



# THE CHARTERED ACCOUNTANT

JOURNAL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

## Union Budget 2010-11



The month of March traditionally signalled a period for post-budget blues. Businessmen as well as the salaried class traditionally worried about how to adjust to the increased taxes and prices, and they made resolutions to cut down upon consumption of items like cigarettes and cosmetics. Chartered accountants were busy reading the fine print of the Finance Bill, attending innumerable lectures and seminars to gather varying perceptions and interpretations of the proposed Amendments and looking for hidden devils in the text.

Budget presented by Hon'ble Finance Minister Shri Pranab Mukherjee marked a refreshing shift from the past. Instead of the usual hoopla that surrounds the presentation of budget, this year's budget was virtually a non-event. The change is welcoming. This is an indication of the increasing maturity of the Indian economy and marks a departure from the practice of making huge policy shifts on an annual basis. In the past, attention was riveted on the budget because, when the economy was less stable and resources more scarce, finance ministers were compelled to juggle around with rate, relief, subsidy and sources of revenue in an attempt to balance the conflicting pulls and pressures of political necessity, fiscal prudence and economics. These pressures undoubtedly remain. However, the success that has been achieved on the economic front has enabled the leadership to take a more statesmanlike long-term approach. Knowing that a new direct tax code is already under formulation, the Finance Minister has resisted the temptation to tinker with the overall tax provisions. Few changes that have been made can be largely attributed to fine tuning of certain issues. Business and industry as well as investors within and outside the country have welcomed such an approach. A steady

trajectory on tax and economic policy contributes to a sense of continuity and stability and inspires confidence that India Inc means business. This projects a positive picture of the Indian economy cruising in auto-pilot mode with minimal political interference. There is, of course, the mild turbulence of inflationary pressure arising out of the ever-burgeoning developmental expenditures. However, it would appear that this has been factored into the transition of India from a developing economy to a country on the path to becoming a world economic power. The government would do well to keep in mind the benefits of such stability while introducing the reforms by way of a new direct-tax code. While it may be alluring to talk about a radical reform in the tax system, it would be equally important to recognise that rocking the boat could upset the steady progress made by the economy in the recent past.

While appreciating the minimalist approach of the Finance Minister, one must take note of the fact that credit is also due to the leadership provided by the Prime Minister, Dr. Manmohan Singh, who has guided the professional team that he built, which includes the Planning Commission, the Finance Commission and the bureaucracy. This team has been encouraged to adopt a more open approach. The initial draft of the direct-tax code raised more questions and issues rather than offering solutions. What needs to be appreciated, however, is its openness to discussion and debate. We can hope for sure that not only the views of the profession will be given their due weightage, but these would be considered positively and acted upon, where one is convinced that the suggestions made have merit.

- Editorial Board  
**ICAI – Partner in Nation Building**

## EDITORIAL BOARD

<b>EDITOR</b>	CA. AMARJIT CHOPRA, President
<b>JOINT EDITOR</b>	CA. G. RAMASWAMY, Vice-President
<b>MEMBERS</b>	CA. JAYDEEP N. SHAH CA. SHIWAJI B. ZAWARE CA. P. RAJENDRA KUMAR CA. SUMANTRA GUHA CA. ANUJ GOYAL CA. PANKAJ TYAGEE CA. LAXMINIWAS SHARMA CA. SUBHASH C. GOEL CA. DHARAM V. CHOPRA CA. VIMAL R. KHANNA
<b>SECRETARY</b>	SHRI VIJAY KAPUR
<b>ICAI EDITORIAL TEAM</b>	NADEEM AHMED CA. NITIN JAIN DR. N. K. RANJAN

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA**

ICAI Bhawan, Post Box No.7100, Indraprastha Marg,  
New Delhi-110002, Tel: +91 (11) 39893989.

E-mail: [icaiho@icai.org](mailto:icaiho@icai.org), Website: [www.icai.org](http://www.icai.org)

**SUBSCRIPTION RATES**

Inland subscribers : Rs. 1000 per annum  
Overseas : \$ 150 per annum (subscribers by sea mail)

For Overseas Members/Subscribers

- Air Mail Surcharge : Rs. 2100 per annum
- Sea Mail Surcharge : Rs. 1100 per annum

CA Students : Rs. 1400 for 3.5 years

Rs. 400 per annum

Other students & Faculties : Rs. 600 per annum

**CLASSIFIEDS:**

Minimum Rs. 1000/- for the first 25 words or part thereof and Rs. 250/- for five words or part thereof over and above first twenty five words. Please contact: The Journal Section at ICAI Bhawan, Noida or call at +91(120) 3045921 or e-mail at [journal@icai.org](mailto:journal@icai.org)

**DESIGN, ADVERTISEMENT & MARKETING****SPENTA MULTIMEDIA**

**MUMBAI:** Spenta Multimedia, Peninsula Spenta, Mathuradas Mill Compound, N. M. Joshi Marg, Lower Parel, Mumbai-400013. Tel: +91 (22) 24811022/24811025, Telefax: -91(22) 24811021. **DELHI:** No.7, 1st Floor, Nizamuddin (West) Market, New Delhi-110013. Tel: +91 (11) 4669 9999. **BANGALORE:** House No. 64, 5th Block, 4th Cross, Koramangala, Bangalore - 560 095. Tel: +91(80) 2553 4105/2553 9512. **KOLKATA:** 206-Jodhpur Park, Kolkata - 700068. Tel: +91(33) 2473 5896. Telefax: +91(33) 2413 7973. **CHENNAI:** AKS Pooja Complex, 2nd Floor, Old No: 203 New No: 154, R. K. Mutt Road, Mandevelli (Next to Jagan Mohan Clinic), Chennai - 600 028. Tel: +91(44) 4216 8984/85. **HYDERABAD:** Flat No. 2, Vimala Vihar Apts. Goutham Nagar, Dilruk Nagar, Hyderabad - 500 060.

**ICAI RESERVES THE RIGHT TO REJECT ADVERTISEMENTS**

Printed and published by Vijay Kapur on behalf of The Institute of Chartered Accountants of India (ICAI)  
Editor — CA. Amarjit Chopra

Published at ICAI Bhawan, P. O. Box No. 7100, Indraprastha Marg, New Delhi - 110 002 and printed at Spenta Multimedia. Peninsula Spenta, Mathuradas Mill Compound. N. M. Joshi Marg, Lower Parel, Mumbai - 400013

*The views and opinions expressed or implied in THE CHARTERED ACCOUNTANT are those of the authors and do not necessarily reflect those of ICAI. Unsolicited articles and transparencies are sent in at the owner's risk and the publisher accepts no liability for loss or damage. Material in this publication may not be reproduced, whether in part or in whole, without the consent of ICAI.*

*DISCLAIMER: The ICAI is not in any way responsible for the result of any action taken on the basis of the advertisement published in the Journal. The members, however, may bear in mind the provision of the Code of Ethics while responding to the advertisements.*

**TOTAL CIRCULATION : 1,90,000**

Total No. of Pages: 164 including Covers

# THE CHARTERED ACCOUNTANT

JOURNAL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

<b>EDITORIAL</b>	<b>1559</b>
<b>FROM THE PRESIDENT</b>	<b>1562</b>
<b>READERS WRITE</b>	<b>1568</b>
<b>PHOTOGRAPHS</b>	<b>1570</b>
<b>KNOW YOUR ETHICS</b>	<b>1572</b>
<b>SPECIAL ADDRESS</b>	
Minister of Corporate Affairs Shri Salman Khurshid	<b>1574</b>
<b>LEGAL UPDATE</b>	
Legal Decisions	<b>1580</b>
Circulars & Notifications	<b>1592</b>
<b>EAC OPINION</b>	<b>1599</b>
<b>ECONOMIC UPDATE</b>	<b>1679</b>
<b>NATIONAL UPDATE</b>	<b>1680</b>
<b>INTERNATIONAL UPDATE</b>	<b>1682</b>
<b>ACCOUNTANT'S BROWSER</b>	<b>1684</b>
<b>ICAI NEWS</b>	
Last Date of Registration for Post Qualification Course in International Trade Laws & WTO for November 2010 Part I Examinations	<b>1685</b>
ERP Courses	<b>1685</b>
Announcement on Guidance Note on Audit of Banks	<b>1686</b>
Queries Relating to Audit of Banks and Bank Branches Relating to FY 2007-08	<b>1686</b>
Bank Audits for the FY ended 31.03.2010	<b>1686</b>
Important Announcement	<b>1687</b>
Classifieds	<b>1687</b>
Additional Disclosures by Banks in Notes to Accounts	<b>1688</b>
Request of Proposals for Development of Study Material	<b>1690</b>
Non-Receipt of Journal	<b>1690</b>
<b>CAREER WATCH</b>	<b>1691</b>
<b>STANDARDS</b>	
Standard on Auditing (SA) 710 (Revised)	
Comparative Information - Corresponding Figures and Comparative Financial Statements	<b>1693</b>
Standard on Auditing (SA) 800	
Special Considerations - Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks	<b>1699</b>
Standard on Auditing (SA) 805	
Special Considerations - Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement	<b>1703</b>
Standard on Auditing (SA) 810	
Engagements to Report on Summary Financial Statements	<b>1709</b>

## UNION BUDGET 2010-11

**Salient Features of Finance Bill, 2010**

- CA. Ved Jain

### User-Friendly Proposals in the Union Budget

- CA. T. Banusekar

### Proposals for Change in Conversion to LLP and MAT

- CA. Chandrashekhar V. Chitale

### Issues on Amendments in Deductions by Finance Bill, 2010

- CA. Barun Kumar Ghosh

### Service Tax Proposals under the Finance Bill, 2010

- CA. Ravi Holani

### Analysis of Latest Changes Effected in CENVAT Rules in Finance Bill, 2010

- CA. Ashok Batra

### Expanded Scope of Construction Services

- CA. Tushar K. Doctor

1602

1614

1618

1622

1628

1635

1640

## ACCOUNTING

1643

**Accounting for and Issue related to Preliminary/Share Issue Expenses**

- CA. Kevin Daftary

## TAXATION

### Taxability Under Central Sales Tax Act on Interstate Transfer of Goods for Job Work

- CA. Sanjay K. Agarwal

1646



## BANKING & FINANCE

1650

**Money Laundering and Financing of Terrorism – A Study on Methods to Fight Money Laundering in India & USA**

- Dr. Anuradha Gupta

1658

**Behavioural Finance: A Road Less Travelled**

- Prof. S. S. Khanka

1668



## ERP

1673

**Enterprise Resource Planning SAP: An Overview**

- CA. Vairavan Sitambaram

## CORPORATE & ALLIED LAWS

### Available Rights and Benefits to Micro, Small and Medium Enterprises

- CA. Nelatur Syamasundaran

## BACKPAGE

Cross Word 046  
Smile Please

1717





**PRESIDENT**

### **Dear All**

*"We are what we repeatedly do. Excellence, then, is not an act, but a habit,"* says the ancient Greek philosopher Aristotle, which aptly fits our profession. Following a glorious tradition of excellence for more than six decades, our profession today is an integral part of India's success story. The persistent pursuit of perfection, integrity, skills and knowledge has placed us in an exalted position in the present professional order of our country. But this triumph of our profession must continue unhindered even in these times of transition. We need to think different and think big. We need to continuously strive to explore and conquer the emerging frontiers of challenges. The best way to be ready for the future is to invent it. And I am sure that together WE CAN.

### **Working in Unison with Government**

And in line with that spirit, we recently had the august presence of the Hon'ble Minister for Corporate Affairs, Shri Salman Khurshid amidst us to address the CA profession — first time since he took over. According to him, the next big revolution after the software revolution could happen in the world of accountancy. In fact, with the convergence of accounting standards, India can play a crucial role by contributing possibly the best and the largest number of young accountants. To that effect, he said, *Indian accountancy today needs a veritable vision that combines confidence, competence, capacity and creativity - "a telescopic vision to be able to see much further".* Though on a cautious note, he said that it was important that Indian accountancy didn't stay behind in the age of rapid advancements and *"so if the profession thinks of protection, it must not think of protecting itself in a manner that it becomes incapable of fighting in the rest of the world."* However, he assured us that the Government would be alive to the interests of *"the struggling smaller professionals trying to find a little space in the world of extreme competition with large big fishes floating around"* and that the Ministry would continue *"working to improve the opportunities and platforms"* for the CA profession. *"We are committed to you; we are here for you in an enlightened way, we want to re-chart you and help you,"* he concluded. We completely agree with his view and vision and, on behalf of the Council and the CA fraternity, assure him to proactively work to translate his vision into reality. Full text of his speech

is published elsewhere in this issue of the journal for your information.

Secretary of the Ministry of Corporate Affairs Shri R. Bandyopadhyay also paid a special visit recently to the ICAI headquarters to address our Council. In his address, he said that he considered the Institute as an extended family of the MCA that can act as a friend, philosopher and guide to the corporate world and show it the right way to work and prosper. He said that Indian chartered accountants are comparable with the best in the world. However, he said, that concerted and constant proactive efforts need to be made on part of the Institute and its members to maintain that high stature and trust, and live up to the increasing expectations of the various stakeholders, including the Government.

We, on our part, utilised this opportunity to apprise him of the Institute's commitments, views, suggestions and concerns on several important issues including the convergence of accounting and auditing standards; the Companies Bill, 2009, auditors' liability and independence, limited liability partnership, and our well-acknowledged and appreciated educational, regulatory and standard setting functions, etc. We impressed upon him that there should be some limitation on auditors' liability and there should be greater emphasis on their independence in the Companies Bill, 2009. We explicitly expressed our reservation about the proposal to have a NACAS-like government body for Auditing and Assurance Standards, which has been one of our core areas of competence. We reassured him that the Institute is committed to uphold the trust bestowed on it and it will never let down the society, government and nation. We thank him for guiding us to serve better, and look forward to his continued support.

In between, we also met the Hon'ble Finance Secretary Shri Ashok Chawla and discussed some important issues of professional interest, particularly about the change in the system of appointment of auditors for public sector banks. We apprised him of the Institute's apprehension about the misuse of the changed system and stressed that it would be more prudent and in the larger interest of the banking system and related stakeholders, if auditors are appointed from the ICAI panel by the RBI as before. We emphasised that the profession appreciates the need for greater functional autonomy for bank managements. But at



the same time there is a need to balance the greater autonomy through checks and balances which could include appointment of auditors by an independent regulatory body like RBI. To emphasise on our stand, we also apprised him of similar autonomy enjoyed by Navratna Public Sector Undertakings where the auditors continue to be appointed by Comptroller and Auditor General of India. We had similar meetings with RBI Deputy Governor Smt. Usha Thorat and Executive Director Shri. G. Gopalakrishna respectively.

Many of our members conducting central and statutory bank branch audits have regularly expressed their concern, dismay and discomfort over insufficient time given by bank managements to complete the audit. We will take up this genuine concern of our members with the RBI to do away with irrationally short deadlines. However, the tight deadlines can never be an excuse for compromise on quality of an audit. The responsibility to complete the audit work conforming to and complying with the prescribed standards lies with the auditor only.

We recently also had a meeting with the Executive Director of the SEBI, Smt. Usha Narayanan, wherein we suggested to alter the Clause 49 of listing agreement to prescribe for independent internal audit by the external professional firm of chartered accountants. Alternatively, in case a corporate entity has its own internal audit department to mandate for external monitoring of the compliance of standards of the internal audit system by independent firm of chartered accountants. Further, it was requested to suitably amend the SEBI circular on Systems

Audit of Mutual Funds to expressly include DISA qualification of ICAI as a recognised qualification. Moreover, it was emphasised that "Chartered Accountants" may alone be permitted to conduct internal audit of credit-rating agencies under the Regulation 22 as we are most suitable for the purpose. It was also suggested that a standard audit manual for inspection of mutual funds may be prepared to address the shortcomings and improve quality of inspection of mutual funds and bring uniformity in reporting the same.

Meanwhile, the general debate about the Union Budget 2010-11 is almost over. And now it is time for us to sit up and take stock of the consequent new changes and challenges pertaining to our area of activity in detail and move on with professional panache for which we are known. Let us update ourselves with the latest and continue with our professional journey confidently and ethically. Remember that knowing is not enough; we must simplify the knowledge and apply it to the fullest satisfaction of our clients and other stakeholders. While knowledge is a process of piling up facts, wisdom lies in their simplification.

Now let you be updated on some of other major developments concerning our Institute and profession over the last month:

#### **Consolidating ICAI Tie-ups Abroad**

It is our earnest desire to see the Indian CA community play a lead role on global stage. We, in the Council, have been relentlessly pursuing this dream and have met with some notable success too. Today Indian CAs are known, recognised



**President**

and respected globally. However, a large number of them are yet to make full use of that recognition, particularly abroad. We are actively working on that front. The Institute on its part has already signed MoUs/MRAs/joint declarations, mainly for qualification recognition arrangements, with some leading organisations like the Institute of Chartered Accountants in England and Wales, The Institute of Chartered Accountants in Australia, the Certified Practicing Accountants Australia, the Certified General Accountants Association of Canada, the Canadian Institute of Chartered Accountants, and the Bahrain Institute of Banking and Finance, etc. But only signing the MoUs/MRAs/joint declarations is not enough. These tie-ups have great potential for Indian CA profession. Hence, these need to be made one of the most vibrant aspects of our global profession-boosting initiatives and systems. As such, we have decided to consolidate, fine-tune, optimise and systematically and effectively implement and popularise the existing tie-ups before entering into new ones so that these can be beneficial to a larger segment of members. The focus will be on providing a sustainable framework of capacity building through these mutual recognition arrangements. We are already in touch with respective foreign bodies in this regard. In between, we will be proactively guiding and assisting our members in exploiting the potential of the tie-ups to the hilt. We are sure this initiative will help our members excel globally, besides opening avenues for professional opportunities and global collaborations in the field of research. Meanwhile, we are open to your suggestions on further tie-ups for better prospects of the Indian CAs. But our immediate focus is to strengthen the existing tie-ups and make them more useful to members.

#### **Reactivating Foreign Chapters**

Our other priority with regard to the ICAI's international standing is to rejuvenate some of our international chapters whose performance is not up to expectations. Such chapters make about one-third of the total 21 existing chapters at present. In case they fail to reactivate themselves and serve the cause of the ICAI in the spirit with which they have been formed, we will have to consider appropriate action. The main objectives of our foreign chapters were to bring our members on a common platform to

promote the brand Indian CA, carry out the mission of ICAI, augment professional avenues abroad and act as informational resource hubs and an interface between the ground realities in such countries for the ultimate benefit of the profession. We are determined to ensure that our foreign chapters achieve these objectives.

#### **Four New Groups to Make ICAI More Robust**

The Institute has been relentlessly and successfully serving the cause of its members and our nation for more than six decades. However, of late, there has been a manifold increase in expectations, particularly in view of a sharp rise in the number of members and students. There is an urgent need to bring the ICAI effectively in tune with the reality to serve its members and students, and the nation better. And there is a lot of scope for improvement on this front. As such, to make the Institute more responsive, progressive, robust and member/student-friendly, we have constituted four new groups — 'Central Grievances Redressal Cell,' 'Group on Codification of Regulations, Directions of Council regarding functions of Branches of Regional Councils,' 'Infrastructure Acceleration Group,' and 'Information Technology Initiatives Group'.

The *Central Grievance Redressal Cell* will mainly work to effectively and speedily resolve the grievances received from the members and students across the nation centrally. The *Group on Codification of Regulations, Directions of Council regarding functions of Branches of Regional Councils*, will study and examine the provisions of existing regulations, directions of the Council regarding the functions of Regional Councils or their Branches and various decisions of the Council/the Executive Committee in place and suggest suitable changes therein so as to make such provisions more effective and members-/students-friendly and improve overall functioning of the Branches, including the aspect of staff and technology requirements. The *Infrastructure Acceleration Group* will mainly prioritise various infrastructure projects of the ICAI and study, consider and suggest ways and means of accelerating the ongoing projects besides ensuring efficient management and maintenance of the ICAI properties. The *Information Technology Initiatives Group* will see to it that the Institute becomes more hi-tech to the ultimate benefit of its members and

students. As part of this hi-tech drive, the members can now view their membership records and access various prescribed forms online, just at the click of the mouse, without having to visit ICAI offices. This facility is available on the ICAI website on the link: [http://220.227.161.82/mem\\_card.asp](http://220.227.161.82/mem_card.asp). We sincerely hope that these groups will go a long way in uplifting the Institute, its members and the profession as a whole.

### **Tendering Process for Utilising Our Services**

As you know, the Government is now utilising the services of CAs to audit the schemes like the massive Rs. 39,000 crore NREGA. This is an acknowledgement of the trust that the government has in our profession. Generally, such audits are allotted to CAs or accounting firms on a consolidated basis through tenders. However, there are some related issues which need to be resolved in the best interest of the profession. We have raised our concerns with relevant authorities about certain issues including depositing earnest money, specifying restrictive conditions in terms of turnover/size, etc., the quotation of unrealistic low amounts by some members having no relationship with the scope of work in conducting an audit, and lack of clarity on scope of work under the tender. These issues are restricting the participation by CAs to just about one per cent of their total numbers. CAs are offering their services and not selling any commodity, therefore, asking CAs to pay earnest or deposit money is not logical. The Council will take up this matter and arrive at a decision soon. We are impressing upon the various government authorities that acceptance of lowest tender is not desirable in all the cases, as there could be compromise on quality. We are emphasizing that there need to be a benchmark for tender fee offered.

### **Review of Scope of Concurrent Audit in Banks**

With the IT revolution and reforms flooding the financial sector, the operational environment of the banks has changed completely. In the changed scenario, the role of concurrent audit has become more critical and important for the banks in carrying out operations properly and efficiently, particularly for timely detection of irregularities and lapses, as well as prevention of frauds. To respond to these changes, a group was constituted

to review the scope of Concurrent Audit in banks to make it more effective. For greater effectiveness of concurrent audit, its various aspects *inter-alia* coverage of business/ branches, types of activities to be covered, facilities required from banks and training aspects of chartered accountants were reviewed. The aim is to bring about the qualitative improvement in the concurrent audit so that the end user can be benefited and uniform fee structure is applicable across the banking sector. The report as prepared is being reviewed and would soon be submitted to the Reserve Bank of India.

### **Improving the Policy of Transfer of Articles**

Practical training is the cornerstone of the CA profession. Our profession's whole future depends on the efficacy of the system of practical training, which is a very important part of the CA Course. The articled assistants need be made to realise this fact in right earnest for the sake of continuous high standards of the profession. As such, we have been urging the members to impress upon the articled assistants not to take transfers lightly and definitely not to take multiple or unnecessary transfers. On its part, the Council too had recently put certain restrictions on the transfers with the prime objective of making students take their training more seriously. However, it is being felt that these restrictions are causing un-intended hardships for the students. Keeping this in view, we may review some of these restrictions in the best interest of the students and profession but without compromising on the utmost relevance and need of the practical training.

### **Optimum Utilisation of Secondment Scheme**

For articled assistants, the practical training is the stepping stone to ultimate professional success. This training not only facilitates an insight into the real life world for the articled assistants but also provides them an opportunity to apply theoretical knowledge in practical life. Now, with the changed economic scenario and ongoing fast-paced changes in the areas of professional interest, it is high time that our articled assistants got exposure in as many such areas as possible. This is the time that we should encourage our articled assistants to help them reap full benefits of Secondment



**President**

scheme as per Regulation to increase their versatility. We are sure this will help our articled assistants grow into all-round multi-dimensional professionals.

#### **Strengthening Examination System**

We are known for having set very high standards for the CA examination. And now we are going to further upgrade our examination. As part of the process, we are strengthening our panel of examiners and paper-setters with professionals/academicians/resource persons for all the papers in the CA IPCE and Final (New Course) examinations, particularly for Indirect Tax Laws, Advanced Auditing and Professional Ethics, Information Systems Control and Audit, Information Technology, Advanced Management Accounting, Strategic Financial Management, and Direct Tax Laws. All professionals, who have the requisite proficiency and expertise in above-mentioned subjects, may send in the duly-filled Empanelment Form to the Institute. The form has been hosted on the ICAI's website.

#### **Novel Initiative for Needy Students**

On our recent visit to Jaipur, we had the occasion to visit a hostel run by certain firms of CAs for the benefit of students who hail from rural background. We also learnt that a large number of those students not only qualified the CA examinations but also found place in merit lists. This goes on to prove the need to support economically-challenged and rural students. This novel initiative for the students is indeed laudable. We need more and more members to come forward to support such initiatives and students in the larger interest of the profession.

#### **Boosting the CA Benevolent Fund**

'Charity begins at home but should not end there,' is the saying which is worth taking note of by us today — particularly when we have scores of families of deceased professional brethren and those suffering from terminal/serious ailments in our fraternity who are in dire need of financial assistance. It is our duty to support and stand by them in times of distress. And the Chartered Accountant Benevolent Fund offers an excellent opportunity to do that in an organised and systematic manner. The CABF is an initiative by the CAs for the CAs, which has aided 586 needy families in the last five years (2004-09) giving out a total of Rs. 3,56,79,277 as help and support. However, presently the corpus of the fund

is not adequate to cater to the needs of all the families in distress and, therefore, it becomes our urgent requirement to boost and bolster this fund, which is not possible without your generosity and support. We are happy to note that many members are coming forward to help this noble cause. In the recent visit of the undersigned to some of the branches, an appeal in this regard got extremely positive response and we wish to place on record our gratitude for commitment for donation of Rs. 25 lakh by members of Jaipur, and actual contribution of Rs. 2.5 lakh by members of Karnal. But, much more is desired. I call upon all of you to join this benevolent initiative and make CABF integral part of your socio-professional duty. More than 94,500 members have already joined as life members of CABF, but what is needed is that all of us not only become life members but also contribute more than the minimum stipulated amount and continue to contribute in future as well. Life subscription of the fund is for Rs. 2,500 and ordinary subscription is for Rs. 250 per annum payable in favour of 'Chartered Accountant Benevolent Fund'. We will duly acknowledge the donors by publishing the photographs of those contributing Rs. 1 lakh and above, and by publishing the names of those contributing Rs. 5,100 or more in the journal on monthly basis. Remember that charity, howsoever trifling to us, can be utterly precious to our brethren in need. Let's make CABF a thriving movement for CAs' welfare, nationally as well as internationally.

My approach has all along been to achieve overall growth in the professional avenues coupled with the image-building exercise that ultimately will take the profession to new heights. Progress is impossible without change. So let's change our outlook, set our vision very high and start thinking ahead of our times for a brighter future. My fervent hope is that the next decade belongs to the Indian accountants. And for that purpose, we are committed to produce professionally dynamic chartered accountants fully equipped to meet the challenges.

With best wishes

Yours sincerely,

**CA. Amarjit Chopra**

New Delhi, March 24, 2010

**March 2010 Issue Highly Useful**

As a member of the esteemed organisation ICAI, I am indeed happy to note the truly transformed *The Chartered Accountant* journal for more than one reason, such as reduction of Editorial Board, far lesser number of Presidential photographs, the omission of features like Health Tips, *Vastu Shastra* and *Know Your Future*, which had no relevance to professional knowledge. The Cover Page was truly relevant while the illustrative articles by the experts greatly enhanced the knowledge on various aspects of Bank Audit/Branch Audit and other topics. It was good to read the President's message, which, besides sharing the vision and agenda of the president, also acknowledged many past stalwarts of the ICAI and recalled the words of wisdom by the first ICAI President Shri G. P. Kapadia. The frequent use of 'We' in the President's message is highly welcoming as it makes the tone and tenor of the message more effective and inclusive. I must congratulate the new President for his views and vision, particularly for articulating the expression "Temples of learning" for Centres of Excellence, and for giving quotes like: "It is not simply about land, buildings or spaces but about providing means to reach out to more and more sections of the society and bring them in to our fold". I hope that the journal continues to live up to the expectations of professionals in future as well. My only suggestion is increase the font size of the published content for the benefit of elderly members.

-CA. Suniel R. Karbhari, Pimpri Chinchwad, Pune



The March 2010 issue of the Journal is truly the reader's delight as it packs highly useful information for professionals in a reader-friendly attractive manner. The Editorial and coverage on Bank Audit, including the elaborate list of circulars, proved to be highly beneficial for all those engaged in bank-audit work. The articles under 'Insurance' and 'Auditing' section were equally informative. Thanks for re-including 'Book Review' section in your scheme of things. It was enlightening and satisfying to go through the President's and Vice President's profile. I admire the vision and agenda of the new President as summarised in his first message in March 2010 issue. I hope this year proves to be highly successful for the CA profession.

-CA. A. Chakravorty

The article titled 'Audit of Investments in a Bank's Treasury' authored by CA. Akeel Master and CA. Ashwin Suvarna was very informative and useful. It helped professionals like me a lot. I congratulate the ICAI for publishing articles like this.

-CA. Subhash Podder

I highly appreciate discontinuation of 'Vastu Shastra' and 'Know Your Future' sections in the March 2010 issue of the Journal as these were not serving any professional purpose. Such features do not go with the professional objective of the Journal. Please keep such columns off the journal in future too.

-CA. Ashish Karani

**Information is Power**

Information is indeed power. And it is more so for chartered accountants and those pursuing the CA course. In today's time of cut-throat competition, professionals just cannot survive without the power of information. We need to be up-to-date, particularly with respect to our professional areas of interest. I am happy to note that our journal is playing a very important role in passing on the power of information to its readers, particularly CAs and CA students.

-Emakshi Jagga, CA Final Student

**Journal in Soft Copy for Easy Reference**

Downloading the Journal page by page from the ICAI website is a tedious and time-consuming process. I suggest the Institute prepares one consolidated PDF file of every issue and post it for the members desiring to have a soft copy. This would serve two purposes: (1) You can save on paper, in respect of members who opt for receiving soft copies; (2) Persons like us, who have very limited space in office and home, can relax and need not worry where to keep the fresh volumes. The ICAI can follow the IRDA journal in this regard which is available for download and its size does not exceed 2.5 MB.

-CA. Shrawan Bhatia

I thank the Institute for taking many initiatives for the benefit of the CA fraternity. *The Chartered Accountant* journal is one of such welcome initiatives. However, I suggest that it will be further beneficial for the fraternity if we have all the issues of the Journal in CD-format for easy reference and storage.

-CA. Aditya Singhal, Bangalore

**Generous Contributions to CABF**

The ICAI duly acknowledges the following members for making generous contributions to the Chartered Accountants Benevolent Fund:

1. CA. Ravinder Nagpal, M. No. 81954  
- Rs. 1,00,000/-
2. CA. Madhukar Narayan Hiregange, M. No. 27409 - Rs. 25,000/-
3. CA. E. Phalgun Kumar, M. No. 020278 - Rs. 25,000/-



CA. Ravinder Nagpal

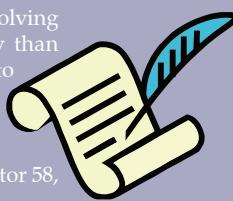
# EDITOR

**For the Attention of Readers**

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

**Write to Editor**

'Information is Power' and our ever-evolving profession needs more and more of that today than ever before. Do you have any relevant points to make, experiences to share, and views to spread among the CA fraternity? If yes, e-mail us at [eboard@icai.org/nadeem@icai.org](mailto:eboard@icai.org/nadeem@icai.org) or write to: The Editor, The Journal Section, ICAI, A-94/4, Sector 58, Noida (UP) - 201301





#### Minister of Corporate Affairs Addresses CA Profession

Shri Salman Khurshid, Minister of State (independent charge), Ministry of Corporate Affairs, Government of India, receives a memento from CA. Amarjit Chopra, President, ICAI, while CA. G. Ramaswamy, Vice-President, ICAI, looks on at the function in Vigyan Bhawan, New Delhi (March 12, 2010).



#### Secretary, MCA, at the ICAI

Shri R. Bandyopadhyay, Secretary, Ministry of Corporate Affairs, Government of India, receives a bouquet from CA. Amarjit Chopra, President, ICAI, in the presence of CA. G. Ramaswamy, Vice-President, ICAI, in the Council Hall of the ICAI in New Delhi (March 12, 2010).



#### WIRC Members Felicitate the Newly-elected President and Vice-President of the ICAI

Among the dignitaries sitting on the dais on the occasion are CA. Amarjit Chopra, President, ICAI, CA. G. Ramaswamy, Vice-President, ICAI, with the Chairman of the WIRC-ICAI, CA. Sanjeev Lalan (March 5, 2010).



#### ICAI Leadership Meets the Deputy Chairman of the Rajya Sabha

Shri K. Rehman Khan, Deputy Chairman, Rajya Sabha, with CA. Amarjit Chopra, President, ICAI, CA. G. Ramaswamy, Vice-President, ICAI, and Shri T. Karthikeyan, Secretary, ICAI, (March 4, 2010).



#### Meeting with C&AG of India

Comptroller & Auditor General of India Mr. Vinod Rai with Shri T. Karthikeyan, Secretary, ICAI, CA. Amarjit Chopra, President, ICAI, and CA. G. Ramaswamy, Vice President, ICAI (March 4, 2010).



#### President, ICAI, Addresses the NIRC

CA. Amarjit Chopra, President, ICAI, addressing the NIRC members on the occasion of the Felicitation Function of President, Vice-President and NIRC Central Council members during the Seminar titled *Clause by Clause Discussion on Finance Bill, 2010*. CA. G. Ramaswamy, Vice President, ICAI, and Central Council members CA. Sanjay K. Aggarwal and CA. Pankaj Tyagie also shared the dais (March 7, 2010).

# Know Your Ethics\*

(...Continued from the March 2010 issue)

## Ethical Issues in Question-Answer Form

- Q.** Can a practicing Chartered Accountant accept a position as auditor previously held by some other Chartered Accountant in such conditions as to constitute undercutting?
- A.** Yes, a Chartered Accountant in practice can accept a position as auditor previously held by some other Chartered Accountant in such conditions as to constitute undercutting (vide amendment in the CA Act in 2006).
- Q.** Whether a member of the Institute be guilty of professional misconduct, if he, not being a fellow, styles himself as a fellow?
- A.** Yes, as per Clause (1) of Part III of the First Schedule to the CA Act, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct if he, not being a fellow, styles himself as a fellow.
- Q.** Whether a member of the Institute shall be deemed to be guilty of professional misconduct, if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute?
- A.** Yes, a member of the Institute shall be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute (As per Clause (2) of Part III of the First Schedule to the CA Act).
- Q.** Can a Chartered Accountant in practice disclose information acquired in the course of his professional engagement?
- A.** No, as per Clause (1) of Part I of Second Schedule to the CA Act, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force.
- Q.** Whether an auditor is required to provide the client or other auditor of the same enterprise access to his audit working papers?
- A.** No, working papers are the property of an auditor. An auditor is not required to provide the client access to his audit working papers. The main auditors of an enterprise do not have right of access to the audit working papers of the branch auditors, except in case it is required by the regulatory norms.
- Q.** Whether a joint auditor will be responsible for the work done by other joint auditor?
- A.** Council direction under Clause (2) of Part I of the Second Schedule to the CA Act prescribes that in respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. However, on the other hand, all the joint auditors are jointly and severally responsible for the work which is not interse divided among the auditors, and also for compliance of requirements of relevant statutes.
- Q.** Whether the member in practice will be liable if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast?
- A.** Yes, he shall be liable under Clause (3) of Part I of the Second Schedule to the CA Act.
- Q.** Can a member in practice express his opinion on financial statements of any business or enterprises in which he, his firm or a partner in his firm has a substantial interest?
- A.** No, as per Clause (4) of Part I of the Second Schedule to the CA Act, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he expresses his opinion on financial statements of any business or any enterprise in which he, his firm or a partner in his firm has substantial interest. (vide amendment in the CA Act in 2006, even after disclosure of interest by the member, expression of opinion is not allowed.)  
The meaning of the word "substantial interest" shall be the same as are contained in the Resolution passed by the Council in pursuance to Regulation 190A of CA Regulations.(Pl. refer Appendix-9 of the CA Regulations)
- Q.** Whether a member in practice will be held liable for failing to keep moneys of his client in a separate banking account or to use such moneys for purposes other than they are intended for?
- A.** Yes, as per Clause (10) of Part I of Second Schedule to the CA Act, a member in practice shall be deemed to be guilty of professional misconduct, if he fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or uses such moneys for purposes other than they are intended for.
- Q.** Can an auditor write the books of accounts of the auditee?
- A.** No, Council directions under Clause (4) of Part I of the Second Schedule to the CA Act prescribes that an auditor is not permitted to write the books of accounts of his auditee clients.
- Q.** Whether a statutory auditor can accept the system audit of same entity?
- A.** Yes, the statutory auditor can accept the assignment of a system audit of the same entity, provided it did not involve any scrutiny/review of financial data and information.

\*Contributed by Ethical Standards Board of ICAI

(... to be Continued)

**Special Address by the Minister of State (Independent Charge),  
Ministry of Corporate Affairs, Shri Salman Khurshid**

## **'CA Profession's Vision Should Combine Confidence, Competence, Capacity and Creativity'**

Shri Salman Khurshid, Hon'ble Minister of State (independent charge) of the Ministry of Corporate Affairs, Government of India, attended and addressed a special function as the Chief Guest organised by The Institute of Chartered Accountants of India held at the Vigyan Bhawan, New Delhi, on March 12, 2010. Other dignitaries present on the dais were Shri R. Bandyopadhyay, Secretary, Ministry of Corporate Affairs, CA. Amarjit Chopra, President, ICAI, CA. G. Ramaswamy, Vice-President, ICAI, Shri T. Karthikeyan, Secretary, ICAI, and CA. Atul Gupta, Chairman, NIRC-ICAI. Following are the excerpts from Shri Khurshid's speech:



**“**I think my purpose of coming here is basically to reinforce and re-endorse the essential message that the Secretary (of Ministry of Corporate Affairs) has already given you today. Through our constant dealings with you, we try to send this message repeatedly: to endorse that we are always here to help you help yourself.

This is the attitude the Government has towards organisations like yours and towards stakeholders that we cannot now be paternalistic about. We cannot assume ourselves to be better than you. But we do have certain responsibilities and certain capacities and capabilities. We certainly have a vision that we want to achieve effective institutional growth of our country and, therefore, we want to be the enlightened partners

of stakeholders, be it corporate sector, professional bodies, or, professional institutions like you.

We have to continue to improve the opportunities and platforms for you. As you celebrate the first month of working under a new President and look forward to working closely with Government throughout this year, it is important today to talk of the vision. I think what the profession needs today is a vision that you yourself should develop worthy of being realised.

We had been through a brilliant speech by the Finance Minister Shri Pranab Mukherjee defending the Union Budget 2010. He inquired whether the world has ever experienced a financial crisis that we witnessed a year ago since 1929. And to the best of my information, for many many years, India has not seen the capital markets moving consistently upwards for five days at a stretch after the Budget speech as it has happened this year.

But having said that, I will say that we have this great feeling that something wonderful is happening and something even greater is going to happen. I think it is the right time for us to sustain our presence and then celebrate as we do this. We must equip ourselves with the required confidence and competence, and then with capacity and creativity. This is what should be included and integrated into the vision about your profession.

There are issues we have repeatedly flagged and highlighted. It is important for the Government to be concerned about the struggling smaller professionals who are trying to find a little space of their own in the world of extreme competition with the presence of large fishes floating around them. We are here for the common man, *aam Aadmi*, and we are here for the people at the bottom of the pyramid. But, while you think of yourselves being at the bottom of the pyramid, you accept now the theory that the real strength of society can come from the bottom of the pyramid not necessarily from the top of the pyramid. Going by the distinguished and one of the business world's most influential professors

and consultants Dr. C.K. Prahalad's, remarkable work in this connection, you will have to think of being able to dream big, to accomplish great things and to make your mark and your footprints global. It is true that Indian companies now have the confidence to go and buy not just a company but icons of the western world. You don't just go and ask for the best in the market, unless you have muscle and solid grounding. That is where professional backup is extremely important. I think it is important to have a telescopic vision to be able to see much further and to be able to make a splash in the world and to come and say, "We are here. We are here to do something big." I think there is no doubt at all that after great software revolution to which India made an enormous contribution, we continue to dominate the software world even today. I think the next big revolution and explosion that may happen is in the

**"It is important for the Government to be concerned about the struggling smaller professionals who are trying to find a little space of their own in the world of extreme competition with the presence of large fishes floating around them. We are here for the common man, *aam Aadmi*, and we are here for the people at the bottom of the pyramid."**

world of accountancy. With convergence to the IFRS standards, India seamlessly will be a part of the global accounting, and we would be contributing to it possibly the best and largest number of young accountants. I think that we have this specific advantage.

However, at this stage, we must not forget a fact that we have very ambitious neighbours as well. We want to be friends with China and at the same time we want to compete with it. We want to grow with China and we want it to partner us in the 21<sup>st</sup> century as harbinger of the Asian century. But, that will not be possible unless we put whatever advantages we have to good use. If China is going to come out into the world with the message that they want to dominate not only the manufacturing world, not

only the world of toys, not only the world of fabric, and not only the world of leather garments, but also the world of accountancy profession, it becomes a challenge for you. I think while India works on other fields, the accountancy world must not stay behind. So, when you think of protection, you must not think of protecting yourselves in a manner in which you are becoming incapable of fighting the rest of the world. While you ask for a level-playing field, you must not forget that it requires a lot of effort, endeavour and exercise. I do believe that you have elected an outstanding committee with an outstanding President having great foresight and ambitions. He constantly keeps a watch over my calendar to see how many more times I can attend the ICAI functions. I barely finish one and I have an invitation for the next. I will, in the next two weeks, I will probably be seeing many of you in different parts of the country on several occasions. I can just say this to you that we are committed to you; we are here for you and in an enlightened way, we want to re-chart you and help you.

The troubles and hiccups that we have encountered in the past few months or years, are not something that distress or dismay us. They actually propel us to face the challenges with greater confidence and greater determination, and I know if we put our heads together, there is nothing that we cannot overcome. The bottom line is that while we remain rooted in principles and beliefs about how we structure our efforts, we must be willing to dream a little bit, to open up a little bit, and to allow our imagination to run riot for a while. Without imagination and creativity, a profession becomes exceptionally boring. In my opinion, of all professions, your profession

is particularly going to be a challenging one in the times to come. It is challenging because it will grow simultaneously with the growing corporate world in our country. At present, sadly they are yet in a humble stage, but the Indian corporate world and capital markets are poised for a huge growth because they have intrinsic strength, quality and caliber.

We were talking in the Parliament today about savings' rates. We also know that there is a constant talk about the requirement of enough and sufficient and quality independent directors for rotating them. Now I think of somebody who can read a balance sheet, somebody who can understand figures and somebody who can understand the heart of business. In my opinion, we may name others as lungs of business, limbs of business or the belly of business, but the heart of business in true sense, according to me, is the balance sheet. The heart of business in essence is the numbers that tell you are on the right track or on the wrong track. And, the heart of business is that tells the real story that you are concerned with. You have works and management accountants who do other complementary or supplementary exercises. But the heart still remains yours. I do wish that this heart ticks away, beats with strength, with sincerity and with sustainability, which will give the incredible India a strength that it needs in challenging the more developed economies of the world. You have the challenge of converting ourselves from being a developing country to a developed country in your lifetime or in less than your lifetime. I think that this vision and challenge should guide you today."

