsibilities, or agree to provide the written representations, the auditor will be unable to obtain sufficient appropriate audit evidence<sup>17</sup>. In such circumstances, it would not be appropriate for the auditor to accept the audit engagement, unless law or regulation requires the auditor to do so. In cases where the auditor is required to accept the audit engagement, the auditor may need to explain to management the importance of these matters, and the implications for the auditor's report.

#### *Preparation of the Financial Statements (Ref: Para. 6(b)(i))*

A14. Most financial reporting frameworks include requirements relating to the

presentation of the financial statements; for such frameworks, preparation of the financial statements in accordance with the financial reporting framework includes presentation. In the case of a fair presentation framework the importance of the reporting objective of fair presentation is such that the premise agreed with management includes specific reference to fair presentation, or to the responsibility to ensure that the financial statements will "give a true and fair view" in accordance with the financial reporting framework.

#### *Internal Control (Ref: Para. 6(b)(ii))*

A15. Management maintains such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives due to the inherent limitations of internal control<sup>18</sup>.

A16. An independent audit conducted in accordance with the SAs does not act as a substitute for the maintenance of internal control necessary for the preparation of financial statements by management. Accordingly, the auditor is required to obtain the agreement of management that it acknowledges and understands its responsibility for internal control. However, the agreement required by paragraph 6(b)(ii) does not imply that the auditor will find that internal control maintained by management has achieved its purpose or will be free of deficiencies.

A17. It is for management to determine what internal control is necessary to enable the preparation of the financial statements. The term "internal control" encompasses a wide range of activities within components that may be described as the control environment; the entity's risk assessment process; the information system, including the related business processes relevant to financial reporting, and communication; control activities; and monitoring of controls. This division, however, does not necessarily reflect how a particular entity may design, implement and maintain its internal control, or how it may classify any particular component<sup>19</sup>. An entity's internal control (in particular, its accounting books and records, or accounting systems) will reflect the needs of management, the complexity of the

business, the nature of the risks to which the entity is subject, and relevant laws or regulation.

A18. In some cases, law or regulation may refer to the responsibility of management for the adequacy of accounting books and records, or accounting systems. In some other cases, general practice may assume a distinction between accounting books and records or accounting systems on the one hand, and internal control or controls on the other. As accounting books and records, or accounting systems, are an integral part of internal control as referred to in paragraph A18, no specific reference is made to them in paragraph 6(b)(ii) for the description of the responsibility of management. To avoid misunderstanding, it may be appropriate for the auditor to explain to management the scope of this responsibility.

#### *Considerations Relevant to Smaller Entities (Ref: Para. 6(b))*

A19. One of the purposes of agreeing the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and the auditor. For example, when a third party has assisted with the preparation of the financial statements, it may be useful to remind management that the preparation of the financial statements in accordance with the applicable financial reporting framework remains its responsibility.

#### *Agreement on Audit Engagement Terms*

#### *Agreeing the Terms of the Audit Engagement (Ref: Para. 9)*

A20. The roles of management and those charged with governance in agreeing the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant law or regulation.

#### *Audit Engagement Letter or Other Form of Written Agreement<sup>20</sup> (Ref: Para. 10-11)*

A21. It is in the interests of both the entity and the auditor that the auditor sends an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit. In some entities, however, the objective and scope of an audit and the responsibilities of management and of the auditor may be sufficiently established by law, that is, they prescribe the matters described in paragraph 10. Although in these circumstances paragraph 11 permits the auditor to include in the engagement letter only reference to the fact that

<sup>16</sup> SA 580 (Revised), "Written Representations," paragraphs 10-11.

<sup>17</sup> SA 580 (Revised), paragraph A28.

<sup>18</sup> SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment," paragraph A42.

<sup>19</sup> SA 315 (Revised), paragraph A47 and Appendix 1.

<sup>20</sup> In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement.

relevant law or regulation applies and that management acknowledges and understands its responsibilities as set out in paragraph 6(b), the auditor may nevertheless consider it appropriate to include the matters described in paragraph 10 in an engagement letter for the information of management.

#### *Form and Content of the Audit Engagement Letter*

A22. The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on SA 200 (Revised)<sup>21</sup>. Paragraphs 6(b) and 12 of this SA deal with the description of the responsibilities of management. In addition to including the matters required by paragraph 10, an audit engagement letter may make reference to, for example:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, SAs, and ethical and other pronouncements of professional bodies to which the auditor adheres.
- The form of any other communication of results of the audit engagement.
- The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SAs.
- Arrangements regarding the planning and performance of the audit, including the composition of the audit team.
- The expectation that management will provide written representations (see also paragraph A13).
- The agreement of management to make available to the auditor draft financial statements and any accompanying other information in time to allow the auditor to complete the audit in accordance with the proposed timetable.
- The agreement of management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.
- The basis on which fees are computed and any billing arrangements.
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the

terms of the engagement outlined therein.

- The fact that the audit process may be subjected to a peer review under the Chartered Accountants Act, 1949.

A23. When relevant, the following points could also be made in the audit engagement letter:

- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
- Arrangements concerning the involvement of internal auditors and other staff of the entity.
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit.
- Any restriction of the auditor's liability when such possibility exists.
- A reference to any further agreements between the auditor and the entity.
- Any obligations to provide audit working papers to other parties.

An example of an audit engagement letter is set out in Appendix 1.

#### *Audits of Components*

A24. When the auditor of a parent entity is also the auditor of a component, the factors that may influence the decision whether to send a separate audit engagement letter to the component include the following:

- Who appoints the component auditor;
- Whether a separate auditor's report is to be issued on the component;
- Legal requirements in relation to audit appointments;
- Degree of ownership by parent; and
- Degree of independence of the component management from the parent entity.

#### *Responsibilities of Management Prescribed by Law or Regulation (Ref: Para.11-12)*

A25. If, in the circumstances described in paragraphs A22 and A27, the auditor concludes that it is not necessary to record certain terms of the audit engagement in an audit engagement letter, the auditor is still required by paragraph 11 to seek the written agreement from management that it acknowledges and understands that it has the responsibilities set out in paragraph 6(b). However, in accordance with paragraph 12, such written agreement may use the wording of the law or regulation if such law or regulation establishes responsibilities for management that are equivalent in effect to those described in paragraph 6(b).

A26. In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), law or

regulation governing the operations of that entities generally mandate the appointment of the auditor and commonly set out the auditor's responsibilities and powers, including the power to access an entity's records and other information. When law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor may nonetheless consider that there are benefits in issuing a fuller audit engagement letter than permitted by paragraph 11.

#### *Recurring Audits (Ref: Para.13)*

A27. The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior management.
- A significant change in ownership.
- A significant change in nature or size of the entity's business.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation of the financial statements.
- A change in other reporting requirements.

#### *Acceptance of a Change in the Terms of the Audit Engagement*

#### *Request to Change the Terms of the Audit Engagement (Ref: Para.14)*

A28. A request from the entity for the auditor to change the terms of the audit engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit as originally requested or a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances. The auditor, as required by paragraph 14, considers the justification given for the request, particularly the implications of a restriction on the scope of the audit engagement.

A29. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement.

A30. In contrast, a change may not be

<sup>21</sup> See foot note no. 2.

considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. An example might be where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion.

*Request to Change to a Review or a Related Service* (Ref: Para.15)

A31. Before agreeing to change an audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with SAs may need to assess, in addition to the matters referred to in paragraphs A29-A31 above, any legal or contractual implications of the change.

A32. If the auditor concludes that there is reasonable justification to change the audit engagement to a review or a related service, the audit work performed to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the related service would not include reference to:

- (a) The original audit engagement; or
- (b) Any procedures that may have been performed in the original audit engagement, except where the audit engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

*Additional Considerations in Engagement Acceptance*

*Financial Reporting Standards Supplemented by Law or Regulation* (Ref: Para.18)

A33. In case of some entities, law or regulation may supplement the financial reporting standards established by an authorised or recognised standards setting organization with additional requirements relating to the preparation of financial statements. In such cases, the applicable financial reporting framework for the purposes of applying the SAs encompasses

both the identified financial reporting framework and such additional requirements provided they do not conflict with the identified financial reporting framework. This may, for example, be the case when law or regulation prescribes disclosures in addition to those required by the financial reporting standards or when they narrow the range of acceptable choices that can be made within the financial reporting standards<sup>32</sup>.

*Financial Reporting Framework Prescribed by Law or Regulation—Other Matters Affecting Acceptance* (Ref: Para.19)

A34. Law or regulation may prescribe that the wording of the auditor's opinion use the phrases "present fairly, in all material respects" or "give a true and fair view" in a case where the auditor concludes that the applicable financial reporting framework prescribed by law or regulation would otherwise have been unacceptable. In this case, the terms of the prescribed wording of the auditor's report are significantly different from the requirements of SAs (see paragraph 21).