**"The heart of business in true sense, according to me, is the balance sheet. The heart of business in essence is the numbers that tell you are on the right track or on the wrong track. And, the heart of business is that tells the real story that you are concerned with. I do wish that this heart ticks away, beats with strength, with sincerity and with sustainability, which will give the incredible India a strength that it needs in challenging the more developed economies of the world."**

# Legal Decisions<sup>1</sup>

## DIRECT TAXES



### Income-tax Act

#### Section 32 of the Income-tax Act, 1961 - Depreciation

*Use of individual asset for purpose of business can be examined only in first year when asset is purchased and in subsequent years use of block of assets is to be examined; existence of individual asset in block of asset itself amounts to use for purpose of business [Assessment Year 2001-02]*

**Swati Synthetics Ltd. vs. ITO, 17<sup>th</sup> December 2009 (ITAT- MUM)**

The condition/requirement of word 'used for the purpose of business' as provided in Section 32 of (1) for the concept of depreciation on block of assets can be summarized, that use of individual asset for the purpose of business can be examined only in the first year when the asset is purchased. In subsequent years use of block of assets is to be examined. Existence of individual asset in block of asset itself amounts to use for the purpose of business. This view is fully supported by various provisions of the Act including the proviso to Section 32. The said proviso to Section 32 requires that where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than one hundred and eighty days in that previous year, the deduction under this sub-section in respect of such asset shall be restricted to fifty per cent of the amount calculated at the percentage prescribed for an asset under Clauses (i), (ii) or, (iia), as the case may be. When an asset purchased satisfies the above condition in the year of purchase, that asset will be included in the respective block of asset. Deprecation for that year will be calculated on the written down value in accordance with Section 43(6) by increasing the opening WDV with the actual cost of any asset acquired during the previous year which is falling within that block. Once an asset is included in the block of assets, it remains in block for its entire life. The end of asset, i.e., to go out from block, is possible only in accordance with the provisions of the Act. There are following three situations provided in the statutes when an individual

asset of the block goes out of block:

- 1) an asset is sold or discarded or demolished or destroyed during that previous year as provided in Sections 43(6)(C)(i)(B) and 32(1)(iii).
- 2) an asset not exclusively used for the purposes of the business or profession but used for purposes other than business for purposes as provided in Section 38(2) of the Act.
- 3) where any block of assets does not cease to exist but the full value of the consideration received or accruing as a result of the transfer of the depreciable assets by the assessee during the previous year exceeds the aggregate of the amounts stated in Section 50 and where any block of assets ceases to exist for the reason that all the assets in that block are transferred during the previous year.

Where the assessee had two units, one at Surat and another at Dombivili and the division of Surat had been closed, the block of assets of the closed unit, (the division of Surat) along with other assets of the block were used for the purpose of business in earlier years. The year under consideration was not the first year of the assets acquired. The assets of closed unit still remained or existed in the block of assets. The assets did not fall under any of the above exceptional three conditions.

The Mumbai Bench of Tribunal held that the said block of assets was used for the purpose of business during the year. Under the circumstances the assets of the said closed unit amounted to use for the purpose of business in the year under consideration, and therefore, the assessee was entitled for depreciation.

#### Section 32, read with Section 43, of the Income-tax Act, 1961 - Depreciation

*Where non-operating plant and machinery is a part of block of assets and said block of assets is used, depreciation is to be allowed on non-operating plant and machinery also [Assessment Year 1995-96].*

**CIT vs. Bharat Alumunium Co. Ltd, 15<sup>th</sup> October 2009 (DEL)**

The rationale and purpose for which the concept of block asset was introduced by the amendment in the provisions of the Act, as reflected in the Circular dated 23-9-1988 of the CBDT is to be kept in mind. The intention behind these provisions is apparent. Once various assets are clubbed together and they become block asset

within the meaning of Section 2(11), for the purpose of depreciation, it is one asset. Every time, a new asset is acquired, it is to be thrown into the common hotchpotch, i.e., block asset for meeting the requirement of depreciation allowable at the same rate. The value of the block asset increases and the depreciation is to be given on the aforesaid value, which is to be treated as written down value. Individual assets lose their identity from that very moment it becomes inseparable part of block asset insofar as calculation of depreciation is concerned. Fusion of various assets into the block asset gets disturbed only when eventuality contained in Clause (iii) of Section 32 takes place, viz., when a particular asset is sold, discarded or destroyed in the previous year (other than the previous year in which the asset was first brought in use). Even in that event, the amount by which the moneys payable in respect of that particular building, machinery, etc. together with the amount of scrap value is to be deducted from total written down value of the 'block asset'.

Once this scheme contained in the aforesaid provisions is understood and appreciated, it is not possible to accept the contention that unless a particular asset is used for the purpose of business or provision, depreciation is not allowed. No doubt, as per Section 32(1) in order to be entitled to claim depreciation, the asset is to be owned by the assessee and it is also to be used for the purpose of business or profession. However, the expression "used for the purpose of business" when applied to block asset would mean use of block asset and not any specific building, machinery, plant or furniture in the said block asset as individual assets have lost their identity after becoming inseparable part of the block asset. That is the only manner in which various provisions can be harmonized.

If a particular asset is acquired after 30th September during the previous year and is put to use for a period of less than 180 days in the previous year, the deduction under sub-Section (1) of Section 32 is restricted to 50 per cent of amount admissible. The requirement of user of individual asset would be relevant in the first year when the particular asset is acquired. With the user, it would meet the requirement of Section 32. In the subsequent years, it is the use of block asset, which becomes the yardstick and not the individual asset already acquired in the earlier years, other than the previous year in which it is first brought into use.

<sup>1</sup> Edited by Mr. Susanta K. Sahu, Sr. Asst. Secretary, ICAI. Readers are invited to send their comments on the selection of cases and their utility at [eboard@icai.org](mailto:eboard@icai.org). For the convenience of readers full text of these cases have been hosted on the website of the institute at the link: [www.icai.org/post.html?post\\_id=967&c\\_id=59](http://www.icai.org/post.html?post_id=967&c_id=59)

When equipment is purchased and put to use, the same enters into the block asset in the first year. It loses individual identity for the allowance of depreciation in that year. If in the relevant year the block of assets is used, the assessee will be given the benefit of depreciation in the relevant years.

#### **Section 36(1)(iii) of the Income-tax Act, 1961**

##### **- Interest on borrowed capital**

*Where from borrowed fund no investment has been made during year and borrowed funds are utilised for making payments to sundry creditors only, interest expenditure on borrowed capital was to be disallowed, being funds not utilized for purpose of business [Assessment Year 2004-05].*

**DCIT, Circle 3(1) vs. Bombay Diamond Co. Ltd, 30<sup>th</sup> November 2009 (ITAT- MUM)**

#### **Section 36(1)(vii) of the Income Tax Act, 1961 – Bad Debts**

*After 1-4-1989, it is not necessary for assessee to establish that debt, in fact, has become irrecoverable; it is enough if bad debt is written off as irrecoverable in accounts of assessee [Assessment Years 1990-91 & 1993-94].*

**T.R.F. Ltd. vs. CIT, 9<sup>th</sup> February 2010 (SC)**

Prior to 1-4-1989, every assessee had to establish, as a matter of fact, that the debt advanced by the assessee had, in fact, become irrecoverable. That position got altered by deletion of the word "established", which earlier existed in Section 36(1)(vii).

After 1-4-1989, it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debt is written off as irrecoverable in the accounts of the assessee.

When bad debt occurs, the bad debt account is debited and the customer's account is credited, thus, closing the account of the customer. In the case of Companies, the provision is deducted from sundry debtors.

Where the assessing officer had not examined whether, in fact, the bad debt or part thereof is written off in the accounts of the assessee, the matter was to be remitted to the assessing officer for de novo consideration of the above-mentioned aspect only and that too only to the extent of the write off.

#### **Section 36(1)(vii) of the Income-tax Act, 1961- Bad Debts**

*Amended provisions of the Income Tax Act, 1961 with effect from 1-4-1989, to Section 36(1)(vii), read with 36(2), do not grant specific amnesty to assessee who is claiming any amount of debt as bad barring Assessing Offi-*

*cer to question veracity of same [Assessment Year 2002-03].*

**CIT vs. Kohli Brothers color Lab (P.) Ltd, 5<sup>th</sup> November 2009**

Once in an assessment year debt or part thereof has been written off, as irrecoverable, qua the same, deductions are to be accorded as per provision of Section 36(1)(vii), subject to the provisions of 36(2). Prior to amendment in the aforementioned section with effect from 1-4-1989 the words 'any bad debt, or part thereof, which is established to have become, a bad debt in the previous year' were used and after the amendment with effect from 1-4-1989, same has been substituted by "any bad debt or part thereof which is written off as irrecoverable in the account of assessee for the previous year". Effect of said amendment is that now it is not necessary for the assessee to establish that debt had become bad in the previous year, before getting deductions. Mere writing of debt or part thereof, as irrecoverable, is substantial compliance of the same. The question is, is entry of writing of bad debt or part thereof, made in books of accounts conclusive and the assessing officer is precluded from making inquiries, before according/refusing deductions. Under the scheme as provided for under Income-tax Act, when such entries have been made, the assessing officer is fully empowered to make inquiry as to whether same are genuine entry, and it is not imaginary and fanciful entry. However,

wisdom of the assessee cannot be in such matter questioned and no demonstrative or infallible proof of bad debt having become bad is required, and commercial expediency is to be seen from the point of view of assessee, depending on nature of transaction, capacity of debtor etc. but qua entry, semblance of genuineness has to be there and same should not be mere paper work.

Under Section 143(2), the assessing officer is empowered to require the assessee to produce the evidence in support of the return. As such where assessee has claimed to write off bad debt or part thereof, as irrecoverable in the accounts of the assessee under the provision of Section 36(1)(vii), then on the strength of the amendment made on 1.4.1989, it cannot be said that an inquiry is not permissible under the provision of Income-tax Act to see and satisfy that there is some semblance of the genuineness in the entry, which had been made, and same is not at all totally fake entry as assessee would be entitled for deduction only of its bad debt, or part thereof. The Supreme Court in the case

of Travancore Tea Estates Co. Ltd. v. CIT (1999) 151 CTR (SC) 231; (1998) 233 ITR 203 (SC) has taken the view, that as to whether a debt has become bad or at what point of time it became bad, are pure question of fact. Though standard of proof of proving the same is bad debt, is not required to be adopted and is to be decided on the wisdom of the assessee and not on the wisdom of the assessing officer, but to show that entry which had been made as bad debt, there has to be some material in support of the same, giving some semblance of genuineness and truthfulness to the same in the direction of forming an opinion that said debt was arising out of trading activity, that there was relationship of debtor or creditor, and that the same was irrecoverable. Where entries have been made in respect of bad debt or part thereof and the same is written off claiming deduction, the said entries can always be examined by the assessing officer before proceeding to award deductions. Deduction cannot be allowed by merely blindly following the assessee's claim, but stand of the assessee has to be tested from the point of view of assessee. No assessee can come forward and say that on account of change brought in by way of amendment with effect from 1-4-1989 under Section 36(1)(vii), inquiry is not permissible.

#### **Section 37(1) of the Income-tax Act, 1961 – Business Expenditure**

*Where assessee-company put up power plant in its factory and for its functioning shared different facilities available with NTPC and contributed its share of capital expenditure to NTPC, total expenditure was to be spread over a period of five years and deduction was to be claimed as revenue expenditure of each year [Assessment Year 1995-96].*

**CIT vs. Bharat Alumunium Co Ltd, 15<sup>th</sup> October 2009 (DEL)**

The assessee, a Government sector undertaking, entered into an arrangement with another public sector corporation, NTPC. The assessee put up its power plant for its aluminium plant. It did not create many facilities of its own and shared these facilities available with NTPC. It was decided to contribute a sum of Rs. 22.68 Crore to NTPC as its share of capital expenditure for sharing common facilities created by NTPC. Out of the sum contributed by the assessee, the assessee had claimed depreciation till the assessment year 1991-92. However, the assessee decided to change the accounting policy and to write off the balance expenditure of Rs. 15.07 Crore over a period of five years, i.e., at the rate of Rs. 3.76 Crore per year. This was

necessitated because of the suggestion and direction given by the Comptroller and Auditor General (CAG) to the assessee to follow the guidelines stipulated by the Institute of Chartered Accountants of India (ICAI) under the guidance Note No. 10. The assessee accordingly received clarification from the ICAI for amortizing the balance expenditure of Rs. 15.07 Crore and to claim the same over a period of five years.

According to the Assessing Officer, the money was contributed towards capital expenditure incurred by the NTPC in laying infrastructure facilities for coal handling/supply. By doing so, the assessee had obtained a long duration usage of permanent assets and therefore, was not a revenue/business expenditure.

The Delhi High Court held that once expenditure in question was of revenue nature, the moot question would be as to whether it could be allowed over a period of five years. That has been permitted by the Supreme Court in various decisions. There was no doubt till 1991-92, the part of the expenditure was allowed every year. It was loosely called as depreciation. What could be said was that the revenue expenditure was allowed every year at the rates on which depreciation is allowed. Since this was wrong practice adopted, the CAG rightly advised the assessee to change the accounting method to bring it in tune with ICAI guidelines. What was done from the subsequent assessment year, was that the assessee took the correct step as it should have been taken in accordance with law. Therefore, the amount was to be allowed as deduction.

#### **Section 45 of the Income-tax Act, 1961 – Capital Gains – Chargeable as**

*Where assessee-society had no right to construct additional floors on existing building and so, they granted permission to developer for construction of additional floors as said developer was in possession of transferable development rights (TDR), since TDR was not obtained by assessee and sold to third party, i.e., developer, assessee had not transferred any existing right to developer nor any cost was incurred/suffered prior to permitting developer to construct additional floors in absence of any cost at time of granting permission to developer to construct additional floors, computation provisions of section 45 would fail, and amount received by assessee society and its member from developer was not assessable as long term capital gains [Assessment Year 1999-2000].*

**Om Shanti Co-operative Society Ltd. vs. ITO, 28<sup>th</sup> August 2009 (ITAT-MUM)**

Members of the assessee-co-operative Housing Society owned a piece of land on which 12 flats were constructed as per the maximum FSI available to them. A developer approached the society seeking permission to construct two floors and 8 flats on the existing building by exploiting the TDR/FSI available with it and in return the assessee-society was offered a lump sum amount and each member was also offered certain sum since they had to bear with the disturbance caused due to further construction and also for certain modifications necessary to enable construction of two additional floors.

According to the assessing officer, the assessee having agreed to receive consideration of Rs. 26 Lakh, the income earned thereon ought to have been declared as capital gains in the previous year.

The assessee submitted that it merely permitted the developers to exploit the TDR/FSI, purchased by the developers from elsewhere at their cost, over the existing structure belonging to the society and, hence, it could not be said to be a transfer of any right in respect of the land or part thereof. Thus, the amount received by the assessee-society could not be brought to tax.

The ITAT Mumbai held that the assessee-society and its members did not have any right to construct additional floors on the existing building since they have already exhausted the right available with it while constructing the existing 12 flats. It was not the case of the revenue that the TDR was obtained by the assessee and sold to the third party, i.e., developer. In the light of these facts, it was clear that the assessee had not transferred any existing right to the developer nor any cost was incurred/suffered prior to permitting the developer to construct additional two floors. In the absence of any cost at the time of granting permission to the developer to construct additional floors, the computation provisions of Section 45 would fail. Hence, the amount received by the assessee and its Members was not assessable to tax under the head "Long term capital gains".

#### **Section 80P of the Income-tax Act, 1961 - Deductions - Cooperative societies, income of**

*Where assessee-co-operative society marketed produce of its members whose sale proceeds at times were retained by it and since fund created by such retention was not required immediately for business purposes, it was invested in specified securities, interest on such deposits/securities, which strictly speaking accrued to members' account could*

*be taxed as 'other income' and assessee was not entitled to benefit of Section 80P for said amount [Assessment Years 1991-92 to 1994-05 and 1996-07 to 1999-2000].*

#### **Totgars Co-operative Sales Society Limited vs. ITO, 8<sup>th</sup> February 2010 (SC)**

Section 80P comes in Chapter VI-A, which, in turn, deals with "Deductions in respect of certain Incomes". The Headnote to Section 80P indicates that the said section deals with deductions in respect of income of co-operative societies. Section 80P(1), inter alia, states that where the gross total income of a cooperative Society includes any income from one or more specified activities, then such income shall be deducted from the gross total income in computing the total taxable income of the assessee-society. An income, which is attributable to any of the specified activities in Section 80P(2), would be eligible for deduction. The word "income" has been defined under Section 2(24)(i) to include profits and gains. This sub-Section is an inclusive provision. The Parliament has included specifically "business profits" into the definition of the word "income". Therefore, a precise meaning is to be given to the words "profits and gains of business" mentioned in Section 80P(2).

Section 80P(2)(a)(i) cannot be placed at par with Explanation (baa) to Sections 80HHC, 80HHD(3) and 80HHE(5). Each of the said Sections has to be interpreted in the context of its subject-matter. For example, Section 80HHC, at the relevant time, dealt with deduction in respect of profits retained for export business. The scope of Section 80HHC is, therefore, different from the scope of Section 80P, which deals with deduction in respect of income of cooperative societies. Even Explanation (baa) to Section 80HHC was added to restrict the deduction in respect of profits retained for export business. The words used in Explanation (baa) to Section 80HHC, therefore, cannot be compared with the words used in Section 80P which grants deduction in respect of "the whole of the amount of profits and gains of business".

To say that the source of income is not relevant for deciding the applicability of Section 80P would not be correct because weightage is to be given to the words "the whole of the amount of profits and gains of business" attributable to one of the activities specified in Section 80P(2)(a). An important point needs to be mentioned. The words "the whole of the amount of profits and gains of business" emphasise that the income in respect of which deduction is sought must constitute the operational income and not

the other income which accrues to the society.

The assessee marketed the produce of its members whose sale proceeds at times were retained by it. Since the fund created by such retention was not required immediately for business purposes, it was invested in specified securities. The question was as to whether interest on such deposits/securities, which strictly speaking accrued to the members' account, could be taxed as business income under Section 28.

The Supreme Court held that such interest income would come in the category of "Income from other sources", hence, such interest income would be taxable under Section 56.

In the instant case, the assessee-society regularly invested funds not immediately required for business purposes. Interest on such investments, therefore, could not fall within the meaning of the expression "profits and gains of business". Such interest income could not be said also to be attributable to the activities of the society, namely, carrying on the business of providing credit facilities to its members or marketing of the agricultural produce of its members. When the assessee-society provided credit facilities to its members, it earned interest income. In the instant case, interest held as ineligible for deduction under Section 80P(2)(a)(i) was not in respect of interest received from members. This case was concerned only with interest which accrued on funds not required immediately by the assessee(s) for its business purposes and which had been only invested in specified securities as "investment". Further, assessee marketed the agricultural produce of its members. It retained the sale proceeds in many cases. It is this "retained amount" which was payable to its members, from whom produce was bought, which was invested in short-term deposits/securities. Such an amount, which was retained by the assessee-society, was a liability and it was shown in the balance-sheet on the liability-side. Therefore, to that extent, such interest income could not be said to be attributable either to the activity mentioned in Section 80P(2)(a)(i) or in section 80P(2)(a)(iii). Therefore, the interest income was to be taxed under Section 56.

#### **Section 92B of the Income-tax Act, 1961 - Transfer Pricing - International transaction**

*Interest free foreign currency loans extended to associated foreign enterprise being not quasi capital/capital contribution and a mechanism to shift profits to tax heavens or low tax regimes to bring down aggregate tax incidence*

*of a multinational group, are international transactions which are not at arm's length [Assessment Years 2002-03 to 2003-04].*

#### **Perot Systems TSI (India) Limited vs. Dy. CIT, 30<sup>th</sup> October 2009 (ITAT\_DEL)**

The assessee extended two foreign currency loans to its associated foreign enterprises. The TPO held that the international transactions undertaken by the assessee in relation to the interest free loan were not at arm's length and undertook an upward adjustment to income.

The ITAT Delhi Bench held that the principle of transfer pricing aims at determining the pricing in the situations of cross border international transactions, where two enterprises which are subject to the same centre or direction or control (associated enterprise) maintain commercial or financial relation with other. The possibility exists that by way of intervention from the centre or otherwise, business conditions must be accepted by the acting units which differs from those which in the same circumstances would have agreed upon between un-related parties. The aim is to examine whether there is anomaly in the transaction which arise out of special relationship between the creditor and the debtor. Hence the contention of having actually not earned any income cannot come to the rescue of an assessee in this scenario.

The first objection of the TPO was that no two persons in normal business situation would grant interest free loan to the other persons. This is a fairly settled position. The assessee's contention in this regard was that no other person would have given the AEs loan at that point of time as they were in a start-up stage and that debt ratio was not comfortable. However, there was no case for not providing or charging any interest, if assessee was coming to the rescue of the AEs. There was no feature in the agreement to accept the contention of the counsel that loan was quasi capital. It was also not the case that there was any technical problem that loan could not have been contributed as capital originally if it was actually meant to be capital contribution. If the assessee's contention that whenever interest free loan was granted to associated enterprises, there should not be any adjustment, was accepted, it would tantamount to taking out such transactions from the realm of Sections 92(1) and 92B. Section 92(1) mandates that any income arising from an international transaction shall be computed having regard to the arm's length price.

From Section 92B, it is clear that lending or borrowing money between two associated enterprises comes within the ambit of international transaction and whether the same is at arms length price has to be considered. The question of rate interest on the borrowing loan is an integral part of arms length price determination in this context. An interpolation is not permissible, that when an interest free loan is given to the AEs, income on account of interest cannot be attributed from the point of view of arms length consideration.

Another argument of the TPO was that one of the AEs was situated in a tax heaven country of Bermuda and not charging of the interest by the assessee from the AEs, would result in higher income in the hands of the AEs, and the income of the assessee in India would reduce by the corresponding amount. Thus, this would bring down the overall tax incidence of the group by shifting profit from Indian jurisdiction to Bermuda which is a tax heaven country with zero rate of tax on corporate profit. It would be a classic case of violation of transfer pricing norms where profits are shifted to tax heavens or low tax regimes to bring down the aggregate tax incidence of a multi national group. Further, as observed by the TPO even if profit were sufficient it was not mandatory to declare dividend the same might be retained as profit in Bermuda for further investment in group companies. There was considerable cogency in this argument.

RBI's approval would not put a seal of approval on the true character of the transaction from the perspective of transfer pricing regulation as the substance of the transaction has to be judged as to whether the transaction is at arms length or not.

Therefore, the Commissioner (Appeals) was justified in not accepting the interest free loan extended to the associated concerns as at arm's length.

#### **Section 92C of the Income-tax Act, 1961**

*Where in respect of interest free foreign currency loans extended to foreign associated enterprise, using CUP method only one LIBOR rate had been applied which had been adjusted as required, since there was not more than one price in respect of each transaction, allowance of plus/minus 5 per cent from arms length interest computed, would be in fructuous [Assessment Year 2002-03 to 2004-05]*

#### **Perot Systems TSI (India) Limited vs. Dy. CIT, 30<sup>th</sup> October 2009 (ITAT\_DEL)**

The assessee extended two foreign currency loans to its associated foreign enterprises. The TPO applied the monthly

LIBOR (London International Bank Official Rate) downloaded from the British Bankers Association website. During the financial year 2001-02 LIBOR for US dollar loan was 2.39 per cent. On that LIBOR the Assessing Officer added average basis point charged by other companies and for this purpose he took rate for 5 companies. The arithmetic mean came to 1.64 per cent. Accordingly, Assessing Officer computed the arms length rate to be LIBOR plus 1.64 per cent using CUP method. The assessee agitated before the Commissioner (Appeals) that the Assessing Officer had not allowed the variation of plus/minus 5 per cent from the arm's length interest computed. The Commissioner (Appeals) found that first and foremost reason for not allowing deduction of 5 per cent from the arms' length interest was the fact that there was not more than one price in respect of each of the transaction, as specific one year LIBOR rate had been held to be arm's length price for the transactions. Therefore, he held that 5 per cent allowance itself was in fructuous.

The ITAT Delhi Bench held that no more than one price had been used for each transaction. Only one LIBOR rate had been applied which had been adjusted for some basis points as required. This could not be equated with more than one price in respect of each transaction. Hence, the order of the Commissioner (Appeals) was to be upheld.

#### **Section 115J of the Income-tax Act, 1961 – Special Provisions for Companies**

*If a Company is a MAT Company, then be it a private limited company or a public limited company, for purposes of Section 115J, assessee-Company has to prepare its profit and loss account in accordance with Parts II and III of Schedule VI to Companies Act, 1956 alone [Assessment Year 2090-91].*

#### **Dynamic Orthopedics Pvt. Ltd. vs. CIT, 16<sup>th</sup> February 2010 (SC)**

Chapter XII-B containing "Special provisions relating to certain Companies" was introduced in the Income Tax Act, 1961, by the Finance Act, 1987, with effect from 1st April, 1988. In fact, Section 115J replaced Section 80VVA of the Act. Section 115J [as it stood at the relevant time], inter alia, provided that where the total income of a company, as computed under the Act in respect of any accounting year, was less than thirty per cent of its book profit, as defined in the Explanation, the total income of the company, chargeable to tax, shall be deemed to be an amount equal to thirty per cent of such book profit. The whole purpose of Section 115J, therefore, was to take care of the phenomenon of prosperous 'zero tax' Companies not paying taxes though they continued to earn profits and declare dividends. Therefore, a Minimum Alternate Tax was sought to be imposed on 'zero tax' Companies. Section 115J imposes tax on a deemed income. Section 115J is a special provision relating only to certain Companies. The said section does not make any distinction between public and private limited companies. Section 115J legislatively only incorporates provisions of Parts II and III of Schedule VI to 1956 Act. Such incorporation is by a deeming fiction. Hence, Section 115J(1A) is to be read in the strict sense. If it is so read, it is clear that, by legislative incorporation, only Parts II and III of Schedule VI to 1956 Act have been incorporated legislatively into Section 115J. Therefore, the question of applicability of Parts II and III of Schedule VI to 1956 Act does not arise. If a Company is a MAT Company, then be it a private limited company or a public limited company, for the purposes of Section 115J, the assessee-Company has to prepare its profit and loss account in accordance with Parts II and III of Schedule VI to 1956 Act alone.

Section 115J does not make any distinction between public and private limited companies. It needs to be reiterated that, once a Company falls within the ambit of it being a MAT Company, Section 115J

## BUDGET CUTS? CUSTOMIZE YOUR MEDIA PLAN!



**spenta**  
multimedia

India's largest custom publisher

Peninsula Spenta, Mathuradas Mill Compound,  
N. M. Joshi Marg, Lower Parel, Mumbai 400 013  
Tel.: 91-22-2481 1010 / 6734 1010  
E-mail: ho@spentamultimedia.com  
www.spentamultimedia.com

- 22 custom magazines • Fully integrated operation • State-of-the-art printing facility.

applies and, under that section, a Company was required to prepare its profit and loss account only in terms of Parts II and III of Schedule VI to 1956 Act. The reason being that rates of depreciation in Rule 5 of the Income Tax Rules, 1962, are different from the rates specified in Schedule XIV of 1956 Act. In fact, by the Companies (Amendment) Act, 1988, the linkage between the two has been expressly de-linked. Hence, what is incorporated in section 115J is only Schedule VI to 1956 Act and not Sections 205, 350 or, 355.

**PER COURT:** The judgement of this Court in Malayala Manorama Company Limited vs. Commissioner of Income Tax, reported in [2008] 300 ITR 251 needs re-consideration.

#### **Section 115JB of the Income-tax Act, 1961 - Special provision for payment of tax by certain companies**

*Where accounts are not prepared in manner provided in Part II and Part III of Schedule VI to Companies Act, 1956 Assessing Officer has got power to go beyond book profit as per audited accounts; where surplus from sale of rights in a premise was taken directly to Balance Sheet as "capital reserve" without routing same through Profit and Loss Account and assessee did not consider above amount as a part of book profit under section 115JB, Assessing Officer had rightly recasted accounts and made addition of said surplus [Assessment Year 2004-05].*

**DCIT, Circle 3(1) vs. Bombay Diamond Co. Ltd, 30<sup>th</sup> November 2009 (ITAT-MUM)**

The assessee has made investment in the rights in booked premises at a Diamond Bourse in the preceding years. The said rights were sold during the year and the assessee earned a profit of Rs. 10,38,13,765 which was taken directly to the Balance Sheet as "capital reserve" without routing the same through the Profit and Loss Account. The assessee did not consider the above amount as a part of book profit under Section 115JB. On being questioned by the assessing officer it was submitted that since the rights in booked premises were held as capital asset, the profit arising from the sale thereof was not credited to the Profit and Loss Account. It was submitted that the surplus of Rs. 10,38,13,765 arising on the sale of the rights in the booked premises did not constitute trading profit. It was further submitted that the accounts of the assessee company were duly certified by the auditors and the same has been adopted in the AGM. However, the assessing officer observed that every company has to prepare its accounts in the manner provided in Part II

and Part III of Schedule VI to the Companies Act. He accordingly recomputed the book profit for the purpose of Section 115JB.

The Mumbai Bench of the Tribunal held that from a bare reading of Part II and Part III of Schedule VI to the Companies Act it is clear that the profit and loss account of a company shall disclose every material feature including credits or receipts and debits or expenses in respect of non-recurring transactions or transactions of exceptional nature also. Further, the company is also required to set out the various items relating to the income and expenditure of the company arranged under most convenient heads and disclosing profit or loss in respect of transactions of a kind not usually undertaken by the company or undertaken in circumstances of exceptional or non-recurring nature if material in amount.

In the instant case, although the assessee had earned a profit of Rs. 10,38,13,765 from the sale of rights in an immovable property, the same had not been routed through the profit and loss account and had directly been credited to the Balance Sheet. Therefore, the accounts were not prepared in accordance with the manner provided in Part II and Part III of Schedule VI to the Companies Act. The assessing officer could not go beyond the book profits as per the audited accounts provided they were prepared as per the manner provided in Part II and Part III of Schedule VI to the Companies Act, 1956 and were adopted in the AGM. However, in the instant case the accounts were not prepared in the manner provided in Part II and Part III of Schedule VI to the Companies Act, 1956. Since the profit on sale of investments was a material amount and the same was not routed through the Profit and Loss Account, the assessing officer has the power to re-work the book profit by recasting the accounts in the manner provided as per Part II and Part III of Schedule VI to the Companies Act, 1956 and he was justified in making addition.

#### **Section 143 of the Income-tax Act, 1961 - Assessment**

*Issue of notice under Section 143(2) within prescribed time for purpose of block assessment under Chapter XIV-B is mandatory prerequisite for assessing undisclosed income detected during search conducted under Section 132.*

**CIT vs. Hotel Blue Moon, 2<sup>nd</sup> February 2010 (SC)**

Section 158BC(b) provides for enquiry and assessment. The said provision reads "that the assessing officer shall proceed to

determine the undisclosed income of the Block period in the manner laid down in Section 158BB and the provisions of Section 142, sub-Sections (2) and (3) of Section 143, Section 144 and Section 145 shall, so far as may be, apply." An analysis of this sub-Section indicates that, after the return is filed, this clause enables the assessing officer to complete the assessment by following the procedure like issue of notice under Sections 143(2)/142 and complete the assessment under Section 143(3). This section does not provide for accepting the return as provided under Section 143(i) (a). The assessing officer has to complete the assessment under Section 143(3) only. In case of default in not filing the return or not complying with the notice under Sections 143(2)/142, the assessing officer is authorized to complete the assessment ex parte under Section 144. Clause (b) of Section 158 BC by referring to Sections 143(2) and 143(3) would appear to imply that the provisions of Section 143(1) are excluded. But Section 143(2) itself becomes necessary only where it becomes necessary to check the return so that where block return conforms to the undisclosed income inferred by the authorities there is no reason, why the authorities should issue notice under Section 143(2). However, if an assessment is to be completed under Section 143(3), read with Section 158-BC, notice under Section 143(2) should be issued within one year from the date of filing of block return. Omission on the part of the assessing authority to issue notice under Section 143(2) cannot be a procedural irregularity and the same is not curable and, therefore, the requirement of notice under Section 143(2) cannot be dispensed with. The other important feature that is required to be noticed is that the Section 158BC(b) specifically refers to some of the provisions of the Act which requires to be followed by the assessing officer while completing the block assessments under Chapter XIV-B. This legislation is 'by incorporation'. This section even speaks of sub-sections which are to be followed by the assessing officer. Had the intention of the legislature was to exclude the provisions of Chapter XIV of the Act, the legislature would have or could have indicated that also. A reading of the provision would clearly indicate, if the assessing officer, if for any reason, repudiates the return filed by the assessee in response to notice under Section 158BC(a), the assessing officer must necessarily issue notice under Section 143(2) within the time prescribed in the proviso to Section 143(2). Where the legislature intended to exclude

certain provisions from the ambit of Section 158BC(b), it has done so specifically. Thus, when Section 158BC(b) specifically refers to applicability of the proviso thereto, the same cannot be excluded. The clarification given by CBDT in its circular No.717 dated 14th August, 1995, has a binding effect on the department, but not on the Court. This circular clarifies the requirement of law in respect of service of notice under sub-Section (2) of Section 143. Accordingly, it is to be concluded even for the purpose of Chapter XIV-B, for the determination of undisclosed income for a block period under the provisions of Section 158BC, the provisions of Section 142 and sub-Sections (2) and (3) of Section 143 are applicable and no assessment can be made without issuing notice under Section 143(2).

#### **Section 147 of the Income-tax Act, 1961 – Income Escaping Assessment**

*Recourse to power under Section 147 cannot be sustained on a mere change of opinion, there being no failure of assessee to disclose fully and truly, all material facts necessary for assessment [Assessment Year 2002-03].*

**Bhavesh Developers vs. Assessing Officer, 12<sup>th</sup> January 2010 (BOM)**

An exceptional power has been conferred upon the Revenue to reopen an assessment after a lapse of four years. The conditions which are prescribed by the statute for the exercise of such a power must be strictly fulfilled and in their absence, the exercise of power would not be sustainable in law. Further, recourse to the power under Section 147 cannot be sustained on a mere change of opinion, there being no failure of the assessee to disclose fully and truly, all material facts necessary for assessment.

The assessee was claiming a deduction under section 80-IB in the amount of Rs. 3.85 Crore. However, as per details filed and profit and loss account, it was observed that the assessee had during the year, other income of Rs. 50.13 Lakh which mainly comprised of society deposit, stilt parking and sundry credit balances. Since this income did not qualify as income eligible for deduction under Section 80IB, it was stated that there was reason to believe that the income had, to that extent, escaped assessment.

The Bombay High Court held that ex-facie, the reasons which had been disclosed to the assessee would show that the inference that the income had escaped assessment was based on the disclosure made by the assessee itself. The finding was based on the details filed by the assessee

and from the profit and loss account. Quite clearly, therefore, it was impossible for the assessing officer to even draw the inference that there was a failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment. Significantly, the reasons that had been disclosed to the assessee did not contain a finding to the effect that there was a failure to fully and truly disclose all necessary facts, required for the purpose of assessment. In these circumstances, the condition precedent to a valid exercise of the power to reopen the assessment, after a lapse of four years from the relevant assessment year, was absent in the instant case.

#### **Section 254 of the Income-tax Act, 1961 – Appellate Tribunal – Orders of**

*Where assessee was an undertaking owned by State Government, no approval had to be obtained from Committee on Disputes in order to prefer an appeal before Appellate Tribunal [Assessment Year 2003-04].*

**Shivshahi Punarvasan Prakalp Ltd vs. Union of India & Ors, 5<sup>th</sup> January 2010 (SC)**

The Tribunal, in the course of its judgment noted that the assessee is an undertaking owned by the Government of Maharashtra and then proceeded on the basis that “admittedly approval has to be obtained from Committee on Disputes in order to prefer an appeal before the Appellate Tribunal”.

The Additional Solicitor General stated that the permission of the Committee of Dispute would not be necessary, in case of the adjudication of a dispute between the Central Government and State Government entities under the Income-tax Act, 1961.

The Mumbai High Court held that the basis on which the appeal was dismissed by the Tribunal was erroneous. In order to facilitate an adjudication on merits the matter was to be restored to the file of the Tribunal for a decision on its merits.

#### **INDIRECT TAXES**



#### **Excise/Customs**

#### **Rule 20 of the Customs, Excise and Gold (Control) Appellate Tribunal Procedure Rules, 1982**

*Where Tribunal had dismissed appeal in absence of appellant only on one occasion, fact that appellant immediately thereafter applied for restoration of appeal showed his intention that he was interested in prosecuting appeal and might be he had a justifiable cause for his absence on one occasion; Tribunal ought to have restored appeal to its file.*

*applied for restoration of appeal showed his intention that he was interested in prosecuting appeal and might be he had a justifiable cause for his absence on one occasion; Tribunal ought to have restored appeal to its file.*

**Chemipol vs. Union of India, 17<sup>th</sup> September 2009**

Every court or tribunal has an inherent power to dismiss a proceeding for non prosecution when the petitioner/appellant before it does not wish to prosecute the proceeding. In such a situation, unless the statute clearly requires the court or tribunal to hear the appeal/proceeding and decide it on merits it can dismiss the appeal/proceeding. Of course, the power must be exercised judiciously and taking into consideration all the facts and circumstances of the case. The Tribunal presently has its benches only at four or five places in India. An appellant who on account of his place or residence or business being far away from the place of sitting for the Tribunal may not except at a high cost be able to attend the hearing especially when the matters are adjourned for several times. In such an event, if the appellant files on record his submissions in writing, the Tribunal must decide the appeal on merits on the basis of the said submissions. In that case, the Tribunal does not have a power to dismiss the appeal. However, where the appellant in spite of notice is persistently absent and the Tribunal on facts of the case is of the view that the appellant is not interested in prosecuting the appeal, it can in exercise its inherent power to dismiss the appeal for nonprosecution. Of course, the conclusion of the Tribunal that the appellant is not interested in prosecuting the appeal must be reached on the facts of each case and not merely on account of absence of an appellant on a solitary occasion.

Where the Tribunal had dismissed the appeal on the absence of the appellant only on one occasion, the fact that the appellant immediately thereafter applied for restoration of the appeal showed his intention that he was interested in prosecuting the appeal and might be he had a justifiable cause for his absence on one occasion. In the circumstances, the Tribunal ought to have restored the appeal to the file.



# CIRCULARS/NOTIFICATIONS

## DIRECT TAXES

### I. CIRCULAR

#### 1. Circular No. 03/2010, dated 2-3-2010

The CBDT, has, vide its Circular No. 03/2010 dated 2-3-2010, made a clarification on tax deduction at source on payment of interest on time deposits under section 194A of the Income-tax Act, 1961 by banks following core-branch banking solutions (CBS) software. It has been clarified that Explanation to Section 194A is not meant to apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software. It has been further clarified that since no constructive credit to the depositor's / payee's account takes place while calculating interest on time deposits on daily or monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only. In such cases, tax shall be deducted at source on accrual of interest at the end of financial year or at periodic intervals as per practice of the bank or as per the depositor's / payee's requirement or on maturity or on encashment of time deposits, whichever event takes place earlier, whenever the aggregate of amounts of interest income credited or paid or likely to be credited or paid during the financial year by the banks exceeds the limits specified in section 194A.

The complete text of the said circular can be downloaded from [http://law.incometaxindia.gov.in/dittaxmann/circular/Cir3\\_2010.pdf](http://law.incometaxindia.gov.in/dittaxmann/circular/Cir3_2010.pdf)



### II. NOTIFICATIONS

#### 1. Notification No. S.O. 424 (E) dated 18.02.2010

The CBDT has in exercise of the powers conferred by section 295, made the Income-tax (First Amendment) Rules, 2010, which would be effective from 01.04.2010. Rules 30, 31 and 31A of Income-tax Rules, 1962 have been substituted. The new rules 30 and 31 provide for the time and mode of payment to Government account of tax deducted at source or tax paid under section 192 (1A) and certificate of tax deducted at source or tax paid under section 192 (1A), respectively. Further, new Rule 37A on "Returns regarding tax deducted at source in the case of non-residents" has been inserted.

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

### INDIRECT TAXES

#### A. EXCISE

##### I Notifications:

#### 1. Notification No. 04/2010-CE (N.T.) dated 19.02.2010

With effect from

01.04.2010, CBEC has reduced quantum of excise duty, for electronic filing of return from 50 Lakh to 10 Lakh.

It has amended the third proviso to rule 8(1) of the Central Excise Rules, 2002 to provide that where an assessee, who has paid duty of ten lakh rupees or more, other than the amount of duty paid by utilisation of CENVAT credit, in the preceding financial year, shall thereafter, deposit the duty electronically through internet banking.

Further, it has inserted a proviso after second proviso to rule 12(1) of the aforesaid



rules to provide that where an assessee has paid total duty of rupees ten lakh or more including the amount of duty paid by utilisation of CENVAT credit in the preceding financial year, he shall file the monthly or quarterly return, as the case may be, electronically.

#### 2. Notification No. 05/2010-CE (N.T.) dated 27.02.2010

SSI sector is allowed to make the payment of duty on quarterly rather than monthly basis. However, due date for filing return by an SSI unit is advanced to 10th of the close of each quarter from 20th of the close of quarter.

Further, the requirement of pre-authentication of invoices has been dispensed with.

These amendments shall come into effect on the 1st of April, 2010.

#### 3. Notification No. 06/2010-CE (N.T.) dated 27.02.2010

With effect from 01.04.2010, SSI sector is allowed full Cenvat credit on capital goods in one instalment in the year of receipt of such capital goods in the factory.

Besides, following amendments shall be effective from 27.02.2010:

- Lower percentage of CENVAT credit reversal is required in case of used computers and computer peripherals cleared from the factory due to new accelerated depreciation rates.
- Removal of jigs, moulds, dies, fixtures, to vendors is permitted without reversal of CENVAT credit. Earlier, this benefit was available only to job-workers.



- CENVAT credit is admissible on the inputs and input services used in the manufacture of exempted goods supplied to specified mega power projects.
- Rule 15 of the CENVAT Credit Rules, 2004 has been substituted with new Rule 15.

**4. Notification No. 11/2010-CE (N.T.) dated 27.02.2010**

Chewing Tobacco and Unmanufactured Tobacco Packing Machines (Capacity Determination and Collection of Duty) Rules, 2010 have been notified. They come into force on 8th March, 2010.

**II Circulars:**

**1. Circular No. 914/04/2010-CX dated 16.02.2010**

CBEC has clarified regarding beedi cess payable under the provisions of section 3 of Beedi Workmen Welfare Cess Act as follows:

- (i) If the biris are otherwise exempted from payment of Central Excise duty, they are also exempted from payment of biri cess.
- (ii) If cess has been collected on unlabelled beedis, no further cess is required to be collected, if they are subsequently labeled.
- (iii) For cases covered under (i) above, if the exempted beedis are subsequently labeled, cess shall be payable on labeled beedis.

**2. Circular No. 915/05/2010-CX dated 19.02.2010**

CBEC has clarified that value of samples which are distributed free as part of marketing strategy, or as gifts or donations, shall be determined under rule 4 of the valuation rules by taking into consideration the deemed value under section 4A(1) notwithstanding the non-availability of normal price under section 4(1)(a) of the Act. Accordingly, the value for payment of excise duty for sample would be the value determined under section 4A for the similar goods (subject to adjustment for size, pack, etc.).

**3. Circular No. 916/06/2010-CX dated 04.03.2010**

It has been clarified that tractors are chargeable to tractor cess in terms of the Tractor Cess Rules, 1992 read with the IDRA Act, 1951.

**4. Circular No. 918/08/2010-CX dated 04.03.2010**

It has been clarified that the officers at the level of Superintendents and above of the Customs & Central Excise Department are empowered for entry, search and seizure only at the premises registered under the Central Excise & Customs. Therefore, officers are not empowered to enter, search etc. for premises which are not registered with the Department for carrying out any act under the Cigarettes and Other Tobacco Products Act, 2003.

**B. CUSTOMS**

**I Notifications:**

**1. Notification No. 18/2010-Customs NT dated 27.02.2010**

It has amended Customs Tariff (Identification, Assessment and Collection of Anti-Dumping Duty on Dumped Articles and for Determination of Injury) Rules, 1995.



### C. SERVICE TAX

#### I Notifications:-

##### 1. Notification No. 01/2010 – ST dated 19.02.2010

With effect from 01.04.2010, CBEC has reduced quantum of service tax, for electronic filing of return from 50 Lakh to 10 Lakh.

It has amended the proviso to Rule 6(2) of the Service Tax Rules, 1994 to provide that where an assessee has paid a total service tax of rupees ten lakh or more including the amount paid by utilisation of CENVAT credit, in the preceding financial year, he shall deposit the service tax liable to be paid by him electronically, through internet banking.

Further, it has inserted a proviso after Rule 7(2) to provide that where an assessee has paid total duty of rupees ten lakh or more including the amount of duty paid by utilization of CENVAT credit in the preceding financial year, he shall file the monthly or quarterly return, as the case may be, electronically.

##### 2. Notification No. 02/2010-ST and Notification No. 17/2010-ST dated 27.02.2010

Packaged I.T. software, pre-packed in retail packages for single use is exempted from service tax subject to specified conditions.

##### 3. Notification No. 03/2010-ST dated 27.02.2010

Service tax exemption available to vocational training institutes has been made limited only to industrial training institutes or industrial training centres affiliated to National Council of Vocational Training (NCVT) and offering courses in the designated trades covered under Schedule I of the Apprentices Act, 1961.

##### 4. Notification No. 04/2010-ST dated 27.02.2010

Transport of food grains and pulses by road by a goods transport agency is exempted from service tax.

##### 5. Notification No. 05/2010-ST dated 27.02.2010

Exemption from service tax, presently available to Group Personal Accident Scheme provided by Government of Rajasthan to its employees, under 'general insurance service' has been withdrawn.

##### 6. Notification No. 06/2010-ST and Notification No. 16/2010-ST dated 27.02.2010

The taxable service, namely 'mandap keeper service' has been shifted from the list under Rule 3(1)(ii) of the Export of Services Rules, 2005 [i.e. performance related services] to the list under Rule 3(1)(i) [immovable property related services] and three taxable services, namely 'Chartered Accountant services', 'Cost Accountant services' and 'Company Secretary's services', have been shifted from the list under Rule 3(1)(ii) of the aforesaid rules [i.e. performance related services] to the list under Rule 3(1)(iii) [residual category of services]. Identical changes have been made under the Taxation of services (Provided from Outside India and Received in India) Rules, 2006 as well. Further, the condition prescribed under Rule (2)(a) of the Export of Services Rules, 2005 i.e. 'such service is provided from India and used outside India' has been deleted.

##### 7. Notification No. 07/2010-ST dated 27.02.2010

With effect from 01.04.2010, exemption from service tax on service provided in relation to 'transport of goods by rail' by

Notification No.33/2009, dated 01.09.2009 is being withdrawn

##### 8. Notification No. 08/2010-ST dated 27.02.2010

With effect from 01.04.2010, the exemption provided to certain specified goods transported by rail vide Notification No.28/2009-ST, dated 31.08.2009, which was subsequently withdrawn vide Notification No. 36/2009-ST dated 09.09.2009, has been restored.

##### 9. Notification No. 09/2010-ST dated 27.02.2010

With effect from 01.04.2010, an abatement of 70% of the gross value of the freight charged on goods (other than exempted goods) is being provided by adding the service of 'transport of goods by rail' in Notification No. 1/2006-ST dated 01.03.2006.

##### 10. Notification No. 10/2010-ST dated 27.02.2010

Exemption from service tax is provided on 'technical testing and analysis service' and 'technical inspection and certification service' as provided by Central and State seed testing laboratories, and Central and State seed certification agencies.

##### 11. Notification No. 11/2010-ST dated 27.02.2010

Exemption from service tax is provided to the taxable service provided in relation to transmission of electricity.

##### 12. Notification No. 12/2010-ST dated 27.02.2010

Exemption from service tax is provided to erection, commissioning or installation of:

- mechanized food grain handling systems,
- equipments for setting up or substantial expansion of cold storage or units for processing of products such as agricultural, dairy and poultry etc.

**13. Notification No. 13/2010-ST dated 27.02.2010**

Exemption from service tax is provided to Indian news agencies under 'online information and database retrieval service' and 'business auxiliary service' subject to specified conditions.

**14. Notification No. 14/2010-ST dated 27.02.2010**

Construction and operation of installations, structures and vessels for prospecting/extraction/ production of mineral oils and natural gas in the Exclusive Economic Zone and the Continental Shelf of India and supply of any goods connected with these activities has been brought within the service tax purview.

**15. Notification No. 15/2010-ST dated 27.02.2010**

Under 'air passenger transport service', statutory taxes charged by any Government on air passenger is to be excluded from the taxable value.

For complete text of the above notifications and circulars please refer to the following link: <http://www.cbec.gov.in/cae1-english.htm>

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

**FEMA**

**1. Memorandum of Procedure for channeling transactions through Asian Clearing Union (ACU)**



RBI/2009-10/318 A. P. (DIR Series) Circular No.35

**dated February 17, 2010**

Ref - Memorandum of procedural instructions for channeling transactions through Asian Clearing Union (ACU) (Memorandum ACM) issued in April, 2003

In the 37<sup>th</sup> ACU Board Meeting held in June, 2008, the changes were made in the settlement system in ACU mechanism. The revised Memorandum ACM containing Memorandum of Procedure for channeling transactions through Asian Clearing Union (ACU) has been updated to that effect. The revised Memorandum ACM is given as an annexure in Circular.

The same can be seen on RBI website <http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/APD35M180210.pdf>

**2. Overseas Investment Application - Online Reporting of Overseas Direct Investment in Form ODI**

**RBI/2009-10/36 A. P. (DIR Series) Circular No.36 dated February 24, 2010**

Ref - A.P. (DIR Series) Circular No. 68 dated June 1, 2007

In above referred circular RBI had expressed its intention to receive Form ODI on-line. This Circular is in respect of making operational the on-line reporting system in a phased manner, with effect from **March 2, 2010**, to simplify the existing reporting framework.

The new system would enable on-line generation of the Unique Identification Number (UIN), acknowledgment of remittance/s and filing of the Annual Performance Reports (APRs) and easy accessibility to data at the AD level for reference purposes.

The application for overseas investment under the approval route would continue to be submitted to the Reserve Bank in physical form as hitherto, in addition to the on-line reporting of Part I, for approval purposes. Further, the transactions relating to closure / disinvestment/ winding up/ voluntary liquidation of the overseas Joint Ventures/ Wholly Owned Subsidiaries (JVs / WOSS) under the automatic and approval routes (Part IV of form ODI) would continue to be submitted to the Reserve Bank in physical form as is being done at present.

As per the new reporting system, AD Category-I banks would be able to generate the UIN on-line under the automatic route. However, subsequent remittances under the automatic route and remittances under the approval route should be made and reported on-line in Part II, only after receipt of the letter, confirming the UIN from the Reserve Bank.

### **3. External Commercial Borrowings (ECB) Policy**

**RBI/2009-10/333 A. P. (DIR Series) Circular No.38 dated March 02, 2010**

According to announcement made in Union Budget 2010-11, definition of infrastructure project for the purpose of availing of ECB has been expended to include "cold storage or cold room facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat".

Accordingly, the infrastructure sector would henceforth include (i) power, (ii) telecommunication, (iii) railways, (iv) road including bridges, (v) sea port and airport, (vi) industrial parks, (vii) urban infrastructure (water supply, sanitation and sewage projects), (viii) mining, exploration and refining and (ix) cold storage or cold

room facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat.

All other aspects of the ECB policy, such as, USD 500 million limits per company per financial year under the automatic route, eligible borrower, recognised lender, end-use, average maturity period, prepayment, refinancing of existing ECB, reporting arrangements and terms and conditions shall remain unchanged.

### **4. External Commercial Borrowings (ECB) Policy**

**RBI/2009-10/334 A. P. (DIR Series) Circular No.39 dated March 02, 2010**

(Ref - A.P. (DIR Series) Circular No. 5 dated August 1, 2005, A.P. (DIR Series) Circular No. 46 dated January 2, 2009, A.P. (DIR Series) Circular No. 71 dated June 30, 2009 and para 2 (iv) of A.P. (DIR Series) Circular No. 19 dated December 9, 2009)

As per the extant ECB policy, Non-Banking Finance Companies (NBFCs), which are exclusively engaged in financing of infrastructure sector, are permitted to avail of ECB from the recognized lender category including international banks, under the approval route, for on-lending to the infrastructure sector, as defined in the extant ECB policy.

A separate category of NBFCs viz. Infrastructure Finance Companies (IFCs) has been introduced in terms of the guidelines contained in circular DNBS.PD.CC No. 168/03.02.089/2009-10 dated February 12, 2010. Accordingly, proposals for ECBs by the IFCs, which have been classified as such by the Reserve Bank, for on-lending to the infrastructure sector, as defined in the extant ECB policy may be considered under the approval route, subject to their

complying with the following conditions:

1. compliance with the norms prescribed in the aforesaid DNBS Circular dated February 12, 2010;
2. hedging of the currency risk in full; and
3. the total outstanding ECBs including the proposed ECB not exceeding 50 per cent of the Owned Funds.

The AD Category-I bank should certify the compliance with the above conditions by the IFCs.

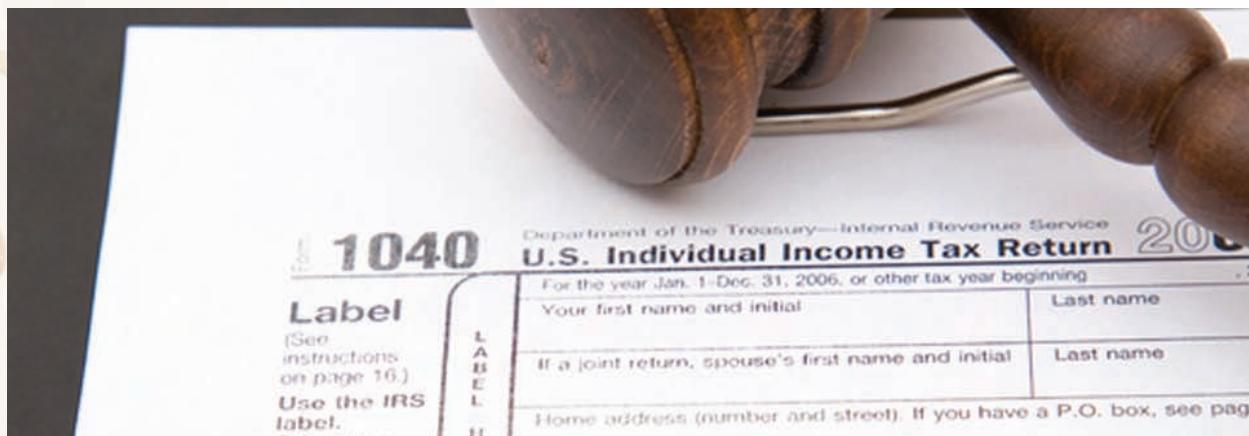
All other aspects of ECB policy such as USD 500 million limits per company per financial year under the automatic route, eligible borrower, recognised lender, end-use, average maturity period, prepayment, refinancing of existing ECB, reporting arrangements and terms and conditions shall remain unchanged.

### **5. External Commercial Borrowings (ECB) Policy – Structured Obligations**

**RBI/2009-10/335 A. P. (DIR Series) Circular No.40 dated March 05, 2010**

(Ref - Notification No. FEMA 29 / 2000-RB dated September 26, 2000, A.P. (DIR Series) Circular No. 28 dated March 30, 2001 and A.P. (DIR Series) Circular No. 5 dated August 1, 2005)

Borrowing and lending of Indian Rupees between two persons resident in India does not attract the provisions of the Foreign Exchange Management Act, 1999. In case where a Rupee loan is granted against the guarantee provided by a person resident outside India, there is no transaction involving foreign exchange until the guaranteee is invoked and the non-resident guarantor is required to meet the liability under the guarantee. The Reserve Bank vide Notification No. FEMA 29/2000-RB dated September 26, 2000 has granted general





permission to a person resident in India, being a principal debtor, to make payment to a person resident outside India, who has met the liability under a guarantee.

As per the extant policy, domestic Rupee denominated structured obligations has been permitted to be credit enhanced by non-resident entities under the approval route. In view of the growing needs of funds in the infrastructure sector, a comprehensive policy framework on credit enhancement to domestic debt has been introduced.

The facility of credit enhancement by eligible non-resident entities may be extended to domestic debt raised through issue of capital market instruments, such as debentures and bonds, by Indian companies engaged exclusively in the development of infrastructure and by the Infrastructure Finance Companies (IFCs), which have been classified as such by the Reserve Bank in terms of the guidelines contained in the circular DNBS.PD. CC No. 168 / 03.02.089 / 2009-10, dated February 12, 2010, subject to the following conditions:

1. credit enhancement will be permitted to be provided by multilateral/regional financial institutions and Government owned development financial institutions;
2. the underlying debt instrument should have a minimum average maturity of seven years;
3. prepayment and call/put options would not be permissible for such capital market instruments up to an average maturity period of seven years;
4. guarantee fee and other costs in connection with credit enhancement will be restricted to a maximum two per cent of the principal amount involved;

5. on invocation of the credit enhancement, if the guarantor meets the liability and if the same is permissible to be repaid in foreign currency to the eligible non-resident entity, the all-in-cost ceilings, as applicable to the relevant maturity period of the Trade Credit / ECBs, would apply to the novated loan. Presently, the all-in-cost ceilings, depending on the average maturity period, are applicable as follows:

Average maturity period of the loan on invocation	All-in-cost ceilings over 6 month Libor*
Up to 3 years	200 basis points
Three years and up to five years	300 basis points
More than five years	500 basis points

6. In case of default and if the loan is serviced in Indian Rupees, the applicable rate of interest would be the coupon of the bonds or 250 bps over the prevailing secondary market yield of five years Government of India security, as on the date of novation, whichever is higher;
7. IFCs proposing to avail of the credit enhancement facility should comply with the eligibility criteria and prudential norms laid down in the circular DNBS.PD.CC No.168 / 03.02.089 / 2009-10 dated February 12, 2010 and in case the novated loan is designated in foreign currency, the IFC should hedge the entire foreign currency exposure; and
8. The reporting arrangements as applicable to the ECBs would be applicable to the novated loans.

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

#### CORPORATE LAWS

1. Reporting by I classified as infrastructure finance companies  
[www.rbi.gov.in](http://www.rbi.gov.in)



The RBI has issued Circular No. BP. BC. 74/21.04.172/ 2009-10 dated 12.02.2010 in relation to linking the risk weights of banks' exposure to NBFCs categorised as Infrastructure Finance Companies (IFCs) to the credit rating assigned to these NBFCs by external credit assessment institutions (ECAs) and it is not clarified that banks' exposures to NBFC-IFCs will henceforth be risk weighted as per the ratings assigned to these NBFCs by the rating agencies registered with the SEBI and accredited by the Reserve Bank of India. The new capital adequacy framework would be applicable and appropriate risk weights would be assigned, i.e. similar to corporates / corporate bonds, while computing capital for credit risk and specific risk under market risk. It is also provided that in relation to the prudential ceilings for exposure of banks to NBFCs which have been prescribed, it is advised that the exposure of a bank to the IFCs should not exceed 15 per cent of its capital funds as per its last audited balance sheet, with a provision to increase it to 20 per cent if the same is on account of funds on-lent by the IFCs to the infrastructure sector. One may refer to the above website for further details.

2. Infrastructure financing NBFCs  
[www.rbi.gov.in](http://www.rbi.gov.in)

The RBI has issued Circular No. 168/03.02.089/2009-10 dated 12.02.2010 introducing a fourth category of NBFCs as "Infrastructure Finance Companies" (IFCs) which is a separate category of infrastructure financing NBFCs in view of the critical role played by them in providing credit to the infrastructure sector. An IFC is defined as non deposit taking NBFC that fulfills the criteria like, (a) a minimum of 75 per cent of its total assets should be deployed in infrastructure loans as defined in Para 2(viii) of the Non Banking Financial (Non Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, (b) net owned funds of Rs. 300 crore or above, (c) minimum

credit rating ‘A’ or equivalent of CRISIL, FITCH, CARE, ICRA or equivalent rating by any other accrediting rating agencies, and (d) CRAR of 15 percent (with a minimum Tier I capital of 10 percent).

The other norms include in relation to not to exceed the concentration of credit norms as provided in paragraph 18 of the aforesaid Directions like, (a) in lending to any single borrower by ten per cent of its owned fund and any single group of borrowers by fifteen per cent of its owned fund, and, (b) in lending and investing (loans/investments taken together) by five percent of its owned fund to a single party and ten cent of its owned fund to a single group of parties. One may refer to the above website for further details.

### **3. Allottees in the Qualified Institutional Placements**

[www.sebi.gov.in](http://www.sebi.gov.in)

The SEBI has issued Circular No. SEBI/CFD/DIL/LA/1/2010/05/03 dated 05.03.2010 whereby it has been decided that the details of allottees and the corresponding pre and post QIP issue shareholding in the issuer company may be disclosed on the website of the stock exchanges in terms of this circular which is issued in exercise of powers conferred by section 11(1) of the SEBI Act, 1992, to protect the interest of investors in securities and to promote the development of, and to regulate the securities market. One may refer to the above website for further details.



### **4. Anti money laundering (AML) standards/ combating financing of terrorism (CFT)**

[www.sebi.gov.in](http://www.sebi.gov.in)

The SEBI has issued Master Circular No. ISD/AML/CIR/1/2010 dated 12.02.2010 combining all the regulations and directives issued by SEBI on the captioned subject and the various directives issued vide circulars from time to time, covering issues related to know your client (KYC) norms, anti-money laundering (AML), client due diligence (CDD) and combating financing of terrorism (CFT). The directives lay down the minimum requirements and it is emphasised that the intermediaries may, according to their requirements, specify additional disclosures to be made by clients to address concerns of money laundering and suspicious transactions undertaken by clients. Reference to applicable statutes and reporting guidelines for intermediaries is available at the website of the Financial Intelligence Unit – India (FIU-IND). Directives to all intermediaries under section 12 of the SEBI Act are also issued in the context of compliance with the standards set by the Financial Action Task Force (FATF) on AML and CFT. This master circular consolidates all the requirements/instructions issued by SEBI with regard to AML / CFT till 31 January, 2010 and supersedes all the earlier circulars issued in this regard. One may refer to the above website for further details.

### **5. Application for rectification of mistakes for MCA filings**

[www.mca.gov.in](http://www.mca.gov.in)

The Ministry of Corporate Affairs (MCA) has issued Notification GSR 177(E) dated 05.03.2010 notifying the application form no. 68 which is an application for rectification of mistakes made while filing Form Nos. 1/1A/44 electronically, on the Ministry’s website, and that such application shall be accompanied by a fee of Rs.1,000/- for rectification of mistakes in Form Nos. 1/1A and Rs.10,000/- for rectification of mistakes in Form No. 44. This application in Form No. 68, complete in all respects, shall be made to the Registrar within a period of 365 days from the date of approval of Form Nos. 1/1A/44 by the Registrar. It is also provided that after receiving the application for rectification of mistakes, the Registrar shall examine the application based on the relevant documents filed and available on record and thereafter approve the application and intimate the mistakes rectified to the applicant within a period of 60 days from the date of filing of the application and it is qualified that the rectification of mistakes shall be allowed only

once in respect of one company. One may refer to the above website for further details and the full copy of the notification appended to the circular which also contains the form 68.

### **6. Revised form 32 notified by MCA**

[www.mca.gov.in](http://www.mca.gov.in)

The MCA has issued Notification No. GSR 68(E) dated 10.02.2010 revising the form 32 relating to “Particulars of appointment of Managing Director, directors, manager and secretary and the changes among them or consent of candidate to act as a Managing Director or director or manager or secretary of a company and / or undertaking to take and pay for qualification shares”. One may refer to the above website for further details.

### **7. Circular for directives for mutual funds**

[www.sebi.gov.in](http://www.sebi.gov.in)

The SEBI has issued Circular No. SEBI/IMD/CIR No 18 / 198647/2010 dated 15.03.2010 in relation to directives on Brokerage and commission paid to associates, additional mode of payment through Applications Supported by Blocked Amount (ASBA) in mutual funds and reduction in New Fund offer (NFO) period, non-availability of Unit Premium Reserve for dividend distribution, role of mutual funds in Corporate Governance of public listed companies, provision of charging of additional management fees by the asset management companies in case of schemes launched on no load basis and the Fund of Funds Scheme. One may refer to the above website for further details and reporting formats.

### **8. Reporting half-yearly by portfolio managers**

[www.sebi.gov.in](http://www.sebi.gov.in)

The SEBI has issued Circular No. IMD/DOF-1/PMS/Cir-1/2010 dated 15.03.2010 regarding submission of half yearly report by portfolio managers in relation to which the format for the half yearly report on portfolio management activity has been revised and given as an annexure to the circular and that all portfolio managers are advised to submit the half yearly report to SEBI in the revised format within 30 days after the end of respective period ended 30/9 & 31/3 of each year. One may refer to the above website for further details and the reporting format.

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

# Disclosure in the cash flow statement of borrowings and loan disbursements and related repayments in case of a financial institution.

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 undertaking, incorporated under the Companies Act, 1956 in the year 1987, is a dedicated financial institution engaged in the financing of power sector in India. The company is also notified as a public financial institution under section 4A of the Companies Act, 1956. The company is mainly engaged in providing loans and other non-fund based products to various power utilities.

2. The company prepares its cash flow statement using the indirect method as per Accounting Standard (AS) 3, 'Cash Flow Statements'. While preparing the draft financial statements for the financial year 2008-09, according to the querist, the company being a financial institution, disclosed the net cash outflows/inflows from loan disbursements made to/principal repayments received from the borrowers under the head 'cash flows from financing activities' in the cash flow statement prepared in accordance with the indirect method as per AS 3. The company also disclosed the net cash inflows/outflows from loans borrowed from/principal repayments made to lenders under the head 'cash flows from financing activities'.

3. The government auditors during the audit of the draft financial statements observed that the "amount of Rs. XXXX crore on account of loans disbursed (net) shown under 'cash flow from financing activities' should be shown under 'cash flow from operating activities' in terms of paragraph 14 of AS 3". Reference was also made to paragraph 14 of AS 3 which provides that "an enterprise may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial enterprises are usually classified as operating activities since they relate to the main revenue-producing activity of that enterprise".

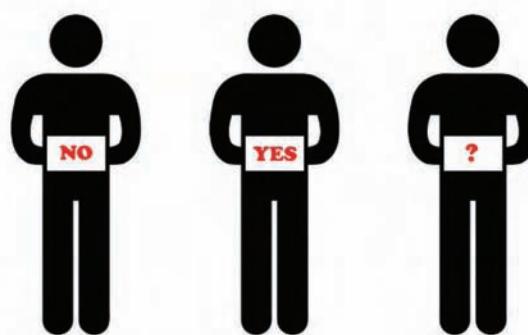
4. The querist has stated that AS 3 defines operating activities as "the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities". The querist has also stated that paragraph 12 of AS 3 further explains that cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. According to the querist, for a financial institution, main revenues are generated from interest on the loans advanced, unlike manufacturing companies, which generate revenues from sale of goods. Also, paragraph 20 of AS 3 provides as under:

"20. Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:  
 (a) changes during the period in inventories and operating receivables and payables;  
 (b) non-cash items such as depreciation, provisions, deferred taxes, and

unrealised foreign exchange gains and losses; and  
 (c) all other items for which the cash effects are investing or financing cash flows."

Therefore, according to the querist, for a financial institution, since the operating revenues, i.e. interest on loans, etc., are generated from the loans disbursed, the loan disbursements made/repayments received from the borrowers should be classified as cash flows from the operating activities.

5. The querist has also mentioned that AS 3 defines financing activities as "activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise", which generally arise from the issue of shares, bonds, debentures and such type of instruments. Since the borrowings of a company, i.e., bonds and loans raised are to be classified as financing activities as stated in AS 3, it is not prudent to classify the loan disbursements to / repayments received from borrowers under the operating activities since both





are interdependent in nature for a financial company. Further, as per the querist, if loan disbursements to /repayments received from borrowers are classified under the cash flows from operating activities, and the borrowings of a company are classified as financing activities, the net operating cash flows will show huge negative cash flows which imply that the operational performance/capability of the company is very weak as is also described in paragraph 11 of AS 3, which, *inter alia*, states that "the amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise, pay dividends, repay loans and make new investments without recourse to external sources of financing" and similarly, net cash flows from the financing activities will show huge excessive cash inflows year on year. Therefore, in the view of the querist, loan disbursements to / repayments received from borrowers should ideally be shown under the financing activities along with the borrowings of a company, i.e., bonds and loans raised.

6. The querist has expressed his view that the classification of the loan disbursements to/repayments received from borrowers under the head 'cash flows from operating activities' resulting in huge negative net operating cash flows will

- not present a true and fair view of the financial statements thereby contradicting the fundamental qualitative characteristics of financial statements, namely, understandability and relevance, and
- indicate that a cash rich company having a net worth of around Rs. 10, 800 crore has not generated sufficient cash flows to maintain the operating capability, pay dividends, repay loans and make new investments without recourse to external sources of financing.

7. The querist has also stated that the industry practice is also such that even some of the leading financial institutions are classifying increase/decrease in both the loan assets (disbursed to borrowers) and loan liabilities (borrowings of a company) under the head 'cash flows from financing activities'.

#### B.Query

8. The querist has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India on the following issues:

- (i) Whether it is correct to classify the amounts of loans disbursed to and the repayments received from the borrowers under the head 'cash

flows from operating activities', and the amounts of loans raised from and the repayments made to the lenders under the head 'cash flows from financing activities', as per the indirect method of preparation of cash flow statement as per AS 3.

- (ii) If not, what is the correct method of disclosure of the amounts of loans disbursed to and the repayments received from the borrowers, and the loans raised from and the repayments made to the lenders, as per the indirect method of preparation of cash flow statement as per AS 3.

#### C.Points considered by the Committee

9. The Committee notes that the basic issue raised in the query relates to the disclosure of loan disbursements to and repayments received from the borrowers and that of loans raised from and repayments made to the lenders by the company (a financial institution) in the cash flow statement. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, classification and disclosure of interest paid on the loans raised by the company, etc.

10. As far as disclosure of cash flows arising from loan disbursements to and repayments from the borrowers is concerned, the Committee notes the definition of 'operating activities' (reproduced in paragraph 4 above) and paragraph 14 of AS 3 (reproduced in paragraph 3 above). The Committee notes that the Standard explicitly states that cash flows





arising from loans advanced by a financial enterprise should be classified as operating activity as these relate to main revenue-producing activities of the enterprise. As far as classification of these activities under 'financing activities', as being argued by the querist, is concerned, the Committee notes the definition of 'financing activities' (reproduced in paragraph 5 above) and paragraph 17 of AS 3 which provides as follows:

"17. The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise. Examples of cash flows arising from financing activities are:  
 (a) cash proceeds from issuing shares or other similar instruments;  
 (b) cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings; and  
 (c) cash repayments of amounts borrowed."

From the above, the Committee is of the view that the basic objective of the financing activities is to finance the business of the enterprise irrespective of its nature of operations. An activity could be classified as financing activity only if it meets this definition. Since the loans disbursed and the repayments received do not result in changes in the size and composition of the owners' capital and borrowings of the company, these cannot, in any case, be classified as financing activities.

11. With respect to the disclosure of cash flows arising from loans raised and repayments made to the lenders by the company (a financial institution) in the cash flow statement, the Committee notes the definition of 'financing activity' and paragraph 17 of AS 3 (reproduced



in paragraph 10 above). From the above, the Committee is of the view that the cash flows from loans raised and bonds issued and cash repayments of the amounts borrowed in case of all enterprises (financial or non-financial) have to be classified under 'financing activities' as the definition of 'financing activities' as per AS 3 does not make any distinction between financial and non-financial enterprises or between the funds raised for operating activities or

investing activities. Accordingly, in case of a financial enterprise, even though the 'loans raised and repayments made' and 'loan disbursements and repayments received' are interdependent, the former cannot also be classified as 'operating activity' for the purposes of AS 3.

#### D.Opinion

12. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 8 above:

- (i) Yes, it is correct to classify the amounts of loans raised from and the repayments made to the lenders under the head 'cash flows from financing activities' and the amounts of loans disbursed to and the repayments received from the borrowers under the head 'cash flows from operating activities', as per the indirect method of preparation of cash flow statement as per AS 3. For the purpose of the preparation of cash flow statement, the aforesaid amounts would be arrived as increase/decrease in the borrowings and loans & advances outstanding in the two balance sheets relevant for the Cash Flow Statement.
- (ii) Since the answer to (i) above is not in the negative, this question does not arise.

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 26 volumes. A CD of Compendium of Opinions containing 25 volumes has also been released by the Committee. 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: [http://www.icai.org/category.html?c\\_id=146](http://www.icai.org/category.html?c_id=146)

# Salient Features of Finance Bill, 2010



The Budget 2010 is essentially about government finances. The Finance Minister has addressed the key issues of containing fiscal slippage and has outlined a clear road map for fiscal consolidation for the next three years. According to analysts, this indicates the government's net borrowing is under control and is unlikely to put pressure on interest rates. It is a welcome fact that the current Bill removes the anomaly and discrimination against the tax payers by amending certain provisions of the Income-tax Act retrospectively which were not only harsh, but inequitable as well. Also, this Bill attempts to address a few amendments carried out in the past to make compliance much easier. The author highlights the characteristics of the Finance Bill and then analyses the amendments that have been proposed to be effective from April 1, 2011, unless otherwise stated.



**CA. Ved Jain**

(The author is a former President of the Institute. He may be contacted at [jainved@gmail.com](mailto:jainved@gmail.com))

## Introduction

Finance Minister Mr. Pranab Mukherjee presented the budget for the year 2010-11 on February 26, 2010. He had a difficult task to address, i.e. to address rising inflation and fiscal deficit, withdrawal of stimulus package and simultaneously to provide enough money to boost growth, and to give impetus to economy. In the current fiscal year, there was a significant improvement in the economy after a slowdown in the second half of 2008-09 following the financial crisis that began in the industrialised nations in 2007 and eventually spread to economy across the world. The growth rate in the last two quarters of the year 2008-09 has come down to 6 per cent. There were apprehensions that this trend would persist for some more time. The policymakers had taken a calculated risk in providing substantial stimulus packages to counter the negative fallout of the slowdown resulting in increased fiscal deficit. The fiscal deficit for the country increased to 5.9

per cent of the GDP in year 2008-09 and went up to 6.8 per cent in the year 2009-10 as against 2.6 per cent in 2007-08. The recession continued in the developing nations during 2009-10. However, the Indian economy posted a remarkable recovery in terms of overall growth evident from the figures of tax collections that justify the optimism shown by the Finance Minister in 2010-11 budget.

The total tax collections for the year 2009-10 are expected to be Rs. 6,33,095 crore as against Rs. 6,05,298 crore in the year 2008-09 and Rs. 5,93,147 crore for the year 2007-08. The increase in tax collections on account of direct taxes is far more impressive as compared to indirect taxes. The total direct tax collections during the year 2009-10 are expected to increase to Rs. 3,86,497 crore from Rs. 3,33,960 crore in the year 2008-09, whereas indirect tax collections are expected to decrease to Rs. 2,46,598 crore as against Rs. 2,71,338 crore in the year 2008-09. However, the indirect tax collections are projected to be Rs. 3,17,254 crore for the year 2010-11, an increase of 29 per cent on the indirect tax collections for the year 2009-10, because of the partial withdrawal of the stimulus package. The direct tax collections are projected to be Rs. 4,29,397 crore for the year 2010-11, an increase of just 11 per cent on the direct tax collections estimated for 2009-10, mainly because of the relief given to individual taxpayers by the restructuring of tax slabs. An interesting aspect of the direct tax collections are that there is a substantial increase over the period in the income tax collected from corporations. While non-corporate income tax collection has remained almost static, the corporate tax, within a period of three years, has increased by 56 per cent from Rs. 1,92,911 crore to Rs. 3,01,331 crore. On the other hand, income tax from non-corporations has increased just by 17 per cent from Rs. 1,02,644 crore to Rs. 1,20,566 crore and, for the year 2010-11, it is even estimated to be around 4 per cent less than estimated for the year 2009-10 as can be seen from Table A:

**Table A:**  
(Rs. in crore)

Year	2007-08	2008-09	2009-10	2010-11
Corporations	Rs. 1,92,911	Rs. 2,13,395	Rs. 2,55,076	Rs. 3,01,331
Non-corporations	Rs. 1,02,644	Rs. 1,06,046	Rs. 1,25,021	Rs. 1,20,566

Another noticeable feature of the direct tax collection from corporations is that 77.68 per cent of it is paid just by 1,261 big companies and another

9.14 per cent is paid by 2,907 companies, which meant that out of more than nine lakh companies registered under the Companies Act, 1956, only 4,168 companies contributed about 87 per cent of the corporate tax. Out of the total 3,66,233 companies which filed the return electronically for 2009-10 till December 31, 2009, 1,32,356 companies reported loss and 24,529 companies reported zero income, while 1,88,584 companies reported income less than Rs. 1 crore. Table B gives an analysis of the percentage of share of corporate income tax of different levels of companies for the assessment year 2009-10:

**Table B:**  
Analysis of Tax paid by Corporates Assessment Year 2009-10

Profit Before Taxes	Number of Companies	Share in Total Corporate Income Tax Payable
Less than Zero	1,32,356	0.36 %
Zero	24,529	1.39 %
Rs. 0-1 crore	1,88,584	3.56 %
Rs. 1-10 crore	16,596	7.87 %
Rs. 10-50 crore	2,907	9.14 %
Rs. 50-100 crore	531	5.37 %
Rs. 100-500 crore	551	16.60 %
Greater than Rs. 500 crore	179	55.71 %
All Companies	3,66,233	67.17 %

The above analysis shows that corporate tax collection is heavily dependent on a very few large corporations and that a substantial number of corporations are still not contributing much to the revenue. A similar analysis of firms can also provide interesting results. However, data on firms is not in the public domain.

On the front of direct taxes, the Finance Bill has 56 Clauses providing amendments to the various provisions of the Income-tax Act and the Wealth-tax Act. The focus of these amendments is to lower the tax burden on individual tax payers, widening the scope of small-business enterprises, to reduce compliance burden, to encourage research & development by enhancing benefit, to streamline some of the provisions relating to tax deducted at source, and to provide funds for the infrastructure development by allowing the additional benefit.

A welcome change in the current Finance Bill is to remove the anomalies and discrimination against the tax payers by amending certain provisions of the Income-tax Act retrospectively which were not only harsh, but inequitable as well. This Bill makes an attempt to address a few of these amendments

carried out in the past and one can hope that in the coming years some other harsh and inequitable provisions introduced in the past will also get addressed, so that compliance becomes much easier and punitive action is commensurate with the nature of the default.

The various amendments proposed in the Bill are analyzed below. Unless otherwise stated, all these amendments are proposed to be effective from April 1, 2011, i.e., assessment year 2011-12, relevant to the income earned in the financial year 2010-11.

#### A. Tax Rates

##### 1. Tax Slabs Restructured :

The Finance Bill in a bold move has restructured the tax slabs applicable individuals, HUFs, association of persons, body of individuals and artificial juridical persons. Though there is no change in the threshold limit of Rs. 1,60,000, the slab has been widened to lower the tax incidence. The new tax rates are:

Upto Rs. 1,60,000	NIL
Rs. 1,60,001 - Rs. 5,00,000	10%
Rs. 5,00,001 - Rs. 8,00,000	20%
Above Rs. 8,00,000	30%

The threshold limit for woman residents in India will continue to be Rs. 1,90,000 and that for a resident senior citizen shall continue to be Rs. 2,40,000. No surcharge is applicable as the same had been abolished last year. However, educational cess and higher education cess @ 2 per cent and 1 per cent respectively shall be payable. The above restructuring has given a substantial benefit to tax payers having income above Rs. 3,00,000. An idea of the benefit can be had from the following table:

**Table C:**

Income	Tax * payable as per the existing provision	Tax* Payable as per the proposed provision	Benefit*
Rs. 1,60,000	Nil	Nil	Nil
Rs. 3,00,000	Rs. 14,420	Rs. 14,420	Nil
Rs. 5,00,000	Rs. 55,620	Rs. 35,020	Rs. 20,600
Rs. 8,00,000	Rs. 1,48,320	Rs. 96,820	Rs. 51,500

\*includes educational cess

2. The Finance Bill, besides restructuring the tax slabs has also introduced another provision allowing deductions up to Rs. 20,000 on investments in long-term infrastructure bonds. This deduction shall be in addition to the existing

deduction of Rs. 1,00,000 allowed under section 80C of the Income Tax Act in respect of Life Insurance Premium, contribution to Provident Fund, etc., and Rs. 15,000 allowed under section 80D in respect of health insurance premium. Combined with the above deduction and the deduction in respect of interest on the housing loan of Rs. 1,50,000, there will be no tax liability on income up to Rs. 4,45,000 in case of individuals, Rs. 4,75,000 in case of resident women and Rs. 5,30,000 in case of resident senior citizens. The average tax liability up to an income of Rs. 10,00,000 shall now be less than 8 per cent as against 12.82 per cent at present as can be seen from the table:

**Table D:**

Income	Proposed Tax Liability	Existing Tax Liability
Income	Rs. 10,00,000	Rs. 10,00,000
Deductions*		
80C	Rs. 1,00,000	Rs. 1,00,000
80D	Rs. 15,000	Rs. 15,000
80CCF	Rs. 20,000	--
Interest on Housing Loans	Rs. 1,50,000	Rs. 1,50,000
Total Deductions	Rs. 2,85,000	Rs. 2,65,000
Taxable Income	Rs. 7,15,000	Rs. 7,35,000
Tax thereon (including cess)	Rs. 79,310	Rs. 1,28,235
Average Tax on income of Rs. 10,00,000	7.93%	12.82%

(\* The above deductions are available to all tax payers and does not include higher exemption limit for women/senior citizens and specific deductions available under various other provisions of the Act such as interest on loan for higher education under the Section 80E, donation to charitable trusts under the Section 80G, rent paid for housing accommodation under the Section 80GG, donation for research under the Section 80GGA, etc.

The above comparison further reveals that there is around 40 per cent reduction in the tax liability on an income of Rs. 10 lakh from Rs. 1,28,235 to Rs. 79,310.

##### 3. MAT Rate Raised from 15 per cent to 18 per cent

The Finance Bill proposes to enhance the minimum alternate tax (MAT) rate from 15 per cent to 18 per cent. The increase in MAT is in continuation for the second year, as the Finance (No.2) Bill, 2009 had increased the rate from 10 to 15 per cent. Thus within a period of two years, there is a substantial increase of 8 per cent, i.e. from 10 to 18 per cent. With the rationalization of the rates of depreciation under the Income-tax Act with that of the Companies Act the difference on account of depreciation in the book profits and the taxable income is not much. However, companies enjoying exemption under the various provisions of the Income Tax Act will now be required to pay tax on exempted income @ 18

per cent as against 30 per cent otherwise payable had the income not being exempt. This increase in the MAT rate is an indication of the intention of the government to withdraw the exemptions presently available, which will affect all companies claiming exemption in respect of income from free trade zone, software technology park under the Section 10A and export-oriented unit under the Section 10B of the Act for which the assessment year 2011-12 is the last year for claiming exemption. Similar will be the case of the companies claiming deduction in respect of income from infrastructure facilities, telecom, power generation, etc., under the Section 80-IA; companies claiming deduction in respect of income from multiplex theatres, convention centres, housing projects, hospitals, etc., under the Section 80-IB; companies claiming exemption in respect of undertakings in Himachal Pradesh and Uttarakhand under the Section 80-IC; and companies claiming exemption in respect of undertakings in north-eastern States under the Section 80-IE of the Act. However, these companies in the subsequent year will be eligible to take credit of the MAT paid in earlier years. Thus in a way MAT is not an additional tax but an advance tax paid for subsequent years. No MAT is payable in respect of the income from special economic zone (SEZ) exempt under the Section 10AA of the Act.

An interesting feature of the liability under the MAT is in respect of long-term capital gain on non-STT (Securities Transactions Tax) paid equity shares. Such long-term capital gains without any indexation benefit will be liable for the MAT at the rate of 18 per cent as against 20 per cent applicable after indexation in respect of non-STT paid long-term capital gain. Thus, the MAT liability can be more than the normal tax liability in case such company does not have the possibility of claiming credit of the MAT in future. The net effect of this is not only double taxation by way of STT and MAT but MAT rate goes beyond the normal tax rate. Similar will be the case in respect of short-term capital gain arising on STT paid equity shares where normal tax rate applicable is 15 per cent under the section 111A of the Act. Thus, this increase in the MAT rate will make the provision of the Section 10(38) exempting long-term capital gain in respect of the STT-paid shares, the Section 48 allowing indexed cost of acquisition consequent to cost-inflation index, the Section 111A taxing short-term capital gain on the STT paid shares at the rate of 15 per cent and the Section 112 taxing long-term capital gain after indexation at the rate of 20 per cent virtually redundant in the case of a company which

does not have other income chargeable to tax.

#### **4. Rate of Surcharge Reduced from 10 per cent to 7.5 per cent**

The Finance Minister, keeping his commitment to gradually withdraw the surcharge has reduced the surcharge from 10 to 7.5 per cent applicable to domestic companies if its total income exceeds Rs. 1 crore. The surcharge applicable to companies other than domestic ones shall continue to be 2.5 per cent. No surcharge is payable by any other entity i.e. individuals, HUFs, firms, etc. This reduction in surcharge will bring down the tax rate applicable to companies on its taxable income as well as dividend distribution tax payable besides reducing the effective increase in the MAT rate as seen in the Table E:

**Table E:**  
**(In per cent)**

Particulars	Normal Tax Rate	Dividend Distribution Tax	Minimum Alternate Tax Rate
Existing Rate	30	15	15.00
Existing Surcharge @ 10%	3	1.5	1.500
Existing Effective Rate	33	16.5	16.5
New Normal rate	30	15	18.00
Proposed Surcharge @ 7.5%	2.25	1.125	1.35
Proposed Effective Rate	32.25	16.125	19.35
Savings/increase	(-) 0.75	(-) 0.375	(+) 2.85

Thus all corporates liable to pay normal tax (other than those liable to pay MAT) will be benefited first by 0.75 per cent in tax on its regular income and further 0.375 per cent while distributing dividend, whereas corporates liable to pay MAT will have to pay higher MAT by 2.85 per cent whereas the benefit will be of 0.375 per cent while paying dividend distribution tax.

Reduction in surcharge from 10 to 7.5 per cent will not have any impact on corporates whose income does not exceed Rs.1 crore as surcharge is not applicable to such companies.

#### **B. Deductions**

##### **1. Investment in Long-term Infrastructure Bonds**

The Finance Bill proposes to provide an additional deduction to individuals and HUFs to the extent of Rs. 20,000 in respect of investment made in the long-term infrastructure bonds by inserting a new

Section 80CCF. This deduction will be in addition to the existing deduction of Rs. 1 lakh available under the Section 80C of the Act in respect of life insurance premiums, contribution to provident fund, etc.

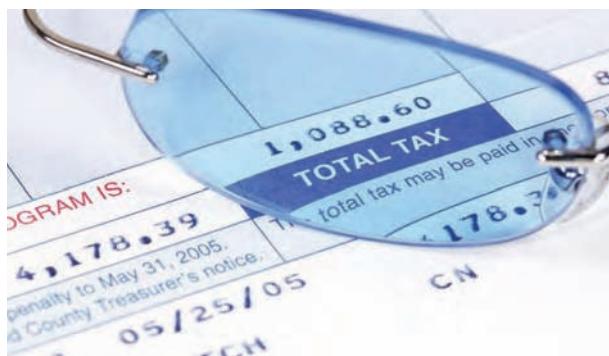
## **2. Contribution to CGHS Schemes to be Eligible under Section 80D**

The Bill proposes to include the amount contributed by serving and retired government servants to the Central Government Health Schemes (CGHS) as eligible deduction under the Section 80D which allows deduction in respect of premium paid towards a health insurance policy up to Rs. 15,000 and enhanced deduction of Rs. 20,000 in case of senior citizens. It may be clarified that this is not an additional deduction but will be part of the deduction presently available under the Section 80D in respect of health insurance premium.