*Auditor's Report Prescribed by Law or Regulation* (Ref: Para.21)

A35. SAs require that the auditor shall not represent compliance with SAs unless the auditor has complied with all of the SAs relevant to the audit<sup>33</sup>. When law or regulation prescribes the layout or wording of the auditor's report in a form or in terms that are significantly different from the requirements of SAs and the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor may consider including a statement in the auditor's report that the audit is not conducted in accordance with SAs. The auditor is, however, encouraged to apply SAs, including the SAs that address the auditor's report, to the extent practicable, notwithstanding that the auditor is not permitted to refer to the audit being conducted in accordance with SAs.

A36. In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report

directly to a regulator or the legislative body or the stakeholders if the entity attempts to limit the scope of the audit.

**Material Modifications to ISA 210, "Agreeing the Terms of Audit Engagements"**

*Addition*

1. Paragraph A8 of ISA 210 provides the examples of the financial reporting standards, which can be used for the preparation and presentation of general purpose financial statements. 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 under Companies (Accounting Standards) Rules, 2006' or 'Accounting Standards for Local Bodies promulgated by Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India (ICAI)', these have been added in the list of examples of financial reporting standards. References have accordingly been changed.

*Deletions*

1. Paragraph A10 of the ISA 210 deals with situations where the entity operates in a jurisdiction that does not have a standard setting organisation or a prescribed financial reporting framework. Since in India, this kind of situation does not exist, paragraph A10 has been deleted. However, the reference to Appendix 2, Determining Acceptability of General Purpose Frameworks, has been shifted to paragraph A9.

2. Paragraph A27 of ISA 210 deals with the condition where the law or regulation governs the operations of public sector audits, and also prescribes the public sector auditor's responsibilities and powers. Paragraph A37 of ISA 210 deals with the specific reporting requirements within the legislation governing the audit which may mandate; for example, the auditor may be required to report directly to a minister or the legislature or to public if the entity attempts to limit the scope of the audit in case of public sector entities. Since as mentioned in the "Preface to the Standards

<sup>32</sup> See paragraph 15 of the Exposure Draft of Revised SA 700, "Forming an Opinion and Reporting on Financial Statements", which includes a requirement regarding the evaluation of whether the financial statements adequately refer to or describe the applicable financial reporting framework. The Exposure Draft is published in the June, 2009 issue of the Journal of ICAI.

<sup>33</sup> ISA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing", paragraph 20, states as under:

"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".

Presently, SA 200, "Basic Principles Governing an Audit", issued in April 1985 and SA 200A, "Objective and Scope of an Audit of Financial Statements", issued in April 1985, correspond to the 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 (Revised).

on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted. However, since it is also possible that such situations may also exist in case of certain non-public entities pursuant to a requirement under the statute or regulation under which they operate, the spirit of erstwhile A27 and A37 has been retained.

#### Appendix 1

(Ref: Paras. A22-A23)

**Example of an Audit Engagement Letter**  
 The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with Financial Reporting Standards<sup>24</sup> of a company registered under the Companies Act, 1956. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this SA. It will need to be varied according to individual requirements and circumstances. It is drafted to refer to the audit of financial statements for a single reporting period and would require adaptation if intended or expected to apply to recurring audits (see paragraph 13 of this SA). It may be appropriate to seek legal advice that any proposed letter is suitable.

\*\*\*

To the Board of Directors of ABC Company Limited.<sup>25</sup>

[The objective and scope of the audit]  
 You<sup>26</sup> have requested that we audit the financial statements of ABC Company Limited, which comprise the Balance Sheet as at March 31, 20X1, and the Statement of Profit & Loss, and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information. We are pleased to confirm our acceptance and our understanding.

standing of this audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.<sup>27</sup>

[The responsibilities of the auditor]

We will conduct our audit in accordance with Standards on Auditing (SAs), issued by the Institute of Chartered Accountants of India (ICAI). 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SAs.

In making our risk assessments, we consider 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. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.

[The responsibilities of management and

identification of the applicable financial reporting framework (for purposes of this example it is assumed that the auditor has determined that the provisions of the Companies Act, 1956 relating to responsibility of the Board of Directors be supplemented by the descriptions in paragraph 6(b) of this SA).]

Our audit will be conducted on the basis that [management and, where appropriate, those charged with governance]<sup>28</sup> acknowledge and understand that they have responsibility:

(a) For the preparation of financial statements that give a true and fair view in accordance with the Financial Reporting Standards.<sup>29</sup> This includes:

- the responsibility for the preparation of financial statements on a going concern basis;
- the responsible for selection and consistent application of appropriate accounting policies, including implementation of applicable accounting standards along with proper explanation relating to any material departures from those accounting standards;
- the responsibility for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.

(b) For such internal control as [management] determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(c) To provide us with:

- (i) Access, at all times, to all information, including the books, account, vouchers and other records and documentation, of the Company, whether kept at the head office of the company or elsewhere, of which [management] is aware that is relevant to

<sup>24</sup> Refer footnote 6.

<sup>25</sup> The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons – see paragraph A21.

<sup>26</sup> Throughout this letter, references to "you", "we", "us", "management", "those charged with governance" and "auditor" would be used or amended as appropriate in the circumstances.

<sup>27</sup> Where the financial statements of the entity include financial statements/ information of its component(s) which have been audited by another auditor/ auditors, the engagement letter may be modified as under:

*"You have requested that we audit the financial statements of ABC Company Limited, which comprise the Balance Sheet as at March 31, 20X1, and the Statement of Profit & Loss, and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements."*

Further, as informed by you, the financial statements of the components of ABC Company Limited, viz., PQR Company Limited and XYZ Company Pvt Limited, whose financial information/ financial statements have been included in the financial statements of ABC Company would be/ have been audited by another auditor/ auditors. However, we expect to be furnished the reports of such other auditor(s) before the date of our audit report so as to enable us to deal with such reports in accordance with the principles enunciated in the Standard on Auditing (SA) 600, Using the Work of Another Auditor, issued by the Institute of Chartered Accountants of India".

<sup>28</sup> Use terminology as appropriate in the circumstances.

<sup>29</sup> Or, if appropriate, "For the preparation and fair presentation of the financial statements in accordance with the Financial Reporting Standards".

the preparation of the financial statements such as records, documentation and other matters;

(ii) Additional information that we may request from [management] for the purpose of the audit; and

(iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence. This includes our entitlement to require from the officers of the Company such information and explanations as we may think necessary for the performance of our duties as auditor.

As part of our audit process, we will request from [management and, where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We also wish to invite your attention to the fact that our audit process is subject to 'peer review' under the Chartered Accountants Act, 1949 to be conducted by an Independent reviewer. The reviewer may inspect, examine or take abstract of our working papers during the course of the peer review.

We look forward to full cooperation from your staff during our audit.

[Other relevant information]

[Insert other information, such as fee arrangements, billings<sup>30</sup> and other specific terms, as appropriate]

#### [Reporting]

[Insert appropriate reference to the expected form and content of the auditor's report.]

The form and content of our report may need to be amended in the light of our audit findings.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.  
Chartered Accountants  
.....  
(Signature)

Date: (Name of the Member)

Place: (Designation<sup>31</sup>)  
Acknowledged on behalf of ABC Company  
by:.....

(Signature)  
Name and Designation  
Date

#### **Appendix 2**

(Ref: Para. A9)  
**Determining the Acceptability of**

#### **General Purpose Frameworks**

1. Acceptable financial reporting frameworks normally exhibit the following attributes that result in information provided in financial statements that is useful to the intended users:

(a) Relevance, in that the information provided in the financial statements is relevant to the nature of the entity and the purpose of the financial statements. For example, in the case of a business enterprise that prepares general purpose financial statements, relevance is assessed in terms of the information necessary to meet the common financial information needs of a wide range of users in making economic decisions. These needs are ordinarily met by presenting the financial position, financial performance and cash flows of the business enterprise.

(b) Completeness, in that transactions and events, account balances and disclosures that could affect conclusions based on the financial statements are not omitted.

(c) Reliability, in that the information provided in the financial statements:

(i) Where applicable, reflects the economic substance of events and transactions and not merely their legal form; and

(ii) Results in reasonably consistent evaluation, measurement, presentation and disclosure, when used in similar circumstances.

(d) Neutrality, in that it contributes to information in the financial statements that is free from bias.

(e) Understandability, in that the information in the financial statements is clear and comprehensive and not subject to significantly different interpretation.

2. The auditor may decide to compare the accounting conventions to the requirements of an existing financial reporting framework considered to be acceptable. For example, the auditor may compare the accounting conventions to IFRSs. For an audit of a small entity, the auditor may decide to compare the accounting conventions to a financial reporting framework specifically developed for such entities by an authorised or recognised standards setting organization. When the auditor makes such a comparison and differences are identified, the decision as to whether the accounting conventions adopted in

the preparation and presentation of the financial statements constitute an acceptable financial reporting framework includes considering the reasons for the differences and whether application of the accounting conventions, or the description of the financial reporting framework in the financial statements, could result in financial statements that are misleading.

3. A conglomeration of accounting conventions devised to suit individual preferences is not an acceptable financial reporting framework for general purpose financial statements. Similarly, a compliance framework will not be an acceptable financial reporting framework, unless it is generally accepted in the industry to which the entity belongs by preparers and users.

#### **Limited Revision Consequential to issuance of Standard on Auditing (SA) 210 (Revised), "Agreeing the Terms of Audit Engagements"**

*The amendments to the following Standards on Auditing (SAs) have been shown in track change mode.*

#### **SA 580 (Revised), "Written Representations"**

[No amendments are proposed to paragraphs 1-4]

#### **Objectives**

5. The objectives of the auditor are:

(a) To obtain written representations from management and, where appropriate, those charged with governance that they management believes that they have it has fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor; the fundamental responsibilities that constitute the premise on which an audit is conducted; (Ref: Para. A2-A3)

(b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and

(c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance does not provide the written representations requested by the auditor.

[No amendments are proposed to paragraph 6.]

<sup>30</sup> For example, "Our fees will be billed as the work progresses".

<sup>31</sup> Partner or proprietor, as the case may be.

**Definitions**

7. For purposes of this SA, references to "management" should be read as "management and, where appropriate, those charged with governance". Furthermore, in the case of a fair presentation framework, management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; or the preparation of financial statements that give a true and fair view in accordance with the applicable financial reporting framework.

[No amendments are proposed to paragraphs 8.]

**Written Representations about Management's Responsibilities****Preparation and Presentation of the Financial Statements**

9. The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement<sup>32</sup> and, in particular, whether the financial statements are prepared and presented in accordance with the applicable financial reporting framework. (Ref: Para. A9-A11, A16, A24)

**Information Provided and Completeness of Transactions to the Auditor**

10. The auditor shall request management to provide a written representation that:

- (a) it has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement,<sup>33</sup> and
- (b) that all transactions have been recorded and are reflected in the financial statements. (Ref: Para. A9-A11, A16, A24)

**Description of Management's Responsibilities in the Written Representations**

11. Management's responsibilities shall be described in the written representations required by paragraphs 9 and 10 in the manner in which these responsibilities are described in the terms of the audit engagement. (Ref: Para. A3)

[No amendments are proposed to paragraphs 12-19 and A1.]

**Premise, relating to Management's Responsibilities, on which an Audit is Conducted** (Ref: Para. 5(a), 11)

A2. Law or regulation may establish management's responsibilities in relation to financial reporting. However, the extent of these responsibilities, or the way in which they are described, may differ under each law or regulation. Despite these differences, an audit in accordance with the SAs is conducted on the premise that management has 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
- (iii) Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence<sup>34</sup>.

A3. SA 210 (Revised) requires the auditor to obtain the agreement of management that it acknowledges and understands those responsibilities as a precondition for accepting the audit engagement<sup>35</sup> by him. If management's responsibilities prescribed by law or regulation are equivalent in effect to those described in paragraph A2, the auditor may use the wording of the law or regulation to describe them in the terms of the audit engagement<sup>36</sup>.

[No amendments are proposed to paragraphs A4-A8.]

**Written Representations about Management's Responsibilities** (Ref: Para. 9-10)

A9. Audit evidence obtained during the audit that management is fulfilling has fulfilled the responsibilities referred to in paragraphs 10 and 11 that it agreed to in the terms of the audit engagement is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether

management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities. For example, the auditor could not conclude that management has provided the auditor with all relevant the information agreed in the terms of the audit engagement described in paragraph A2(b) without asking it whether, and receiving confirmation that, such information has been provided.

[No amendments are proposed to paragraphs A10-A20.]

**Form of Written Representations** (Ref: Para. 14)

A21. Written representations are required to be included in a representation letter addressed to the auditor. Some laws or regulations may, however, require management to make a written public statement about its responsibilities. Although such statement is a representation to the users of the financial statements, or to relevant authorities, the auditor may determine that it is an appropriate form of written representation in respect of some or all of the representations required by paragraph 9 or 10. Consequently, the relevant matters covered by such statement need not be included in the representation letter. Factors that may affect the auditor's determination include:

- Whether the statement includes confirmation of the fulfillment of the responsibilities referred to in paragraphs 10 and 11 that are equivalent to some or all of those set out in the terms of the audit engagement.
- Whether the statement has been given or approved by those from whom the auditor requests the relevant written representations.
- Whether a copy of the statement is provided to the auditor as near as practicable to, but not after, the date of the auditor's report on the financial statements (see paragraph 13).

[No amendments are proposed to paragraphs A22-A27.]

**Written Representations about Management's Responsibilities** (Ref: Para. 19)

A28. As explained in paragraph A9, the auditor is not able to judge solely on other audit evidence whether management has fulfilled the responsibilities referred to in paragraphs 10 and 11. prepared and presented the financial statements and

<sup>32</sup> SA 210 (Revised), "Agreeing the Terms of Audit Engagements", paragraph 6(b)(i).

<sup>33</sup> SA 210 (Revised), paragraph 6(b)(iii).

<sup>34</sup> SA 200, "Basic Principles Governing an Audit" (earlier known as AAS1), refer paragraphs 18 and 19. The Standard is being revised in the light of the corresponding International Standard.

<sup>35</sup> Refer footnote 3.

<sup>36</sup> Refer footnote 3.

provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities. Therefore, if, as described in paragraph 19(a), the auditor concludes that the written representations about these matters are unreliable, or if management does not provide those written representations, the auditor is unable to obtain sufficient appropriate audit evidence. The possible effects on the financial statements of such inability are not confined to specific elements, accounts or items of the financial statements and are hence pervasive. [Proposed] SA 705 requires the auditor to disclaim an opinion on the financial statements in such circumstances.<sup>37</sup>

[No amendments are proposed to paragraph A29 and Appendix 1.]

## Appendix 2

(Ref: Para. A23)

### Illustrative Representation Letter

The following illustrative letter includes written representations that are required by this and other SAs in effect for audits of financial statements for periods beginning on or after as at [date]. It is assumed in this illustration that the applicable financial reporting framework is applicable accounting standards in India; the requirement of SA 570 (Revised)<sup>38</sup> to obtain a written representation is not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor) (Date)  
This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended March 31, 20XX<sup>39</sup> for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, (or give a true and fair view) in accordance with the applicable accounting standards in India. We confirm that, (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves):

#### Financial Statements

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert date], for the preparation and presentation of the

financial statements in accordance with Financial Reporting Standards as set out in the terms of the audit engagement dated [insert date] and, in particular, the financial statements are fairly presented (or give a true and fair view) in accordance therewith the applicable accounting standards in India.

...

#### Information Provided

- We have provided you with:
  - Access to all information of which we are aware, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements such as records, documentation and other matters;
  - Additional information that you have requested from us for the purpose of the audit; and
  - Unrestricted access to persons those within the entity from whom you determined it necessary to obtain audit evidence.

...

[No other amendments are proposed to Appendix 2.]

### SA 240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"

39. The auditor shall obtain written representations from management and, where applicable, those charged with governance that:

- (a) They acknowledge its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud;
- (b) It has disclosed to the auditor the results of its management's assessment of the risk that the financial statements may be materially misstated as a result of fraud;
- (c) It has disclosed to the auditor its knowledge of fraud or suspected fraud affecting the entity involving:
  - (i) Management;
  - (ii) Employees who have significant roles in internal control; or
  - (iii) Others where the fraud could have a material effect on the financial statements; and
- (d) It has disclosed to the

auditor its their knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (Ref: Para. A57-A58)

...

A12. Management is responsible accepts responsibility for the entity's internal control and for the preparation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it. The nature, extent and frequency of management's assessment of such risk and controls may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other entities, management's assessment may be less structured and less frequent. The nature, extent and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control.

...

A57. SA 580, "Management Representations<sup>40</sup>", establishes requirements and provides guidance on obtaining appropriate representations from management and, where appropriate, those charged with governance in the audit. In addition to acknowledging its that they have fulfilled their responsibility for the preparation of the financial statements, it is important that, irrespective of the size of the entity, management and, where appropriate, those charged with governance acknowledge its their responsibility for internal control designed, implemented and maintained to prevent and detect fraud.

A58. Because of the nature of fraud and the difficulties encountered by auditors in detecting material misstatements in the financial statements resulting from fraud, it is important that the auditor obtain a written representation from management and, where appropriate, those charged with governance confirming that

<sup>37</sup> [Proposed] SA 705, paragraph [12].

<sup>38</sup> Revised SA 570, "Going Concern".

<sup>39</sup> Where the auditor reports on more than one period, the auditor adjusts the date so that the letter pertains to all periods covered by the auditor's report.

<sup>40</sup> Revised Standard on Auditing (SA) 580, "Written Representations".

it has they have disclosed to the auditor:

- The results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud; and
- Its—Their knowledge of actual, suspected or alleged fraud affecting the entity.