## **C. Charitable Trusts/Institutions**

### **1. Receipt of Commercial Nature up to Rs. 10 lakh not to Affect 'Charitable Purpose'**

The Bill proposes to address the hardship cause by the amendments made by the Finance Act, 2008 in the definition of 'charitable purpose' under the Section 2(15) of the Act whereby an absolute restriction was



**The Bill proposes to increase the limit of turnover or gross receipts of small business covered by the presumptive taxation under the Section 44AD of the Act. The Finance (No.2) Act, 2009 had introduced the Section 44AD whereby 8 per cent of the total turnover of the gross receipts of the business shall be deemed to be the income of such business chargeable to tax. The scheme was applicable to business whose total turnover or gross receipts do not exceed Rs. 40 lakh.**

placed in respect of receipts if it involves carrying on of any act in the nature of trade/commerce or business or any act of rendering any service for a cess, or, a fee, or, any other consideration. This has caused a lot of hardship to all NGOs that provide valuable services to society. It has been proposed that such an organization shall still be within the definition of 'charitable purpose' if the total receipts of such nature do not exceed Rs. 10 lakh in a year. Thus, there is a partial relief. It may be noted that the moment the receipt of such nature exceeds Rs. 10 lakh, the institution shall not be covered within the definition of the charitable purpose and the whole of the income will become liable for taxation and the benefit of the Sections 11 and 12 will not be available. Further, it may be noted that this restriction of rendering services for a fee is not applicable in respect of relief of poor, education, medical relief, preservation of environment, monuments, places or objects of artistic/historic importance. The restriction is applicable in respect of the objective of 'any other object of general public utility'. This amendment is proposed to be retrospective from the assessment year 2009-10, i.e. from the year when restriction was introduced.

### **2. Commissioner can Cancel Old Registration Granted under Section 12A.**

The Bill proposes to amend the lacuna left out by the Finance (No.2) Act, 2004 whereby power was given to the commissioner to cancel the registration granted to any charitable trust/institution under the Section 12AA of the Act. The said amendment did not cover such registration granted under the old provision of the Section 12A of the Act.

Now it is proposed that the commissioner shall have the power to cancel the registration granted under the old Section 12A as well, in case he is satisfied that the activities of such trusts/institutions are not genuine or, are not being carried out in accordance with the objects of trust or institution.

## **D. Salaries and Income from House Property – No Change Except Saral Form**

The Bill proposes no amendment in respect of any provision relating to income under the head 'Salaries' and 'Income from House Property'. However, the Finance Minister has promised to come out with the Saral-II form to simplify filing of the return by salaried tax payers.

## **E. Business Income**

### **1. No Disallowance if TDS Paid before the Due Date of Filing Return**

The Finance Bill proposes to remove the hardship arising consequent to the provision of the Section 40a(ia) whereby the entire expenditure incurred in respect of interest, commission, brokerage, rent, royalty, fee paid for professional or technical services, payment to contractor or subcontractor is disallowed, in case TDS has not been deducted or after deduction has not been paid. As per the proposed amendment the disallowance can be made only when the same has not been paid before the due date of filing the return. Thus, this amendment partially addresses the undue hardship of the provision. As per this provision, the entire expenditure gets disallowed and is added to the taxable income resulting in the same getting taxed at the rate of 30 per cent, as against failure to deduct tax at the rate of 1 or 10 per cent as the case may be. Though the proviso provides for deduction of such expenditure in the subsequent year in which TDS is paid, this does not mitigate the hardship of huge tax demand in one year and heavy losses in subsequent year consequent to disallowance of expenditure in the year in which it is incurred and being allowed in the subsequent year. The assessee may not be in a position to pay such huge demand of taxes in the year in which it gets disallowed. Further, this punitive provision is too harsh. For a default of TDS at the rate of 1 to 10 per cent, the assessee is made liable to pay tax up to 30 times of the default amount. Ideally there should be no such disallowance as there are enough mechanism available under the Section 201(1), 201(1A) to recover such amount along with interest, to levy penalty for default under the Section 271C and to prosecute in case the person fails to pay tax after deduction, under the Section 276B of the Act. Even if this provision is to be retained, it will be advisable to allow rectification under the Section 155 of the Act of the original assessment as and when the tax is paid rather than allowing deduction in the subsequent year. The TDS provisions are quiet complex and many a times because of dispute on interpretation there is every possibility that the same may not have been paid before the due date of filing of return.

Further, the proviso makes it incumbent that the tax has to be deducted and paid in case claim of expenditure is to be allowed in the subsequent year. Under the existing TDS provisions, there is no mechanism available to the deductee of claiming credit of such taxes paid once he has filed a return. The existing provision of the Section 155(14) read with Explanation (c) to the Section 139(9) provides for rectification only in those cases where claim for

**The Finance Bill, besides restructuring the tax slabs, has also introduced another provision allowing deductions up to Rs. 20,000 on investments in long-term infrastructure bonds. This deduction shall be in addition to the existing deduction of Rs. 1,00,000 allowed under the Section 80C of the Income-tax Act in respect of life insurance premium, contribution to provident fund, etc., and Rs. 15,000 allowed under the Section 80D in respect of health insurance premium.**



TDS has been made in the return and a certificate is not enclosed with the return. It does not provide for those cases where TDS has not been deducted and accordingly not claimed by the deductee in the return but later on the same is deducted and paid by the deductor to claim the expenditure in terms of proviso to the Section 40a(ia). Accordingly, there is a need to amend the Section 155(14) to allow rectification where TDS is later on deducted and paid by the deductor.

This amendment is proposed to be effective retrospectively from April 1, 2010. But, still there can be a dispute on interpretation as to whether the amendment is clarifying in nature and hence applicable retrospectively from the date when the Clause (ia) was introduced as the case of similar amendment in the Section 43B of the Act.

## 2. Limit of Turnover for Presumptive Taxation Increased for Small Business

The Bill proposes to increase the limit of turnover or gross receipts of small business covered by the presumptive taxation under the Section 44AD of the Act. The Finance (No.2) Act, 2009 had introduced the Section 44AD whereby 8 per cent of the total turnover of the gross receipts of the business shall be deemed to be the income of such business chargeable to tax.

The scheme was applicable to only such business whose total turnover or gross receipts do not exceed Rs. 40 lakh. The present Finance Bill proposes to increase the same to Rs. 60 lakh. Such persons are not required to maintain the accounts and get audit under the Section 44AB of the Act. Sixty lakh turnover per annum means a turnover of Rs. 20,000 per day considering 300 working days in a year and the total tax liability on gross total income of Rs. 4,80,000 in case of an individual after claiming deduction of Rs. 1 lakh under the Section 80C and Rs. 20,000 under the newly-introduced Section 80CCF will be just Rs. 20,600 on taxable income of Rs. 3,60,000, i.e. 0.33 per cent of the turnover. This proviso is also applicable to a firm and the firm can claim deduction on account of interest and remuneration to the partners against the presumptive income of 8 per cent of the turnover.

### **3. Tax Audit Limit Increased**

The Finance Bill proposes to increase the limit to get the accounts audited from Rs. 40 lakh to Rs. 60 lakh in case of a business and from Rs. 10 lakh to Rs. 15 lakh in case of a profession.

### **4. Special Economic Zones (SEZs)**

The Bill now proposes to remove the anomaly in computation of the eligible income of SEZ. Section 10AA was introduced by the SEZ Act, 2005 providing exemption in respect of income of a unit in SEZ. However, while prescribing the formula for the computation of the eligible income there was a drafting error whereby the eligible income of eligible undertaking was to be apportioned in the ratio of export turnover to the total turnover of the 'assessee' instead of the total turnover of the eligible 'undertaking'. The Finance (No.2) Bill, 2009 had removed this anomaly prospectively, i.e. from the assessment year 2010-11 only. The current Bill proposes to remove this anomaly retrospectively by making the amendment effective from the assessment year 2006-07.

### **5. Incentive for New Hotels of Two-star Category and Above**

The scope of the Section 35AD that was introduced last year in respect of the setting up and operating of a cold chain facility, a warehousing facility for storage of agricultural product and laying and operating cross country natural gas or crude oil pipe line network is being widened to allow investment-linked tax incentives to new hotels of two-star category and above anywhere in India. Benefit will be available to the business of building and operating a new hotel of two-star category and above that starts functioning after April 1, 2010. As

per the provision of the Section 35AD, the whole of the capital expenditure other than that incurred on land, goodwill and financial instruments is allowed as deduction in the year in which the business is commenced. However, this provision may not be so much beneficial except in the cases where eligible business is in position to earn substantial profits in the initial years of its operation. There is a restriction under the Section 73A of the Act in respect of such eligible business whereby loss computed in such business can not be set off against any other business and the same can be carried forward and set off against income of such eligible business only. In the case of a new business normally there is no substantial profit in the initial years to take the benefit of entire capital expenditure. The capital expenditure allowed under this section otherwise can be claimed as depreciation over a period of years. A capital expenditure whether allowed to be claimed in the first year or over a period of years by way of depreciation does not provide any additional advantage to the tax payer.

### **6. Enhanced Benefit for Research & Development**

Presently under the Section 35(1) Clause (i), deduction is allowed in respect of expenditure (other than capital expenditure) incurred on scientific research related to the business. Further under the Clause (ii) a weighted deduction of 125 per cent is allowed on any amount paid to scientific research associations and a weighted deduction of 125 per cent is allowed under the Clause (iii) in respect of the amount paid to any approved university, college or other institution to be used for research in social science and statistical science. Under the Section 35(2AA) amount paid to a National Laboratory, a University, or, to an IIT, to be used for approved scientific research is eligible for weighted deduction of 125 per cent. Under the Section 35(2AB), a company engaged in the business of manufacturing or production of any article or thing including biotechnology is eligible to claim weighted deduction of 150 per cent of the expenditure (including capital expenditure other than cost of land or building) incurred on approved in-house scientific research. The Finance Bill proposes to widen the scope of the research so as to include social sciences or statistical research by deleting the word 'scientific'. Further, according to the weighted deduction in respect of the Clause (ii), the amount paid to any research association is proposed to be increased from 125 to 175 per cent. Similarly in respect of amount paid to a National Laboratory, an IIT, etc., under the Section 35(2AA), the weighted deduction is

proposed to be increased from 125 to 175 per cent, and the weighted deduction in respect of in-house approved research under the Section 35(2AB) is proposed to be increased from 150 to 200 per cent. Further, the scope of the Section 10(21) is also being widened by deleting the words 'scientific' so as to include within its scope 'social science and statistical research'. With the proposed amendment, income of a research association, if approved under the Section 35(I)(ii) including that of social science and statistical research shall be exempt and the person who contributes to such association shall be eligible to claim weighted deduction of 175 per cent.

The proposed amendment can go a long way in giving boost to research activities. Now tax payers can promote research by way of contribution to research association whereby persons having common interest in a particular area can form a research association and contribute money to such a research association. On the amount so contributed each of the contributor can claim weighted deduction of 175 per cent and income of such a research association will be exempt under the Section 10(21). Alternatively, a company engaged in the business of manufacturing can carry on an in-house research and claim weighted deduction of 200 per cent in respect of the expenditure incurred on in-house research. This way the effective expenditure shall be just 35 per cent and almost 65 per cent contribution towards such expenditure shall be that on the government account as can be seen in the following example:

**Table F:**

Particulars	Company not carrying on in-house research	Company carrying on approved in-house research	Company contributing to approved research association
Income	Rs. 10,00,00,000	Rs. 10,00,00,000	Rs. 10,00,00,000
Expenditure on research including capital expenditure other than on land or building	Nil	Rs. 1,00,00,000	Rs. 1,00,00,000
Taxable Income after	33	16.5	16.5
Weighted deduction @ 200% and 175%	Rs. 10,00,00,000	Rs. 8,00,00,000	Rs. 8,25,00,000
Tax Payable	Rs. 3,22,50,000	Rs. 2,58,00,000	Rs. 2,66,06,250
Net funds available 1-(2+4)	Rs. 6,77,50,000	Rs. 6,42,00,000	Rs. 6,33,93,750

Thus with an additional amount of just Rs. 35,50,000, the company can have the benefit of in-house research expenditure of Rs. 1 crore which may include capital assets other than land and building to be owned and enjoyed by the company.

Corresponding amendment is being proposed in

the Section 80CGA of the Act which allows deduction to all taxpayers not even carrying on business in respect of donation for scientific research or rural development by deleting the words 'scientific' so as to include 'social science and statistical research'. Thus, the amount contributed to a research association which has research in social science and statistical research as its objects shall also be eligible for deduction.

#### 7. Extension of Time for Starting Hotel and Convention Centre for Commonwealth Games

The time for starting hotel and convention centre for the Commonwealth Games in the NCR (national capital region) for claiming exemption under the Section 80-ID is being extended from 31.03.2010 to 31.07.2010. This extension is being given in view of non-completion of hotels and convention centres in the NCR for the Commonwealth Games.

#### F. Capital Gain

##### 1. Conversion of a Private or Unlisted Public Company into an LLP not to Attract Capital Gain Tax

The Finance Bill proposes to exempt conversion of a private company or an unlisted public company into an LLP from the levy of capital gain tax to exclude such transfer from the definition of transfer by inserting the Clause (xiib) to the Section 47 of the Act. As per this amendment any transfer of capital asset or intangible asset by a private company or an unlisted public company, as a result of conversion of a company into an LLP as per the provision of the Sections 56 and 57 of the LLP Act, shall not be regarded as 'transfer' liable for capital gain, provided the following conditions are fulfilled:

- (i) total sales, turnover, or, gross receipts in business of the company do not exceed Rs. 60 lakh in any of the preceding previous years;
- (ii) shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company;
- (iii) no consideration other than share in profit and capital contribution in the LLP arises to partners;
- (iv) erstwhile shareholders of the company continue to be entitled to receive at least 50 per cent of the profits of the LLP for a period of five years from the date of conversion;
- (v) all assets and liabilities of the company become the assets and liabilities of the LLP; and
- (vi) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of three years from the date of conversion.

In case the above conditions are not complied with, the benefit availed of by the company shall be deemed to be the profits and gains of the successor LLP chargeable to tax for the previous year in which the requirements are not complied with. The LLP shall be eligible to carry forward and set off business loss and unabsorbed depreciation of the company. The depreciation allowed in the year of conversion shall be apportioned between the predecessor company and the LLP in the ratio of the number of days. The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company as on the date of conversion.

The cost of acquisition of the capital asset for the successor LLP shall be deemed to be the cost which the predecessor company incurred for acquiring it. The period for which such asset is held by the previous owner, i.e., the company, shall be included for determining whether the asset is a short-term capital asset or a long-term capital asset in terms of the Section 2(42A).

Credit under the Section 115JAA in respect of the MAT paid by a company shall not be allowed to the successor LLP. However, the successor LLP shall be eligible to claim amortization of expenditure incurred under the VRS (voluntary retirement scheme) by the company for the remaining period in terms of the Section 35DDA.

An idea of how much benefit this conversion can provide can be had by making comparison of tax implications on a company and on an LLP. Under the existing provision, a company is liable to pay regular tax and MAT on book profits if the regular tax is less than that MAT and also pay Dividend Distribution Tax while distributing profit to the shareholders. In addition thereto, there is a restriction on payment of any money or advance to shareholders which is considered to be deemed dividend under the Section 2(22)(e) of the Act. As against this LLP is recognized under the Income-tax Act as a firm and it is neither liable for MAT nor for dividend distribution tax. Neither provision of the Section 2(22)(e) is applicable except for three years on conversion as stipulated in the conditions. The LLP can also pay interest on the amount of capital of the partner but the restriction is regarding the rate of interest at 12 per cent under the Section 40(b)(iv). The company cannot pay interest on capital. However, there is no restriction on the rate of interest but in view of the Section 40A(2)(b), the rate of interest paid to shareholders /directors in case of company has to be commensurate with the fair-market value.

The remuneration paid to directors subject to the Section 40A(2)(b) is fully allowable, whereas in case of an LLP, the remuneration to partners is governed by the Section 40(b)(v) whereby remuneration to partner on the first Rs. 3 lakh of book profit cannot be more than 90 per cent of book profit and on the remaining profit cannot be more than 60 per cent of book profit.

Thus in the overall analysis for a profit making company, it may be more suitable to have an LLP which has all the advantages so far as liability and corporate status are concerned and also minimal restrictions, applicability of the MAT, Dividend Distribution Tax and deemed dividend. Thus the proposed amendment of allowing conversion of a company into an LLP may help in case the company wants to get converted to an LLP. Under the proposed amendment, even the accumulated profits of a company will not be subject to Dividend Distribution Tax in case the stipulation stated therein of three years not to pay the amount to partner is complied with.

The Finance Bill, however, has put a condition allowing only those companies whose turnover or gross receipts in business are not more than Rs. 60 lakh in any of the three preceding years. As such companies carrying on business and having turnover beyond this limit will not be able to get the benefit. But those companies which are investment companies or which have income from house property, capital gains and income from other sources irrespective of the amount of such income can take the advantage of conversion. Companies in business need to plan for three years so as to bring the turnover below Rs. 60 lakh before it can take advantage of this newly-introduced provision. It may be noted that MAT paid by a company will not be eligible for credit. Further, one needs to be cautious about the penal provision in the LLP Act for various defaults such as not filing documents in time, etc., which are quite harsh.

## G. Income from Other Sources

### 1. Acquisition of Shares by Company or Firm at less than Fair-Market Value (FMV) to be Taxed as Income from Other Sources

The Finance (No.2) Act, 2009 had introduced the Section 56(2)(vii) taxing in the hands of individuals or HUFs, where any property such as share and security, jewellery, archaeological collections, drawings, paintings, sculptures or any work of art, is received without consideration or for a consideration less than the aggregate fair-market

value by an amount exceeding Rs. 50,000, the difference as deemed income from other sources of individuals or HUFs. The above amendment was applicable to individuals and HUFs only. The Finance Bill proposes to widen the scope of such income by taxing in the hand of a company or a firm other than widely held companies where shares of a company are received without consideration or for a consideration less than fair-market value by an amount exceeding Rs. 50,000 as deemed income. Thus transfer of shares of a company whether to individuals, HUFs, or, to a company has to be at fair-market value and in case it is less than that, the difference shall be deemed as income from other sources of the receiver. This amendment will be applicable from June 1, 2010, and as such transfer made before this date will be outside the purview of the proposed amendment. Interestingly, this is not applicable to the listed companies that can still buy shares of other companies at a value less than fair-market value.

Further, 'Bullion' has been included within the definition of the term 'property'. A corresponding amendment has been made in the Section 2(24) to include the above income in the definition of income and in the Section 49 to provide that the cost of acquisition in such cases shall be the value which has been taken into account for the purpose of this Section. This amendment shall be effective from June 1, 2010.

### **2. Immovable Property to be Outside the Purview of this Provision**

The Finance Bill proposes to exclude immovable property from the purview of this Section which was included by the Finance (No.2) Act of 2009.

### **3. Only Capital Asset other than Immovable Property to be Covered within the Scope of Section 56(2)(vii)**

Further, the Bill has introduced clarifying amendment to provide that the property which is in the nature of a capital asset of the recipient would only be covered by this provision. Accordingly, any such property, if purchased as stock-in-trade, raw material, or, consumable stores by recipients, shall not be covered by this provision. This clarifying amendment has been introduced retrospectively with effect from October 1, 2009. It may be noted that as per the proposed amendment this restriction of capital asset shall be applicable for individuals and HUFs. The shares purchased by a company even as stock-in-trade will be covered by the proposed Clause (viiia) as no such exclusion has been inserted in this Clause.

### **4. Assessing Officer being Empowered to Refer the Matter to Valuation Officer for Determination of Fair-Market Value**

The scope of the Section 142A empowers the assessing officer to refer the matter to a Valuation Officer where an estimate of the value of any unexplained investment made outside the books of accounts as referred to in the Section 69, or, where an estimate of investment not fully disclosed in the books of accounts as referred in the Section 69B, or where an estimate of value of any unexplained money, bullion, jewellery, or, other valuable articles found with the assessee is to be made so as to include determination of the fair-market value of any property acquired without consideration or at a consideration less than the fair-market value, taxable as 'income from other sources' under the Section 56(2) of the Act. This amendment shall be effective from July 1, 2010.

### **H. Tax Deduction at Source**

#### **1. Threshold Limit for TDS raised**

The Finance Bill proposes to raise the threshold limit applicable for deduction of tax at source under the various heads:

**Table G:**

Section	Nature of Expenditure	Existing threshold limit (Rupees)	Proposed threshold limit (Rupees)	Rate of TDS
194B	Winning from Lottery or Crossword puzzle	5,000	10,000	30%
194BB	Winnings from Horse Race	2,500	5,000	30%
194C	Payment to contractors (for single transaction)	20,000	30,000	1% (if paid individuals or HUFs) 2% (for others)
	(For aggregate of transactions during the year)	50,000	75,000	
194D	Insurance Commission	5,000	20,000	10%
194H	Commission or Brokerage	2,500	5,000	10%
194-I	Rent	1,20,000	1,80,000	2% For plant & machinery 10% for land & building
194-J	Fee for professional or technical services	20,000	30,000	10%

The above amendment shall be effective from July 1, 2010. If the threshold limit has been reached before July 1, 2010, then the existing threshold limit will be applicable, but in case threshold limit has

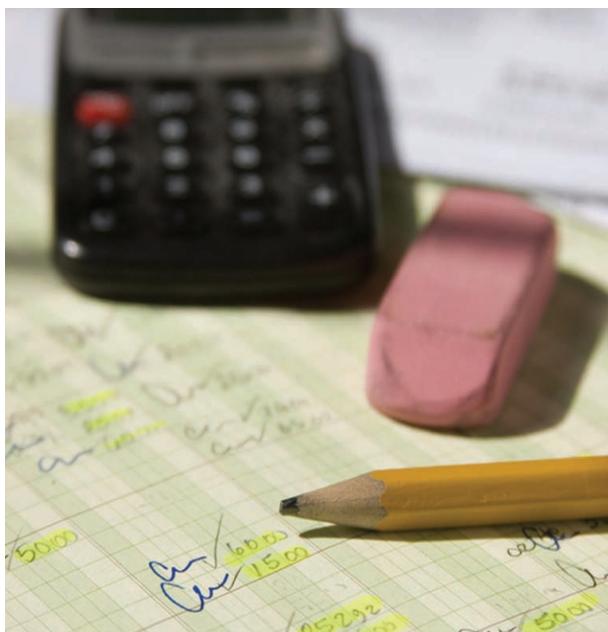
not been reached by July 1, 2010, the new threshold limit will be applicable for determining the liability to deduct TDS.

### **2. TDS Certificate Need to be Issued**

The Finance Bill proposes to delete the Section 203(3) and proviso to the Section 206C (5) whereby it was provided that no TDS or TCS certificate need to be issued on or, after 1.4.2010. With the deletion of these provisions it will be mandatory to issue TDS/TCS certificate and on failure to issue such certificate, penalty under the Section 272A(2) at Rs. 100 for each day of default shall be leviable, subject to the maximum of the amount of TDS/TCS.

### **3. Higher Rate of Interest in case Tax not Paid after Deduction**

The Finance Bill proposes to create a separate



**The Finance (No.2) Act, 2009 had introduced the Section 56(2)(vii) taxing in the hands of individuals or HUFs, where any property such as share and security, jewellery, archaeological collections, drawings, paintings, sculptures or any work of art, is received without consideration or for a consideration less than the aggregate FMV by an amount exceeding Rs. 50,000, the difference as deemed income from other sources of individuals or HUFs.**

class of default in respect of tax deducted but not paid to levy interest at a higher rate of 1.5 per cent per month, i.e. 18 per cent p.a. as against 1 per cent p.m., i.e. 12 per cent p.a., applicable in case the tax is deducted late after the due date. The rationale behind this amendment is that the tax once deducted belongs to the government and the person withholding the same needs to be penalized by charging higher rate of interest.

It may further be noted that the benefit of the proposed amendment under the Section 40a(ia) of making the payment before the due date of filing the return shall be available only in those cases where tax has been deducted during the previous year but paid after the end of the previous year and before the due date of filing the return. Accordingly, all such persons in terms of the Section 201(1A) need to pay a higher rate of interest, i.e. 18 per cent, from the date of deduction of tax till the date it is actually paid before furnishing the statement under the Section 200(3) of the Act.

In case any person claims that tax has been deducted after the end of the previous year and hence a higher interest rate of 18 per cent is not applicable, such a person will not be eligible for the benefit of the proposed amendment to the Section 40a(ia), as this benefit is available only when the tax has been deducted during the previous year itself.

### **I. Penalty**

#### **1. Penalty for Default in Tax Audit Enhanced**

The Finance Bill proposes to amend the provisions of the Section 271B of the Act, raising the amount of maximum penalty leviable from Rs. 1 lakh to Rs. 1,50,000. Accordingly, penalty for default in getting the accounts audited under the Section 44AB shall be  $\frac{1}{2}$  per cent of the total sales turnover or gross receipts subject to maximum of Rs. 1,50,000.

### **J. Non-Resident**

#### **1. Clarificatory Amendment Regarding Income Deemed to Accrue or Arise in India**

The Finance Bill proposes to make a clarificatory amendment retrospectively from June 1, 1976, to provide that income of a non-resident in respect of interest, royalty, or, fee for technical services shall be deemed to accrue or arise in India irrespective of the fact that non-resident has a residence or place of business or business connection in India or non-resident has rendered services in India. The above amendment has been made to overrule the judgement of the Karnataka High Court in the case of *Jindal Thermal Power Company Ltd. Vs DCIT(TDS)*

whereby it was held that income shall be deemed to accrue or arise in India under the Section 9 only when the requirement of rendering of service in India is fulfilled. This was done on the basis of the judgement of the Supreme Court in the case of *Ishikawajima Harima Heavy Industries Ltd. Vs DIT (SC) 288 ITR 408*, where it was held that both the criteria of rendering services in India and utilization of services in India need to be met for applying the deeming fiction of the Section 9(1). The above amendment has been made to ensure the intent of the legislation that the 'situs' of the payer and the 'situs' of the utilization of services determine the taxability of such services and the 'situs' of rendering services is not relevant.

## **2. Income by Way of Fee for Technical Services in Respect of Mineral Oils not Covered by Presumptive Taxation**

The Finance Bill proposes to amend the Section 44BB that provides presumptive computation of income of a non-resident engaged in the business of prospecting or extraction of mineral oil to provide that this section shall not be applicable in respect of income by way of fee for technical services which shall be governed by the Section 44DA of the Act. Such income by way of fee for technical services shall be computed as per the provisions applicable to profits and gains from business or profession.

## **K. Settlement Commission**

### **1. Search Assessments to be Eligible for Settlement**

The Finance Bill proposes to allow filing of application for settlement in the case of a search where assessment proceedings are taken up under the Sections 153A or 153C as the case may be. As per the proposal, such application for settlement can be filed at any time after the issue of notice under the Sections 153A or 153C and before the assessment is completed. However, such application can be filed only when the amount of additional tax payable on the income disclosed in application of settlement exceeds Rs. 50 lakh. Further, in other cases, i.e., where regular assessment is pending before the assessing officer, the amount of additional tax payable is being increased from Rs. 3 lakh to Rs. 10 lakh in case assessee wants to file application for settlement.

The additional tax along with interest has to be deposited before filing the application. Further, the period for passing the final settlement order in respect of an application filed on or after 1.6.2010 is being increased from 12 months to 18 months from the end of the month in which the application is filed.

A corresponding amendment is being proposed in the Wealth-tax Act also.

The above amendment shall be applicable from June 1, 2010, and in cases where search assessment under the Sections 153A or 153C is pending as on June 1, 2010, these persons shall become eligible to file application for settlement before the assessing officer passes the assessment order.

## **L. Miscellaneous**

### **1. High Court to Have Power to Condone Delay in Filing Appeals**

The Finance Bill proposes to amend the Section 260A(2) to empower the High Court to admit an appeal after the expiry of a period of 120 days if it is satisfied that there was a sufficient cause for not filing the appeal in time. This amendment is proposed to be retrospective from October 1, 1998. A similar amendment is being made in the Section 256(2A) to admit a reference beyond the period of six months on being satisfied about the reasons for delay. This amendment is being made retrospectively with effect from June 1, 1981. A corresponding amendment has been proposed in the Wealth-tax Act also.

### **2. Central Processing of Returns**

In view of a delay in setting up the Central Processing Centre the period for setting up of this centre under the Section 143(1B) and under the Section 115WE is being extended from March 31, 2010, to March 31, 2011. This amendment is also being made retrospectively from April 1, 2010.

### **3. Document Identification Number (DIN)**

The Finance (No.2) Act, 2009 had made it mandatory to allot DIN to every document, letter, correspondence, notice received or issued by the department on or after October 1, 2010. This Finance Bill proposes to extend the period in respect of DIN from October 1, 2010, to July 1, 2011, by amending the provisions of the Section 282B of the Act. The extension is being proposed to provide time to develop the infrastructure and facility for the same.

### **4. Taxation of Income of Non-Life Insurance Business**

The Finance Bill proposes to amend the first schedule of the Income-tax Act to undo the amendment made by the Finance (No.2) Act, 2009 which provided that while computing income of non-life insurance business, appreciation in investment taken credit for in the accounts shall be treated as income liable for taxation. Now, it is being proposed that unrealized gains or losses will not be included in the income and the same shall be added or deducted only on the realized investment.



# User-Friendly Proposals in the Union Budget

The year 2009 was a landmark year for Indian taxes. In 2010, the government has introduced the landmark Direct Taxes Code Bill that will affect all, as it will alter the tax we pay and impact our investments, borrowings, and expenses. The biggest impact of the new tax system is the significant widening of income slabs applicable from the financial year 2011-12. However, the Government plans to make most of our allowances taxable, so people earning a lot of allowances will have significantly a higher tax liability. As per the new code, both the short-term and long-term capital gains are treated equally recommending both contribution and return from investments tax-free but maturity proceeds to be taxed, which will affect our stocks and equity mutual funds. The author attempts to analyse some of the proposed amendments in the article.

**CA. T. Banusekar**

(The author is a member of the Institute and he can be reached at [eboard@icai.org](mailto:eboard@icai.org))

The Direct Tax proposals in the Finance Bill, 2010 contain several user-friendly proposals and those to simplify the Act. Some of these proposed amendments have been presented using analysis and discussion:

## Charitable and Religious Trusts

The Finance Act, 2009 had amended the provisions relating to charitable or religious trusts by providing: charitable purposes, though, will include relief to the poor, education and medical relief, will not include any other object to general public utility if it involves any activity in the nature of trade, commerce, business, or, rendering of any service in relation to trade, commerce, or, business, though an object to general

**Under the provisions of the Income-tax Act as they stand presently, the conversion of a company into an LLP has certain tax implications. The transfer of assets on such conversion attracts the levy of capital gains tax.**

public utility will still be a charitable purpose except in the cases mentioned above. It is proposed to amend the definition to provide that if the gross receipts from trade, commerce, or, business/services relating thereto is not in excess of Rs. 10,00,000/-, the exemption would still be available.

Though this amendment will, to some extent, mitigate the hardship caused by the amendment made by the Finance Act, 2009, it may be noticed that the limit of Rs. 10,00,000/- being the gross receipts from trade, commerce, or, business/services relating thereto is not in the form of an exclusion as a threshold, which would effectively mean that this benefit will not be available even if the aggregate receipts from such activities marginally exceeds Rs. 10,00,000/. It may, however, be noticed that even if the gross receipts exceeds Rs. 10,00,000/, it cannot be said that the trust will not be entitled to registration under the Section 12AA, or, to exemption under the Section 11. It is only that the income so derived from carrying on an activity in the nature of trade, commerce, or, business/services in relation thereto in the advancement of objects of general public utility which can be taxed. Further, the taxability or otherwise of such income may vary from year to year depending on whether the gross receipts exceeds Rs. 10,00,000/-, or, otherwise in each year. One will also have to look at how the revenue would interpret the term gross receipts whether on the basis of actual receipts or on the basis of the method of accounting regularly employed by the trust.

One issue which needs clarification will be with reference to the manner in which the accumulated income is to be treated as utilized. The law as it stands presently provides that charitable or religious trusts could apply 85 per cent of their income for charitable or religious purposes in India and in which case the balance 15 per cent can be accumulated and utilized in future years. If, however, the application is less than 85 per cent, the same can be accumulated for specified purposes for up to five years under

intimation to the assessing officer. In case where, say, a trust has accumulated the income for a period of five years, it is possible that in the intervening year or years, the income from the activity of carrying on business as explained earlier may not be eligible for the exemption. If this view is acceptable, there would be no confusion on the application of accumulated income. If, on the other hand, a view is taken that the exemption to the trust should be denied in its entirety if it has income from business as explained earlier, the assessee may have also applied the income which was accumulated in that or those years when the exemption is denied, and in which case there could be a doubt as to the view that is to be taken on the application of accumulated income, as it has been applied in a year when the trust is not otherwise entitled to exemption.

#### **Limited Liability Partnerships (LLP)**

Under the provisions of the Income-tax Act as they stand presently, the conversion of a company into an LLP has certain tax implications. The transfer of assets on such conversion attracts the levy of capital gains tax. Similarly, the carry forward of losses and of unabsorbed depreciation is not available to the successor LLP.

It is proposed that the transfer of assets on conversion of a company into an LLP will not attract capital gains tax subject to satisfying the following conditions:

- a. total sales, turnover or gross receipts in business of the company do not exceed Rs. 60 lakh in any of the three preceding previous years;
- b. shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company;
- c. no consideration other than share in profit and capital contribution in the LLP arises to partners;
- d. the erstwhile shareholders of the company continue to be entitled to receive at least 50 per cent of the profits of the LLP for a period of five years from the date of conversion;
- e. all assets and liabilities of the company become the assets and liabilities of the LLP; and
- f. no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of three years from the date of conversion.

It is also proposed to allow carry forward and set off of business loss and unabsorbed depreciation to the successor LLP, which fulfills the above-mentioned conditions. The proposal permits the

business loss to be set off against any source of income in the year of conversion and to allow carry forward of business loss for a fresh period of eight years. This would mean that in the year of conversion the business loss of the company can be set off against income from any source or head and the balance, if any can be carried forward and set off against the business income of the LLP for eight further years. It will, however, be necessary that the company in the year of loss must have filed the returns within the time allowed under the Section 139(1) and further that in the hands of the company the eight year period should not have elapsed. Unabsorbed depreciation, of course, in any case can be set off against any source or head and can be carried forward indefinitely.

It is also proposed to amend the Section 47A to provide that if the conditions stipulated above are not complied with, the benefit availed by the company shall be deemed to be the profits and gains of the successor LLP chargeable to tax for the previous year in which the requirements are not complied with. It may be noticed that of the conditions stated above while the conditions **a**, **b**, **c** and **e** are one-time conditions, the conditions **d** and **f** are conditions which have to be satisfied in future years. Therefore it can be seen that if the conditions **a**, **b**, **c**, or, **e** are not satisfied, no benefit would be available under the proposed amendments to the LLP and consequently, the Section 47A would not apply. However, if the conditions **d** or **f**, or, both are violated, it is then that the Section 47A would come into play.

It is also proposed that the aggregate depreciation allowable to the predecessor company and the successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. In the year of succession, the depreciation is to be computed as though no such conversion took place and is to be pro-rated between the predecessor company, and the successor LLP based on the date on which the succession took place.

It is further proposed that the actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion. It is also provided that the cost of acquisition of the capital asset for the successor LLP shall be deemed to be the cost for which the predecessor company acquired it.

Credit in respect of the tax paid by a company under the Section 115JB is allowed only to such

company under the Section 115JAA. It is proposed to clarify that the tax credit under the Section 115JAA shall not be allowed to the successor LLP.

A reading of the conditions imposed for providing that capital gains will not be charged makes one understand that what should not be withdrawn by the partners is only the reserves representing accumulated profits transferred from the company and not the capital or the profits after conversion into the LLP. The challenge, however, could be on identifying which of the amounts has been withdrawn by the partners whether the profits of the company or the capital or the subsequent profits of the LLP.

These amendments are proposed to take effect from the assessment year 2011-12.

#### **Sums/Assets Received without Consideration or Inadequate Consideration**

Under the present provisions of the Section 56(2)(vii), any sum of money or any property in kind which is received without the consideration or for inadequate consideration (in excess of the prescribed limit of Rs. 50,000/-) by an individual, or, a Hindu undivided family (HUF) is chargeable to income tax in the hands of recipient under the head 'income from other sources'. However, receipts from relatives or on the occasion of marriage or under a will are outside the scope of this provision.

The existing definition of property for the purposes of the Section 56(2)(vii) includes immovable property, e.g. land or building, or, both, shares and securities, jewellery, archeological collection, drawings, paintings, sculpture or any work of art. Movable property is proposed to include bullion with effect from 01.06.2010.

It is proposed to amend the Section 56 to also include within its ambit transactions undertaken in shares of a company (not being a company in which public are substantially interested) either for inadequate consideration or without consideration where the recipient is a firm, or, a company (not being a company in which public are substantially interested). This will not apply where the transactions are undertaken for business reorganization, amalgamation and demerger which are not regarded as transfer under the Act. There are however situations such as a case where there could be shares received by a firm or company on partition of an HUF, or, other situations where the Section 56 does not make a specific exclusion and these could be areas where there could be doubt

and consequent litigation. Though the amendment is intended to plug the loophole whereby firms and companies were used as conduits to get over the provisions of the Section 56(2)(vii), the amendment could affect genuine transactions particularly where there is foreign participation by an investor. For example, if a foreign company were to invest in the shares of an Indian company at a differential price from the price at which the shares are allotted to the promoter group, it is possible that the promoter group may have the provisions of the Section 56(2) as proposed to be amended applicable and consequently a tax implication. This issue needs to be addressed and resolved for; otherwise it could affect foreign participation in Indian companies.

#### **Amendments are proposed in the:**

- (i) Section 2(24), to include the value of such shares in the definition of income; and
- (ii) Section 49, to provide that the cost of acquisition of such shares will be the value which has been taken into account and has been subjected to tax under the provisions of the Section 56(2).

These amendments are proposed to take effect from 01.06.2010.

It is proposed to amend the Clause (vii) of the Section 56(2) to provide that it would apply only if the immovable property is received without any consideration and to remove the stipulation regarding transactions involving cases of inadequate consideration in respect of immovable property.

These amendments are proposed to take effect retrospectively from October 1, 2009, i.e. even from the date on which the provision first came into force.

#### **Disallowance in respect of Failure to Deduct or Remit Tax at Source**

The existing provisions of the Section 40(a)(ia) of the Income-tax Act provide for the disallowance of expenditure like interest, payment for works contracts, rent, commission, brokerage and fees for professional or technical services and royalty, if tax on such expenditure was not deducted, or, after deduction was not paid during the previous year. However, in case the deduction of tax is made during the last month of the previous year, no disallowance is made if the tax is deposited on or before the due date of filing of return.

It is proposed to amend the said section to provide that no disallowance will be made if after



**It is proposed to amend the Section 56 to also include within its ambit transactions undertaken in shares of a company (not being a company in which public are substantially interested) either for inadequate consideration or without consideration where the recipient is a firm, or, a company (not being a company in which public are substantially interested).**

deduction of tax during the previous year, the same has been paid on or before the due date of filing of return of income specified in the sub-Section (1) of the Section 139.

This amendment, it is stated, is proposed to take effect retrospectively and will apply from the assessment year 2010-11. Though the Bill seeks to make the applicability of the amendment operative only from the assessment year 2010-11, it is possible that a view may be taken that the amendment is effective even from the assessment year 2006-07 that was the year in which the provision came into force. This view is expressed as in similar circumstances when the Section 43B was amended to provide that contributions to an employee welfare fund would be allowed, even if such sums are paid within the due date for filing the return of income as against the due date stipulated in the relevant Act, Rule, Notification, or, Order by the Finance Act, 2003 with effect from the assessment year 2004-05, the Supreme Court held in *CIT v Vinay Cement Ltd [2007] 213 CTR (SC) 268* that the amendment is retrospective in operation and will apply even in relation to the assessment years prior to the assessment year 2004-05.



# Proposals for Change in Conversion to LLP and MAT

**The Finance Bill, 2010 has proposed certain changes in tax provisions concerning conversion of certain companies into limited liability partnerships (LLP) and in the provisions relating to minimum alternate tax (MAT). While the former set of amendments is with a view to lighten tax burden associated with the process of conversion of a company into an LLP, the changes relating to MAT are increasing tax burden. This article analyses these changes.**



**CA. Chandrashekhar V. Chitale**

(The author is a member of the Institute.  
He can be reached at [eboard@icai.org](mailto:eboard@icai.org))

## Conversion into LLP

On the horizon of business matrix, a new star is now sighted. Ease in operations of partnership and armor of limited liability have been provided under a new format of business entity i.e. limited liability partnership (LLP).

For the purpose of taxation, the Income-tax Act, 1961 (the Act) equates an LLP with the partnership firm [Section 2(23)] of the Act. Therefore, no separate tax rate is prescribed for LLPs. Tax rate prescribed for firms of 30 per cent is automatically applicable and similar is in case of the rest of the provisions.

On account of the obvious advantages of an LLP medium for conducting business owned by multiple entities, it will be fancied by many. The new ventures will embrace to this ownership platform. But what about the existing ones, who desire to convert to this new model?

The Finance Bill, 2010 has given some relief for the process of conversion.

Sections 56 and 57 of the Limited Liability Partnership Act, 2008 allow conversion of a private company or an unlisted public company (hereafter referred as company) into an LLP. Under the existing provisions of Income-tax Act, 1961, conversion of a company into an LLP has definite tax implications. Transfer of assets on conversion attracts levy of capital gains tax. Similarly, carry forward of losses, unabsorbed depreciation and certain other allowances is not available to the successor LLP.

It is proposed that the transfer of assets on conversion of a company into an LLP in accordance with the Sections 56 and 57 of the Limited Liability Partnership Act, 2008 shall not be regarded as a transfer for the purposes of capital gains tax under the Section 45. Clause (xiib) is proposed to be inserted in the Section 47 of the Act. However, in order to access and retain this benefit, it is necessary to fulfill and continue to observe certain

**It is proposed to increase the rate of MAT charged under the Section 115JB to 18 per cent from the existing 15 per cent. This amendment increasing rate on MAT is proposed to take effect from 1st April, 2011, and will accordingly apply in relation to the assessment year 2011-12 and the subsequent years.**

conditions. These conditions are as follows:

- (i) The total sales, turnover or gross receipts in business of the company do not exceed Rs. 60 Lakh in any of the three preceding previous years;
- (ii) The shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company;
- (iii) No consideration other than share in profit and capital contribution in the LLP arises to partners;
- (iv) The erstwhile shareholders of the company continue to be entitled to receive at least 50 per cent of the profits of the LLP for a period of five years from the date of conversion;
- (v) All assets and liabilities of the company become the assets and liabilities of the LLP; and
- (vi) No amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of three years from the date of conversion.

It is also proposed to insert a sub-Section (6A) in the Section 72A of the Act, in order to enable carry forward and set-off of business loss and unabsorbed depreciation by the successor LLP which fulfills the above mentioned conditions of the Section 47(xiib) of the Act. Amendments are also proposed in the sub-Section (7) of the Section 47 to the Clause (a) 'accumulated loss' and to the Clause (b) - 'unabsorbed depreciation' to enlarge meaning of these terms so as to include loss and depreciation of a private company or an unlisted public company, which has been converted into an LLP.

Provisions have been proposed for computation of depreciation allowance on conversion of private or unlisted public company into an LLP. Like in the case of amalgamation and demerger of companies, in case of succession of a private company or unlisted public company into an LLP, the total depreciation allowable to the predecessor company and the successor LLP will not exceed the total depreciation that would have been allowed if no succession had taken place. It further provides that in case of such

succession, the amount of depreciation shall be apportioned in the processor and the successor in the ratio of number of days for which assets were used by them.

Section 43(6) of the Act defines 'written down value' of assets for claim of depreciation. The cost of acquisition of capital assets for the successor LLP will be deemed to be the cost for which the predecessor company acquired it.

Section 35DDA allows amortisation of expenditure incurred for payment of compensation of voluntary retirement scheme (VRS) in five equal annual installments from the year of compensation payment. If private company or unlisted public company is succeeded by an LLP fulfilling the conditions laid down in the proviso to the Clause (xiib) of the Section 47, amount of deduction under the Section 35DDA unamortised in the hands of the predecessor company shall be allowed to the successor limited liability partnership. No deduction will be available to the company during the year in which the company is being succeeded by an LLP and the same will be fully allowed to the LLP.

Where the conditions stipulated under the Section 47(xiib) are not met, the benefit availed by the company shall be deemed to be the profits and gains of the successor LLP chargeable to tax for the year in which the aforesaid conditions have not been complied with.

Credit in respect of tax paid by a company under the Section 115JB is allowed only to such company under the Section 115JAA. It is proposed to clarify that the tax credit under the Section 115JAA shall not be allowed to the successor LLP.

These amendments are proposed to take effect from 1st April, 2011, and will accordingly apply in relation to the assessment year 2011-12 and the subsequent years.

In order to avail the benefits stated herein above, turnover of the company for past three years should be within the limit of rupees sixty lacs. This condition will disentitle a number of companies from exemption capital gains tax. Similar condition has not been stipulated for giving concession from capital gains tax on conversion of proprietorship of partnership into a company. Therefore, this condition needs to be omitted.

In case of succession of a company by an LLP, there is no exemption from tax on sale/transfer of any property that is not a capital asset like stock in trade, raw materials, consumable stores and spares, etc. In this context, it needs to be noted that the Supreme Court in case of *ALA Firm v. CIT (189 ITR 285)* has held

that in taking accounts for the purpose of dissolution, since the firm and the partners, being commercial men, would value assets on real basis and not at cost or their other value appearing in the books. Therefore, at the time of dissolution value of closing stock should be taken at market value and not at cost and the difference is income. Similar principles would apply at the time of conversion of a company into an LLP.

Merely by sparing LLPs capital gains tax, one cannot expect wholesale conversion of companies into LLPs, as there are other issues involved, e.g. stamp duty, state taxes, central excise and service tax, IEC code, bank borrowings, etc. While stamp duty causes substantial outflow, in other matters necessary paper work needs to be done. Under indirect taxes, carry forward on CENVAT or set-off not consumed may not be available.

There is no justification for denying MAT tax credit available in the hands of predecessor company to the LLP. When the entity is same, what changes is the legal form of organization and as such, there is no reason why the tax paid earlier for which the law has promised benefit in later years, be withdrawn.

Therefore, in order to make the exemption meaningful these hurdles need to be addressed by the respective governments.

A partnership firm which converts into an LLP is, expressly, afforded the benefit of allowance of carry forward and set-off of business loss and unabsorbed depreciation to the successor LLP.

However, the other benefits are not made available to the firm. It is, perhaps, because, under the Act, there is no difference between a 'firm' and an 'LLP' and there is no necessity of express provision of concession, as in case of such a conversion status of the entity continues to be 'firm', there is no 'transfer'. And as there is no transfer, the capital gain does not arise.

Taxation on conversion of a firm into an LLP also needs to be expressly clarified, in order to avoid litigation.

The proposed amendments giving concession on conversion of a company into an LLP, are welcome. However, these will be of little utility, unless suggestions made in this article are addressed by the Finance Minister.

**Merely by sparing LLPs capital gains tax, one cannot expect wholesale conversion of companies into LLPs, as there are other issues involved, e.g. stamp duty, state taxes, central excise and service tax, IEC code, bank borrowings, etc. While stamp duty causes substantial outflow, in other matters necessary paper work needs to be done. Under indirect taxes, carry forward on CENVAT or set-off not consumed may not be available.**

### Minimum Alternate Tax

As stated earlier, India, in tax arena, is discredited for constant changes in tax policy. This makes tax payers difficult to make long range planning. If one wants proof of this contention, one can simply look at the provisions relating to, what is commonly referred to as, 'minimum alternate tax' (MAT).

A couple of decades ago, while companies were earning handsome profits and declaring dividends but managing to remain away from the direct tax net, it made tax gatherers unhappy. Not that the companies were resorting to any unlawful practice to achieve 'nil' tax liability. Albeit, the benefits and deductions offered by law were being consumed by such companies, to keep the taxman away.

Therefore, in the year 1987, the concept of 'minimum alternate tax', was slapped on tax efficient corporate. the Section 115J was introduced providing that when there is profit in the books, taxable income shall be minimum thirty percent of the said profit when income normally calculated falls below that limit. The reasoning afforded for enacting this provision was that it is an accepted canon of taxation to levy tax on the basis of ability to pay. However, as a result of various tax concessions and incentives certain companies making huge profits and also declaring substantial dividends, have been managing their affairs in such a way as to avoid payment of income-tax. As a measure of equity, it was contended, the Section 115J was introduced in 1987.

Thereafter, with the turn of the current decade, the thought process changed. The Government then observed that the number of zero tax companies and companies paying marginal tax had grown, MAT was levied under the Section 115J (thereafter under the Section 115JA). However, it felt that efficacy of these provisions has declined in view of the exclusions of various sectors from the operation of MAT and the credit system. The new Section 115JB was brought about. This new provision provides that all companies having book profits under the Companies Act, 1956 shall be liable to pay a minimum alternate tax at a lower rate of 7.5 per cent of book profit if the tax on income computed under the normal provisions falls below that amount.

Section 115JB has been made applicable to all corporate entities without much exception.

Section 115JB commenced innings from the assessment year 2001-02. It was provided that if income tax payable on income of a company is less than 7.5 per cent of its profits as per profit and loss account prepared as per provisions of the company law (called book profit), the company shall be liable to pay as income tax, an amount of 7.5 per cent of book profits.

1. After enactment, the section has been amended on several occasions, the table hereunder appearing, provides the information:

FINANCE ACT	PERIOD	RATE OF MAT
2001	AY 2001-02 TO 2006-07	7.5% of Book Profits
2007	AY 2007-08 TO 2008-10	10% of Book Profits
2009	AY 2010-11	15% of Book Profits
2010	AY 2011-12	18% of Book Profits
*2011	AY 20011-12 onwards	2% of Gross Assets

Thus, it is proposed to increase the rate of MAT charged under the Section 115JB to 18 per cent from the existing 15 per cent. After considering impact of surcharge reduction from 10 per cent to 7.5 per cent for companies having income exceeding rupees one crore, the effective MAT rates are as follows:

Income	Existing		Proposed	
	Domestic	Foreign	Domestic	Foreign
UptoRs. 1 cr	15.45	15.45	18.54	18.54
OverRs. 1 cr	17.00	15.84	19.93	19.00

This amendment increasing rate on MAT is proposed to take effect from 1st April, 2011, and will accordingly apply in relation to the assessment year 2011-12 and the subsequent years.

For increasing the rate of MAT, no reasoning has been offered by the explanatory memorandum. It only states that the amount of tax paid under the Section 115JB is allowed to be carried forward and set off against tax payable up to the tenth assessment year immediately succeeding the assessment year in which tax credit becomes allowable.

Corporate sector is not happy with the hike in rate, which has canvassed abolishing MAT in their pre-budget memorandums.

In order to provide incentive for certain activities, industries capital-based deductions

**It is proposed that the transfer of assets on conversion of a company into an LLP in accordance with the Sections 56 and 57 of the Limited Liability Partnership Act, 2008 shall not be regarded as a transfer for the purposes of capital gains tax under the Section 45. Clause (xiib) is proposed to be inserted in the Section 47 of the Act. However, in order to access and retain this benefit, it is necessary to fulfill and continue to observe certain conditions.**

are being offered. These are available under the Section 35 for scientific research, Section 35AD for investment in cold storage, warehousing, pipeline, two stars and above category hotels (proposed in the Finance Bill, 2010). Deduction is available of the whole of the capital expenditure in the first year of commencement. When huge expenditure is allowed as deduction in the very first year, it can take substantial number of years for such a company to reflect taxable income, whereas profits will be posted early as depreciation is lower under the Company Law. In such case, MAT will wash out the tax advantage of deduction.

Under the Section 115JAA, MAT paid by a company is available as tax credit, to be utilised in the next ten years, against the normal tax liability of the company. An amendment is proposed to deny deduction of any unutilised MAT tax credit with the private or unlisted public company in the hands of an LLP upon conversion.

When amendments are made for carry forward and set off unutilised benefits like carry forward of depreciation, losses, etc; it is not understood why MAT paid by the company cannot be adjusted against tax liability of the LLP.

### Conclusion

Changes proposed in the LLP taxation have some merits, however, a lot of shortcomings remain. Increase in MAT is going to affect corporate sector and availing incentives is becoming a useless exercise. It is hoped that the government takes note of the flip side of the proposed amendments and fine-tunes them.

# Issues on Amendments in Deductions by Finance Bill, 2010



In the Union Budget 2010-11 tabled in the Parliament on 26.02.2010, the Finance Minister has made a number of proposals in the Direct Tax area, some of which are to be implemented with retrospective effect. The Bill also includes certain provisions which are proposed to be made to nullify certain judicial pronouncements. One of the unique features of this year's bill is that it is very short compared to the budgets of the past. It consists of 20 pages (excluding the schedules) and 86 sections, of which 12 pages and 56 sections are devoted to direct tax proposals. It was not so in earlier years, e.g. in the Finance Bill, 2002, there were as many as 112 sections. In this article an analysis is sought to be made of the proposals relating to various deductions including deductions under the Chapter VI-A of the Income-tax Act, 1961 ("the Act").



**CA. Barun Kumar Ghosh**  
*(The author is a member of the Institute.  
He can be reached at [eboard@icai.org](mailto:eboard@icai.org))*

## Rationalisation of Provision Relating to Deduction Available to SEZ Under Section 10AA

Originally when the Section 10AA was introduced by the Special Economic Zones Act, 2005 with effect from 10th February, 2006, sub-Section (7) of the Section provided that "profits derived from export" was to be computed by multiplying the profit of the undertaking situated in the SEZ by proportion of export turnover of the said unit to the total turnover of the business of the assessee. Where the assessee was having one unit in SEZ and another unit in other area, the amount of deduction admissible under the Section 10AA used to get diluted as the total

**Amendments in the provisions relating to depreciation under the Section 32 and amortisation of expenses on voluntary retirement under the Section 35DDA consequent to the proposed introduction of the new provision [Clause (xiib)] relating to conversion of closely-held company into an LLP: A new Explanation 2C is proposed to be inserted to the Clause (6) of the Section 43 to provide that where a private limited company or an unlisted company is converted into an LLP in a previous year, the actual cost of the assets transferred to the LLP shall be the written down value of the block of assets of the predecessor company on the date of conversion.**

turnover of the entire business of the assessee was the denominator in computing the said proportion. There was a lot of representation from the industry for making the said provision to be in line with the Sections 10A and 10B which provide for computation of tax holiday benefit on the basis of proportion export turnover of the eligible unit to the total turnover of the said unit. The Finance (No.2) Act, 2009 amended the provision of the Section 10AA to make it at par with the Sections 10A and 10B. But such amendment was made with effect from assessment year 2010-11 only and not with retrospective effect, which had been expected by the industry. The Finance Bill, 2010 now seeks to meet that expectation by making the change operative from retrospective effect from the assessment year 2006-07. Thus, the assessees having units both in the SEZ and other areas may seek rectification under the Section 154 of the completed assessments for the assessment years 2006-07 and 2007-08 and file revised return for the assessment year 2008-09 (if assessment not yet completed) and the assessment year 2009-10.

Amendments in the provisions relating to depreciation under the Section 32 and amortisation of expenses on voluntary retirement under the Section 35DDA consequent to the proposed introduction of the new provision [Clause (xiib)] relating to conversion of closely-held company into an LLP:

New Clause (xiib) proposed to be inserted in the Section 47 to make conversion of closely-held company into an LLP tax neutral is not the subject matter of this article. However, such conversion has

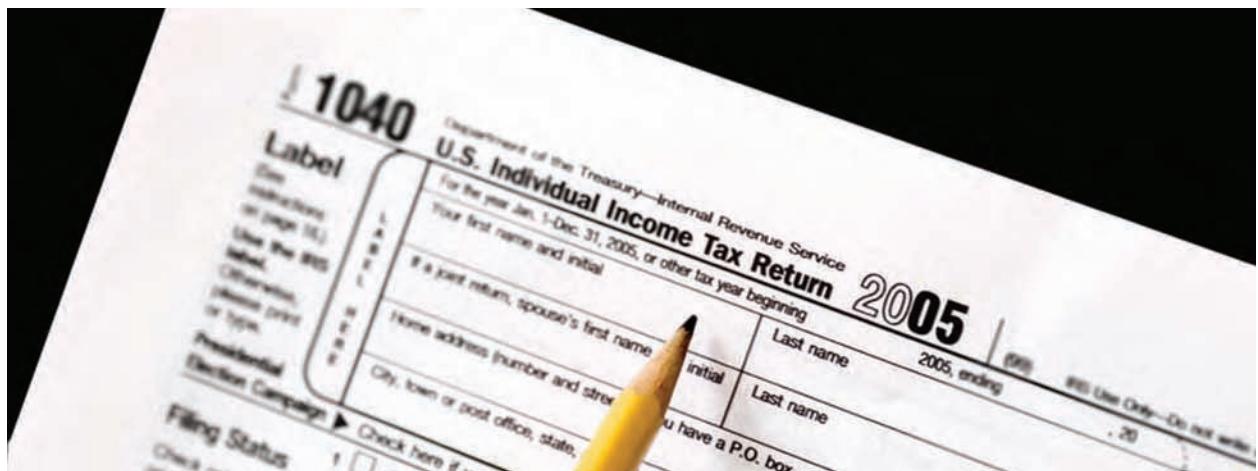


impact on claim for depreciation and claim for amortisation of expenses on voluntary retirement.

The Fifth Proviso to the sub-Section (1) of the Section 32 shall now be changed to provide that the total deduction for depreciation on the assets allowable to the predecessor closely-held company and the successor LLP shall not exceed the deduction calculated at the prescribed rates if such conversion had not taken place. Total depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of number of days such assets for which such assets were used by the two entities.

A new Explanation 2C is proposed to be inserted into the Clause (6) of the Section 43 to provide that where a private limited company or an unlisted company is converted into an LLP in a previous year, the actual cost of the assets transferred to the LLP shall be the written down value of the block of assets of the predecessor company on the date of conversion.

Section 35DDA allows the assessee to claim deduction in respect of expenditure incurred under voluntary retirement scheme over a period of five assessment years commencing from the assessment year corresponding to the previous year in which such expenditure is incurred for computing taxable business income. It may so happen that before expiry of the said-five years, a company is converted into an LLP. The Bill proposes to allow the LLP to claim deduction in respect of the unamortised amount over the remaining period out of the said -five years.



However, the following issues that may arise from such reorganisation have not been addressed in the Finance Bill:

- Under the Section 35D a company claims amortisation of certain preliminary expenses over a period of five years commencing from the year in which the business commences or in case of extension of industrial undertaking or setting up a new unit, the year of completion of extension work or commencement of production or operation of the new unit, as the case may be. Moreover, the claim under the Section 35D can also be made by any non-corporate assessee resident in India. It is possible that a closely-held company is converted into an LLP before expiry of the said-period of five years. But the benefit of unamortised preliminary expenses cannot be claimed by the LLP.
- The benefit of unabsorbed capital expenditure on promotion of family planning among employees as available under the Section 36(1)(ix) to a corporate assessee has not been proposed to be extended to the successor an LLP.
- Under the Section 35(5) of the Act, in case of amalgamation of two companies the unabsorbed capital expenditure on scientific

research of the amalgamating company is allowed to be carried forward and set off by the amalgamated company. There has been no proposal to allow the successor LLP to carry forward and set off capital expenditure on scientific research, which may remain unabsorbed in the hands of the company immediately before conversion.

- In case of conversion of a closely held company into an LLP, there will be an extinguishment of right of the shareholders in the shares of the company, which is a "transfer in relation to a capital asset" within the meaning of the Section 2(47) of the Act. Clauses (vid) and (vii) of the Section 47 make demerger and amalgamation tax neutral also for the shareholders of the demerged company and amalgamating companies. A clarification in this regard will be useful.

The above matters may be considered by the Government before passing the Finance Act, 2010 to make conversion of closely-held company into an LLP more tax neutral.

#### **Incentives for Scientific Research and Development and Research in Social Sciences**

With a view to further encourage research and development in India, the Finance Bill has increased

**Sub-Section (2AA) of the Section 35 is also proposed to be amended to increase the weighted deduction in respect of contribution to a National Laboratory, a University, an Indian Institute of Technology, or, a specified person towards approved research programme from 125 per cent to 175 per cent. Not only the change proposed in the Section 35, the Finance Bill, 2010 also seeks to grant exemption from tax under the Section 10(21) to association which carries on any research and not necessarily scientific research, e.g. research in social science or research in statistics.**

the weighted deduction in the Section 35(2AB) on expenditure including capital expenditure (other than cost of land) incurred on approved in-house scientific research by any company engaged in the business of biotechnology or any other business, other than business of manufacturing items specified in XIth Schedule, from 150 per cent to 200 per cent. This in effect would result in, an availability of Rs. 200 deduction for every Rs. 100 spent on research and development.

In order to provide further impetus to corporate contributions to approved institutions engaged in research and not necessarily scientific research or a university, a college or any other institution, the Section 35(1)(ii) has been proposed to be amended to increase the weighted deduction on such contributions from 125 per cent to 175 per cent.

Sub-Section (2AA) of the Section 35 is also proposed to be amended to increase the weighted deduction in respect of contribution to National Laboratory, a University, an Indian Institute of Technology, or, a specified person towards approved research programme from 125 per cent to 175 per cent.

Not only the change proposed in the Section 35, the Finance Bill, 2010 also seeks to grant exemption from tax under the Section 10(21) to association which carries on any research and not necessarily scientific research, e.g. research in social science or research in statistics.

As a consequential amendment deduction under the Section 80GGA has been proposed to be available in respect of contribution made any person to any association, which is an approved research association. Thus deduction under this Section is not restricted to contribution to any association engaged in scientific research activities only.

#### **Expansion of Scope of Investment-linked Deduction under Section 35AD**

By the Finance (No.2) Act, 2009, the Section 35AD was introduced from the assessment year 2010 -11 to provide investment-linked deduction to the assessee engaged in three specified businesses, viz. setting up and operating cold chain facility, setting up and operating warehousing facility for storage of agricultural produce and laying and operating cross-country natural gas or crude oil or petroleum pipeline network for distribution including storage facilities being integral part of such network. The scope of the Section 35AD is proposed to be extended to the business of building and operating a new hotel of two-star or above category in India from the



**Section 40(a)(ia) is proposed to be amended to provide that expenses shall not be disallowed, if tax deducted from the amount credited or payment made for such expenses in any month during the previous year is paid to the Central Government on or before the due date for filing return of income prescribed in the Section 139(1). The assessment year from which the amendment will be effective is not mentioned in the Finance Bill. However, in the Explanatory Memorandum, it is stated to be effective retrospectively from the assessment year 2010-11.**

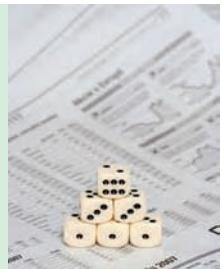
assessment year 2011-12.

As a result of this amendment the assessee engaged in the business of building and operating a new hotel shall be entitled to claim 100 per cent of capital expenditure other than cost of land, goodwill and financial instrument incurred during the previous year, wholly and exclusively, for such business as deduction from the business income.

Further, the expenditure incurred, wholly and exclusively, for such business prior to commencement of operation shall also be allowed as deduction during the previous year in which the assessee commences operation of the hotel. This is, however, subject to the condition that such amount incurred prior to commencement of business should be capitalised in the books of account.

However, the conditions for grant of this deduction as applicable for other specified businesses like not setting up the business by splitting up or reconstructing any existing business, non-use of second-

**New Section 80CCF shall enable an individual or a Hindu Undivided Family (HUF) to claim deduction for an amount up to Rs. 20,000 for investment by way of subscription to notified long-term infrastructure bonds. This deduction shall be in addition to Rs. 1 lakh, which can be claimed in aggregate under the Sections 80C, 80CCC and 80 CCD.**



hand plant and machinery, etc. will apply.

For example, X.Limited commences operation of a five-star hotel in Kolkata on 1st April, 2011. It starts its project on 1st April, 2010. Capital expenditure incurred for the hotel from 1st April, 2010, to 31st March, 2011, is Rs. 40 crore (including cost of land Rs. 10 crore) and such expenditure is capitalised in the books of account on 1st April, 2011. Further, the company incurs capital expenditure of Rs. 20 crore for such business during the previous year 2010-11. Assuming the company complies with all the conditions of the Section 35AD, the deduction admissible under the Section 35AD for the assessment year 2011-12 will be Rs. 30 crore + Rs. 20 crore = Rs. 50 crore.

Consequently, profit-linked deduction provided in the Section 80-IB shall not be available to the assessee.

It may be noted that the builder and the operator of the hotel must be same.

#### **Rationalisation of Provision Relating to Disallowance of Certain Expenses for not Fulfilling TDS Obligations under Section 40(a)(ia)**

Section 40(a)(ia) seeks to disallow payment to contractors, rent, interest, commission or brokerage, fees for technical services or professional services, etc., in the event tax deductible at source is not deducted or tax deducted at source is not deposited within the time as prescribed in the Chapter XVII-B of the Act. However, under the existing provision, if the TDS relates to last month of the previous year, the deduction for the related expenses shall not be denied if the tax deducted is paid on or before the due date for filing return of income prescribed in the Section 139(1). Section 40(a)(ia) is proposed to be amended to provide that expenses shall not be disallowed, if tax deducted from the amount credited or payment made for such expenses in any month during the previous year is paid to the Central Government on or before the due date for filing return of income prescribed in the Section 139(1).

The assessment year from which the amendment will be effective is not mentioned in the Finance Bill. However, in the Explanatory Memorandum, it is stated to be effective retrospectively from the assessment year 2010-11.

The amendment is definitely going to bring relief for many assessee particularly multi-division or multi-location organisations where there may be occasional unintentional lapses in complying with TDS obligations.

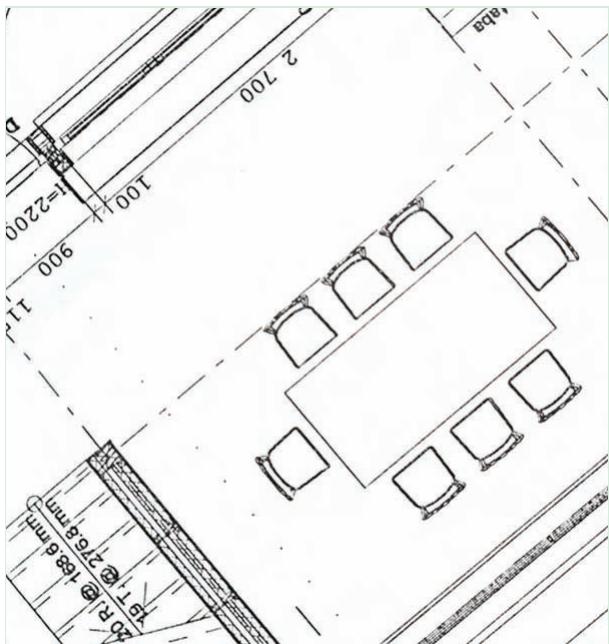
One should, however, note carefully that only tax deducted in any month during the previous year but deposited on or before the due date for filing the return of income is considered under the Section 40(a)(ia). If the assessee fails to deduct tax during the previous year but deducts and pays before the due date for filing the return of income or pays the tax deductible out of her/his own pocket, the deduction for related expense shall not be admissible.

Although the assessee can claim deduction of the expenses despite delay in depositing the TDS amount as per the amended provision, the same is at the cost of higher interest for not depositing TDS amount within stipulated time. The rate of interest payable under the Section 201(1A) for delay in making payment of TDS is proposed to be raised from 1 per cent per month or part of a month to 1.5 per cent per month or part of a month with effect from 1st July, 2010.

Further, it may be noted that there is no change proposed in the sub-Clause (i) of the Clause (a) of the Section 40 which seeks to disallow salary, interest, royalty, fees for technical services or any other sum paid or payable to non-resident, which is chargeable to tax in India if tax deductible is not deducted or after deduction, such tax is not paid within the time prescribed in the Chapter XVII-B.

#### **Amendments in Deductions under Chapter VI-A**

In addition to what have been stated in the preceding paragraphs, the following amendments have been proposed in respect of deductions from gross total income:



In view of the acute recession, many real estate developers could not complete their projects within the four year time limit. In this backdrop the Finance Minister has proposed to increase the period allowed in the Section 80-IB (10) for completion of a housing project in order to qualify for availing the tax benefit under the section, from the existing four years to five years from the end of the financial year in which the housing project is approved by the local authority. This extension will be available for housing projects approved on or after 1st April, 2005.

- New **Section 80CCF** shall enable an individual or a Hindu Undivided Family (HUF) to claim deduction for an amount up to Rs. 20,000 for investment by way of subscription to notified long-term infrastructure bonds. This deduction shall be in addition to Rs. 1 lakh, which can be claimed in aggregate under the Sections 80C, 80CCC and 80 CCD.
  - The scope of the **Section 80D** in respect of deduction on account of payment of health insurance premium is proposed to be extended to contribution made to the Central

Government Health Insurance Scheme. This scheme is available to the serving and retired Government employees. The monetary limit of Rs. 15,000 / Rs. 20,000 remains unchanged.

- In view of the acute recession many real estate developers could not complete their projects within the four year time limit. In this backdrop, the Finance Minister has proposed to increase the period allowed in the Section 80-IB (10) for completion of a housing project in order to qualify for availing the tax benefit under the Section, from the existing four years to five years from the end of the financial year in which the housing project is approved by the local authority. This extension will be available for housing projects approved on or after 1st April, 2005. Further, the existing permissible area for shops and other commercial establishment in housing project is 5 per cent of the total built-up area or 2000 square feet, whichever is less. The said limit will be modified to 3 per cent of total built-up area of the project or 5000 square feet, whichever is higher. This benefit will be available to projects approved on or after the 1.4.2005, which are pending for completion, in respect of their income relating to the assessment year 2010-11 and thereafter.
  - As the amendment in the Section 80-IB(10) is proposed to be effective from the assessment year 2010-11, the assessees who have already completed the projects and profits have already been offered to tax and deduction under the Section 80-IB(10) has been claimed already prior to the assessment year 2010-11 are not entitled to the benefit of additional space for commercial establishment. The prospective implementation of the proposed amendment appears to lack equity. The Government may give a fresh look to this amendment.
  - Section 80-ID provides for 100 per cent deduction of profit from business of two-star, three-star or four-star category hotel, or, business of building, owning and operating convention centre located in Delhi and other specified districts. However, the unit should start functioning from 1st April, 2007, to 31st March, 2010. For providing some more time for the hotels or convention centers to be set up in the light of the Commonwealth Games in October 2010, the Section 80-ID is proposed to be amended to extend the date from 31st March, 2010, to 31st July, 2010.

# Service Tax Proposals under the Finance Bill, 2010



**While cheering us with IT-benefits on one hand, the Budget 2010-11 may irritate us as we will have to cough up service tax on a number of activities like buying a flat from builder and availing of health services through medical insurance companies. The Federation of Indian Airlines has decided to represent to Union Finance Minister to drop the move to levy 10 per cent service tax on domestic travel. To prop up revenue collections, Finance Minister Pranab Mukherjee has widened the ambit of service tax by bringing eight new services under the tax net thereby making us pay more for availing these services. The author presents an analysis on the scope of the Service Tax Proposals as presented in the Finance Bill, 2010.**



**CA. Ravi Holani**

(The author is a member of the Institute.  
He can be reached at raviholani@rediffmail.com)

There are several proposals in the Finance Bill, 2010 about the imposition of the levy including imposition of the penalty. Though there is no need to insert the Clause 75 because of the existence of the Section 80 which is sufficient, but, still, due to indecisiveness because of the consideration of the entire facts by the adjudicating authority, the law itself provides that there is no need to pass any order under the Section 80, because of the provision under the Section 73 itself in the specific circumstances where the assessee herself/himself pay service tax along with interest prior to issue of the show cause notice except in case of fraud or evasion or suppression with intent to evade the service tax. In terms of the Clause 73(D), the Government could issue an order for classification or valuation within one year and the Clause 76 is about retrospective effect of the Section 65(105)(zzzz) in terms of the Clause 75(A)(5)(h) of the Finance Bill, 2010.

The scope of the levy has been proposed to be expanded by modification in the existing title as well as insertion of new titles through the Clause 75 of the Finance Bill, 2010, under which there is an admission of the term Business Entity in which individuals have been excluded. Since individuals and their business title, i.e. sole proprietorship business title commonly known as proprietorship firm, both are one and same, so proprietorship business title shall not be included under the term Business Entity. *[Ashok Transport Agency Vs. Awadesh Kumart & Another (1998) 5 SCC 567, S.K. Real Estates & Another Vs. Ahmed Meeran (2002) 111 Comp. 400(Mad).]*

**In the definition, it has not been stipulated that the training or coaching centre must be a business centre; it is a mere service title, Commercial, it has been assessed that unless the Coaching Centre is for the motive of profit, no tax shall be applicable in this title. Besides in the definition, it has never been stated that it must be the business of the Institute.**



*Lawn Hosiery Mills & Others Vs Durga Fashions (2002)111 Comp. Case 568 (Mad.)*] The term Business Entity is reproduced as follows:

(19b) Business entity includes an association of persons, body of individuals, company or firm but does not include an individual;

#### **Scope of the Existing Service**

**(a) Port Service [Section 65(82)]:**

*Refer to the Clause 75(A)(5)(4) of the Finance Bill, 2010:*

Taxable service means any service provided or to be provided-

xxxx

xxxx

(82) "port service" means any service rendered within a port or other port, in any manner,';

xxxx

xxxx

(a) for the sub-Clause (zn), the following the sub-Clause shall be substituted, namely:

Taxable service means any service provided or to be provided-

"(zn) to any person, by any other person, in relation to port services in a port, in any manner:

Provided that the provisions of section 65A shall not apply to any service when the same is rendered wholly within the port,';

*[Refer to the Clause 75(A)(5)(a) of the Finance Bill, 2010]*

Taxable service means any service provided or to be provided-

xxxx

xxxx

"(zzl) to any person, by any other person, in relation to port services in other port, in any manner:

Provided that the provisions of section 65A shall not apply to any service when the same is rendered wholly within other port,';

xxxx

xxxx

Taxable service means any service provided or to be provided-

xxxx

xxxx

"(zzm) to any person, by airports authority or by any other person, in any airport or a civil enclave:

Provided that the provisions of section 65A shall not apply to any service when the same is rendered wholly within the airport or civil enclave,';

xxxx

xxxx

*[Refer to the Clause 75 (A)(5)(c) of the Finance Bill, 2010]*

Port is a composite term and in such a situation, there is no need to go into each class separately in terms of the Section 65A.

**(b) Commercial Coaching [Section 65(105)(zzc)]:**

"taxable service" means any service provided or to be provided to any person, by a commercial training or coaching centre in relation to commercial training or coaching;

And in above the sub-Clause (zzc) of the Section 65(105) of the Finance Act, 1994, the following Explanation shall be inserted and be deemed to have been inserted with effect from the July 1, 2003, namely:

*'Explanation.* For the removal of doubts, it is hereby declared that the expression commercial training or coaching centre occurring in this sub-Clause and in the Clauses (26), (27) and

(90a) shall include any centre or institute, by whatever name called, where training or coaching is imparted for consideration, whether or not such centre or institute is registered as a trust or a society or similar other organisation under any law for the time being in force and carrying on its activity with or without profit motive and the expression "commercial training or coaching" shall be construed accordingly;"

*[Refer to the Clause 75(A)(5)(b) of the Finance Bill, 2010]*

In the definition, it has not been stipulated that the training or coaching centre must be a business centre; it is a mere service title. Unfortunately, with a specific word in the title, *Commercial*, it has been assessed that unless the Coaching Centre is for the motive of profit, no tax shall be applicable in this title. Besides in the definition, it has never been stated that it must be the business of the Institute. Because of the partial interpretation by breaking down the each word separately, it was assumed that coaching centre would be taxable only where there is profit motive. Though this was the issue of interpretation, still, the Explanation merely points to the scope with retrospective effect to close down all the controversies, but the show-cause notice in such a situation, could not be issued by invoking an extended period under the Section 73.

#### **(c) Construction Service [Section 65(105)(zzq)]:**

*Refer to the Clause 75(A)(5)(d) and (e) read with the Clause 75(A)(3) of the Finance Bill, 2010 which is as follows:*

- (i) the word "service" under the Section 65(105) (zzq) and (25b) shall be omitted;
- (ii) the following Explanation under the Section 65(105)(zzq) shall be inserted:—

"Explanation.—For the purposes of this sub-Clause, the construction of a new building which is intended for sale, wholly or partly, by a builder or any person authorised by the builder before, during or after construction (except in cases where no sum is received from or on behalf of the prospective buyer by the builder or the person authorised by the builder before grant of completion certificate by the authority competent to issue such certificate under any law for the time being in force) shall be deemed to be service provided by the builder to the buyer;"

- (iii) In the sub-Clause(zzzh) of the Section 65(105), the following Explanation shall be inserted:

*"Explanation.—For the purposes of this sub-clause, construction of a complex which is intended for sale, wholly or partly, by a builder or any person authorised by the builder before, during or after construction (except in cases for which no sum is received from or on behalf of the prospective buyer by the builder or a person authorised by the builder before the grant of completion certificate by the authority competent to issue such certificate under any law for the time being in force) shall be deemed to be service provided by the builder to the buyer;"*

*[Refer to the Clause 75(A)(5)(e) of the Finance Bill, 2010]*

The construction of new building which is intended for sale, wholly or partly, by builder or any person authorised by him before, during or after the construction shall be deemed to be the service provided to the prospective buyer except in the situation where the entire sum shall be paid by the buyer after completion of construction. Now, because of such amendment, there shall be a multiple Service Tax on the same construction under different stages:

**On medical services provided to the employees of business entity by any hospital, or any insurance company on behalf of employers of such business entity would be taxable, but its effect would only be on those business entities who are not covered under the CENVAT credit net in totality.**



(i) in hands of the contractors as works contract or as construction service as the case may be as contractor vs. builder

(ii) in hands of the builder while entering into contract with the buyer before completion of the construction as builder vs. prospective buyer

Now the effect would be the multiple taxation because of tax at construction stage in hands of the contractor under the construction service or under work contract, so and also the service tax levy in hand of the builders at the time of entering the agreement with prospective buyer, so, because of the same, now in such a situation, the most reasonable method of valuation would be paying tax on full consideration after deducting tax on full consideration after deducting cost of materials under the Notification No. 12/2003 S.T. by not taking any CENVAT credit on input except input service, or, capital goods and as such along with contractors, builder shall also be liable to pay tax.

Now, there are multiple taxations on construction of residential or commercial complex. The terms and conditions of agreement would be the key factor to decide the applicability of multi-stage taxation.

#### (d) Sponsorship Service [Section 65(105)(zzzn)]:

*Refer to the Clause 75(A)(5)(f). The Clause 105 (zzzn) of the Section 65 shall be replaced as follows:*

Taxable service means any service provided or to be provided-

xxxx

xxxx

"(zzzn) to any person, by any other person receiving sponsorship, in relation to such sponsorship, in any manner;"

xxxx

xxxx

Now, sports sponsorship shall also be taxable.

#### (e) Air Transportation of Passengers [Section 65 (105)(zzzo)]:

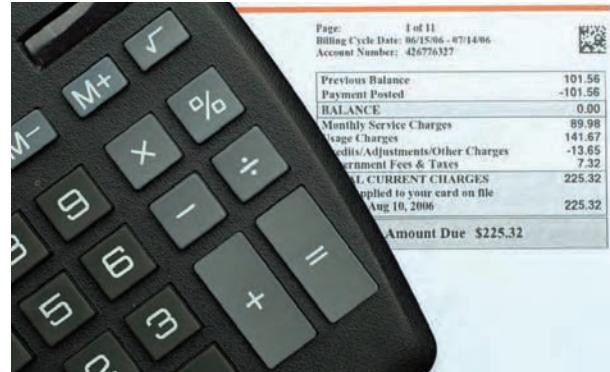
The Clause shall be replaced as follows:-

Taxable service means any service provided or to be provided-

xxxx

xxxx

"(zzzo) to any passenger, by an aircraft operator, in relation to scheduled or non-scheduled



**Since the term *Business Entity* has been defined in various services like security service, manpower recruitment, etc., either for service receiver or provider, or for both, the term should be inserted instead of "any person to any other person" to maintain and consider genuine hardship as well as social economic democratic structure of the country. Since the levy is on the gross amount, it creates very ambiguous situation among those who belong to lower class of society and give their casual labour service by creating at group.**

air transport of such passenger embarking in India for domestic journey or international journey;"

xxxx

xxxx

Now the domestic transport of passengers shall also be taxable

*[Refer to the Clause 75(A)(5)(f) of the Finance Bill, 2010].*

#### (f) Auction of Property [Section 65(105)(zzzr)]:

In the sub-Clause (zzzr), the following Explanation shall be inserted, namely:

'Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, "auction by the Government" means the Government property being auctioned by any person acting as auctioneer,';

*[Refer to the Clause 75(A)(5)(g) of the Finance Bill, 2010]*

**(g) Renting of Property [Section 65(105)(zzzz)]:**

After giving the effect of the proposal as given by the Clause 75(A)(5)(h) of the Finance Bill, 2010, the Section 65(105)(zzzz) is reproduced as follows:

(zzzz) to any person, by any other person by renting of immovable property or any other service in relation to such renting, for use in the course or furtherance of business or commerce.

*Explanation 1.* For the purposes of this sub-Clause, "immovable property" includes:

- (i) building and part of a building, and the land appurtenant thereto;
- (ii) land incidental to the use of such building or part of a building;
- (iii) the common or shared areas and facilities relating thereto; and
- (iv) in case of a building located in a complex or an industrial estate, all common areas and facilities relating thereto, within such complex or estate,

but does not include:

- (i) vacant land, given on lease or license for construction of building or temporary structure at a later stage to be used for furtherance of business or commerce;
- (ii) vacant land solely used for agriculture, aquaculture, farming, forestry, animal husbandry, mining purposes;
- (iii) vacant land, whether or not having facilities clearly incidental to the use of such vacant land;
- (iv) land used for educational, sports, circus, entertainment and parking purposes; and
- (v) building used solely for residential purposes and buildings used for the purposes of accommodation, including hotels, hostels, boarding houses, holiday accommodation, tents, camping facilities.

*Explanation 2.* For the purposes of this sub-clause, an immovable property partly for use in the course or furtherance of business or commerce and partly for residential or any other purposes shall be deemed to be immovable property for use in the course or furtherance of business or commerce;

As per the proposal, now mere renting of property would also be assumed as taxable service retrospectively.

However, such type of retrospective amendment shall be re-considered due to the reason that it creates the misuse of summons proceedings including issuing

the show-cause notice by adopting the interpretation by adding few words which have not been employed by the Legislature or avoiding to consider various words and phrases employed in the definition with the expectation of probability of retrospective amendments in the definition, so it is not an ambiguous situation besides the unexpected financial burden on the unorganized class of tax payers most of them are also not having any law department or not in a position to take proper legal assistance.

However, show-cause notice could not be issued beyond period of one year because of a mere interpretation, so those who honored the summons by putting the entire figure and receiving the show-cause notice shall now be facing the trouble instead of those who instead of giving the figures have contested the Summon on taxability, they shall now be free from all the liabilities.

**(h) Information Technology Service [Section 65(105)(zzze)]:**

Refer to the Clause 75(A)(5)(i) of the Finance Bill, 2010, In the sub-Clause (zzze) of the Section 65(105), the words "for use in the course, or furtherance, of business or commerce," shall be omitted;

*And due to the above, now for any purpose, the service would be taxable irrespective of the fact whether it is for furtherance of business of commerce or not.*

**(i) Insurance Service [Section 65(105)(zzzf)]:**

In the sub-Clause (zzzf) of the Section 65(105), in the Explanation, for the Clauses (ii) and (iii), the following Clause shall be substituted, namely:

"(ii) the gross amount charged by the insurer from the policy holder for the said service provided or to be provided shall be equal to the maximum amount fixed by the Insurance Regulatory and Development Authority established under section 3 of the Insurance Regulatory and Development Authority Act, 1999, as fund management charges for unit linked insurance plan or the actual amount charged for the said purpose by the insurer from the policy holder, whichever is higher;

*[Refer to the Clause 75(A)(5)(j) of the Finance Bill, 2010]*

**(j) Legal Service [Section 65(105)(zzzm)]:**

Refer to the Clause 75(A)(5)(k) of the Finance Bill, 2010, Explanation to the sub-Clause (zzzm) of the Section 65(105) shall be omitted due to insertion of the new clause under the Section 65 to define the word Business Entity, Section 65(19a).

### New Titles of Service

#### (a) Games of Chances [Section 65(105)]:

Taxable service means any service provided or to be provided-

xxxx

xxxx

'(zzzzn) to any person, by any other person, for promotion, marketing, organising or in any other manner assisting in organising games of chance, including lottery, Bingo or Lotto in whatever form or by whatever name called, whether or not conducted through internet or other electronic networks;

xxxx

xxxx

[Refer to the Clause 75(A)(5)(l) of the Finance Bill, 2010]

#### (b) Medical Service and Medical Record Keeping [Section 65(105)]:

Taxable service means any service provided or to be provided-

xxxx

xxxx

(zzz zo) by any hospital, nursing home or multi-specialty clinic,—

- (i) to an employee of any business entity, in relation to health check-up or preventive care, where the payment for such check-up or preventive care is made by such business entity directly to such hospital, nursing home or multi-specialty clinic; or
- (ii) to a person covered by health insurance scheme, for any health check-up or treatment, where the payment for such health check-up or treatment is made by the insurance company directly to such hospital, nursing home or multi-specialty clinic;

xxxx

xxxx

Taxable service means any service provided or to be provided-

xxxx

xxxx

(zzzzp) to any business entity, by any other person, in relation to storing, keeping or maintaining of medical records of employees of a business entity;

xxxx

xxxx

[Refer to the Clause 75(A)(5)(l) of the Finance Bill, 2010]

On medical services provided to the employees of business entity by any hospital, or any insurance company on behalf of employers of such business entity would be taxable, but its effect would only be on those business entities who are not covered under the CENVAT credit net in totality. So, there is no impact on public in general.

- (i) Health checkup and treatment, including preventive checkups, directly paid by any business entity to any nursing home, hospital or multi-specialty clinic (consideration of such facility has been paid by directly by the business entity for their employees).
- (ii) Any health treatment or checkup for any person covered under health insurance scheme, paid to a hospital, a nursing home or a multi-specialty clinic directly by such insurance company.

Now the question is about the CENVAT credit in hand of the employers as input service to pay the excise duty or service tax. Prima facie, the same would be available in hand of service receivers as input service, but, strictly, it is a pure question of interpretation of the Rule 2(l) of the CENVAT Credit Rules, 2004.