#### **SA 540 (Revised), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures"**

22. The auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they management believes significant assumptions used by it in making accounting estimates are reasonable. (Ref: Para. A126-A127)

#### **SA 550 (Revised), "Related Parties"**

A16. The audit is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged and understand that they have responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, and for such: This

includes the design, implementation and maintenance of internal control as management and, where appropriate, those charged with governance, determine is necessary to enable relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error<sup>41</sup>. Accordingly, where the framework establishes related party requirements, management, with oversight from those charged with governance, is responsible for the design, implementation and maintenance of adequate controls over related party relationships and transactions so that these are identified and appropriately accounted for and disclosed in accordance with the framework. In their oversight role, those charged with governance are responsible for monitoring how management is discharging its responsibility for such controls. Regardless of any related party requirements the framework may establish, those charged with governance may, in order to fulfill their oversight responsibilities, obtain information from management to enable them to understand the nature and business rationale of the entity's related party relationships and transactions.

#### **SA 560 (Revised), "Subsequent Events"**

Management Responsibility Towards Auditor (Ref: Para. 10)

A11. As explained in SA 210 (Revised), agreed in the terms of the audit engagement, include the agreement of management has a responsibility to inform the auditor of relevant facts that may affect the financial statements, of which management it—may becomes aware during the period from the date of the auditor's report to the date the financial statements are issued.

#### **SA 570 (Revised), "Going Concern"**

16. When events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include: (Ref: Para. A15)

....

(e) Requesting written representations from management and/or, where appropriate, those charged with governance, regarding their plans for future action and the feasibility of these plans.

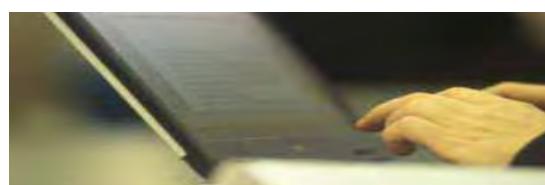
<sup>41</sup> SA200 [See footnote 2].

#### ICAI NEWS

## Committee on Government Accounting Online Registration Form for Engagement as a Resource Person

(Chartered Accountants who are having experience in the area of Government Accounting are only to be registered.)

The Committee on Government Accounting (CGA) of the Institute of Chartered Accountants of India (ICAI) is in the process of developing a database of the members as Resource Persons having experience in the ongoing accrual accounting reforms in the Central Government, State Government and UTs. The main objective of this database is to develop a platform where the members across the country can discuss various issues concerning the accrual accounting reforms in the Government. Seminars / Conferences / Round Table meetings may also be organised to discuss the matters pertaining to the Government Accounting Reforms and equip the profession to develop as per the expectations of the stakeholders. The members listed in the database would also be consulted on contemporary accounting matters concerning the accrual accounting reforms in



the Government so as to develop a pool of Chartered Accountants which would enable the profession to move forward and gain insight relating to the ongoing accounting reforms in the Government at the Union and the State level in India.

For registration, members may kindly log on to Institute's website i.e., <http://www.icai.org/cga1.html>

For any further queries, kindly contact to Secretary to the Committee on Government Accounting (CGA) at [cga@icai.in](mailto:cga@icai.in).

# Standard on Auditing (SA) 265

## Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

(Effective for all audits relating to accounting periods beginning on or after April 1, 2010)

**Standard on Auditing (SA) 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management"** should be read in the context of the "**Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services<sup>1</sup>**", 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<sup>2</sup>**".

### Introduction

#### Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control<sup>3</sup> that the auditor has identified in an audit of financial statements. This SA does not impose additional responsibilities on the auditor regarding obtaining an understanding of internal control and designing and performing tests of controls over and above the requirements of SA 315 and SA 330<sup>4</sup>. SA 260 (Revised)<sup>5</sup> establishes further requirements and provides guidance regarding the auditor's responsibility to communicate with those charged with governance in relation to the audit.
2. The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement<sup>6</sup>. In making those risk assessments, the auditor considers internal control 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 internal control. The auditor may identify deficiencies in internal control not only during this risk assessment process but also at any other stage of the audit. This SA specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management.
3. Nothing in this SA precludes the

auditor from communicating to those charged with governance and management other internal control matters that the auditor has identified during the audit.

#### Effective Date

4. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

#### Objective

5. The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

#### Definitions

6. For purposes of the SAs, the following terms have the meanings attributed below:
- (a) Deficiency in internal control – This exists when:
  - (i) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or
  - (ii) A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.
- (b) Significant deficiency in internal control – A deficiency or combination of deficiencies in internal control that,

in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance. (Ref: Para. A5)

#### Requirements

7. The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control. (Ref: Para. A1-A4)
8. If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies. (Ref: Para. A5-A11)
9. The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. (Ref: Para. A12-A18, A27)
10. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis: (Ref: Para. A19, A27)
- (a) In writing, significant deficiencies in internal control that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances; and (Ref: Para. A14, A20-A21)
- (b) Other deficiencies in internal control

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> 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.

<sup>3</sup> SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", paragraphs 4 and 12.

<sup>4</sup> SA 330, "The Auditor's Responses to Assessed Risks".

<sup>5</sup> SA 260 (Revised), "Communication with Those Charged with Governance".

<sup>6</sup> SA 315, paragraph 12. Paragraphs A56-A61 provide guidance on controls relevant to the audit.

- identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention. (Ref: Para. A22-A26)
11. The auditor shall include in the written communication of significant deficiencies in internal control:
- (a) A description of the deficiencies and an explanation of their potential effects; and (Ref: Para. A28)
  - (b) Sufficient information to enable those charged with governance and management to understand the context of the communication. In particular, the auditor shall explain that: (Ref: Para. A29-A30)
    - (i) The purpose of the audit was for the auditor to express an opinion on the financial statements;
    - (ii) The audit included consideration of internal control relevant to the 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 internal control; and
    - (iii) The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

\*\*\*

### **Application and Other Explanatory Material**

#### **Determination of Whether Deficiencies in Internal Control Have Been Identified (Ref: Para. 7)**

A1. In determining whether the auditor has identified one or more deficiencies in internal control, the auditor may discuss the relevant facts and circumstances of the auditor's findings with the appropriate level of management. This discussion provides an opportunity for the auditor to alert management on a timely basis to the existence of deficiencies of which management may not have been previously aware. The level of management with whom it is appropriate to discuss the findings is one that is familiar with the internal control area concerned and that has the authority to take remedial action on any identified deficiencies in internal control. In some circumstances, it may not be appropriate for the auditor to discuss the auditor's findings directly with

management, for example, if the findings appear to call management's integrity or competence into question (see paragraph A20).

A2. In discussing the facts and circumstances of the auditor's findings with management, the auditor may obtain other relevant information for further consideration, such as:

- Management's understanding of the actual or suspected causes of the deficiencies.
- Exceptions arising from the deficiencies that management may have noted, for example, misstatements that were not prevented by the relevant information technology (IT) controls.
- A preliminary indication from management of its response to the findings.

#### **Considerations Specific to Smaller Entities**

A3. While the concepts underlying control activities in smaller entities are likely to be similar to those in larger entities, the formality with which they operate will vary. Further, smaller entities may find that certain types of control activities are not necessary because of controls applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide effective control over important account balances and transactions, lessening or removing the need for more detailed control activities.

A4. Also, smaller entities often have fewer employees which may limit the extent to which segregation of duties is practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This higher level of management oversight needs to be balanced against the greater potential for management override of controls.

#### **Significant Deficiencies in Internal Control (Ref: Para. 6(b), 8)**

A5. The significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may therefore exist even though the auditor has not identified misstatements during the audit.

A6. Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

- The likelihood of the deficiencies leading to material misstatements in

the financial statements in the future.

- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process; for example:
  - ▶ General monitoring controls (such as oversight of management).
  - ▶ Controls over the prevention and detection of fraud.
  - ▶ Controls over the selection and application of significant accounting policies.
  - ▶ Controls over significant transactions with related parties.
  - ▶ Controls over significant transactions outside the entity's normal course of business.
  - ▶ Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.