**Medical Record Keeping:** Any record keeping relating to medical histories of their employees of any business entity by any person including medical centres on consideration would also be taxable under the Clause (105)(zzzzp) of the Section 65 as proposed by the Section 75(A)(5)(l) of the Finance Bill, 2010.

#### (c) Brand Promotion or Marketing [Section 65(105)]:

Taxable service means any service provided or to be provided-

xxxx

xxxx

(zzzzq) to any person, by any other person, through a business entity or otherwise, under a contract for promotion or marketing of a brand of goods, service, event or endorsement of name, including a trade name, logo or house mark of a business entity by appearing in advertisement and promotional event or carrying out any promotional activity for such goods, service or event.

*Explanation.* For the purposes of this sub-clause, "brand" includes symbol, monogram, label, signature or invented words which indicate

connection with the said goods, service, event or business entity;

xxxx

xxxx

*[Refer to the Clause 75(A)(5)(l) of the Finance Bill 2010]*

**(d) Commercial Use of Events [Section 65(105)]:**

Taxable service means any service provided or to be provided-

xxxx

xxxx

(zzzr)to any person, by any other person, by granting the right or by permitting commercial use or exploitation of any event including an event relating to art, entertainment, business, sports or marriage organised by such other person;

xxxx

xxxx

*[Refer to the Clause 75(A)(5)(l) of the Finance Bill 2010]*

**(e) Service Relating to Supply of Electricity [Section 65(105)]:**

Taxable service means any service provided or to be provided-

xxxx

xxxx

(zzzs)to any person, by an electricity exchange, by whatever name called, approved by the Central Electricity Regulatory Commission constituted under section 76 of the Electricity Act, 2003, in relation to trading, processing, clearing or settlement of spot contracts, term ahead contracts, seasonal contracts, derivatives or any other electricity related contract;

xxxx

xxxx

*[Refer to the Clause 75(A)(5)(l) of the Finance Bill, 2010].*

**(f) Use of Copyright [Section 65(105)]:**

Taxable service means any service provided or to be provided-

xxxx

xxxx

(zzzt)to any person, by any other person, for  
(i) transferring temporarily; or

(ii) permitting the use or enjoyment of, any copy right defined in the Copyright Act, 1957, except the rights covered under subclause  
(a) of clause (1) of section 13 of the said Act;



xxxx

xxxx

*[Refer to the Clause 75(A)(5)(l) of the Finance Bill, 2010]*

**(g) Service Relating to Selection of Location in Building [Section 65(105)]:**

Taxable service means any service provided or to be provided-

xxxx

xxxx

'(zzzu)to a buyer, by a builder of a residential complex, or a commercial complex, or any other person authorised by such builder, for providing preferential allocation or development of such complex but does not include services covered under sub-clauses (zzg), (zzq), (zzzh) and in relation to parking place.

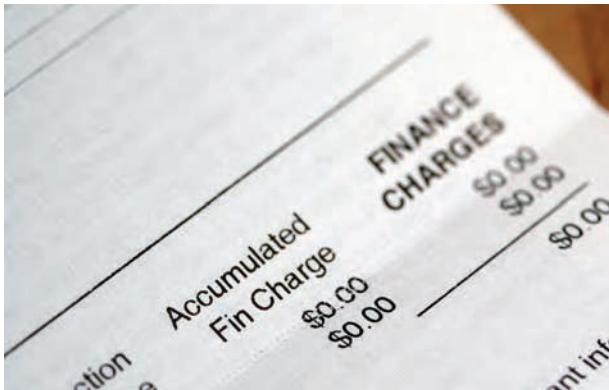
*Explanation.—For the purposes of this sub-clause, "preferential location" means any location having extra advantage which attracts extra payment over and above the basic sale price.'*

xxxx

xxxx

*[Refer to the Clause 75(A)(5)(l) of the Finance Bill, 2010]*

Since the term Business Entity has been defined, in various services like security service, manpower recruitment, etc., either for service receiver or provider, or for both, the term Business Entity should be inserted instead of "any person to any other person" to maintain and consider genuine hardship as well as social economic democratic structure of the country. Since the levy is on the gross amount, it creates very ambiguous situation among those who belong to lower class of society and give their casual labour service by creating at group. In such cases, where the reimbursement of service tax is not been given by the service receiver, the tax amount is deducted from their wages. The law should be made considering the social strata instead of treating all social classes alike.



# Analysis of Latest Changes Effected in CENVAT Rules in Finance Bill, 2010

**CENVAT is one of the most crucial but sensitive issues both in service tax and central excise. Money saved is money earned. In case an assessee calculates its output tax liability on a higher side or claims less CENVAT credit, the result is that the net tax liability of the assessee goes up. It is of paramount importance to understand the CENVAT Rules properly as lesser claim will increase the net tax liability and excess claim of CENVAT will result into heavy penalties and interest. It, therefore, becomes imperative to understand in the right perspective the minutest implications of the CENVAT changes in the latest Financial Bill, 2010. This article analyses the latest changes in the CENVAT Rules.**



**CA. Ashok Batra**

(The author is a member of the Institute.  
He can be reached at [eboard@icai.org](mailto:eboard@icai.org))

To begin with, CENVAT credit is available to a manufacturer of excisable goods and provider of output service in respect of the following:

- (A)Excise duty paid in respect of Inputs
- (B)Excise duty paid in respect of capital goods
- (C)Service tax paid in respect of input services
- (D)Primary education cess and secondary and higher education cess in respect of inputs, capital goods, and input services

Keeping in view the ease and convenience of understanding of readers all changes effected in the Finance Bill, 2010 in respect of the CENVAT credit have been dealt hereunder:

**1. Higher Percentage Reduction in Case of Disposal of Computer & Computer Peripherals after Use- Notification No. 06/2010-Central Excise (NT) dated 27-02-2010**

First of all, it is necessary to know the position prevailing until 26-02-2010 in the present context. Rule 3(5) provides that when inputs or capital goods on which the CENVAT credit has been taken, are removed as such from the factory or premises of the provider of output service, the manufacturer of the final product or provider of output service, as the case may be, shall pay an amount equal to the credit availed in respect of such inputs or capital goods, and such removal shall be made under the cover of an invoice referred to in Rule 9. The sub-Rule (5) of Rule 3 deals with a situation in which capital goods are removed without being used at all. However, in many practical situations capital goods are removed after being used for a certain period of time. To take care of this practical situation second proviso to Rule 3(5) of the CENVAT Credit Rules 2004 has been inserted w.e.f 13.11.2007. According to aforementioned second proviso if the capital goods on which the CENVAT credit has been taken, are removed after being used, the manufacturer or provider of output service shall pay an

amount equal to the CENVAT credit taken on the said capital goods reduced by 2.5 per cent for each quarter of a year or part thereof from the date of taking the CENVAT credit.

However, with an aim to provide greater benefit to a manufacturer or service provider, as the case may be, in case of disposal of Computer & Computer Peripherals Notification No. 06/2010-Central Excise (NT) dated 27-02-2010 has been issued whereby a proviso has been substituted in place of the above mentioned second proviso to the Rule 3(5). As per substituted second proviso if the capital goods, on which the CENVAT credit has been taken, are removed after being used, the manufacturer or provider of output service shall pay an amount equal to the CENVAT credit taken on the said capital goods reduced by the percentage points calculated by straight line method specified below for each quarter of a year or part thereof from the date of taking the CENVAT credit namely:

(a) For computers and computer peripherals

Particulars	Percentage Reduction
For each quarter in the first year	10%
For each quarter in the second year	08%
For each quarter in the third year	05%
For each quarter in the fourth & fifth year	01%

(b) For capital goods, other than computers and computer peripherals @ 2.5 per cent for each quarter.

In order to fully understand the practical implications of above change, following simple illustration is given:

ABC Ltd. acquired the following assets on 1-4-2007:

Kinds of Capital Assets	Total Amount (including Excise Duty) (Rs.)	Amount of Excise Duty (Rs.)
Computers and Computer Peripherals	5,00,000	80,000
Capital Assets other Computers & Computer Peripherals	20,00,000	3,20,000

It is assumed that ABC Ltd. removed of above capital Assets after use on 6<sup>th</sup> March 2010.

Thus, in accordance with substituted second proviso to Rule 3(5) of CENVAT Credit Rules 2004, ABC Ltd. will pay the following amounts:

Date of Acquisition of Assets	01-04-2007
Date of Disposal of Assets	06-03-2010
Time Gap in terms of number of quarters/part thereof between above two dates	12 quarters

#### (A) Case of Computer & Computer Peripherals:

Total CENVAT availed in case of Computers & Computer Peripherals:	Rs. 80,000
Amount reduced for each quarter in the first year @ 10% i.e. $4 \times 10\% = 40\%$	Rs. 32,000
Amount reduced for each quarter in the second year @ 8% i.e. $4 \times 8\% = 32\%$	Rs. 25,600
Amount reduced for each quarter in the third year @ 5% i.e. $4 \times 5\% = 20\%$	Rs. 16,000
Thus Total amount to be reduced	Rs. 73,600
Amount to be paid in cash by ABC Ltd. (Rs. 80,000 – Rs. 73,600)	Rs. 6,400/-

#### (B) Case of disposal of other Capital Assets:

Total Amount of CENVAT availed	Rs. 3,20,000
Amount reduced for 12 quarters @ 2.5% i.e. $2.5 \times 12 = 30\%$	Rs. 96,000/-
Thus amount to be paid by ABC Ltd.	Rs. 2,24,000/-

#### 2. Full CENVAT to be Allowed in the Year in which Capital Goods are Received where the Assessee is Entitled to Avail Exemption under a Notification Based on the Value of Clearances in Financial Year w.e.f. 01-04-2010 - Notification No. 06/2010-CE (NT) dated 27-02-2010

According to the Rule 4(2)(a) of the CENVAT Credit Rules 2004 the CENVAT Credit in respect of capital goods received in a factory or in the premises of the provider of output service at any point of time in a financial year shall be only for an amount not exceeding fifty per cent of the duty paid on such capital goods in the same financial year. However, two provisos were already there as under:

*"PROVIDED that the CENVAT credit in respect of capital goods shall be allowed for the whole amount of the duty paid on such capital goods in the same financial year if such capital goods are cleared as such in the same financial year.*

*PROVIDED FURTHER that the CENVAT credit of the additional duty leviable under sub-section (5) of section 3 of the Customs Tariff Act, in respect of capital goods shall be allowed immediately on receipt of the capital goods in the factory of a manufacturer."*

Now, a third proviso is proposed to be added w.e.f. 01-04-2010, where an assessee is eligible to avail of the exemption under a notification based on the value of clearances in a financial year, the CENVAT credit in respect of capital goods received by such assessee shall be allowed for the whole amount of the duty paid on such capital goods in the same financial year. Further, as per Explanation to aforementioned third proviso, an assessee shall be "eligible" if her/his aggregate value of clearances of all excisable goods for home consumption in the

preceding financial year in the manner specified in the said notification did not exceed rupees four hundred lakhs.

### **3. Expansion in the Scope of the Situation when CENVAT Credit is Allowed in Respect of Jigs, Fixtures, Moulds and Dies- Notification No. 06/2010-Central Excise (NT) dated 27-02-2010**

According to the erstwhile Rule 4(5)(b), the CENVAT credit was also allowed in respect of jigs, fixtures, moulds and dies sent by an manufacturer of final products to a job worker for the production of goods on his behalf and according to his specifications. There was a lacuna in the said Rule 4(5)(b), i.e. it did not cover the situation when jigs, fixtures, moulds and dies were sent by a manufacturer of final products to another manufacturer for the production of goods. In order to overcome the above lacuna, an erstwhile sub-Clause (b) has been substituted by a new sub-Clause. Consequently, according to substituted Rule 4(5)(b) the CENVAT credit shall also be allowed in respect of jigs, fixtures, moulds and dies sent by a manufacturer of final products to:

- (i) Another manufacturer for production of goods; or
- (ii) A job worker for the production of goods on his behalf, according to his specifications.

### **4. Expansion in Scope of Rule 6(6)(vii) - Notification No. 06/2010-Central Excise (NT) dated 27-02-2010**

Rule 6 of the CENVAT Credit Rules 2004 deals with obligation of manufacturer of dutiable and exempted goods and provider of taxable and exempted services. Further, Rule 6(6) contains seven sub-Clauses which provide that the provisions of sub-Rule (1),(2),(3) and (4), of the Rule 6 shall not be applicable in case the excisable goods removed without payment of duty are cleared or supplied in the ways specified in the seven sub-clauses. The erstwhile sub-clause (vii) used to read as under:

*"all goods which are exempt from the duties of customs leviable under the First Schedule to the Customs Tariff Act 1975 and the additional duty*

*leviable under section 3 of the said Customs Tariff Act when imported into India and supplied against International Competitive Bidding in terms of Notification No. 6/2002-Central Excise dated 01-03-2002 or Notification No. 6/2006-CE dated 01-03-2006, as the case may be".*

The scope of above sub-Clause (vii) has been increased substantially and as a result, a new sub-Clause (vii) has been substituted in place of above mentioned sub-Clause (vii).

*"all goods which are exempt from the duties of customs leviable under the First Schedule to the Customs Tariff Act 1975 and the additional duty leviable under section 3 of the said Customs Tariff Act when imported into India and supplied:*

- (a) Against international competitive bidding; or
- (b) To a power project from which power supply has been tied up through tariff based competitive bidding; or
- (c) To a power project awarded to a developer through tariff based competitive bidding, in terms of the Notification No. 6/2006-Central Excise dated 1st March 2006.

### **5. Increase in Penalty if the CENVAT Credit in Respect of Input Services is Taken or Utilised Wrongly**

Rule 15 of the CENVAT Credit Rules 2004 deals with confiscation and penalty for wrongly taking the CENVAT credit in respect of inputs or capital goods or input services. Notification No. 06/2010 C.E (N.T.) dated 27.02.2010 substituted Rule 15 of the CENVAT Credit Rules, 2004. Prior to such substitution, a penalty of upto Rs.2000/- could be imposed if CENVAT credit in respect of input services was taken wrongly or in contravention of any of the provisions of these rules in respect of any input service. Further, if CENVAT credit in respect of inputs or capital goods was taken wrongly or in contravention of any of the provisions of these rules in respect of inputs or capital goods then a penalty not exceeding the duty on excisable goods in respect of which contravention has taken place or Rs.2,000

**Now, after the substitution, penal provisions for incorrect availment of the CENVAT credit of duty paid on inputs or capital goods or input services have been harmonised. In other words, if the CENVAT credit in case of input services has been taken or utilised wrongly or in contravention of any of the provisions of these rules, then penalty shall not be exceeding service tax payable on such services, or Rs. 2000/-, whichever is higher. Further the word "takes" has been replaced by the words "takes or utilises".**



**Since the CENVAT credit will be available in respect of large number of taxes under the proposed Goods and Service Tax (GST), it is highly desirable on the part of professionals to thoroughly understand the significance and implications of the CENVAT. Many professionals jokingly say that a true & deep understanding of the CENVAT tantamount to winning more than half a battle in service tax. The joke may not hold true in all situations. However, it does emphasize the significance of the CENVAT credit.**

whichever is greater was leveiable. However, now, after the substitution, penal provisions for incorrect availment of the CENVAT credit of duty paid on inputs or capital goods or input services have been harmonised. In other words, if the CENVAT credit in case of input services has been taken or utilised wrongly or in contravention of any of the provisions of these rules, then penalty shall be imposed as under:

A penalty not exceeding service tax payable on such services

Or

Rs.2000/-, whichever is higher.

Further the word "takes" has been replaced by the words "takes or utilises".

#### **6. Amendment in the Central Excise & CENVAT Credit Rules for the Period 01.09.1996 to 31.03.2008 in Respect of Reversal of the CENVAT Credit on Exempted Goods**

To resolve the disputes pending (on the date of enactment of Finance Bill, 2010) in respect of reversal of the CENVAT credit in case of a manufacturer of both dutiable and exempted goods, an amnesty scheme is proposed to be introduced from the said date i.e. date of enactment of Finance Bill, 2010. Accordingly, it is proposed to amend retrospectively w.e.f 01.09.1996 to 31.03.2008, the following rules:

- (i) The Central Excise Rules, 1944;
- (ii) The CENVAT Credit Rules, 2001;
- (iii) The CENVAT Credit Rules, 2002; and
- (iv) The CENVAT Credit Rules, 2004.

The purpose is to provide an option to a manufacturer of both dutiable and exempted goods availing the MODVAT/CENVAT credit in respect of any inputs, other than fuel, to manufacture both dutiable and exempted goods, to reverse credit or pay an amount equivalent to credit attributable to inputs used for manufacture of exempted goods.

However, the option is subject to the condition that such manufacturer pays interest @ 24 per cent p.a. from the date of clearance till date of reversal of the said credit or payment of equivalent amount. It is reiterated that such option shall be available only in those cases where disputes in this regard are

pending on the date of enactment of the Finance Bill, 2010.

Further, amendment is also being made to the Rule 57AD of the Central Excise Rules, 1944; to the Rule 6 of the CENVAT Credit Rules, 2001; to the Rule 6 of the CENVAT Credit Rules, 2002 and to the Rule 6 of the CENVAT Credit Rules, 2004.

According to the said amendments, where the manufacturer opts for the above scheme, she/he shall:

- (i) Pay the amount along with interest; and
- (ii) Make an application to the Commissioner of Central Excise along with documentary evidence, and a certificate from a chartered accountant or a cost accountant certifying the amount of input credit attributable to the inputs used in or in relation to the manufacture of exempted goods.

Note: Such application is to be made within a period of 6 months from the date on which the Finance Bill, 2010 receives the assent of the President.

The Commissioner of Central Excise, on receipt of such application, shall verify the correctness of the amount paid within a period of two months. In case of any shortfall, she/he shall call upon the applicant to pay the differential amount along with interest, which shall be paid within a period of 10 days from the date of receipt of communication from the Commissioner in this regard.

#### **7. Amendments in Notification No. 5/2006-CE (NT) Dated 14-03-2006 Refund of Accumulated CENVAT Credit to Exporters**

According to the Rule 5 of the CENVAT Credit Rules 2004 where any input or input service is used in the manufacture of final product which is cleared for export under bond or letter of undertaking, as the case may be, or used in the intermediate product cleared for export, or used in providing output service which is exported the CENVAT credit in respect of the input or input service so used shall be allowed to be utilised by the manufacturer or provider of output services towards payment of duty of excise on any final product cleared for

home consumption or for export on payment of duty; or service tax on output service, and where for any reason such adjustment is not possible, the manufacturer or the provider of output service shall be allowed refund of such amount subject to such safeguards, conditions and limitations, as may be specified, by the Central Government, by notification. Resultantly, Notification No. 5/2006-CE(NT) dated 14-03-2006 was issued which prescribed six conditions as well as a procedure for claiming the aforementioned refund under the Rule 5 of the CENVAT Credit Rules 2004. However, there was a constant complaint of the exporters' community that they seldom received the refund in time in pursuance of the previously mentioned Notification of 14-03-2006. In order to provide immediate solution to the exporters (mainly BPOs/ Call Centres) in getting timely refund of excise duty and service tax, the C.B.E.C. issued a Circular No. 120/01/2010-ST dated 19-01-2010. This Circular examined in detail the various causes for delay in grant of refunds to exporters. In particular, it was pointed out that use of different phrases in the Notification No. 5/2006-CE (N.T) dated 14-03-2006 and the CENVAT Credit Rules 2004 was causing delay in grant of refund. It was specified that there is a tendency on the part of field formations to take the view that for eligibility of refund the nexus between inputs/input services and the final goods/services has to be closer and more direct than that is required for taking credit. It has been specified that the reason for such restrictive view is the use of different phrases in the Notification No. 5/2006-CE (N.T) and the CENVAT Credit Rules 2004. The following table gives the difference between the two:

Notification No. 5/2006-CE (N.T)	CENVAT Credit Rules 2004
Refund is permitted of duties/taxes paid only on such inputs/input services which are either used in the manufacture of export goods or used in providing the output services exported.	These Rules permit the credit of services used "whether directly or indirectly in or in relation to the manufacture of final product" or "for providing output service."

Now, in order to give legal backing to the above-mentioned Circular No. 120/01/2010 with a view to quickly process refund claims certain changes have been effected in the Notification No. 5/2006-CE. These changes in aforementioned notification can be broadly divided as under:

#### (I) Retrospective Changes w.e.f. 14-3-2006:

- (i) The words "in relation to" has been added in the main condition (a) of the Notification.

- (ii) The word "in" contained in the main condition (b) of the said Notification has been replaced with "for".

As a result of such change, it is ensured that refund is granted on all goods and services on which CENVAT can be claimed by the exporter of goods or services.

#### (II) Prospective Changes:

**Certification of certain details:** Keeping in mind the twin aims of reducing the checking of voluminous records by the officers processing the refund claims and ensuring faster processing of refund claims, certain details needed to be submitted by the claimant are required to be certified as per following two tables:

- (A) If the amount of refund claimed is less than Rs. 5 lakh in a quarter:

In case of a limited company	In case of sole proprietary firms/partnerships
By a person authorised by the Board of Directors	By a proprietor or an authorised partner
Thus amount to be paid by ABC Ltd	Rs. 2,24,000/-

- (B) If the amount of refund claimed is in excess of Rs. 5 lakh in a quarter:

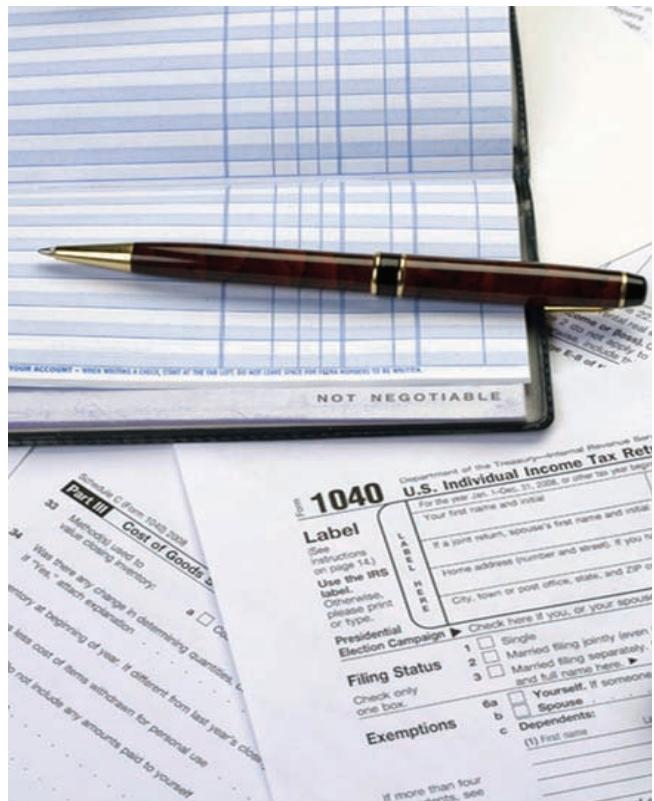
In case of a limited company	In case of sole proprietary firms/partnerships
By a person authorised by the Board of Directors AND by a Chartered Accountant who audits the annual accounts for the purposes of Companies Act 1956.	By a proprietor or an authorized partner <b>AND</b> by a Chartered Accountant who audits the annual accounts for the purposes of Income Tax Act 1961 u/s 44AB.

With the above changes in the Notification No. 5/2006-CE (NT) dated 14-03-2006, it is earnestly hoped that the departmental officers processing the refund will make all-out efforts and exhibit genuine interest and sincerity in promptly processing the refund claims of exporters filed in pursuance of this Notification.

#### Conclusion

Since the CENVAT credit will be available in respect of large number of taxes under the proposed Goods and Service Tax (GST), it is highly desirable on the part of professionals to thoroughly understand the significance and implications of the CENVAT. Many professionals jokingly say that a true and deep understanding of the CENVAT tantamount to winning more than half a battle in service tax. The joke may not hold true in all situations. However, it does emphasize the significance of the CENVAT credit.

# Expanded Scope of Construction Services



**Now the Finance Bill, 2010 proposes to expand the scope of construction services to cover sale of flats/units under construction. Thus now builders/developers are liable to service tax, if any payment towards sale consideration is received before the grant of completion certificate by competent authorities for such flats/units. If entire sales consideration is received by builder/developer after issue of completion certificate, service tax is not leviable. The article analyses the issue.**



**CA. Tushar K. Doctor**

(The author is a member of the Institute.  
He can be reached at [eboard@icai.org](mailto:eboard@icai.org))

Sections 65(105)(zzh) and 65(105)(zzq) of the Finance Act, 1994 define 'taxable service' in the context of construction services as 'any service provided or to be provided to any person by any other person in relation to construction of complex/commercial or industrial construction.'

One of the issues that arises with respect to the aforesaid services whether developer/promoter/any such person is liable to service tax. In the Circular no. 96/7/2007-ST, dated 23.08.2007, the CBEC stated that if no other person is engaged for construction work and the builder/promoter/developer undertakes construction work on his own, then in such cases service provider and service recipient relationship does not exist & services provided are in the nature of self supply of services. Where a builder, promoter or developer engages a contractor for construction of residential complex, the contractor shall be liable to pay service tax on gross amount charged for construction services.

In the case of *Harekrishna Developers* (2008) 14 STT 53 (AAR-New Delhi), facts were that the developer was to develop two residential

**In DOI No. 334/1/2010 TRU New Delhi, dated 26.02.2010, it has been stated that different patterns of execution, terms of payment and legal formalities followed by builders, developers or promoters have given rise to confusion, disputes and discrimination in terms of service tax payment. In order to bring in parity in tax treatment, an explanation (as discussed above) is proposed to be inserted. This proposed amendment would only expand the scope of the existing service, which otherwise remain unchanged.**

complexes one by itself and other through a contractor. The residential units in the complex would be booked in favour of a particular buyer after taking a token booking amount and the physical possession will be given to buyer after construction is completed and full payment is received. As per the developer they were not subject to service tax as they were not rendering any taxable service. The construction was carried out on its own land, using own material either by employing own labour or by engaging contractor. The ownership remains with them till possession is handed over to the buyer and full consideration is received. As the complex is being developed for the self, the service provider and recipient are one and the same. Since service tax is attracted only when a taxable service is provided by one person to another, no levy is attracted in this case.

The Authority for Advance Ruling held that one has to consider not only the construction part of the activity, the correlated and incidental services are also to be considered.

The plot on which residential unit has to be built up and handed over to the buyer is identified, and same cannot be diverted to others so long as the purchaser is ready and willing to pay the agreed installments of the consideration. The applicant has laid undue stress on the aspect of ownership remaining with it till completion. Point of time at which ownership will get transferred cannot determine the liability to pay service tax. Though the applicant is constructing the residential unit on its own, the fact remains that applicant does everything to honor its commitment to the buyer (booker) from whom it receives valuable consideration in installments. The construction service is referable to the agreement with the prospective buyer and



it cannot be viewed in isolation. The possibility of the booker defaulting in payment of installments and the agreement being terminated is really not material. Just because a contractor is appointed to do the construction does not absolve the applicant of responsibility of providing services in relation to construction of residential unit agreed to be sold to the customer ultimately. Thus service tax is leviable in the given case.

In *Rohan Builders Ltd. v. CST* (2008) 16 STT 372 (Bang-CESTAT), it was held that since before selling property, construction activity had to be undertaken by assessee, it was liable to discharge service tax liability.

In *Mokha Builders & Promoters v. CCE* (2008) 15 STT 400 (New Delhi-CESTAT), it was held that since the appellant had entered into an agreement with its customers for sale of flats before starting construction, it was liable to service tax.

In *Magus Construction v. UOI* (2008) 15 STT 9 (Gau.), it was held that until the time the sale deed was executed, the title, and interest, including the ownership and possession in the construction made remained with Magus Construction. The payments made by prospective purchasers, in installments, were aimed at facilitating purchase of the flats/premises by these probable purchasers so that they might not be required to pay whole of the price at a time. Any advance/deposit received from a prospective buyer and not for the purpose of obtaining service from the company. Thus it could not be inferred that the petitioner company was making construction for and on behalf of the probable purchasers. As no service is rendered to the intending buyer in the given case service is not attracted.

In view of the AAR ruling in Harekrishna



Developers case, the Board has issued the Circular no. 108/02/2009-ST, dated 29.01.09 stating that any decision by the AAR in a specific case, which is contrary to the views expressed in the Circular, would have limited application to that case only. The Circular states the ownership of the property remains with the promoter/builder/developer till the completion of construction and full payment of agreed sum and only after that a sale deed is executed whereby the ownership of the property is transferred to the ultimate owner. Therefore, service provided till execution of sale deed would be in the nature of self service and would not attract service tax.

Now the Finance Bill, 2010 proposes to expand the scope of these services to cover sale of flats/units under construction. Thus now builders/developers are liable to service tax, if any payment towards sale consideration is received before the grant of completion certificate by competent authorities for such flats/units. If entire sales consideration is received by builder/developer after the issue of completion certificate then, service tax is not leviable.

In DOI No. 334/1/2010 TRU New Delhi, dated 26.02.2010, it has been stated that different patterns of execution, terms of payment and legal formalities followed by builders, developers or promoters have given rise to confusion, disputes and discrimination in terms of service tax payment. In order to bring in parity in tax treatment, an explanation (as discussed above) is proposed to be inserted. This proposed amendment would only expand the scope of the existing service, which otherwise remain unchanged.

The proposed amendment is contrary to the earlier clarification issued by the CBEC. As a result

of the proposed amendment, once again the view accepted by the CBEC after much debate that builders are not liable for service tax is unsettled. Again new doubts will arise.

Issues likely to arise on account of proposed amendment.:

- a) Whether service tax will be leviable on cost of land (embedded in the sale price of the flat)?
- b) Where say 20 per cent is paid as advance by prospective buyer and balance 80 per cent is paid after issue of completion certificate, whether service tax will be levied on balance 80 per cent so received?
- c) What would be the position in case of redevelopment contracts?
- d) As composite contracts are covered under works contract service, construction services will cover only pure labour contracts. Whether the proposed amendment will have any impact on pure labour contracts needs to be considered?
- e) If the developer merely acts as a contractor and develops the premises and does not have right to sell the premises, and the premises are sold by landowner, the developer is liable for service tax. Whether the landowner will also be liable for service tax if he receives any booking amount?
- f) If the builder constructs property using own workforce and takes advance from prospective buyers then whether service tax will apply or services provided are in nature of self supply of services and not subject to service tax? Whether one can apply/refer to the decision in case of *Magus Construction (P) Ltd.* 15 STT 9, and say that advance received was against consideration for sale of flat?

# Accounting for and Issue related to Preliminary/Share Issue Expenses



**This article covers the discussion on accounting treatment of preliminary expenses, share issue and public issue expenses including stamp duty paid on increase in authorised share capital and related deferred tax impact.**



**CA. Kevin Daftary**

The author is a member of the Institute.  
He can be reached at  
[eboard@icai.org](mailto:eboard@icai.org)

**A**fter the introduction of Accounting Standard (AS) 26 'Intangible Assets', various deliberations have undergone for what should be the correct accounting treatment of preliminary expenses incurred by the companies at the time of formation. These expenses include initial company formation cost which include the cost of legal consultant for application and formation of company and also includes cost incurred in completing necessary legal formalities with Registrar of Companies (ROC). Significant amount of such costs also includes stamp duty paid on authorised share capital and cost related to issue of share/debenture certificates.

Even after a passage of almost four years of standard becoming mandatory, even today we can see many companies carrying in their balance sheet preliminary expenses under the head of Miscellaneous Expenses. This article aims to elaborate the discussion on the same and also highlight finer points as to which all expenses can be carried forward under the head Miscellaneous Expenses. Preliminary expenses are defined under the Guidance note on terms used in the financial statements as:

"Expenses relating to the formation of an enterprise. These include legal, accounting and share issue expenses incurred for formation of the enterprise."

Schedule VI to the Companies Act allowed following costs to be carried forward under the head Miscellaneous Expenditure. Before the introduction of Companies Accounting Standard Rules, 2006 (Relevant extract is reproduced on the next page):

**"Miscellaneous Expenditure:** (to the extent not written off or adjusted):

- (1) Preliminary expenses.
- (2) Expenses including commission or broker age on underwriting or subscription of shares or debentures.
- (3) Discount allowed on the issue of shares or debentures.
- (4) Interest paid out of capital during construction (also stating the rate of interest).
- (5) Development expenditure not adjusted.
- (6) Other items (specifying nature)."

However AS 26 specified clearly in the para 56 that such preliminary expenses should be expensed when incurred. Hence these should be charged to profit and loss account. The para 56 is reproduced as:

#### **Para 56 of AS 26**

"In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is always recognised as an expense when it is incurred (see paragraph 41). Examples of other expenditure that is recognised as an expense when it is incurred include:

- a. Expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs)."

To this extent, it was conflicting with the requirement of the Schedule VI to the Companies

Act, 1956. There was another conflict in exchange difference capitalisation but the same is not discussed in this article.

Till the introduction of the Companies Accounting Standard Rules, 2006 (as amended), there was a view prevalent in the industry that If there is a conflict between accounting standard published by the ICAI and the statute, the statute will always prevail. In the current case, preliminary expenses being mandatory requirements to be written off to profit and loss account as per the AS 26 as against the same to be carried forward as per the requirement of Schedule VI, wherein Schedule VI will prevail. Hence, most of the companies were carrying these expenses under the head 'Miscellaneous Expenditure' and were avoiding their one time write-off to the profit and loss account and were spreading the same over the period of three to five years.

However, with the introduction of the Companies Accounting Standard Rules, 2006, AS 26 being part of the rules notified under the powers given by the Companies Act to the Government, this conflict has been resolved. Now all preliminary expenses need to be written off in the year when incurred in accordance with AS 26. However, one question remains: What about the share issue expenses including public issue expenses incurred by the company?

AS 26 specifically excludes these costs from the scope of AS 26 by virtue of the para 5 of AS 26 which reads as under:

#### **Para 5 of AS 26**

"Exclusions from the scope of an Accounting Standard may occur if certain activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of contracts between insurance



**There is no clear answer as to how Stamp Duty paid on the increase in authorised share capital should be viewed as increase in authorised share capital generally precede the actual issue and allotment of shares.**



enterprises and their policyholders. Therefore, this statement does not apply to expenditure on such activities. However, this statement applies to other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance enterprises. Accounting issues of specialised nature also arise in respect of accounting for discount or premium relating to borrowings and ancillary costs incurred in connection with the arrangement of borrowings, share issue expenses and discount allowed on the issue of shares. Accordingly, this Statement does not apply to such items also."

This gives an opportunity to the company to defer the cost related to share issue expenses under the head Miscellaneous Expenditure as permitted by Schedule VI and due to scope exclusion made by the AS 26.

The view presently taken is that share issue expenses including those relating to public issue expenses can be carried forward under the head Miscellaneous Expenses.

Another interesting topic of argument connected to share issue expenses is which items should be included in the term share issue expenses/public issue expenses. There is no definition of share issue expenses given under any of the prevailing accounting standard. However, the Guidance note (GN) on terms used in the financial statements defines share issue expenses as follows:

"Costs incurred in connection with the issue and allotment of shares. These include legal and professional fees, advertising expenses, printing costs, underwriting commissions, brokerage, and also expenses in connection with the issue of prospectus and allotment of shares."

Also public issue expenses have been defined under the EAC opinion Vol. XI 3.1, as mentioned below:

"The Committee is of the view that, in general, all expenses incurred directly in relation to a

public issue should be considered as public issue expenses. In other words, public issue expenses are those expenses which would not have been incurred had the public issue not been made, e.g., Registrar's Processing Charges, expenses on printing and distribution of application forms, prospectus, etc. Further, in the view of the Committee, public issue expenses would be those which are incurred between the decision to make the public issue and completion of all necessary formalities with regard to the issue."

Thus share issue expenses can still be allowed to be carried forward under the head Miscellaneous Expenditure, if it satisfies the definition of share issue expenses.

One of the very common element of cost incurred in the nature of share issue expenses, is stamp duty paid on the increase in authorised share capital and argument as to the same can be treated as share issue expenses in the absence of shares being issued. There is no clear answer as to how it is viewed as increase in authorised share capital generally precede the actual issue and allotment of shares. Hence, any stamp duty paid for increase in authorised share capital with this view should be treated to be falling within the definition of share issue expenses.

While dealing with accounting treatment of the share issue expenses one should also remember the implication it will have in income tax, as the same will affect tax expenses in the form of deferred tax. Generally if it is for the first-time issue and falling under the section 35D, it will result in timing difference and hence require the accounting for the deferred tax asset/liability on the same.

However, in case a subsequent increase in authorised share capital and stamp duty paid for increase in authorised share capital is treated as capital expenditure and disallowed under the Income-tax Act, 1961, which will result in permanent difference on which no deferred tax should be recognised.

# Taxability Under Central Sales Tax Act on Interstate Transfer of Goods for Job Work



**Section 6A of the Central Sales Tax Act, 1956 provides for a presumption of sale of goods in case of movement of goods from principal to agent and vice versa and also when goods moves from one business place of dealer in State A to another business place of dealer in State B. Transferor is supposed to obtain declaration in Form F from its transferee in other state and submit the same to its assessing officer. Till the Finance Act, 2002, dealer had option to discharge the onus of proving the transfer otherwise than by way of sale through evidences other than Form F. The situation has been changed by the Finance Act, 2002, which inserted the words "and if the dealer fails to furnish such declaration, then the movement of such goods shall be deemed for all purposes of this Act to have been occasioned as a result of sale." Thus, Form F has now become mandatory. However, different legal positions and stands taken by tax authorities in different states have put dealers in a state of dilemma. The article discusses the issue.**



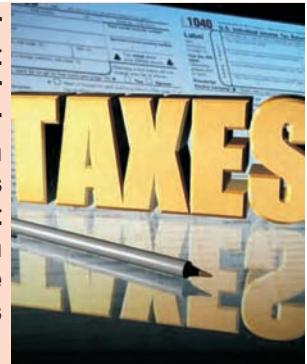
**CA. Sanjay K. Agarwal**  
*(The author is a member of the Institute.  
 He can be reached at eboard@icai.org)*

**C**entral Sales Tax is essentially a tax on interstate sale of goods. 'Sale' is defined in section 2(g) of the Central Sales Tax Act by an inclusive definition. Transfer of property in goods by one person to another is basic ingredient of sale. If there is no transfer of property in goods, movement of goods from one person to another can not be treated as sale for the purposes of taxation under the Act. For being treated as sale, material must move from one person to another and also property in goods should get transferred.

There are situations in business, when material moves from one person to another without intention of transfer of property. Such movement may be for minor or major repairs, for job work on material, returnable samples and so on.

Section 6A of the Central Sales Tax Act provides for a presumption of sale of goods in case of movement of goods from principal to agent and vice versa and also when goods moves from one business place of dealer in State A to another business place of dealer in State B. Section is very

**" The submission that the goods sent for job work or received for doing job work, do not amount to sale would depend upon the contract entered into between the parties and would be the subject matter of examination by the Assessing Authority. Even otherwise, under section 2(g) (ii) of Central Act, transfer of goods used in execution of works contract is treated as sale. If the petitioner claims that it is not liable to tax on the transfer of goods from U.P to ex U.P., then it would have to discharge the burden placed upon it under section 6A by filing declaration Form F. It would be immaterial whether the person to whom the goods are sent for or received after job work is a bailee."**



specific and envisages only two types of transfers of material (i) principal to agent & vice-versa and; (ii) from one business place in one state to another business place in other state. No other interstate movement, which is claimed to be otherwise than by way of sale, can be brought to tax under the Central Sales Tax Act, 1956. For coming out of ambit of presumptive taxation in above two situations, remedy is provided in section 6A itself. Transferor is supposed to obtain declaration in Form F from its transferee in other state and submit the same to its assessing officer. Till the Finance Act, 2002, dealer had option to discharge the onus of proving the transfer otherwise than by way of sale through evidences other than Form F. The situation has been changed by the Finance Act, 2002, which inserted the words "and if the dealer fails to furnish such declaration, then the movement of such goods shall be deemed for all purposes of this Act to have been occasioned as a result of sale." Thus, Form F has now become mandatory and transaction of stock transfer or consignment sale, though duly supported by the evidence of transportation and other documents, is chargeable to tax as sale, if declaration in Form F is not furnished.

### Interstate Transfer of Goods for Job Work

As is clear from above discussion, every movement of material is not necessarily by way of sale. Section 6A of the Central Sales Tax Act, 1956 brings only two types of movement which are otherwise than by way of sale, within the ambit of sale. Essentially, movement of material for job work is not one of such movement. This has been the understanding of trade and regulators throughout. However, there remained some sort of confusion within trade and matter was referred to the Commissioner Trade Tax, Uttar Pradesh for clarification about requirement of Form F on inter-state movement of goods for job work.

Commissioner vide its circular dated November 28, 2005 directed that as per section 6A of the Central Sales Tax Act, in case of transfer of goods for otherwise than by way of sale, Form F will be required. Admittedly, a job worker is not an agent of person whose material it is processing. Section 182 of the Indian Contract Act, 1872 defines 'agent' and 'principal' as "An agent is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the 'principal.' The relation between owner of material and job worker is not that of 'principal' and 'agent'. When a dealer sends any goods to another person located in a different state for job work or for manufacturing etc., the transaction will normally be on a 'principal to principal' basis with an independent operator.

### Proceedings Before High Court

Validity of above clarification (circular) was challenged by way of writ-petitions before honourable Allahabad High Court by several dealers. In some of the writ petitions, apart from the transaction of job work there was transaction of return of goods to the outside the Uttar Pradesh dealers, on which respective assessing authorities had directed the petitioners to furnish declaration Form F failing which the tax under the Central Sales Tax Act, 1956 was to be imposed. A Division Bench of Allahabad High Court, before whom, the writs were listed for admission, disposed off the writs at admission stage itself upholding the validity of the Circular and held as under in *Ambica Steels Limited vs. State of U.P. [2008] 12 VST 216 Judgment dated August 17, 2007:-*

**"The submission that the goods sent for job work or received for doing job work, do not amount to sale would depend upon the contract entered into between the parties and would be the subject matter of examination**

1. Circular No. Vidhi-2(1) CST -8(5) – (05-06) - / 464/ Trade Tax dated November 28, 2005 [Computer no. - 841 dated November 29, 2005]

**Different legal positions and stands taken by tax authorities in different states have put dealers in a state of dilemma. Assessing Authorities in the State of Maharashtra will not insist for Form F whereas their counterparts in Uttar Pradesh, Uttarakhand and Rajasthan are duty bound to ask for Form F in case of inter-state movement of material for job work. Though the Apex Court has not expressed any opinion about legality of requirement of Form F on interstate movement of goods for job work, doctrine of merger applies and now legal position laid down by Allahabad High Court is 'law of the land'.**

by the Assessing Authority.

Even otherwise, under section 2(g) (ii) of Central Act, transfer of goods used in execution of works contract is treated as sale. If the petitioner claims that it is not liable to tax on the transfer of goods from U.P. to ex U.P., then it would have to discharge the burden placed upon it under section 6A by filing declaration Form F. It would be immaterial whether the person to whom the goods are sent for or received after job work is a bailee."

### Proceedings Before Supreme Court

Appeal against aforesaid judgment of Allahabad High Court was decided by Supreme Court on March 31, 2009 in *Ambica Steels Ltd vs. State of U.P. and Others* [2009] 24 VST 356 wherein assessee stated that it will file Form F with the authority. As the assessee agreed to file the form, the legal issue of requirement of form 'F' on transfer of material for job work was not decided by the Court. However, in para 3 of the judgment, the Court ordered as follows:

"At this stage, it may be mentioned that on the scope and applicability of section 6A of the Central Sales Tax Act, 1956, there exists difference of opinion between the various sales tax collectors in the country and, therefore, since the appellant is now ready to file Form F, we are directing the assessing officer not to impose penalty/interest, in the reassessment proceedings as one-time waiver. Needless to add that waiver of penalty and interest shall be admissible only on Form F being furnished by the assessee within the prescribed period."