- The interaction of the deficiency with other deficiencies in internal control.
- Indicators of significant deficiencies in internal control include, for example:

- Evidence of ineffective aspects of the control environment, such as:
  - ▶ Indications that significant transactions in which management is financially interested are not being appropriately scrutinized by those charged with governance.
  - ▶ Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
  - ▶ Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk

- assessment process to have identified.
- Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
  - Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
  - Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss<sup>7</sup>.
  - Evidence of management's inability to oversee the preparation of the financial statements.
- A8. Controls may be designed to operate individually or in combination to effectively prevent, or detect and correct, misstatements<sup>8</sup>. For example, controls over accounts receivable may consist of both automated and manual controls designed to operate together to prevent, or detect and correct, misstatements in the account balance. A deficiency in internal control on its own may not be sufficiently important to constitute a significant deficiency. However, a combination of deficiencies affecting the same account balance or disclosure, relevant assertion, or component of internal control may increase the risks of misstatement to such an extent as to give rise to a significant deficiency.
- A9. Law or regulation in some jurisdictions may establish a requirement (particularly for audits of listed entities) for the auditor to communicate to those charged with governance or to other relevant parties (such as regulators) one or more specific types of deficiency in internal control that the auditor has identified during the audit. Where law or regulation has established specific terms and definitions for these types of deficiency and requires the auditor to use these terms and definitions for the purpose of the communication, the auditor uses such terms and definitions when communicating in accordance with the legal or regulatory requirement.
- A10. Where the jurisdiction has established specific terms for the types of deficiency in internal control to be communicated but has not defined such terms, it may be necessary for the auditor to use judgment to determine the matters to be communicated further to the legal or regulatory requirement. In doing so, the auditor may consider it appropriate to have regard to the requirements and guidance in this SA. For example, if the purpose of the legal or regulatory requirement is to bring to the attention of those charged with governance certain internal control matters of which they should be aware, it may be appropriate to regard such matters as being generally equivalent to the significant deficiencies required by this SA to be communicated to those charged with governance.
- A11. The requirements of this SA remain applicable notwithstanding that law or regulation may require the auditor to use specific terms or definitions.
- Communication of Deficiencies in Internal Control**
- Communication of Significant Deficiencies in Internal Control to Those Charged with Governance** (Ref: Para. 9)
- A12. Communicating significant deficiencies in writing to those charged with governance reflects the importance of these matters, and assists those charged with governance in fulfilling their oversight responsibilities. SA 260 (Revised) establishes relevant considerations regarding communication with those charged with governance when all of them are involved in managing the entity.<sup>9</sup>
- A13. In determining when to issue the written communication, the auditor may consider whether receipt of such communication would be an important factor in enabling those charged with governance to discharge their oversight responsibilities. In addition, in case of listed entities, those charged with governance may need to receive the auditor's written communication before the date of approval of the financial statements in order to discharge specific responsibilities in relation to internal control for regulatory or other purposes. For other entities, the auditor may issue the written communication at a later date. Nevertheless, in the latter case, as the auditor's written communication of significant deficiencies forms part of the final audit file, the written communication is subject to the overriding requirement<sup>10</sup> for the auditor to complete the assembly of the final audit file on a timely basis. SA 230 (Revised) states that an appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report<sup>11</sup>.
- A14. Regardless of the timing of the written communication of significant deficiencies, the auditor may communicate these orally in the first instance to management and, when appropriate, to those charged with governance to assist them in taking timely remedial action to minimize the risks of material misstatement. Doing so, however, does not relieve the auditor of the responsibility to communicate the significant deficiencies in writing, as this SA requires.
- A15. The level of detail at which to communicate significant deficiencies is a matter of the auditor's professional judgment in the circumstances. Factors that the auditor may consider in determining an appropriate level of detail for the communication include, for example:
- The nature of the entity. For instance, the communication required for a public interest entity may be different from that for a non-public interest entity.
  - The size and complexity of the entity. For instance, the communication required for a complex entity may be different from that for an entity operating a simple business.
  - The nature of significant deficiencies that the auditor has identified.
  - The entity's governance composition. For instance, more detail may be needed if those charged with governance include members who do not have significant experience in the entity's industry or in the affected areas.
  - Legal or regulatory requirements regarding the communication of specific types of deficiency in internal control.
- A16. Management and those charged with governance may already be aware of significant deficiencies that the auditor has identified during the audit and may have chosen not to remedy them because of cost or other considerations. The responsibility for evaluating the costs and benefits of implementing remedial action rests with management and those charged with governance. Accordingly, the requirement in paragraph 9 applies regardless of cost or other considerations that management and those charged with

<sup>7</sup> Accounting Standard (AS) 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that prior period items should be separately disclosed in the Statement of Profit and Loss in a manner that their impact on the current profit or loss can be perceived.

<sup>8</sup> SA 315, paragraph A62.

<sup>9</sup> SA 260 (Revised), paragraph 9.

<sup>10</sup> SA 230 (Revised), "Audit Documentation", paragraph 14.

<sup>11</sup> SA 230 (Revised), paragraph A21.

governance may consider relevant in determining whether to remedy such deficiencies.

A17. The fact that the auditor communicated a significant deficiency to those charged with governance and management in a previous audit does not eliminate the need for the auditor to repeat the communication if remedial action has not yet been taken. If a previously communicated significant deficiency remains, the current year's communication may repeat the description from the previous communication, or simply reference the previous communication. The auditor may ask management or, where appropriate, those charged with governance, why the significant deficiency has not yet been remedied. A failure to act, in the absence of a rational explanation, may in itself represent a significant deficiency.

#### *Considerations Specific to Smaller Entities*

A18. In the case of audits of smaller entities, the auditor may communicate in a less structured manner with those charged with governance than in the case of larger entities.

#### *Communication of Deficiencies in Internal Control to Management* (Ref: Para.10)

A19. Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the deficiencies in internal control and to take the necessary remedial action. For significant deficiencies, the appropriate level is likely to be the chief executive officer or chief financial officer (or equivalent) as these matters are also required to be communicated to those charged with governance. For other deficiencies in internal control, the appropriate level may be operational management with more direct involvement in the control areas affected and with the authority to take appropriate remedial action.

#### *Communication of Significant Deficiencies in Internal Control to Management* (Ref: Para.10(a))

A20. Certain identified significant deficiencies in internal control may call into question the integrity or competence of management. For example, there may be evidence of fraud or intentional non-compliance with laws and regulations by management, or management may exhibit an inability to oversee the preparation of adequate financial statements that may raise doubt about management's competence. Accordingly,

it may not be appropriate to communicate such deficiencies directly to management. A21. SA 250 (Revised) establishes requirements and provides guidance on the reporting of identified or suspected non-compliance with laws and regulations, including when those charged with governance are themselves involved in such non-compliance<sup>12</sup>. SA 240 (Revised) establishes requirements and provides guidance regarding communication to those charged with governance when the auditor has identified fraud or suspected fraud involving management<sup>13</sup>.

#### *Communication of Other Deficiencies in Internal Control to Management* (Ref: Para. 10(b))

A22. During the audit, the auditor may identify other deficiencies in internal control that are not significant deficiencies but that may be of sufficient importance to merit management's attention. The determination as to which other deficiencies in internal control merit management's attention is a matter of professional judgment in the circumstances, taking into account the likelihood and potential magnitude of misstatements that may arise in the financial statements as a result of those deficiencies.

A23. The communication of other deficiencies in internal control that merit management's attention need not be in writing but may be oral. Where the auditor has discussed the facts and circumstances of the auditor's findings with management, the auditor may consider an oral communication of the other deficiencies to have been made to management at the time of these discussions. Accordingly, a formal communication need not be made subsequently.

A24. If the auditor has communicated deficiencies in internal control other than significant deficiencies to management in a prior period and management has chosen not to remedy them for cost or other reasons, the auditor need not repeat the communication in the current period. The auditor is also not required to repeat information about such deficiencies if it has been previously communicated to management by other parties, such as internal auditors or regulators. It may, however, be appropriate for the auditor to re-communicate these other deficiencies if there has been a change of management, or if new information has come to the auditor's attention that alters the prior

understanding of the auditor and management regarding the deficiencies. Nevertheless, the failure of management to remedy other deficiencies in internal control that were previously communicated may become a significant deficiency requiring communication with those charged with governance. Whether this is the case depends on the auditor's judgment in the circumstances.

A25. In some circumstances, those charged with governance may wish to be made aware of the details of other deficiencies in internal control the auditor has communicated to management, or be briefly informed of the nature of the other deficiencies. Alternatively, the auditor may consider it appropriate to inform those charged with governance of the communication of the other deficiencies to management. In either case, the auditor may report orally or in writing to those charged with governance as appropriate. A26. SA 260 (Revised) establishes relevant considerations regarding communication with those charged with governance when all of them are involved in managing the entity<sup>14</sup>.

A27. In the case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), the auditors may have additional responsibilities to communicate deficiencies in internal control that the auditor has identified during the audit, in ways, at a level of detail and to parties not envisaged in this SA. For example, significant deficiencies may have to be communicated to the legislature or other governing body. Law, regulation or other authority may also mandate that the auditors report deficiencies in internal control, irrespective of the significance of the potential effects of those deficiencies. Further, legislation may require the auditors to report on broader internal control-related matters than the deficiencies in internal control required to be communicated by this SA, for example, controls related to compliance with legislative authorities, regulations, or provisions of contracts or grant agreements.

#### *Content of Written Communication of Significant Deficiencies in Internal Control* (Ref: Para. 11)

A28. In explaining the potential effects of the significant deficiencies, the auditor need not quantify those effects. The significant deficiencies may be grouped

<sup>12</sup> SA 250 (Revised), "Consideration of Laws and Regulations in an Audit of Financial Statements", paragraphs 22-28.

<sup>13</sup> SA 240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", paragraph 41.

<sup>14</sup> SA 260 (Revised), paragraph 9.

together for reporting purposes where it is appropriate to do so. The auditor may also include in the written communication suggestions for remedial action on the deficiencies, management's actual or proposed responses, and a statement as to whether or not the auditor has undertaken any steps to verify whether management's responses have been implemented.

A29. The auditor may consider it appropriate to include the following information as additional context for the communication:

- An indication that if the auditor had performed more extensive procedures on internal control, the auditor might have identified more deficiencies to be reported, or concluded that some of the reported deficiencies need not, in fact, have been reported.
- An indication that such communication has been provided for the purposes of those charged with governance, and that it may not be suitable for other purposes.

A30. Law or regulation may require the auditor or management to furnish a copy of the auditor's written communication on significant deficiencies to appropriate regulatory authorities. Where this is the case, the auditor's written communication may identify such regulatory authorities.

#### **Material Modifications to ISA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management"**

##### **Deletions**

1. Paragraph A7 of ISA 265 provides the examples of the indicators of significant deficiencies in internal control which may include restatement of previously issued financial statements to reflect the correction of a material misstatement due to error or fraud. Since in India Accounting Standard (AS) 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that prior period items should be separately disclosed in the Statement of Profit and Loss in a manner that their impact on the current profit or loss can be perceived, the restatement of the prior period financial statements does not exist in the Indian scenario. Hence, to align with the requirements of AS 5, the requirement of restatement of prior period items has been replaced with the requirement to disclose the prior period items in the current year's Statement of Profit & Loss.
2. Paragraph A27 of ISA 265 deals with the additional responsibilities of the public sector auditors to communicate/report deficiencies in internal control to the

legislature or governing body. Since as mentioned in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted. Further, it is also possible that such additional responsibilities may also be imposed on the auditor in case of non public sector entities pursuant to a requirement under the statute or regulation under which they operate. Accordingly, the spirit of erstwhile A22, highlighting the fact, has been retained though a specific reference to public sector entities has been deleted.

#### **Limited Revision Consequential to issuance of Standard on Auditing (SA) 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management"**

*The amendments to the following Standards on Auditing (SAs) have been shown in track change mode.*

#### **SA 240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"**

A1. Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act. For example:

- ...
- A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden, for example, because the individual is in a position of trust or has knowledge of specific weaknesses in internal control.
- ...

**Considerations Specific to Smaller Entities**  
A27. In the case of a small entity, some or all of these considerations may be inapplicable or less relevant. For example, a smaller entity may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Domination of management by a single individual in a small entity does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process. In some entities, the need for management authorization can compen-

sate for otherwise weak deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual can be a potential weakness deficiency in internal control since there is an opportunity for management override of controls.

#### **Other Matters Related to Fraud** (Ref: Para. 42)

A63. Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example:

- ...
- A failure by management to appropriately address identified material weaknesses—significant deficiencies in internal control, or to appropriately respond to an identified fraud.
- ...

#### **Appendix 1 – Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting Opportunities**

...  
Internal control components are deficient as a result of the following:

- ...
- Accounting and information systems that are not effective, including situations involving significant deficiencies material weaknesses in internal control.

##### **Attitudes/Rationalizations**

- ...
- Management failing to correct remedy known significant deficiencies material weaknesses in internal control on a timely basis.
- ...

#### **Risk Factors Arising from Misstatements Arising from Misappropriation of Assets**

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and weaknesses—other deficiencies in internal control that is not effective—may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

##### **Attitudes/Rationalizations**

- ...

- Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to correct take appropriate remedial action on known deficiencies in internal control deficiencies.
- ...

**Appendix 3 – Examples of Circumstances that Indicate the Possibility of Fraud**

- Problematic or unusual relationships between the auditor and management, including:
- ...

**SA 260 (Revised), “Communicating with Those Charged with Governance”**

3. Recognising the importance of effective two-way communication during an audit of financial statements, this SA provides an overarching framework for the auditor’s communication with those charged with governance, and identifies some specific matters to be communicated with them. Additional matters to be communicated, which complement the requirements of this SA, are identified in other SAs. In addition, Proposed SA 265<sup>16</sup> establishes specific requirements regarding the communication of significant deficiencies in internal control the auditor has identified during the audit to those charged with governance. Further matters, not required by this or other SAs, may be required to be communicated by laws or regulations, by agreement with the entity, or by additional requirements applicable to the engagement. Nothing in this SA precludes the auditor from communicating any other matters to those charged with governance. (Ref: Para. A28-A31)

12. The auditor shall communicate with those charged with governance: (Ref: Para. A20)

(a) The auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity; (Ref: Para. A21)

(b) Significant difficulties, if any,

encountered during the audit; (Ref: Para. A22)

(c) Unless all of those charged with governance are involved in managing the entity:

(i) Material weaknesses, if any, in the design, implementation or operating effectiveness of internal control that have come to the auditor’s attention and have been communicated to management as required by SA 315 or SA 330;

(ii)(i) Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; (Ref: Para. A23) and

(iii)(ii) Written representations the auditor is requesting; and

(d) Other matters, if any, arising from the audit that, in the auditor’s professional judgment, are significant to the oversight of the financial reporting process. (Ref: Para. A24)

**Supplementary Matters** (Ref: Para. 3)

A29. The auditor may become aware of supplementary matters that do not necessarily relate to the oversight of the financial reporting process but which are, nevertheless, likely to be significant to the responsibilities of those charged with governance in overseeing the strategic direction of the entity or the entity’s obligations related to accountability. Such matters may include, for example, significant deficiencies in issues regarding governance structures or processes, and significant decisions or actions by senior management that lack appropriate authorisation.

**Timing of Communications** (Ref: Para. 17)

A44. The appropriate timing for communications will vary with the circumstances of the engagement. Relevant circumstances include the significance and nature of the matter, and the action expected to be taken by those charged with governance. For example:

• ...

• It may be appropriate to communicate a significant difficulty encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor to overcome the difficulty, or if it is likely to lead to a modified opinion. Similarly, the auditor it may be appropriate to communicate orally to those charged with governance as soon as practicable significant deficiencies material weaknesses in the design,

implementation or operating effectiveness of internal control that the auditor has identified prior to communicating these in writing as required by [proposed] SA 265<sup>16</sup>. have come to the auditor’s attention as soon as practicable.

**SA 300 (Revised), “Planning the Audit of Financial Statements”**

**Appendix – Considerations in Establishing the Overall Audit Strategy**

**Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements**

- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified weaknesses and action taken to address them.

**SA 315 , “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment”**

4. For purposes of the SAs, the following terms have the meanings attributed below:

(f) Material Weakness A weakness in internal control that could have a material effect on the financial statements.

...

14. The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

(a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior; and

(b) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control, and whether those other components are not undermined by deficiencies in the control environment weaknesses. (Ref: Para. A65-A74)

...

16. If the entity has established such a process (referred to hereafter as the ‘entity’s risk assessment process’), the auditor shall obtain an understanding of it, and the results thereof. Where the auditor identifies risks of material misstatement that management failed to identify, the auditor shall evaluate whether there was an underlying risk of a kind that the auditor

<sup>16</sup> SA 265. “Communicating Deficiencies in Internal Control to Those Charged with Governance and Management”.

<sup>16</sup> SA 265. “Communicating Deficiencies in Internal Control to Those Charged with Governance and Management”, paragraphs 9 and A14.

expects would have been identified by the entity's risk assessment process. If there is such a risk, the auditor shall obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or determine if there is a material weakness~~significant deficiency in internal control with regard to~~ the entity's risk assessment process.

...  
17. If the entity has not established such a process or has an ad hoc process, the auditor shall discuss with management whether business risks relevant to financial reporting objectives have been identified and how they have been addressed. The auditor shall evaluate whether the absence of a documented risk assessment process is appropriate in the circumstances, or determine whether it represents a significant deficiency~~material weakness~~ in the entity's internal control. (Ref: Para. A76)

...  
22. The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting, including those related to those control activities relevant to the audit, and how the entity initiates corrective remedial actions to deficiencies in its controls. (Ref: Para. A94-A96)

#### **Material Weakness in Internal Control**

31. The auditor shall evaluate whether, on the basis of the audit work performed, the auditor has identified a material weakness in the design, implementation or maintenance of internal control. (Ref: Para. A124-A125)

32. The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility, and, as required by SA 260 (Revised), "Communication with Those Charged with Governance", with those charged with governance (unless all of those charged with governance are involved in managing the entity). (Ref: Para. A126)

#### **Information Obtained in Prior Periods**

(Ref: Para. 9)

A10. The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as:

- Past misstatements and whether they were corrected on a timely basis.
- The nature of the entity and its

environment, and the entity's internal control (including deficiencies in internal control).

- Significant changes that the entity or its operations may have undergone since the prior financial period, which may assist the auditor in gaining a sufficient understanding of the entity to identify and assess risks of material misstatement.

A11. The auditor is required to determine whether information obtained in prior periods remains relevant, if the auditor intends to use that information for the purposes of the current audit. This is because changes in the control environment, for example, may affect the relevance of information obtained in the prior year. To determine whether changes have occurred that may affect the relevance of such information, the auditor may make inquiries and perform other appropriate audit procedures, such as walk-throughs of relevant systems.