In para 5 of the judgment, the court further stated thus:

"We are informed that certain state(s) within whose jurisdiction the transferee is located is/are not issuing F forms. In such an eventuality it would be open to the assessing officer to complete reassessment proceedings on its own merits after examining the

transaction between the parties, keeping in mind the circumstances that the assessee is not in a position to obtain the F form, for no fault of his."

### Stand by State Tax Authorities in Different States

Dealers in different states have raised questions/queries with respective tax authorities about applicability of Form F on interstate transfer of material for job work. Commissioner of Sales Tax, Maharashtra, in its circular dated February 20, 2007<sup>2</sup> clarified that no Form F need to be submitted in case of interstate movement of material for job work. Para 4 of the circular reads as under:-

"Therefore, when a dealer sends any goods to another person located in a different State for job work or for manufacturing etc., the transaction will normally be on a 'principal to principal' basis with an independent operator and not on a 'principal to agent' basis. Section 6A of the CST Act will have no applicability as regards the transaction where the goods are sent on a 'principal to principal' basis. It follows that in such instances where the contract is on a 'principal to principal' basis, it will not be required for the dealer to obtain a declaration in form F from the person to whom the goods have been dispatched. Similarly, the amendment to section 6A in 2002, which provides that where the dealer fails to produce the declaration in Form F, the movement of goods shall be deemed to have been occasioned as a result of sale is not applicable to 'principal to principal' transaction."

As above circular was issued before decision by Allahabad High Court, Commissioner of Sales Tax, Maharashtra reaffirmed above position in another circular dated January 29, 2009<sup>3</sup> after noting decision by High Court. Besides affirming its stand taken earlier, the Commissioner has further directed that in case of a dealer based in Maharashtra, who wants Form F for issuance to their counterparts

2. Trade Circular No. 16T of 2007, dated February 20, 2007 [No. VAT/Clarification/1006/202/Adm-3]  
 3. Trade Circular No. 5T of 2009, dated January 29, 2009 [No. VAT/MMB/1008/15/Adm-6]

in other States, either against receipt of material for job work in the state of Maharashtra or against material received in Maharashtra after job work in other states, such form will be issued by the Department as per normal procedure.

Commissioner of Taxes, Uttarakhand, in its circular dated February 29, 2008<sup>4</sup> has directed assessing authorities to insist for submission of Form F by dealers for interstate transfer of goods for job work. Circular further directs that if the dealer does not furnish Form F, tax can be imposed on dealer presuming such transfer as interstate sale.

Commissioner of Commercial Taxes, Rajasthan *vide* its circular dated March 30, 2009<sup>5</sup> has directed assessing officers to ask for Form F for interstate transfer of material from the state for job work and also for transfer of material back after job work, in case job work was performed on material received from a dealer situated out of Rajasthan. Circular further states that "in case, a dealer fails to furnish such declaration form, action as per section 6A of the CST Act, 1956 should be initiated."

### Dilemma of Dealers

Above legal position and stand taken by tax authorities in different states has put dealers in a state of dilemma. Assessing authorities in the State of Maharashtra will not insist for Form F whereas their counterparts in Uttar Pradesh, Uttarakhand and Rajasthan are duty bound to ask for Form F in case of inter-state movement of material for job work.

Though the apex court has not expressed any opinion about legality of requirement of Form F on interstate movement of goods for job work, doctrine of merger applies and now legal position laid down by Allahabad High Court is 'law of the land'. The law so laid down is binding on all courts/ tribunals and bodies. Circulars of the administrative authorities cannot prevail over the law laid down by the apex court. This position has been reiterated time and again and recently in *Kalyani Packaging Industry vs. Union of India* [2005] 141 STC 116 (SC) & Commissioner of Central

*Excise vs. Ratan Metting and Wire Industries* [2005] 142 STC 595 (SC). Even the State of Maharashtra has withdrawn its earlier two circulars quoted hereinabove by issue of another circular on January 11, 2010<sup>6</sup>, as both of them were issued before the judgment from the Supreme Court. Commissioner of Sales Tax, Maharashtra State has also laid down that F forms are mandatory for all transactions of inter-state transfers (not by way of sale) including job work and goods return. However this circular does not indicate in clear terms whether authorities in Maharashtra will insist for production of form 'F' for material transferred out of their State. As the apex court has not expressed opinion about legality of requirement of Form F on interstate movement of goods for job work, dealers in Uttarakhand and Rajasthan can approach their High Courts for announcement of correct legal position. Dealers in other states may also approach their respective High Courts either on issuance of circular by their state tax authorities or on getting notices from assessing officers for submission of Form F.

In para 5 of its judgment, the apex court has directed assessing officers to bear in mind that authorities in some of the transferee states may not issue Form F to dealers for issuance to their counterparts in other states. Now, if a dealer is not able to get Form F from its business associate in other state, it will insist for a sort of certificate or communication from tax authorities in that other state of that effect. Tax authorities in that other state may be reluctant to issue such a certificate, and without that certificate, authority in transferor state will not allow exemption from tax.

The other implication created by these judgments is that the authorities may insist on furnishing of F form even for sales return. Interestingly, circulars issued by State Governments referred to above are silent on this aspect.

As the matter pertains to Central Sales Tax, Central Government should come into action and should either amend section 6A of the Central Sales Tax Act or should issue a circular to clear doubts either way.

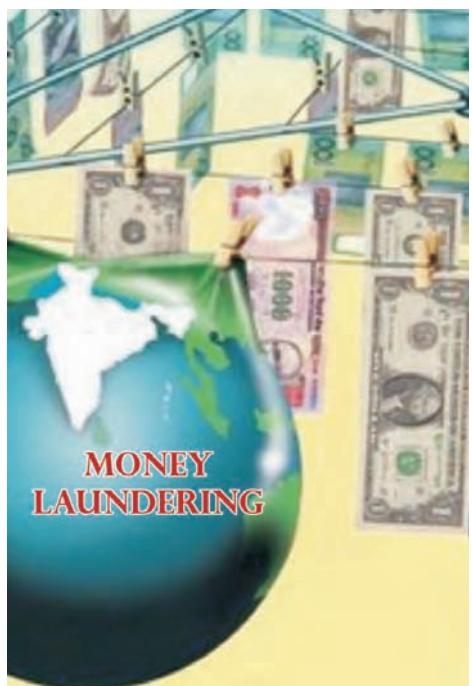
**The other implication created by these judgments is that the authorities may insist on furnishing of F form even for sales return. Interestingly, circulars issued by State Governments referred to above are silent on this aspect. As the matter pertains to Central Sales Tax, Central Government should come into action and should either amend section 6A of the Central Sales Tax Act or should issue a circular to clear doubts either way.**

4. No. 4059/ Com.Tax U.K./ Com. Tax/ Law-Section/ 2007-08/ Dehradun

5. No. F.16 Tax/ VAT/ CCT/2230-32

6. Trade Circular No. 2T of 2010, dated January 11, 2010 [No. VAT/MMB/1008/15/Adm-6/B] [2010] 27 VST (Jou.) 220

# Money Laundering and Financing of Terrorism – A Study on Methods to Fight Money Laundering in India & USA



**Money laundering happens in almost every country in the world and the most common modus operandi typically involves transferring money through several countries in order to obscure its origins.** According to international accounting firms, India is estimated to have a parallel economy of nearly 40 per cent of its \$600 billion Gross Domestic Product. It is widely accepted that money laundering can be defined as the process of legitimising “ill-gotten wealth”. The process of money laundering involves disguising of illegal assets, converting them into legal gains, and removing them from access by the criminal justice system while retaining their economic value. This article tries to explain exactly what money laundering is, who launders money and how they do it and what steps the authorities are taking to foil money-laundering operations and fight against terrorism.

## Dr. Anuradha Gupta

The author is Associate Professor,  
P.G.D.A.V College, Delhi.  
She can be reached at  
[gupta.anuradha@yahoo.co.in](mailto:gupta.anuradha@yahoo.co.in)

## Money Laundering

Money laundering involves disguising financial assets so that they can be used without detection of the illegal activity that produced them. Through money laundering, the launderer transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source. It's a daunting task to trace the origins of any deposit when there are about 700,000 global wire transfers occurring every day. Within United States, there are two primary methods employed by the government to detect and combat money laundering: legislation and law enforcement. In US, money laundering is a serious charge — in 2001, US prosecutors obtained almost 900 money-laundering convictions with an average prison sentence of six years. The rise of global financial markets makes money laundering easier than ever before as countries with bank-secrecy laws are directly connected to countries with bank-reporting laws, making it possible to anonymously deposit “dirty” money in one country and then have it transferred to any other country for use.

Money laundering, at its simplest, is the act of making money that comes from Source A look like it comes from Source B. In practice, criminals are trying to disguise the origins of money obtained through illegal activities so it looks like it was obtained from legal sources. Otherwise, they can't use the money because it would connect them to the criminal activity, and law-enforcement officials would seize it.

The most common types of criminals who need to launder money are drug traffickers, embezzlers, corrupt politicians and public officials, terrorists and con artists. Drug traffickers are in serious need of good laundering systems because they deal almost exclusively in cash, which causes all sorts of logistics problems. Not only does cash draw the attention of law-enforcement officials, but it's also really heavy.

**Money laundering Process:** The basic money laundering process has three steps:

1. Placement - At this stage, the launderer inserts the dirty money into a legitimate financial institution. This is often in the form of cash bank deposits. This is the riskiest stage of the laundering process because large amounts of cash are pretty conspicuous, and banks are required to report high-value transactions.
2. Layering - Layering involves sending the money through various financial transactions to change its form and make it difficult to follow. Layering may consist of several bank-to-bank transfers, wire transfers between different accounts in different names in different countries, making deposits and withdrawals to continually vary the amount of money in the accounts, changing the money's currency, and purchasing high-value items (boats, houses, cars, diamonds) to change the form of the money. This is the most complex step in any laundering scheme, and it's all about making the original dirty money as hard to trace as possible.
3. Integration - At the integration stage, the money re-enters the mainstream economy in legitimate-looking form—it appears to come from a legal transaction. This may involve a final bank transfer into the account of a local business in which the launderer is "investing" in exchange for a cut of the profits, the sale of a yacht bought during the layering stage or the purchase of a \$10 million screwdriver from a company owned by the launderer. At this point, the criminal can use the money without getting caught. It's very difficult to catch a launderer during the integration stage if there is no documentation during the previous stages.

**The most common types of criminals who need to launder money are drug traffickers, embezzlers, corrupt politicians and public officials, terrorists and con artists. Drug traffickers are in serious need of good laundering systems because they deal almost exclusively in cash, which causes all sorts of logistics problems. Not only does cash draw the attention of law-enforcement officials, but it's also really heavy.**



### Methods of Money Laundering

There are many ways to launder money, some of which are sophisticated and complicated. The most common examples include:

- "Smurfing" (or structuring) : Depositing cash at various institutions in amounts less than the amount that must be reported to government, and subsequently transferring them to a central account.
- Currency smuggling : Moving funds across borders to disguise their source and ownership by mail, courier or body packing (often to countries with strict bank secrecy laws).
- Exchanging transactions : Buying foreign currency that can be transferred to offshore banks.
- Purchasing assets with bulk cash : Purchasing cars, boats and real estate in someone else's name then selling them and depositing the funds.
- Gambling : Buying gambling chips and after placing a few bets, redeeming the chips for a casino cheque. Effective anti-money laundering laws make it easier to detect and investigate money laundering activities by establishing links between criminal activity and the funds generated from that activity.

### Financing of Terrorism

In recent years, global efforts to combat money laundering and the financing of terrorism have assumed heightened importance. Money laundering and the financing of terrorism are global problems

that not only threaten security, but also compromise the stability, transparency, and efficiency of financial systems, thus undermining economic prosperity. With the globalisation of economies, the act of money laundering often involves complicated financial transactions in multiple jurisdictions, thus making it virtually impossible to trace the origin of such funds.

With the growing activities of trans-national organised crime syndicates, the laundering of criminally derived gains is fast becoming a lucrative and sophisticated business across the globe. In some countries, which lack the respective legislation, this mechanism of money laundering moves more quickly and smoothly. In countries like Albania, the major part of illegal proceeds is derived from trafficking in drugs and human beings at the transnational level. The huge gains profited are invested by formal means in legitimate businesses, such as construction companies and in the lubricants trade.

In Japan, a money laundering scheme is implemented through the purchasing of bearer securities, use of fictitious accounts and remittance to foreign bank account for the purpose of concealing the true ownership and origin of the money.

### The Alarming Statistics

Estimating how much money is actually laundered in the United States, in any other Country, or globally is extremely difficult. Money laundering is a largely secretive phenomenon. The exact number of launderers that operate every year, how much money they launder in which countries and sectors, and which money laundering techniques they use is not known exactly. A sustained effort between 1996 and 2000 by the FATF to produce such estimates failed. In fact, no direct estimates exist of how much

money passes through the financial system, whether broadly or narrowly defined, for the purposes of converting illegal gains into a no traceable form. John Walker<sup>25</sup> (1995) was the first to make a serious attempt at quantifying money laundering and initial output. His model suggests that US\$2.85 trillion are laundered globally. As per an estimate of the International Monetary Fund, the aggregate size of money laundering in the world could be somewhere between two and five per cent of the world's Gross Domestic Product. Although money laundering is impossible to measure with precision, it is estimated that US\$300 billion to US\$500 billion in proceeds from serious crime (not tax evasion) is laundered each year. Though data on the size of money laundering is scant, UK and US officials estimate that "the amount of money laundered annually in the financial system worldwide was roughly \$500 billion – some 2% of global GDP". According to international accounting firms, India is estimated to have a parallel economy of nearly 40 per cent of its \$600 billion Gross Domestic Product.

The different countries address the crime of money laundering in countless legislative acts. Here we are discussing the various laws enacted in US and India.

### Anti-Money Laundering (AML)-US

Anti-money laundering (AML) is a term mainly used in the financial and legal industries to describe the legal controls that require financial institution and other regulated entities to prevent or report money laundering activities. Anti-money laundering guidelines came into prominence globally after the September 11, 2001 attacks and the subsequent enactment of the 2001 US Patriot Act.

Today, most financial institutions globally, and many non-financial institutions, are required to



**John Walker<sup>25</sup> (1995) was the first to make a serious attempt at quantifying money laundering and initial output. His model suggests that US\$2.85 trillion are laundered globally. As per an estimate of the International Monetary Fund, the aggregate size of money laundering in the world could be somewhere between two and five per cent of the world's Gross Domestic Product. Although money laundering is impossible to measure with precision, it is estimated that US\$300 billion to US\$500 billion in proceeds from serious crime (not tax evasion) is laundered each year.**



**The international community has recognised the adverse consequences of cross-border money laundering movements as early as 1980s and taken several initiatives such as the Vienna Convention (1988), dealing with drug trafficking money, and the Palermo Convention (2000) focusing on transnational crimes, none of which has been ratified by India. India is yet to become a member of the Financial Action Task Force on Money Laundering (FATF), which seeks to improve national legal systems.**

identify and report transactions of a suspicious nature to the financial intelligence unit in the respective country. For example, a bank must perform due diligence by ascertaining a customer's identity and monitor transactions for suspicious activity. To do this, many financial institutions utilise the services of special software, and use the services of companies such as World Compliance to gather information about high risk individuals and organisations. United States federal law related to money laundering is implemented under The Bank Secrecy Act of 1970 as amended by anti-money laundering acts up to the present. The 1986 Money Laundering Control Act makes money laundering a crime in itself instead of just an element of another crime, and the 1994 Money Laundering Suppression Act orders banks to establish their own money-laundering task forces to weed out suspicious activity in their institutions. The 2001 US Patriot Act sets up mandatory identity checks for US bank patrons and provides resources towards tracking transactions in the underground / alternative banking systems frequented by terrorist money handlers. Many people have confused Anti-Money Laundering (AML) with Anti-Terrorist Financing (ATF). Under the Bank Secrecy Act of USA, Money Laundering and Terrorist Financing are classified into two different categories when financial institutions file Suspicious Activity Reports (SAR) to Financial Crimes Enforcement Network (FinCEN) which is a US government agency. To effectively implement AML and ATF measures, The US government encourages financial institutions to work together for AML and ATF purposes in accordance with Section 314(b) of the 2001 US Patriot Act. However, since financial institutions are required by law to protect the privacy of their clients, section 314(b) co-operation has not been generally adopted by

financial institutions. To overcome this obstacle, the United Crimes Elimination Network (UCEN) has been established by AML and ATF professionals to achieve this global co-operation goal in compliance with the privacy laws of most countries.

**Software:** An entire industry has developed around providing software to analyze transactions in an attempt to identify transactions or patterns of transactions that may constitute illegal financial activity. Financial institutions face penalties for failing to properly file CTR (Currency Transaction Report) and SAR (Suspicious Activity Report) reports, including heavy fines and regulatory restrictions, even to the point of charter revocation. These software applications effectively monitor bank customer transactions on a daily basis and, using customer historical information and account profile, provide a whole picture to the bank management. Transaction monitoring can include cash deposits and withdrawals, wire transfers, credit card activity, cheques (checks), share (securities) dealing and ACH activity. In the bank circles, these applications are known as BSA software or AML software.

#### **Anti-Money Laundering (AML)-India**

In countries like India, money laundering takes place through over-invoicing of exports, under-invoicing of imports, investment through shell companies and extensive use of hawala channels in the transmission of money. Indian readers need no introduction to the term "money laundering". The concept of coloured cash and cleaning procedures are familiar, but the perceptions of our lawmakers and citizens have been restricted to tax evasion — with various laws dedicated to eradicate this phenomenon.

No serious efforts were made to identify the genesis of the problem, the sources of tainted

money, accumulation, modes of channelisation into a nation's financial system - yet India is perceived to be a major centre for "hawala" transactions, and needs to assess the threat not just to its economy, but its political system and sovereignty.

The amendments to the Prevention of Money Laundering Act (PMLA), 2002, should be aimed at detecting and identifying money laundering and cross-border proceeds, with appropriate tools for deterrence and detection.

The international community recognised the adverse consequences of cross-border money laundering movements as early as 1980s and took several initiatives such as the Vienna Convention (1988), dealing with drug trafficking money, and the Palermo Convention (2000) focusing on transnational crimes, none of which has been ratified by India. India is yet to become a member of the Financial Action Task Force on Money Laundering (FATF), which seeks to improve national legal systems. Currently, India has three separate laws dealing with money laundering. The Narcotics and Psychotropic Substances (NDPS) Act, 1985, applies to proceeds of drug offences in certain limited situations, the Unlawful Activities Act (UAPA), which under a 2004 amendment, provides for raising funds for terrorism being a predicated offence and PMLA, which came into effect only when the Rules were in place in 2005, and is intended to deal with all types of money laundering.

The NDPS Act, which applies only to drug offences, does not require a conviction for the predicate offence. PMLA requires a predicate offence conviction in order to take cognizance, and the schedules to the Act include corruption, prosecution of wildlife, drug and human trafficking, but virtually ignore capital and financial markets.

India has, however, taken initiatives in the accountability and supervisory roles of regulator in financial and capital markets, which are dealt with by the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI) and Insurance Regulatory and Development Authority (IRDA). The roles are well defined and the RBI was the first to establish the customer due diligence guidelines

while SEBI's vigilance in protecting capital markets does not need elaboration. SEBI promulgated its own guidelines on anti-money laundering measures even before the RBI.

PMLA requires all banks and intermediaries to maintain records of all transactions, according to nature and value and report to the director. Currently under the rules, this includes cash transactions involving more than one million rupees, or even less if connected integrally, involving forgery or counterfeit notes or instruments or any suspicious debits, credits, payments, loans, etc. In all fairness, the PMLA rules pertaining to the maintenance of and verification of records for all the sectors have been in place since 2005. But the existing regimes encompassing PMLA, UAPA and NDPS have been virtually ineffective, with investigations far and few and even lesser prosecutions and convictions till date.

Powers of confiscation, freezing and forfeiture are also largely dependent on the law providing for the predicated offence. In fact the PMLA provides for confiscation of proceeds of crime, but not of the instrumentalities used in an offence. International co-operation depends on bilateral arrangements and treaties where they exist, and letters

of request in others. This is where FATF membership would provide a single window.

The proposed amendments seek to incorporate existing key provisions of the PMLA rules in recording and maintaining information and making reporting mandatory for all intermediaries, particularly for all foreign transactions. Casinos, money changers and transfer service providers, international credit card gateways are to be subjected to regulatory and reporting requirements. As of now, the latter are governed by the RBI regulations that mainly deal with their customer-related operations. All offences pertaining to insider trading and market manipulation will also be brought into PMLA as well as smuggling of antiques, terrorism funding, human trafficking other than prostitution, and a wider range of environmental crimes.

To effectively combat cross-border money laundering, India has to make its financial systems FATF compliant, provide for better tracking

**In the 2008 INCSR report it was stated that India's emerging status as a regional financial centre, its large system of informal cross border money flows and its widely perceived tax avoidance problems all contribute to the country's vulnerability to money laundering activities. Some common sources of illegal proceeds in India are narcotics trafficking; illegal trade in endangered wildlife, trade in illegal gems (diamonds), smuggling, trafficking in persons, corruption, and income tax evasion. India continues to be a drug-transit country.**

measures, and incorporate proper mechanisms for investigation, prosecution, easier extradition processes, cross border applicability in foreign jurisdictions, even when the predicated offence is committed in India.

**Software:** In order to comply with the Reserve Bank of India's regulatory order of preventing the money laundering, India's largest bank, State Bank of India (SBI), has installed AMLOCK, the Anti Money Laundering Solution from 3i InfoTech. SBI contracted with IT software product firm 3i InfoTech to deploy its anti-money laundering solution across the group comprising SBI and six associate banks to monitor any suspicious transfer of money, including terror financing. 3i InfoTech has been deployed in the entire SBI group that includes its associate banks - State Bank of Patiala, State Bank of Bikaner and Jaipur, State Bank of Indore, State Bank of Hyderabad, State Bank of Mysore and State Bank of Travancore.

The banking regulator RBI, along with the Financial Intelligence Unit of India, has made it compulsory for all banks in the country to assume an anti-money laundering technology to maintain its customers' trust.

### Strategy to Deal with Financing of Terrorism

#### • Global Strategy

The global agenda to curb money laundering and the financing of terrorism calls for a co-operative approach among many different international bodies. Money laundering has become a serious global issue. In response, AML law enforcement has toughened up. Fines imposed are up to \$10m, and more than 150 countries have pledged to co-operate in fighting against the funding of terrorism. Efforts to establish an international standard response against money laundering and the financing of terrorism have been led by the Financial Action Task Force on Money Laundering (FATF). The FATF is an intergovernmental body comprising the G-7 member states, the European Commission and eight other countries. Its purpose is to develop and promote policies at both the national and international level, that combat money laundering and terrorist financing aspects for banks and through the development of the FATF 40, forty Recommendations which serve as the international framework for AML efforts. In October, 2001, FATF expanded its mission to include combating the financing of terrorism, and adopted Eight Special Recommendations on Terrorist Financing. The boards of the World Bank and the International Monetary Fund

(IMF) have recognised these recommendations as the appropriate international standard for combating money laundering and the financing of terrorism.

The World Bank and the IMF have also established a collaborative framework with the FATF for conducting comprehensive AML assessments of countries' compliance using a single global methodology. The FATF adopted its new Forty Recommendations in June 2003, and the revised assessment methodology covering both the FATF Forty Recommendations and the eight Special Recommendations was subsequently adopted by the FATF in February 2004.

The boards of the World Bank and the International Monetary Fund have agreed to adopt a more comprehensive and integrated approach to conducting assessments of compliance with international standards for fighting money laundering and terrorist financing in member countries, and to step up the delivery of technical assistance to those countries whose financial systems are most at risk. The assessments are carried out as part of the Financial Sector Assessment Program and lead to a Report on Observance of Standard and Codes (ROSCs).

Despite these victories, the truth is that no individual nation has the power to stop money laundering—if one country is hostile to laundering, criminals simply look elsewhere for a place to clean their money. Global co-operation is essential. The most prominent international organisation in this respect is probably the Financial Action Task Force (FATF), which has 33 member states and international organisations on its roster list as of 2005. The FATF issued the "40 Recommendations" for banks (there are actually 49 now, but the moniker hasn't changed) that have become the anti-money-laundering standard. These recommendations include:

- Identify and do background checks on depositors.
- Report all suspicious activity. (For example, if a background check revealed that depositor A works in a steel factory, and he typically deposits \$2,000 every two weeks, a series of 10 \$9,000 deposits over the course of two weeks should raise a red flag.)
- Build an internal taskforce to identify laundering clues.

The "recommendations" are really more like rules than friendly tips. The FATF keeps a list of "uncooperative countries" -- those who have not enacted

the recommendations. The FATF encourages its member states not to deal with those countries in financial matters.

Other global organisations fighting money laundering include the United Nations, the International Monetary Fund, the World Bank, and smaller groups like the Caribbean FATF and the Asia/Pacific Group on Money Laundering.

While increased worldwide efforts are making a small dent in the money-laundering industry, the problem is huge, and the money launderers are winning overall. Countries with bank-secrecy rules, which arguably have legitimate benefits to the honest depositor, make it extremely hard to track money once it's transferred overseas. Still, the FATF's uncooperative list has come down from 15 countries in 2000 to two countries (Myanmar and Nigeria) in 2005. By most accounts, this is a significant sign of progress. Only increased global awareness and co-operation can curb the success of the money-laundering industry.

**Problem in Identifying Terrorist Financing :** The only problem is that there are no clear red flag indicators of terrorist financing for financial institutions and that is because terrorists often obtain funding for their operations and training through incremental payments from otherwise legitimate charities.

In an analysis by World Bank of some 50 international terrorist financing cases, the charities and individuals who ran them did not appear on any government-issued terrorist blacklist. As a result, banks had no means to determine whether a transaction that might fund a terrorist attack was suspicious.

One way by which financial institutions might try to prevent terrorist financing is to look at each individual involved in running the charity when dealing with a charity. When opening these accounts, compliance officers should ask for the names of board of officers and run their names through [know your customer service] that vendors provide. If one of the individuals turns out to be suspicious, then the officer may want to consider not opening the account.

#### • **Strategy in India**

Anti-money laundering formalities are very powerful in India. These are very effectively in place in India, compared to the other parts of the world. Any economic/banking crime can be easily tracked down in India, compared to any other place. Banks are having Money Laundering Reporting Officers (MLRO's) to raise suspicious transactions

to the concerned due diligence and compliance departments, and for further follow up. It's not easy in India to do money laundering activities and have a cake walk. The banking procedures in India are stricter than many other countries and at many points these are subject to stringent scrutiny. But Hawala transfers in hard cash cannot be easily controlled due to non-availability of documents. However, that does not come under banking. According to Indian observers, funds transferred through the hawala market are equal to between 30 to 40 per cent of the formal market. The RBI estimated that remittances to India amounted to \$28.2 billion.

An international accounting firm has estimated that money laundering flows into India are reported to be in excess of \$1 trillion every year by drug dealers, arms traffickers and other criminals. Recent years have seen rapid changes in the financial services industry and growing regulatory expectations and pressures. Combating money laundering and terrorist financing continues to be a major challenge for the banking sector as gatekeepers to the legitimate financial system. However, the responsibility for stemming money laundering activities is also shared by other financial institutions like insurance companies, brokerage houses, etc.

Regulatory analysis of money laundering risks and anti-money laundering laws in India appear to be still at a nascent stage. However, based on a Global AML Survey conducted by an international accounting firm at the end of 2007, it became apparent that the emerging economies, including India, were investing in tightening the money laundering regulations in India.

In the 2008 INCSR report it was stated that India's emerging status as a regional financial centre, its large system of informal cross border money flows and its widely perceived tax avoidance problems all contribute to the country's vulnerability to money laundering activities. Some common sources of illegal proceeds in India are narcotics trafficking; illegal trade in endangered wildlife, trade in illegal gems (diamonds), smuggling, trafficking in persons, corruption and income-tax evasion. India continues to be a drug-transit country.

On 1st March 2009 US has Cautioned that the Hawala money in India is directly linked to terrorist financing and has suggested to New Delhi to strengthen its anti-money laundering and counter-terrorism-finance legislations. It also recommended that New Delhi should work towards becoming a full-fledged member of Financial Action Task Force (FATF), an inter-governmental body for development

of policies to combat money laundering and terrorist financing.

### A Pressing Need for Strict Enforcement

By a thorough inspection and examination of respective local criminal legislation and the legal means at the disposal of governments to suppress organised crime, it would be reasonable to acknowledge that the legal system to counter money laundering needs considerable strengthening at the global level and a lot of work is required to tackle the menace of the effects of money laundering. In addition, the legal structures on money laundering differ greatly from one country to another since criminalisation of money laundering is dependent upon the economic, social, political and psychological backgrounds that these countries offer.

Actually, we may group countries, based on a three tier assessment device, with regard to the scope of concerns expressed by them on money laundering.

First tier countries, such as Japan and Albania, have well-defined laws against money laundering. They have also set up Financial Information Units (FIUs) which provide and share relevant information on money laundering with investigative authorities. In Japan, the Anti-Organised Crime Law came into force in February 2000. This law expanded the scope of predicate offences of money laundering, from traditional drug crime to various serious crimes. In addition, this law provides for the suspicious transactions reporting systems for these offences and it unifies money laundering crime information. After arrangement and analysis, the chief of the FIU is eligible to share the relevant information with investigation authorities.

Second tier countries are those who have enacted or are in the process of enacting legislation to counter money laundering. India and Bangladesh can be placed in this category since they have enacted legislation on money laundering which defines predicate offences; a suspicious transaction, etc. and seek to put a Financial Intelligence Unit in place. However, the specialised system, to be put in place to combat money laundering operations, will take time to bear fruit.

The third tier countries are those like Laos, which are yet to pay their full attention to this matter. The enforcement of law on economic crime, especially on money laundering is becoming a serious handicap or impediment to the normal functioning of the rule of law. The level of law enforcement differs greatly among countries. More specifically in Albania, there is challenging legislation, when it comes to the

compliance with standards of major international treaties and conventions that universally cover the issues of transnational organised crime, including money laundering, but the level of law enforcement is still modest.

### Conclusion

Weak central banks, existence of illegal non-banking institutions and the failure on behalf of intergovernmental structures to perform adequately and professionally their vital responsibilities in detecting and preventing suspicious transactions are some of the issues which need to be addressed to make the detection of money laundering more effective. Eventually, each country needs to seriously revise their local legal policies, in the light of relevant international engagements in order to invoke more efficient money laundering deterrent devices. To deal with rising regulatory pressures and complex compliance, banks need flexible and evolutionary AML solutions that will readily adapt to future changes in both money laundering practices and the regulations designed to fight them. Implementing long term, adaptive AML procedures and using the latest intelligent IT technology (auditing, transaction filtering, profiling, blacklist management, etc.) are essential.

Organisations must improve international co-ordination and align their processes, technology, and people behind their AML efforts. Tightening regulations and laws call for significant changes in banking processes, including:

- Control of clients' identity and transfers (domestic and cross-border)
- Record-keeping of identity verifications and completed transactions
- Internal reporting of suspicious transactions and appointing an AML reporting officer
- External non-compliance reporting, to government, regulators, and other organisations

Auditing Banks' processes and procedures must also comply with local legislation. The US Patriot Act, for instance, prescribes very strict procedures for foreign account follow up, as well as strict deadlines for answering regulators' requests.

Given the stringency of regulatory requirements, technology is a key enabler for banks. Today's money laundering techniques make manual detection extremely difficult. Most current manual systems are inadequate and banks are being required by regulators to implement robust technological measures. Adaptive and flexible technical solutions are needed to enable necessary upgrades that will meet future regulatory requirements.

# Behavioural Finance: A Road Less Travelled

**Behavioural finance, with its roots in the psychological study of human decision making, is a relatively new and evolving subject in the field of finance. In brief, behavioural finance is the study of investors' psychology while making investment decisions. Being a relatively new subject, not much prodigious research literature is available in this subject. However, some research studies have revealed that psychological biases such as emotions, fear, over-confidence, greed, and risk aversion influence investors' behaviour that, in turn, influences stock markets. As such, there is a need for studying and understanding behavioural finance to exploit investors' psychology for profits. This article provides an overview of past research on behavioural finance and then, based on empirical evidence, investigates into the behaviour of the investors, their psychology, and investing style.**



**Prof S. S. Khanka**

(The author is faculty of National Institute of Financial Management, Faridabad. He can be reached at khanka@nifm.ac.in)

Ever since the popping of the technology stock bubble in March 2000, behavioural finance has taken a more prominent role in the financial media and more importantly in the minds of financial advisors globally. Never in the past behavioural finance was such an important subject as it has emerged in the recent times. The reasons for its ever increasing relevance are not difficult to seek. As individuals differ in their individual characteristics such as attitudes, emotions, beliefs, desires and determination, so do differ their behaviour towards investment decision making. Much of economic and financial theory is based on the notion, popularly known as 'Efficient Market Hypothesis', henceforth EMH, that individuals act rationally and consider all available information in the decision-making process. Researchers have proved with evidence that this is frequently not the case. Behavioural finance operates under the assumption that all investors are not rational. In fact, research studies are replete with large amount of evidences of investors' irrational behaviour and repeated errors made by investors in decision-making activity. This notion is duly

**Behavioural finance is the study of investors' psychology while making financial/investment decisions.** Sewell (2001) has defined behavioural finance as "the study of the influence of psychology on the behaviour of financial practitioners and the subsequent effect on markets". According to Shefrin (1999), "behavioural finance is the application of psychology to financial behaviour - the behaviour of investment practitioners."



supported by the apt statement of Peter L. Bernstein in "Against the God": "*the evidence reveals repeated patterns of irrationality, inconsistency, and incompetence in the ways human beings arrive at decisions and choices when faced with uncertainty.*" Irrational investment decision making has impending effect on profit or loss. Then, the issue is how to deal with such a situation. This has given genesis to a new subject known as 'behavioural finance' in the field of finance. Behavioural finance as a subject attempts to better understand and explain how emotions and cognitive errors influence investors' decision-making process. Many researchers, if not all, believe that these human errors or flaws are consistent, predictable, and can be exploited for profits. The same underlines the need for and significance of understanding behavioural finance with more clarity for exploiting investors' irrational behaviour for making profits. Against this backdrop, the purpose of this article is to explain and exemplify the meaning of behavioural finance, offer a brief review of research and theory on behavioural finance and investigate into the investors' behaviour, their psychology and their investing style based on empirical evidence. Attempt is also made to know whether investors make rational decisions or make

decisions based on emotions and sentiments.

### What is Behavioural Finance?

One way to begin with understanding behavioural finance can be seeking cue from the meaning of organisational behaviour. Just as organisational behaviour is the study of why people behave as they behave at workplace, behavioural finance studies why investors take investment decisions as they take. In other words, behavioural finance studies why people buy or sell the stocks and why they do not buy stocks at all. It means, as human psychology influences people behaviour at work, so it does also influence investors' behaviour in stock market. Behavioural finance is commonly defined as the application of psychology to finance. In other words, behavioural finance is the study of investors' psychology while making financial / investment decisions. Sewell (2001) has defined behavioural finance as "the study of the influence of psychology on the behaviour of financial practitioners and the subsequent effect on markets". According to Shefrin (1999), "behavioural finance is the application of psychology to financial behaviour - the behaviour of investment practitioners. Practitioners need to know that because of human nature, they make

particular types of mistakes. Mistakes can be very costly. Behavioural finance enables investment practitioners to learn to recognise their own mistakes and those of others; understand the reasons of mistakes; and avoid mistakes." In the opinion of Parag Parikh, "behavioural finance is the study of investors' psychology while making financial decisions." He further states with his experience that "investors fall prey to their own and sometimes others' mistakes due to the use of emotions in financial decision making." The principal objective of an investment is to make money, or say, earn profit. It is, therefore, usually assumed that investors act, and based on the 'EMH', in a rational manner to earn profit. But, researchers have reported with evidence that this is not usually the case. Instead, it has been proved that investors' decisions, more often than not, are influenced by their fear, greed, risk seeking and aversion, thus, making decision as irrational and undefined. That is why Thaler (1999) opines: "I think of behavioural finance as simply "open-minded finance." Investors generally take wrong and/or poor decisions and, in turn, perform poorly relative to their objectives. Here comes the role of behavioural finance that tries to understand and explain how such an irrational decision-making of investors can be exploited for profits. In essence, behavioural finance helps the investor become rational in investment decision making. A rational investor acts in different ways including, but not limited to the following:

- Makes decisions to maximise the expected utility.
- Fully informed with unbiased information.
- Absence of any distortion of judgement based on emotions.

### Why Study Behavioural Science?

As regards why to study behavioural finance, it is imbued with multiplicity of justifications. First and foremost, behavioural finance is of interest because it helps explain why and how markets might be inefficient. This is so because the research on investors' behaviour helps explain various market anomalies that challenge the standard theory, i.e. EMH. Speaking alternatively, as against the EMH, investors always do not behave rationally. Researchers have proved that investors' behaviour or decisions at times are influenced by emotions, fears, greed, peer group pressures, herd behaviour, risk seeking and aversion, and other cognitive biases like heuristics. These psychological factors make investors take incorrect or poor investment

decisions. The rationale behind understanding behavioural finance lies in the fact that it helps understand how these mental errors and emotional pitfalls can cause stocks to be wrongly valued, i.e. either overvalued, or undervalued and creates investment strategy that gives a winning edge over the other investors.

### Traditional Finance vs. Behavioural Finance: A Theoretical Perspective

*Traditional Finance:* Traditional finance has a long history and has been dominated by the EMH for over three decades. EMH has dominated the traditional finance mainly because of three basic theoretical arguments in favour of it. The first and most significant is that investors are rational and by implication behave rationally while making investment decisions i.e. valuing securities. Second is based on the assumption that every individual investor takes due care of all available information before making investment decisions. Information is related to internal consistency. In other words, investors need to make each investment decision



**Stock-trading is also plagued by investors' overconfidence. In the study, "Do Investors Trade Too Much?", a researcher Terrance Odean (1999) found that overconfident investors generally conduct more trades than their less-confident counterparts. They do also bet too heavily on particular stock or sectors. This is because the over-confident investors/traders tend to believe that they are better than others at choosing best times to enter/exit a position.**

**In the absence or dearth of better and reliable information, investors generally assume current prices as right. This phenomenon is called ‘anchoring.’ In a bull market, for example, new stocks are anchored by their closeness to their last records. As such, distant history becomes irrelevant. Investors generally tend to give more weight to recent experiences, extrapolating recent trends that are often at odds with long-run averages and probabilities.**

in such a systematic manner that it is in agreement with one another irrespective of the subject.

The third argument is that the individual investor always pursues self-interest while making investment decision. Most widely applied method in finance in this regard is the expected utility model of choice under risk, proposed by Von Neumann and Morgenstern in De Bondt (1991). Its rationality is based on axioms underlying expected utility maximisation as the optimal rule. The accumulation and processing of information and the formation of expectations occur efficiently, yielding possible outcomes and corresponding possibilities.

**Behavioural Finance:** Behavioural finance has emerged as a new subject in finance that drops the traditional assumptions of investors' rational behaviour in an efficient market known as 'EMH.' As against this, behavioural finance is based on two major building blocks: 'cognitive psychology' and the 'limits to arbitrage'. Cognitive psychology refers to how people think and the limit to arbitrage when market is inefficient. The evolution of the concept of behaviour finance can be traced back to 1912, when Selden (1912), in his book 'Psychology of the Stock Market', believed that the movement of prices on the exchanges are dependent, to a very considerable degree, on the mental attitude of the investing and trading public. Later in 1956, the U.S psychologist Leon Festinger (1956) introduced a new concept in social psychology: 'the theory of cognitive dissonance'. The basic tenet of this theory was that when two simultaneously held cognitions are inconsistent, this produces a state of cognitive dissonance. Because the experience of dissonance is unpleasant, the person will strive to reduce it by changing his/her beliefs.

Review of research on behavioural finance



shows that much of the basic theories of behavioural finance concern with a new concept of 'bounded rationality', a term associated with Herbert Simon (2001). It basically relates to the cognitive limitations on decision-making. As a result human behaviour, or, decision-making is made generally on the basis of simplified procedures also called heuristics (Tversky, Amos and Daniel Kahneman 1986). This is consistent with the study done by Slovic (1983) on investment risk-taking behaviour. He found that man has limitations as a processor of information and shows some judgemental biases which lead people to overweight information. Besides, people also tend to be overreacting to certain information (Thaler 1985). Two researchers Amos Tversky and Daniel Kahneman (1974) have used three heuristics that are used in making investment judgements and often lead to systematic biases. These are:

**Anchoring and Adjustment:** In numerical prediction, when a relevant value, i.e. an anchor is available, people make predictions by starting from an initial value, or say, an anchor that is adjusted to yield the final value. The value may be predicted either by formulating a problem or by computation. In either case, such adjustments are typically insufficient.

**Availability:** People assess the possibility of an event by the ease with which occurrences can be brought to mind. In case of availability heuristic, people rely upon information/knowledge that are readily available rather than examine other alternative information. There is research evidence to believe that the reliance on the availability heuristic leads to systematic biases.

**Representativeness:** Representative heuristic suggests that people make judgments based on the similarity between current situations and prototype of those situations. In other words, this heuristic

leads people to believe that 'like causes like' and 'appearance equals reality.'

Subsequently, Kahneman and Tversky (1979) criticised the 'expected utility theory' and developed a new model which they called 'prospect theory' to describe decision making under risk and uncertainty. According to them, expected utility theory is unable to explain why people are often simultaneously attracted to both insurance and gambling. They provided empirical evidences to believe that people often underweight outcomes that are merely probable i.e., uncertain in comparison with outcomes that are obtained with certainty. Under prospect theory, they assigned value to gains and losses rather than to final assets. Also probabilities are replaced by decision weights. Similarly, Shiller (1981) also discovered that stock price volatility is far too high to be attributed to new information about future real returns.

The emergence of the modern concept of 'behavioural finance' is considered the work of Werner F.M. De Bondt and Richard Thaler titled 'Does the Stock Market Overreact?', published in 'The Journal of Finance' (De Bondt & Thaler, 1985). They discovered that people systematically overreacting to unexpected and dramatic news events results in substantial weak-form inefficiencies in the stock market. Such a finding was, of course, both surprising and profound. Subsequently, Thaler (1985) developed a new model of investor behaviour called 'mental accounting' to explain a set of cognitive operations to organise, evaluate, and keep track of their financial activities. With an objective to understand investor's

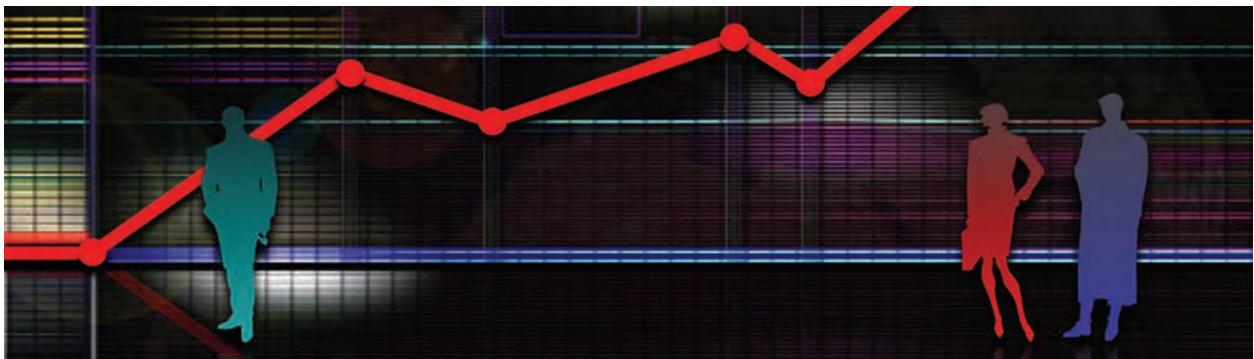
behaviour, Banerjee (1992) developed a simple model of 'herd behaviour', also called 'crowd behaviour', i.e. tendency among investors, analysts and fund managers to respond to stock market in the manner others are doing without giving any rationality to their behaviour or decision. Herd behaviour causes two actions: panic buying and panic selling. An example of investors' herd behaviour can be traced back to the overvalued Reliance Power IPO Q4' 2007. Reliance Power IPO was oversubscribed 73 times. This was an issue from Ambani stable, who were the most high-profile sufferer. Reliance Power ended its first day on the markets at Rs. 372 against issue price of Rs. 450. Millions lost money. The Sensex dropped 863 points in sympathy (Vishnami and Shah 2009).