#### **Nature and Extent of the Understanding of Relevant Controls** (Ref: Para. 13)

A62. Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements. Implementation of a control means that the control exists and that the entity is using it. There is little point in assessing the implementation of a control that is not effective, and so the design of a control is considered first. An improperly designed control may represent a material weakness~~significant deficiency~~ in the entity's internal control.

#### **Effect of the control environment on the assessment of the risks of material misstatement**

A70. The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory control environment is not an absolute deterrent to fraud. Conversely, deficiencies weaknesses in the control environment may undermine the effectiveness of controls, in particular in relation to fraud. For example, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be

processed. As explained in SA 330, the control environment also influences the nature, timing, and extent of the auditor's further procedures.

...

#### **Components of Internal Control—Monitoring of Controls** (Ref: Para. 22)

A94. Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary corrective remedial actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.

...

#### **Considerations specific to smaller entities**

A96. Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to corrective remedial action to the control.

...

#### **Assessment of Risks of Material Misstatement at the Financial Statement Level** (Ref: Para. 24 (a))

A99. Risks at the financial statement level may derive in particular from a weak deficient control environment (although these risks may also relate to other factors, such as, declining economic conditions). For example, deficiencies, weaknesses such as, management's lack of competence may have a more pervasive effect on the financial statements and may require an overall response by the auditor.

...

#### **Understanding Controls Related to Significant Risks** (Ref: Para. 28)

A119. In some cases, management may not have appropriately responded to significant risks of material misstatement by implementing controls over these significant risks. Failure by management to implement such controls is an indicator of a This may indicate a significant deficiency material weakness in the entity's internal control<sup>17</sup>.

...

#### **Material Weakness in Internal Control** (Ref: Para. 31)

A124. The types of material weaknesses in internal control that the auditor may identify when obtaining an

<sup>17</sup> SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", Paragraph A7.

~~understanding of the entity and its internal controls may include:~~

- Risks of material misstatement that the auditor identifies and which the entity has not controlled, or for which the relevant control is inadequate.
- A weakness in the entity's risk assessment process that the auditor identifies as material, or the absence of a risk assessment process in those cases where it would be appropriate for one to have been established.

A125. Material weaknesses may also be identified in controls that prevent, or detect and correct, error, or those to prevent and detect fraud.

A126. In case of certain audit engagements, there may be additional communication or reporting requirements. For example, internal control weaknesses may have to be reported to the regulator.

#### Appendix 1 – Internal Control Components

##### Monitoring of Controls

12. Internal auditors or personnel performing similar functions may contribute to the monitoring of an entity's controls through separate evaluations. Ordinarily, they regularly provide information about the functioning of internal control, focusing considerable attention on evaluating the effectiveness of internal control, and communicate information about strengths and weaknesses ~~deficiencies in internal control~~ and recommendations for improving internal control.

#### Appendix 2 – Conditions and Events that may Indicate Risks of Material Misstatement

- ...
- ~~Weaknesses Significant Deficiencies in internal control, especially those not addressed by management.~~
- ...

#### SA 330, "The Auditor's Responses to Assessed Risks"

18. The auditor shall evaluate whether, on the basis of the audit work performed, the auditor has identified a material weakness in the operating effectiveness of controls.

19. The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility and, as required by SA 260, "Communication with Those Charged with Governance", with those charged with governance (unless all of those charged with governance are involved in managing the entity).

#### Overall Responses (Ref: Para.5)

A2. The assessment of the risks of material misstatement at the financial statement level, and thereby the auditor's overall responses, is affected by the auditor's understanding of the control environment. An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity and thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at the period end. ~~Deficiencies Weaknesses~~ in the control environment, however, have the opposite effect; for example, the auditor may respond to an ineffective control environment by:

- Conducting more audit procedures as of the period end rather than at an interim date.
- Obtaining more extensive audit evidence from substantive procedures.
- Increasing the number of locations to be included in the audit scope.

Controls that have not changed from previous audits (Ref: Para.14(b))

A38. In general, the higher the risk of material misstatement, or the greater the reliance on controls, the shorter the time period elapsed, if any, is likely to be. Factors that may decrease the period for retesting a control, or result in not relying on audit evidence obtained in previous audits at all, include the following:

- A ~~weak deficient control~~ environment.
- ~~Weak Deficient~~ monitoring of controls.
- A significant manual element to the relevant controls.
- Personnel changes that significantly affect the application of the control.
- Changing circumstances that indicate the need for changes in the control.
- ~~Weak Deficient~~ general IT-controls.

#### Evaluating the Operating Effectiveness of Controls (Ref: Para. 16-19)

A40. A material misstatement detected by the auditor's procedures may indicate ~~is a strong indicator of the existence of a material weakness significant deficiency in internal control.~~

#### Evaluating the Sufficiency and Appropriateness of Audit Evidence (Ref: Para. 26-28)

A56. An audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the

nature, timing or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example,

- The extent of misstatements that the auditor detects by performing substantive procedures may alter the auditor's judgment about the risk assessments and may indicate a ~~material weakness significant deficiency~~ in internal control.
- The auditor may become aware of discrepancies in accounting records, or conflicting or missing evidence.
- Analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognised risk of material misstatement.

In such circumstances, the auditor may need to re-evaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the classes of transactions, account balances, or disclosures and related assertions. SA 315 contains further guidance on revising the auditor's risk assessment.

#### SA 540 (Revised), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures"

##### Obtaining an Understanding of How Management Identifies the Need for Accounting Estimates (Ref: Para. 8(b))

A20. During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. SA 315 provides guidance when the auditor identifies a ~~material weakness deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including determining whether there is a significant deficiency in internal control with regard to in the entity's risk assessment processes<sup>18</sup>.~~

#### SA 550 (Revised), "Related Parties"

##### The Entity's Controls over Related Party Relationships and Transactions (Ref: Para. 14)

A18. Controls over related party relationships and transactions within some entities may be weak, ineffective ~~deficient~~ or non-existent for a number of reasons, such as:

...

<sup>18</sup> SA 315, paragraph 16.



# It's Time to Think About the Almighty!



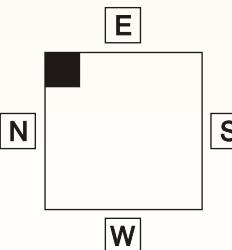
**Kashyap Nitin Pathak**

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He who is omnipresent and is known by so many names in this world, like Bhagwan, Allah, Wahe Guru, Jesus, Mahavir swami, Jhule Laal, Buddha, Jasthust, etc. based on religion or mythology. The whole world understands consciously or subconsciously that there is only one supreme power in existence Who has different names. He takes different forms, shapes, figures and avtaars and sits in our hearts and minds in the way we perceive Him to be.

It was a bit unconvincing for me initially when I learnt about the placement of the abode of God. The one who is the creator of everything, including *Vastu shastra*, does He really need to be placed in a particular location when we all know that He is in fact everywhere. Well...the answer to this question is YES. *Vastu* prescribes a place for the *puja* room because the human mind is unstable and needs to be mastered like a teacher mastering a student.

When you are in the worship room, the energy should impact you in such a way that it acts like a



guiding force in your day-to-day life. The best direction as per the principles of *Vastu* is the North-East direction, also called the *Eshaanya* corner. But why is only this direction suggested by *Vastu*? The reason is that this direction is ruled by the planet

Jupiter which is also called *Guru*. *Guru* (teacher) guides us in the path of spiritualism to attain the ultimate quest of life for mankind which is liberation (*moksh*). *Guru* is calm, soothing, knowledgeable, concentrating, spiritual, tutor, positive, forceful but controlled and saviour. The deities placed in this direction can face the West or South-West.

*Exception:* If there are no doors or windows opening in the North then an idol of Lord Ganesh can be kept in the South. If keeping an idol is not possible, a wall paper or photo frame can be a substitute. This idol or frame will be facing North.

A temple in the East direction is the second best alternative but nothing like the North-East direction. I have met people who did not believe in God and still they did have a temple in the house be-

cause other family members were spiritual. I have concluded with certainty in almost all such cases that the temple was in the wrong direction. Moving the temple in the correct direction changes the direction of your belief in God.

### On the Wall or on the Ground?

Should the temple be hanged on the wall or be attached to the wall also deserves some consideration. A temple hanged on the wall at a height where one has to worship the deities in a standing manner will never let you concentrate on God. It will be more like a *puja* which is a formality or a routine for you. One needs to sit down comfortably and focus on the smallest aspect of a *puja* like bathing the idols, cleaning them, applying *chandan*, offering flowers, reciting mantras and so on. There has to be a loving emotion while doing *puja* which will naturally develop if the temple is in the right direction.

### A Flasher Lamp or a Ghee Lamp

There should be a flasher lamp in the temple and ideally it should be continuously on. While doing *puja*, a ghee lamp should be used and the cot-

ton weed should be kept vertical NOT horizontal, this is ideal.

### Temple Material

Wooden and marble temples are good, steel or iron are not best suited. God deserves the same treatment you give to yourself. So whatever you wear and eat, should be offered to Him before you enjoy it.

### Other Suggestions

- The temple should have a curtain with which the deities can be covered or a gate like structure which can be opened and closed. If there are women in the house then their shadow should not fall on the temple while in their moon cycle.
- Any leather items should be avoided.
- The temple should not be touched if there has been a death in the family for 13 days. In case of the birth of a newborn baby in the family, the temple should not be touched for 10 days.
- For prosperity and wealth there must be a *shree yantra* or a *kuber yantra* in the temple.

### ICAI NEWS

## Using CAATs/ GAS & Using MS-Excel 2007 as an Audit Tool

The Committee on Information Technology, ICAI has issued CD based e-Learning modules on aforementioned topics to enable Institute professional accountants to start these tools to enhance the efficiency and effectiveness of their financial analysis/ reporting/ audits. These modules are available at the Sale Counters of the Institute @ Rs. 100/- each.

Considering demand from members, Regional Councils/ Branches/ CPE Chapters have started organising One Day Practical Workshops on these topics and provide additional hand-holding/ support/ guidance in using these tools. Members interested in joining these workshops are requested to register with their Programme Organising Unit (POU). Members proficient in these topics are also requested to contact their POU to provide faculty support, in organising

these workshops. As a proactive measure to provide basic handholding on the use of these e-Learning modules, the Committee has started offering an Introductory Session of 4 hours at Vishwas Nagar - Delhi Office on these modules to enable computer proficient members to get started @ Rs. 500/-. As a part of this session delegates get a copy each of the two modules, brief introduction, computer to practice and get started with the modules, apart from 2 CPE hours. Members interested in joining the sessions may register online (<http://www.icai.org/ccm.html>) and confirm seat availability/ booking by sending an e-mail to [erp@icai.org](mailto:erp@icai.org). These sessions are organised during working days and timings of the Institute.

Please contact [cit@icai.org](mailto:cit@icai.org) 011-30210621/ 619 for further details/ assistance, if any. Further details are available at <http://cit.icai.org>.

# THIS MONTH FOR YOU

(based on Tarot Card reading)



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*Angelic Message* You are divinely guided for some important information.

## ARIES

This month you have to pay extra attention towards your health and diet plans. Speculation tends to be favourable for you. Pay attention to the lucrative job offers regarding your career. Your bonding with family will be higher. House renovation or shifting is expected.



### TAURUS *Angelic Message*: Be impervious to ego-ride and take proper decision.

Try and excel in your diplomacy regarding your work and improve your social skills and emotional capabilities. Be supportive to your children and don't make any mistakes while communicating with seniors as it may affect your work. Elders may pressurize you against your love affairs.



*Angelic Message* You are on the verge to solve your "Current Issue."

## GEMINI

This month will have whole focus on your relationship. You may feel that it is not going anywhere. Avoid taking important love decision and being spendthrift. You may take risks in your finance. Improve your clarity about your goal.



### CANCER *Angelic Message*: Balance your positive and negative thoughts and rejuvenate your body and soul.

This month you will blindly follow your ambitions about your success. Work with your emotional issue regarding your family, it might affect your health. Look for sales-marketing, media and advertisement. You may have an opportunity to join your family business.



*Angelic Message* Be cautious while surrounded by people and prepare yourself for changes in career.

## LEO

This month is for manifesting, dreaming, visualizing and getting into soul harmony. You have been much career-oriented and made much progress. Pay attention to your family and friends. You are still on a yearly financial peak and enjoyment. Be cautious about your bank statements, credit-cards and things going around you.



### VIRGO *Angelic Message*: Stay connected to complete faith with divine power.

There may be lots of travelling this month. Global opportunity for business might come to you. Neglect specific relationship. Intuition and inner-guidance again will be on top priority. You will be self-confident and rise with self esteem.



*Angelic Message* You are going to feel overwhelmed about your life so start appreciating yourself.



This month is going to have a big windfall of financial opportunities. You will attract relationship with your colleague or while travelling. Protect yourself from taking hasty decisions. Be patient and maintain your harmony. Take out time for your health.



### SCORPIO *Angelic Message*: Whatever dreams you have you will achieve them and rise again to victory.

This month you will become more independent, powerful and very intuitive. Now everything will be in your hands. Major interest will be career. You may go for steady relationship. You will connect with your highest power.



*Angelic Message* See your inner qualities and express yourself.

## SAGITTARIUS

This month your entire focus will be on your family issue. You will find little complications in your career. Keep analysing your business opportunity. Pay attention to your health particularly with respect to your heart.



### CAPRICORN *Angelic Message*: Major changes are ahead in your life.

This month you will face financial disagreement with your partners or your boss which could be regarding income tax also, but you will overcome this situation. It is time to go for higher education and foreign travel. There is a possibility for a new business venture.



*Angelic Message* The world that you have created around you has to be changed.



This month your goal will be on the verge of completion. You may be in a double-minded situation while taking decisions regarding your career. Put extra strength in your workplace and avoid any decision regarding your investment.



### PISCES *Angelic Message*: Take preventive measures for stomach infection.

You have done enough work so you might feel exhausted and want to relax this month. Arguments regarding business or property may be possible in your family. Take extra care for your health.

"DISCLAIMER: The views expressed or implied in this feature are those of the author and not of the ICAI, which will not be responsible for any action taken on the basis of this feature."

# CROSS WORD | 039

## ACROSS

5. 'Go Green Run' organized at Agra as part of ICAI's green initiative – Planet Alert, was also participated by social activist and actor \_\_\_\_\_. (5,4)

6. Interest received by the assessee on compensation or enhanced compensation shall now be taxed on \_\_\_\_\_ basis irrespective of the method of accounting being followed by the assessee. (7)

8. An approval once granted to a trust or institution for donation under section 80G shall be valid in \_\_\_\_\_ unless withdrawn. (10)

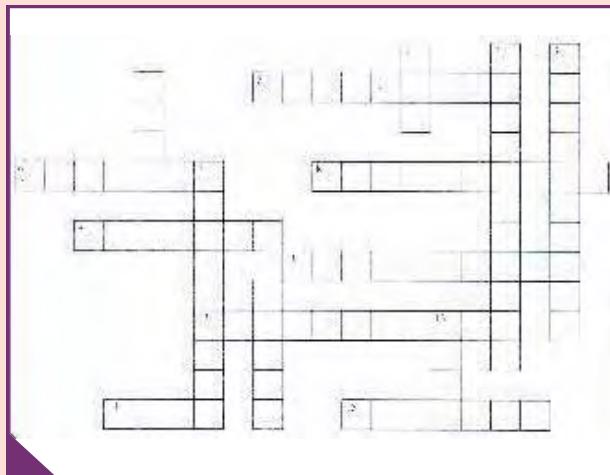
9. Institute launched its own \_\_\_\_\_ channel. (7)

10. Any provision made for \_\_\_\_\_ in the value of any asset shall be added to the book profit for the purpose of levy of minimum alternate tax (MAT). (10)

12. The existing scope of \_\_\_\_\_ taxation by applying a fixed rate of the total income or gross receipts has now been extended to all businesses. (11)

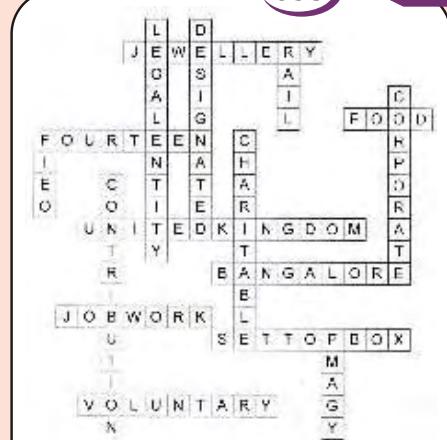
14. The TDS rate in respect of payment of \_\_\_\_\_ has been reduced to 2% from 10% for the use of any plant, machinery or equipment on payment to Individual/HUF. (4)

15. From the financial year 2009-10 \_\_\_\_\_ Tax is required to be paid only if the liability to pay tax is Rs. 10000 or more. (7)



# **SOLUTION** Crossword

- 038



**Note:** Members can claim one hour CPE Credit – Unstructured Learning through self-declaration for attempting above Crossword.



2

A worker approached his employer and held up his last paycheck. "This is 500 rupees less than we agreed on," he said.

"I know," the employer said. "But last month I overpaid you 500 hundred rupees, and you never complained."

"Well, I don't mind an occasional mistake," the worker answered, "but when it gets to be a habit, I feel I have to bring it to your attention."

A salesman was demonstrating unbreakable combs in a department store. He was impressing the people who stopped by to look by putting the comb through all sorts of torture and stress.

Finally to impress even the skeptics in the crowd, he bent the comb completely in half, and it snapped with a loud crack. Without missing a beat, he bravely held up both halves of the 'unbreakable' comb for everyone to see and said, "And this, ladies and gentlemen, is what an unbreakable comb looks like on the inside."