This is also a story of greed becoming graveyard.

Tversky and Kahneman (1992) modified their original 'prospect theory' as 'cumulative prospect theory' employing cumulative rather than separable weights, applying to uncertainties as well as to risky prospects with any number of outcomes, and allowing different weighting functions for both gains and losses. Based on experiments, the theory predicts a distinctive four-fold patterns of risk attitudes: risk aversion for gains and risk seeking for losses of high probability, risk seeking for gains and risk

aversion for losses of low probability. Sewell (2004) as a modification added a calculator to cumulative prospect theory that can deal with greater than four-fold pattern of risk attitudes as reported by Tversky and Kahneman (1992). In the accounting literature, Basu (1997) finds evidence for the conservatism principle, which he interprets as earnings reflecting 'bad news' more quickly than 'good news'. Some





researchers (Daniel, Hirshleifer & Subrahmanyam, 1998) propose a theory of security markets based on investor over-confidence and biased self-attrition (which causes changes in investors' confidence as a function of their investment outcomes) which ultimately leads to market under and overreaction. Lee and Swaminathan (2000) showed that past trading volume provides an important link between 'momentum' and 'value' strategies and these findings help reconcile intermediate-horizon 'under-reaction' and long-horizon 'overreaction' effect. One researcher provides compelling evidence that people have a propensity to invest in the familiar, while often ignoring the principles of portfolio theory (Huberman 2001).

### Behavioural Finance in Practice

Research studies on investors' behaviour have revealed that the limited time, knowledge, and processing ability bound investors to opt for simpler decision procedures or heuristics. Study done by Kent et al. (2001) found that evidence for systematic cognitive errors made by investors and these biases affect prices. They have listed the common behaviour exhibited by investors as follows: (1) Investors generally do not participate in all categories of securities, (2) Individual investors exhibit loss averse behaviour, (3) Investors often use past performance as an indicator of future performance in making investment decisions, (4) Investors exhibit aggressive behaviour in trading, (5) Investors behave on status quo, (6) Investors do not always form efficient portfolios, and (7) Investors use historical high or low in stocks while making investment decisions. The most important of these are discussed as follow:

**Over-confidence:** There is a fine line of distinction between confidence and over-confidence. Confidence implies realistically trusting in one's abilities, while over-confidence usually implies an overly optimistic assessment of one's knowledge

or control over a situation. Over-confidence, i.e. over-estimation or exaggerating, is one's ability to successfully perform a particular task. Consider the number of times that you've participated in a competition or contest with the attitude that you have what it takes to win – regardless of the number of competitors or the fact that there can only be one winner. Stock-trading is also plagued by investors' overconfidence. In a study entitled "Do Investors Trade Too Much?", one researcher Terrance Odean (1999) found that overconfident investors generally conduct more trades than their less-confident counterparts. They do also bet too heavily on particular stock or sectors. This is because the over-confident investors/traders tend to believe that they are better than others at choosing best times to enter/exit a position. Investors' overconfidence leads to momentum investing which is just other way of saying 'buy high & sell higher'. This is a form of gambling which makes investors particularly susceptible to torpedo stocks – the



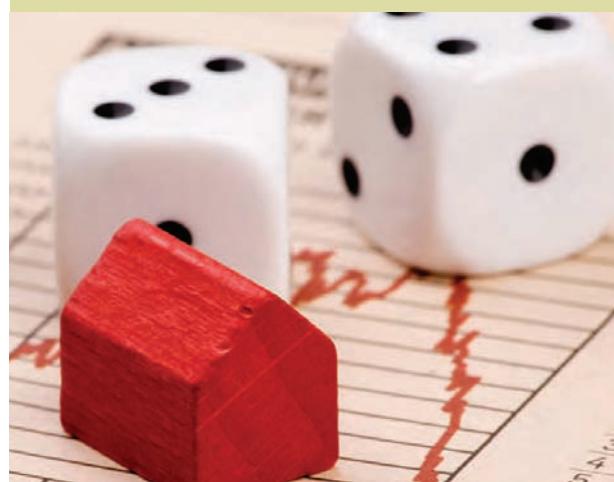
**According to Charles Heath, President of Roller Coaster Stocks, there are four rules before investing in stock market: (i) Do not invest with the crowd, (ii) Get out of the way, (iii) Be patient, and (iv) Take profit – do not give them back.**

overpriced, the speculative stocks whose prospects have been heavily hyped but are also primed for a disastrous plunge that could ruin any portfolio. It is likely to be even worse when investors speculate on margin, investing with borrowed money.

**Anchoring:** In the absence or dearth of better and reliable information, investors generally assume current prices as right. This phenomenon is called 'anchoring.' In a bull market, for example, new stocks are anchored by their closeness to their last records. As such, distant history becomes irrelevant. Investors generally tend to give more weight to recent experiences, extrapolating recent trends that are often at odds with long-run averages and probabilities.

**Heuristic Bias:** In simple words, heuristic means simple or rule of thumb procedure to do something. The human mind craves clairvoyance, but anyone's ability to see the future is extremely limited. In investment decisions, individual investors in the absence of much knowledge and processing ability, use known past data as the predictors for future performance of stocks and accordingly invest in stocks. In reality, such predictions are likely to be faulty and, in turn, wrong leading to poor decisions.

**Investor credulity and systematic mispricing in general suggest for a possible role for investment regulation on part of the Government to protect investors and to improve risk sharing. The government policy and regulation on investment can help investors make better investment decisions and can also improve the efficiency of the market prices.**



Relying on such simple information or heuristics is called 'Heuristic Bias.'

**Over and Under-Reaction:** Anchoring produces over and under-reaction by investors towards stocks. Giving too much weight to recent or current prices at the expense of other information leads to over- or under-reaction. Investors tend to become more optimistic when stock prices go up and, on the contrary, more pessimistic when the stock prices (stock market) slumps. The result is prices fall too much on bad news and rise too much on good news leading to 'bear' and 'bull' markets. History of stock markets in the world including India is replete with such evidences that investors' over- or under-reaction has led to extreme events at times in the stock markets. William Gross sums up such situation by saying: "Markets invariably move to undervalued and overvalued extremes because human nature fall victim to greed and/or fear."

**Prospect Theory:** According to prospect theory (Kahneman and Tversky 1979), investors behave differently to similar situations depending on whether it is presented in the context of a loss or gain. What is typical to notice is they become more distressed at the possibility of losses to occur than they become happy at the prospect of equivalent gains. This is suggestive of the fact that investors are generally loss averse. They are willing to take more risks to avoid losses than to realise gains. This also means that when faced with sure gain, most of the investors are risk averse, but when faced with sure loss, they become risk takers. This is duly confirmed by a research finding (Kahneman & Tversky, 1979).

The researchers presented groups of subjects with a number of problems. One group of subjects was presented with this problem:

**Problem One:** In addition to whatever you own, you have been given \$1,000. You are now asked to choose between:

- A. A sure gain of \$500
- B. A 50% chance to gain \$1,000 and a 50% chance to gain nothing.

Another group of subjects was presented with another problem as follows:

**Problem Two:** In addition to whatever you own, you have been given \$2,000. You are now asked to choose between:

- A. A sure loss of \$500
- B. A 50% chance to lose \$1,000 and a 50% chance to lose nothing.

In the first group 84 per cent chose A. In the second group 69 per cent chose B. See, the two

**There are still some unresolved questions regarding behavioural finance like:**

**(i) Do age, income, previous investment outcomes, or bull and bear market backdrops influence investors' biases and, in turn, their investment decisions?**

**(ii) Are investors' biases rooted to relatively static personality traits? It is hoped that the future researchers will certainly try to answer these questions with their research findings.**



problems are identical in terms of net cash to the subject. It's only the phrasing of the question that causes the problems to be interpreted differently and, in turn, reacted differently.

**Regret Theory:** Regret theory is about emotional reaction to a mistake committed or poor judgment made either buying a stock that has gone down or not buying one which has subsequently gone up. The aftermath effect of regret is to avoid selling stocks that have gone down to further avoid regret of having made a bad investment. Researchers argue that past bad investment decisions cause investors to feel regret and this alters their behaviour in such a way as to become irrational.

**Herding:** Another form of investors' behaviour is herding behaviour. It is found that the irrational investors invest in something that is being hyped up as they feel that others are doing the same thing. They feel that if others are doing it then, it must be a good idea for them to do it as well. They themselves do not rationalize their investment decision in favour of a popular stock. According to Kent et al. (2001), investors tend to behave parallel with each other, regardless of whether the decisions are smart or not.

**Momentum Investing:** During bull phases, markets are full of momentum investing which is just another way of saying "buy high & sell higher". In momentum investing, investors look for the greater fool who will pay more for the share than they did. In a sense, it is a form of gambling that makes investors particularly susceptible to torpedo stocks, i.e. the overpriced, speculative stocks whose prospects have been heavily hyped but are primed for a disastrous plunge to ruin any portfolio.

Investors' behavioural biases and personality dimensions are also found intimately related which have implications for the investors' behaviour. For example:

- ❖ Introverts have low risk tolerance vis-à-vis extroverts.
- ❖ Extrovert people at times are more irrational and over-confident in their investment decision making.
- ❖ People who think a lot before taking an investment decision have high risk tolerance.
- ❖ More structured people are, more realistic and rational they are in their investment decision taking.
- ❖ Males have higher level risk tolerance than their female counterparts.
- ❖ People characterized by personality dimensions like extrovert and critical are more susceptible to behavioural biases such as overconfidence and unrealistic.

### Application of Behavioural Finance

The purpose of behavioural finance is, given the irrational investors' behaviour, to create better investment portfolio for financial advisors. In doing so, certain key challenges relating to investment decisions need to be tackled:

- ❖ First and foremost, the investment advisors need a comprehensive guidebook to make them understand the basics of behavioural biases and how to properly diagnose them in their clients.
- ❖ Second, after having diagnosed the client's behavioural biases, the advisors need to know what to do with that information and how to deal with it. For example, in some given set of behaviours, investment advisors should know whether to change behaviour of the client to match the behavioural set that is right for the client or should they change the behavioural pattern to match the client's behaviour.
- ❖ Third, investment advisors should evolve a common behavioural finance language to

properly describe and communicate the behavioural biases to investment advisors.

### Empirical Evidence on Behavioural Finance

We have made an attempt to investigate into the investment behaviour of 100 investors (50 males and 50 females) in Delhi. The primary data was collected in May 2009. Investors' behaviour has been classified into two broad types, namely, rational and irrational behaviour as shown in the following table:

**Table 1: Investors' Behavioural Profile**

(N= 100)

Variables	Mean	Standard Deviation
<i>Rational Behaviour</i>		
Environmental	2.69	0.794
Financial	3.71	0.905
Economic	3.97	0.786
<i>Irrational Behaviour</i>		
Emotional	3.27	1.349
Frame of References	3.31	0.793
Herding Behaviour	2.74	0.983

It is evident from Table 1 that economic consideration is the most important factor in influencing investors' behaviour followed by financial and frame of references. However, emotional factor, i.e. gut-feeling, over-confidence and over-reaction, is found comparatively less influential in determining investors' behaviour. Herding behaviour and influence of environmental factors are found the least influential in determining investment behaviour of individual investors in that order.

Given the investors' behavioural profile, one obvious but vexing question arises is: Why do investors not behave in the manner we think they should? Based on research findings (De Bondt

**With an objective to understand investor's behaviour, Banerjee (1992) developed a simple model of 'herd behaviour', also called 'crowd behaviour', i.e. tendency among investors, analysts, and fund managers to respond to stock market in the manner others are doing without giving any rationality to their behaviour or decision. Herd behaviour causes two actions: panic buying and panic selling. An example of investors' herd behaviour can be traced back to the overvalued Reliance Power IPO Q4' 2007.**

1991), two major reasons can be attributed to it. First, substantial financial management directly affects people's well-being. Second, investors own behaviour, to a great extent, is likely to affect the market happenings. There is research evidence to support the view that with costly arbitrage, psychological factors become relevant in decision-making activity. As such, investors' behaviour cannot be modelled on the EMH assumption of rational decision making. The reason is stock market like any other market is not just like a weighing machine in which the value of each item is recorded by an external and that too impersonal mechanism. Instead, stock market is like a voting machine where innumerable individuals (i.e., investors) register their choices which are the (internal) product partly of individuals' reasons and partly of their emotions.

### Few Recommendations

As is evident from the preceding description that behavioural biases influence investment decisions making investors prey to mistakes and losses. Here are some recommended tips that can help the investors avoid investors' common behavioural biases leading to investment mistakes:

- According to Charles Heath, President of Roller Coaster Stocks, there are four rules before investing in stock market: (i) Do not invest with the crowd, (ii) Get out of the way, (iii) Be patient, and (iv) Take profit – do not give them back.
- Investor credulity and systematic mispricing in general suggest for a possible role for investment regulation on the part of Government to protect investors and to improve risk sharing. The Government Policy and Regulation on Investment can help investors make better investment decisions and can also improve the





efficiency of the market prices.

- Standardisation of mutual fund advertising, disclosure rules and reporting rules in making financial reports consistent and easy to process, may also be helpful for investors to make decision and also limit their freedom of action.
- Remedial measures can also be initiated on the part of investors by educating investors relating to security market dynamics.

### Concluding Remarks

In conclusion, behavioural finance attempts to prove the assumption that investors do not always behave rationally. Here a good quote to sum up behavioural finance provided by Shleifer (2000) seems worth citing: 'at the most general level, behavioural finance is the study of human fallibility in competitive markets.' Factors like over-confidence, fear of regret, loss or risk aversion, speculations, herd behaviour, emotions, and over and under-reaction more often than not precipitate the irrational behaviour of investors. These factors cause investors not to take the correct and / or rational investment decision. This can go some way to explaining the eventual collapse of several investment episodes like dot.com bubble 2000. Behavioural finance combines elements of psychology and financial to attempt to understand the irrational behaviour of investors and exploits the same for profits.

Behavioural finance being an evolving subject is yet to be researched and understood to adequately and properly understand and apply it for making good and rational investment decisions. There are still some unresolved questions regarding behavioural finance like: (i) Do age, income, previous investment outcomes, or bull and bear market backdrops influence investors' biases and, in turn, their investment decisions? (ii) Are investors' biases rooted to relatively static personality traits? It is hoped that the future researchers will certainly try to answer these questions with their research findings.

### Appendix 1

Following is a checklist for you. Complete the checklist by giving the answer as "Never", "Occasionally," or "Frequently". Assign one point each time to the answer "Never" or "occasionally" and give two points each time you answer "frequently."

#### *How frequently do you do each of these tasks?*

1. Encourage clients to adopt a broad view of their wealth, prospects and objectives.
2. Encourage clients to make long term commitments to policies.
3. Encourage clients not to monitor results too frequently.
4. Discuss the possibility of future regret with your clients.
5. Ask yourself if a course of action is out of character for your client.
6. Verify that the client has a realistic view of the odds, when a normally cautious investor is attracted to risky ventures.
7. Encourage the client to adopt different attitudes to risk for small and for large decisions.
8. Attempt to structure the client's portfolio to the shape that the client likes best (such as insuring a decent return with a small chance of large gain).
9. Make clients aware of the uncertainty involved in investment decisions.
10. Identify the aversion of your clients to the different aspects of risk, and incorporate their risk aversions when structuring an investment programme.

Following is the interpretation of scores:

Score	Interpretation
06 to 10	You need lots of understanding in behavioural finance
11 to 15	You are not too poor in understanding behavioural finance
16 to 20	You did not need any more to understand behavioural finance

# Available Rights and Benefits to Micro, Small and Medium Enterprises



**Micro, small and medium (MSM) enterprises** in India contribute nearly 39 per cent of the manufacturing output and 33 per cent of country's exports in terms of money. These enterprises numbering about 12.8 million provide employment to nearly 31 million people. To help MSM enterprises in India, Micro, Small Scale and Medium Enterprises Development Act, 2006, effective from 02-10-2006, came into force. This Act gives various rights to MSM enterprises, although there are certain deficiencies in the Act. Besides, the Government has formulated many schemes for the benefit of MSM entities, which are not known to many MSM enterprises. Further, the professionals dealing with the MSM sector can assist these entities only if they themselves are aware of the rights/benefits available to MSMs. This article, therefore, intends to acquaint the readers with the current scenario of rights/benefits available to MSM enterprises in India.



**CA. Nelatur Syamasundaran**

(The author is a member of the Institute.  
He can be reached at [eboard@icai.org](mailto:eboard@icai.org))

## Rights of MSEs

**U**nder the Micro, Small Scale and Medium Enterprises Development Act, 2006, effective from 02-10-2006, Micro and Small Enterprises (MSEs) as defined under the Act are entitled to receive the payment from ALL buyers of goods or services from such enterprises within the stipulated period.

The stipulated period is the Credit Period agreed upon between the buyer and the MSEs in writing. In the absence of this, the stipulated period is the day following the expiry of 15 days from the date of delivery of goods or rendering of services, if no objection is raised by the buyer within 15 days of delivery of such goods or rendering of services. In case any objection is raised, the stipulated period is the day following the expiry of 15 days

**The buyer is obliged to pay interest to the supplier who is a MSE in case there is a delay in payment beyond the stipulated period and the interest shall be paid along with the payment due for goods/services. The interest is three times of the bank rate. Currently the bank rate is 6 per cent per annum. The interest shall be compounded at monthly rests. The interest expenditure as above is not allowed for computing income of the buyer of goods/services under the Income-tax Act, 1961.**

from the date of removal of such objection by the supplier who is a MSE.

It should be noted that in no case the agreed credit period in writing shall exceed 45 days from the date of delivery of goods if no objection was raised thereof by the buyer within 15 days from the date of delivery of goods or rendering of services or in case of objection, from the date of removal of the said objection by the supplier who is a MSE.

The buyer is obliged to pay interest to the supplier who is a MSE in case there is a delay in payment beyond the stipulated period and the interest shall be paid along with the payment due for goods/services. The interest is three times of the bank rate. Currently the bank rate is 6 per cent per annum. The interest shall be compounded at monthly rests. The interest expenditure as above is not allowed for computing income of the buyer of goods/services under the Income-tax Act, 1961.

Any buyer whose accounts are subject to Audit under any law, shall disclose in the Annual Statement of Accounts, the information such as interest due and dues to supplier, i.e. Principal Amount, beyond the stipulated period as on the date of balance sheet, amount paid towards interest and amounts paid beyond the stipulated period during the accounting year, interest due but not paid as on the balance sheet date but the Principal Amount thereof was paid, accrued interest as on the balance sheet date and further interest payable in the subsequent accounting years until such interest is actually paid. If default is made in adhering to this provision, a fine of not less than Rs. 10,000 is leviable. In order to avail the benefits as above under the Act, it is necessary for the MSE to file a Memorandum with the appropriate government authority. It should communicate its status as a MSE to the buyer. The MSE can do so while accepting the Purchase Order issued by the buyer.

It is immaterial who the buyer of goods/services is. The above provisions apply to any buyer of goods/services from a micro/small enterprise. In other words, the buyer may be a government undertaking or a private enterprise or an individual or even a MSE itself.

In case of any dispute regarding payment for

goods/services or interest for delayed payment, any party to the dispute can refer the matter to Micro and Small Enterprises Facilitation Council. The Council, which has jurisdiction over the place of the supplier, can entertain the reference irrespective of the place of location of the buyer within India. Further, the dispute shall be resolved within 90 days from the date of reference as provided under the Act.

In case an appeal is to be preferred by the buyer against the order as per the above provisions, in a court, the buyer shall deposit at least 75 per cent of the amount, which may be paid to the supplier as per the directions of the court.

### Deficiencies in the Act

1. The period of 45 days as Maximum Credit under the Act that can be agreed between the buyer and supplier needs to be curtailed to 15 days considering the need to reduce the working capital and interest costs of MSEs.

2. Further, the period within which objection can be raised on the supplies by the buyer shall also be reduced to 7 days from the current 15 days from the date of delivery of goods/ rendering of services.

3. In case of non-payment of dues by the buyer, a simple and faster recovery mechanism shall be available to the MSEs.

4. It does not stand to reason that the medium enterprises are not provided the above legal rights though the Act is for the development of all the three categories of enterprises.

5. The large enterprises have found a way out to circumvent the provisions of the Act by claiming in their Annual Report that they do not have any information on the Status whether any Supplier of theirs is a MSE. In order to plug this loophole, it shall be made obligatory on every buyer of goods/ services to obtain the status of a supplier prior to placing an order. Further, in order to prevent the large enterprises from compelling the MSEs not to register, the registration for such enterprises shall be made obligatory.

### Benefits to MSMEs

Though the Act is for the development of Micro, Small and Medium enterprises, many of the benefits

are not extended to medium enterprises and it is high time that this deficiency is corrected.

### 1. Marketing Assistance:

**Exhibitions:** MSMEs are provided marketing assistance by enabling them to participate in international technical/general exhibitions by providing subsidies for space hire charges, freight for carrying goods to exhibition site, air fare to one person to reach the exhibition site, etc. subject to a ceiling in respect of each item. Generally, these events are organised and routed through National Small Industries Corporation (NSIC). However, the total subsidy for an MSME is limited to about Rs.1 lakh-Rs. 2.70 lakhs. The cap on subsidy depends upon whether it is a micro, small or medium enterprise, the place of exhibition, etc. Further, women/SC/ST/North East entrepreneurs are allowed higher subsidies within the above range. Also, there is an overall limit on subsidies per event of Rs. 20-25 lakhs, beyond which special government approval is required.

As one can notice, the total subsidy for an MSME and also for an exhibition is very meagre and hence makes the scheme practically a less helpful one. Further, subsidy is also available in respect of domestic exhibitions organised by NSIC, but only in respect of space cost. Here also the total subsidy is limited to Rs. 30 lakh for an event beyond which special approval of the Government is required.

**Buyers/Sellers Meet:** NSIC may organise buyers/sellers meet so as to bring face to face the prospective bulk buyers including government departments like Railways and Defence with the MSM enterprises for developing the business prospects of MSM enterprises. Though there is no subsidy for general category of MSM enterprises, women entrepreneurs, entrepreneurs from SC/ST categories/North East are eligible for subsidy in space costs ranging from 50 per cent to 95 per cent depending upon whether it is a medium, small or micro unit. Also, there is an overall ceiling on the net budgetary support for any one event ranging from Rs. 1 lakh to Rs. 5 lakh based on the place where the event is organised.

### 2. Performance and Credit Rating:

Micro and small enterprises can apply for awarding credit rating by submitting an application to the concerned credit rating agency with all necessary documents, through NSIC. The enterprise can choose the agency amongst the panel of seven agencies like ICRA, CARE, CRISIL, D&B and SMERA maintained by NSIC. The application

form appears to be simple and the fee can be obtained from the concerned agency.

SMERA is a collaborative venture of SIDBI, banks and credit rating agencies. It says, that an MSE approaching through NSIC can get itself rated for a fee ranging from Rs. 7,500/- to Rs.12,000/- excluding service tax, depending upon its turnover. It claims that it has MoUs with many banks and the rating would help an MSE to get the loan application processed quickly and may also benefit an MSE with lower collaterals/interest rate. NSIC may reimburse 75 per cent of the fee to an MSE and the maximum reimbursement ranges between Rs. 25,000/- and Rs. 40,000/- depending upon the turnover.

The MSEs that are doing well would surely benefit financially by way of lower interest charges from lenders on its borrowings. It also lends credibility to an MSE in its dealings with external agencies including its bankers/customers/suppliers with a favourable credit rating from SMERA. The



**MSMEs are provided marketing assistance by enabling them to participate in international technical/general exhibitions by providing subsidies for space hire charges, freight for carrying goods to exhibition site, air fare to one person to reach the exhibition site, etc. subject to a ceiling in respect of each item. Generally, these events are organised and routed through National Small Industries Corporation (NSIC). However, the total subsidy for an MSME is limited to about Rs.1lakh - Rs. 2.70 lakh.**

benefits are available for a very nominal subsidised fee.

It is not clear whether medium enterprises are eligible to apply under the NSIC scheme for concessional fee with SMERA and also avail the subsidy. It will be better if the Government clarifies this point.

### **3. Bar Coding:**

Micro and small enterprises which are manufacturing units are eligible to get 75 per cent of the registration fee and also of annual recurring fee payable to GS 1 for Bar Code Certification. Applications in this regard can be submitted to the office of the Development Commissioner, New Delhi. As Per GS 1, the current one-time new registration fee and recurring annual fee is Rs. 50,000/- and Rs. 10,000/- respectively.

### **4. Intellectual Property Rights:**

Micro, small and medium enterprises are eligible for reimbursement of the actual expenses incurred for registration of domestic patent up to a maximum of Rs. 25,000/. In case of international patents the ceiling is Rs. 2,00,000/. For registration under Geographical Indications of the Goods Act, the ceiling is Rs. 1,00,000/. The application for availing the financial benefit as above are to be submitted to the office of the Development Commissioner, New Delhi.

### **5. Lean Manufacturing:**

This is a new programme whereby micro, small and medium enterprises can form a mini cluster of about 10 units, register a special purpose vehicle (SPV), appoint a nodal officer for the purpose of taking the assistance of the Lean Manufacturing Programme of the Government. The intending units have to make an application to the office of the Development Commissioner, New Delhi through the National Productivity Council which is designated as "National Monitoring and Implementing Unit (NMIU). If approved by the government, it can get the benefit of implementing the programme in the phase I of a year under the auspices of the National Productivity Council, by engaging approved Lean Manufacturing Consultants (LMC). The Government would contribute 80 per cent of the consultants' fee. The units shall continue the programme in the second year and report the outcome/results to the LMCs/National Productivity Council.

The nodal officers of SPVs and LMCs would



**Micro, small and medium enterprises are eligible for reimbursement of the actual expenses incurred for registration of domestic patent up to a maximum of Rs. 25,000/. In case of international patents, the ceiling is Rs. 2,00,000/. For registration under Geographical Indications of the Goods Act, the ceiling is Rs. 1,00,000/. The application for availing the financial benefit is to be submitted to the office of the Development Commissioner, New Delhi.**

work with the National Productivity Council which in turn report to the Screening and Steering Committee (SSC) at the office of the Development Commissioner, New Delhi.

### **6. Credit-Linked Capital Subsidy Scheme:**

The Ministry of MSM of the Government also notified on 29-02-2008, the continuation of Credit-Linked Capital Subsidy Scheme during the 11<sup>th</sup> Five-Year Plan, i.e. 2007-12, for micro and small enterprises. So, MSEs, upgrading the technology, covering the listed industries/products/activities like testing, printing, packing and satisfying the other conditions can avail the above capital subsidy of 15 per cent for upgrading technology of their plant and machinery. Apart from SIDBI and NABARD, there are other banks like SBI, Canara Bank which are nodal agencies for disbursing the subsidy. The loan amount sanctioned should not exceed Rs. 100 lakh under this scheme and the subsidy is calculated on the plant and machinery and not on the loan amount. The ministry has notified the industry, products, activities, etc., covered under the scheme.

Further, the unit availing subsidy shall run commercially at least for a period of three years after installation of the said machinery.



**The Ministry of MSM of the Government also notified on 29-02-2008, the continuation of Credit-Linked Capital Subsidy Scheme during the 11<sup>th</sup> Five-Year Plan, i.e. 2007-12, for micro and small enterprises. So, MSEs, upgrading the technology, covering the listed industries, products, activities like testing, printing, packing and satisfying the other conditions can avail the above capital subsidy of 15 per cent for upgrading technology of their plant and machinery.**

#### 7. Credit Guarantee Scheme:

Banks can lend to an existing or new micro and small enterprise without collateral or third party guarantee up to a sum of Rs.100 lakh and can avail the credit guarantee scheme of the Government of India by paying the necessary fee and fulfilling other conditions. The guarantee is for 75-80 per cent of the defaulted amount up to a maximum of Rs. 50 lakh. The loan can be term loan and or working capital credit.

#### 8. Government Purchases:

Micro and small enterprises can enroll with NSIC on payment of a fee; based on their plant and machinery investment value; for Government Purchases Programme. This would entail them for free tender documents, waiver of earnest money, relaxation in security deposit.

#### 9. Subsidy For ISO Certification:

Registered (Permanent) micro, small and small scale service business enterprises (SSSBE) are

eligible under the scheme. Such enterprises are entitled for reimbursement of expenses incurred to obtain ISO 9000/ISO 14000 certificates. The limit for reimbursement is 75 per cent of the amount or Rs. 75,000/- whichever is lower. The limit is applicable for each eligible enterprise having a separate Entrepreneur Memorandum Number even though it may have different units within the same premises or outside. Further, in case of ISO Certificate obtained jointly by group companies, the limit is for all group companies even though it may have separate Entrepreneur Memorandum Numbers. The amount will be distributed to different companies on a pro rata basis.

The application for reimbursement can be made to the office of the Development Commissioner, New Delhi.

The scheme is valid up to 31st March 2012.

#### Note:

The limit for investment in plant and machinery / equipment for manufacturing / service enterprises, as notified, by the Government of India, vide S.O. 1642(E) dtd.29-09-2006 are as under:

<b>Manufacturing Sector</b>	
<b>Enterprises</b>	<b>Investment in plant &amp; machinery</b>
Micro Enterprises	Does not exceed twenty five lakh rupees
Small	More than twenty five lakh
Enterprises	rupees but does not exceed five crore rupees
MediumEnterprises	More than five crore rupees but does not exceed ten crore rupees
<b>Service Sector</b>	
<b>Enterprises</b>	<b>Investment in equipments</b>
Micro Enterprises	Does not exceed ten lakh rupees:
Small Enterprises	More than ten lakh rupees but does not exceed two crore rupees
Medium Enterprises	More than two crore rupees but does not exceed five core rupees

Readers interested in further details, forms, etc., can visit the web site of the Ministry of MSM Enterprises, Government of India.

# Enterprise Resource Planning SAP: An Overview



**Enterprise Resource Planning (ERP)** aims to plan the resources of an enterprise to its maximum efficiency. Resources include money, man, machine and material. In order to manage these resources, these should be integrated. A link between the material and the revenue through system is integration. Same logic will apply to consumption of raw materials at the time of production. The SAP ERP application is an integrated enterprise resource planning (ERP) software that aims to target business software requirements of midsize and large organisations in all industries and sectors. This article discusses the salient features in the SAP with reference to its different components.



**CA. Vairavan Sitambaram**  
*(The author is a member of the Institute.  
He can be reached at eboard@icai.org)*

The SAP ERP application is an integrated enterprise resource planning (ERP) software that aims to target business software requirements of midsize and large organisations in all industries and sectors. It allows for open communication within and between all company functions. Most commonly-used components of the SAP are Finance (FI), Accounts Payable (AP), Account Receivable (AR), Bank Accounting, Asset Accounting, Controlling (CO), Product Costing (PC), Material Management (MM), Sales & Distribution (SD) and Production Planning (PP). According to the needs, it is customised and is made available to its users. While customising, identified business processes of organisations are mapped to the SAP standard process. If industry-specific business processes are not to be mapped to standard SAP process, then work-around solutions are advised. Based on requirements, solutions are devised on the country version, e.g. for specific requirement on Customs & Excise duty related to indirect taxes and TDS related to direct taxes in India, the country India version of SAP has been recommended. Additional developments can be made through advanced business application programmes (ABAP). During the implementation of SAP, we may come across Master records and transaction records. The details which may continue over a period of time can be called Master records, e.g. GL Master, Customer Master, Vendors Master, Material Master, and so on. The term Master does not mean that its details cannot be changed. If required, it can also be changed like the address of a customer, though changes occur rarely. Transaction records are those which are maintained on

**Flexible dunning programme is available in SAP to send different versions of communication to customer to remind their outstanding due to the company. Based on business requirement, interest calculation can be done on outstanding overdue balances. When drawing up financial statements, the items in foreign currency are revalued at the end of the month as a month-end activity and will be reversed on next day.**



daily basis, e.g. payment to vendor. Out of various phases in implementation, an important activity of a super user is that she/he should confirm by means of a User Acceptance test about the mapping of all critical business processes in the SAP, or the purpose of an ERP implementation is defeated.

**Finance (FI):** The term company code is quite often repeated in SAP. It is a legal entity to which balance sheet and profit & loss account can be generated. Finance component generally takes care of the details about the company that include currencies, fiscal year, posting period and chart of accounts. In currencies, there will be one company code currency according to business requirement and additional currencies such as group currency for global consolidation. Transactions can be in any currency but conversion will be done in company code currency based on the varying rates maintained in the system. As for the fiscal year it can be calendar year or any other period consisting of 12 months. Normally, it consists of 12 periods, i.e. one month equaling one period, plus additional 4 periods to take care of closing requirement. The functionality posting period takes care that users are not allowed to post the entries other than the current period which is open for posting, e.g. the current period is January 2010 and users will be allowed to post the entry only in this period. Chart of accounts is the group of accounts listed in an order. Based on requirement, it can be three: country chart of accounts, operating chart of accounts and group chart of accounts. GL accounts can be up to a maximum of 10-digit number with short and long description. Financial statements are generated through financial statement version. A company can have more than one financial statement according to the needs. This may be required due to change in presentation.

**Accounts Payable:** Also known as vendor in SAP, it records and manages accounting data for all creditors/suppliers. It is an integral part of the purchasing system wherein goods receipts are initially posted with a debit to inventory and credit to a clearing account called GR/IR account.

This automatic accounting entry is based on the valuation class entered in the material master. At the time of invoice verification, it will be credited to the respective vendor account with a debit to GR/IR clearing account. Vendor master plays a vital role. Reconciliation accounts entered in the vendor master makes the posting to GL account. Accounts payable supplies details to cash management component with figures from invoices to optimise liquidity planning. Payables are paid with the help of automatic payment programme. It supports standard payment method, e.g. cheques in printed and electronic form. It also covers country-specific payment methods such as RTGS and NEFT. Postings made in accounts payable are simultaneously recorded in the general ledger where different G/L accounts are updated based on the transaction involved. Advance payments which are usually denoted as 'A' (down payment) in SAP will be separately recorded under special GL indicator. With the help of this special GL indicator and other related settings, this advance payment will automatically be shown under asset side of the balance sheet. Due date forecasts and standard reports can help to monitor the payable balances. The balances which are not paid and open for payment are known as open items, and therefore shown differently, usually red in colour. The payments which are cleared to the vendor against their invoices are known as cleared items and are usually shown in green. Balance confirmation, account statement and other reports can be designed according to business requirement.

**Accounts Receivable:** It records and manages accounting data of all debtors. It is otherwise known as customers in SAP. It is also an integral part of sales management. Customer balances are updated based on automatic account assignment through configuration. All postings in accounts receivable are also recorded directly in the general ledger. Different G/L accounts are updated depending on transaction. Down payments and bill of exchange will be shown through special GL indicator. Outstanding balances which are otherwise known as open items

in customers can be managed through different reports such as account analyses, due date list, and so on. Flexible dunning programme is available in SAP to send different versions of communication to customer to remind their outstanding due to the company. Based on business requirement, interest calculation can be done on outstanding overdue balances. When drawing up financial statements, the items in foreign currency are revalued at the end of the month as a month-end activity and will be reversed on next day. Customers who are also vendors can be listed to make out the final net payment due to or from them. It also provides the data required for effective credit management due to close integration with the sales and distribution component. Liquidity planning can be done due to its link with cash management tool.

**Bank Accounting:** It is used to handle accounting transactions related to bank. To make use of the automatic and manual reconciliation process available in SAP, a bank account will be divided in to three account heads, main account, issue account and receipt account. Issue and receipt accounts act as clearing accounts. Issue account takes care of all cheques issued from the company by debiting the vendor and crediting the cheque issue account. In case of receipt, customer will be credited and receipt account will be debited. At the time of uploading the bank statement manually or electronically, the system will automatically pass an entry by debiting cheque issue account and crediting the main account for all the cheques issued and cleared by the company. On customer receipts it will be a debit to main account and credit to cheque receipt account. Cheques remaining in the clearing accounts are nothing but cheques issued not presented and cheques deposited but not cleared. The main account will show the balance as per its bank. Of course, there could be some small adjustments which could be taken care by means of journal posting. Based on business requirement, the number of clearing accounts may vary from company to company, e.g.

one for cheque payment, one for RTGS, and so on.

**Asset Accounting:** Used for managing and supervising fixed assets, it serves as a subsidiary ledger to the general ledger providing detailed information on fixed assets transactions. Based on requirements, it may be necessary to maintain book depreciation, cost accounting depreciation, tax depreciation, special depreciation, and so on. Different depreciation areas will be created to meet above requirements. Collection of these depreciation areas is called chart of depreciation. Asset classes are the most important means of structuring fixed assets. Normally, it could be based on asset characteristics such as buildings, plant and machinery, vehicles, and so on. The asset class functions as a sample master record. With this class, assets can be created easily without error. Asset numbers are controlled based on asset class. It establishes the connection between the different GL accounts such as acquisition, depreciation, provision for depreciation, retirement, loss/profit on retirement, advance payment, and so on, through a term called account determination. Assets under construction are a special type of tangible assets. It is usually displayed as a separate balance sheet item. So it needs separate account determination in their asset classes. Once the asset under construction is completed, this can be settled to one or more asset. Part of the asset under construction can also be settled. Asset under construction can also be handled through an internal order, a component in controlling. Depreciation calculation is based on the depreciation key. It contains the calculation method such as straight line or written down value. It can also be calculated at different percentage for different years, e.g. first year 40 per cent, second year 30 per cent, third year 20 per cent and fourth year 10 per cent, known as multilevel method. Depreciation is calculated at the asset level. In case of acquisition/retirement it can be calculated with reference to date of acquisition/retirement. However to meet the Indian tax requirements,



Normally purchase organisation may be defined as one to one relationship with respect to plant. Plant is a place where either material is produced or goods and services rendered. There could also be one central purchase organisation which could take care of the requirements of all the plants.

deprecations will be calculated using block asset concept through group asset functionality in the SAP with different depreciation area in place. Forecasted depreciation under different depreciation areas could be possible.

**Controlling (CO):** It takes care of the management reporting requirements. Controlling area is the higher level to which the respective company codes are assigned. Based on requirements, there could be one or more controlling area. Each company will be reporting to one controlling area. The data which are entered under the respective GL accounts will also be captured under respective cost centre through cost elements. Cost elements are nothing but detailed recording of data in controlling. It can be either primary or secondary cost element. Primary cost elements arise through the consumption of factors that are sourced externally, e.g. telephone expenses. Secondary cost elements arise through the consumption of production factors that are provided internally, e.g. machine hours. As per the requirements, cost centres are determined, e.g. in a manufacturing sector, the major cost centres could be production, administration and selling, and so on. All expenses spent under different GL will be captured under any one of these cost centre. This is another dimension to analyse the expenses. The expenses collected under one cost centre can be apportioned to other cost centres based on business requirements. This is known as distribution and will be done through cost elements, e.g. costs collected under service cost centre can be apportioned to different production cost centres. Likewise revenue will be captured under profit centre. According to the needs, different profit centres are created based on one centre to one division. Due to indirect assignment of cost centers to profit center in the respective master record, division wise profitability can be ascertained. Profitability analysis is another tool in SAP to analyse the profit according to customer, division, region, and so on. Internal orders can be used for detailed controlling, e.g. repairs and maintenance expenses can be collected

over different internal order for each vehicle. This can be either true order or a statistical order. True orders can collect costs and distribute them later to different cost centres. Statistical orders are for only information purposes.

**Product Costing:** Under this area, product costs are estimated. It is done on the basis of product cost planning. Planning is done for material cost with the help of the bill of material and overheads are estimated at a predefined percentage on material and labour. Such estimation is done with the help of the cost sheet functionality in SAP. Actual costs are collected at the time of order confirmation. Costs can be collected according to make to order or make to stock scenario. So variance analysis can be done between the estimation and the actual costs. Job costs at the level of the products can be managed under 2 methods. It can be either by period or order. The product cost by period is recommended for products that have relatively stable designs and are manufactured over an extended period of time. In case of manufacturing the products in a repetitive environment, product cost by period is used. In product cost by period, costs are collected on product cost collectors. Product cost by order is recommended in lot-based production environments. Typical applications of product cost by order are in order-related production or batch-based process manufacturing. Product cost can also be managed with reference to sales order in case of complex make-to-order production. The feature of complex make-to-order environments is that products are modified or even completely redesigned in response to particular order. The manufacturer needs to plan and monitor the costs and revenues of such production environments effectively. In this case sales document items will carry the costs and revenue with plan and actual data.

**Material Management (MM):** Material purchases are handled through purchase organisation assigned to the respective company code. According to the needs, we can define as

**Production Planning (PP) deals with the production-related activities. While planning the production, it is necessary to identify the bill of materials and the activities required to complete the production process. Bill of material is nothing but structured list of the components that makes up a product. Work centre is another term commonly used in the PP, where operations are carried out, e.g. machines or group of machines, production lines, etc., through different machines for a different length time to get a final product.**



many purchase organisations as required. Normally purchase organisation may be defined as one to one relationship with respect to plant. Plant is a place where either material is produced or goods and services rendered. There could also be one central purchase organisation which could take care of the requirements of all the plants. Storage locations are the places where the materials are stored. It could be separated with respect to the status of the material such as raw material, semi-finished goods and finished goods. Material master plays a vital role in integration. Most of the details will flow from this material master when this material is selected for any transaction. In material master, there are several views such as basic data, MRP, sales, accounting, costing view, and so on. Out of these costing and accounting views are more important from the integration perspective. Materials are recorded either on standard price (S), or, on moving average price (V). Standard price is a price fixed by the management for its material moving average price is calculated with reference to incoming price and quantity. Let us say that company A is having a stock of raw material X as 10 quantities valued at Rs. 8/- per quantity. The present stock value will be Rs. 80/. Another batch of 15 quantities received at the rate of Rs. 9/- per quantity. Then the moving average price will be Rs. 8.6/-. Any issue will be on this price till the arrival of new goods which has an effect on moving average price. The weighted average price is otherwise called as moving average price in the SAP. Normally in-house productions such as semi-finished and finished goods are maintained at standard price. The materials coming from outside such as raw material, are maintained in moving average price. The concept of maintaining standard price to in-house production is to make use of the variance analysis available in the SAP. As a part of month end processing, prices will be updated in the material master so as to calculate the actual stock value. This is called costing run. Costing run will be done only for the material with an indicator (S). Mostly, this will be done for the semi-finished and finished goods as raw materials could have been marked with moving average prices indicator (V). This valuation will be only on company code currency. In case of requirement of valuation on multiple currencies, material ledger needs to be activated. This may be relevant for the company having business in high inflation countries. With the help of material ledger, we can do actual costing for the semi-finished and finished goods. When actual costing is used, all goods movements within

a period are valued preliminarily at the standard price. At the same time, all price and exchange rate differences for the material are collected in the material ledger. At the end of the period, an actual price is calculated for each material based on the actual costs of the particular period. This price is known as periodic unit price and can be used to reevaluate the inventory for the period to be closed. Additionally, this price can be used as the standard price for the next period. Care should be taken before activating the material ledger. Once activated, it may not be possible to go back.

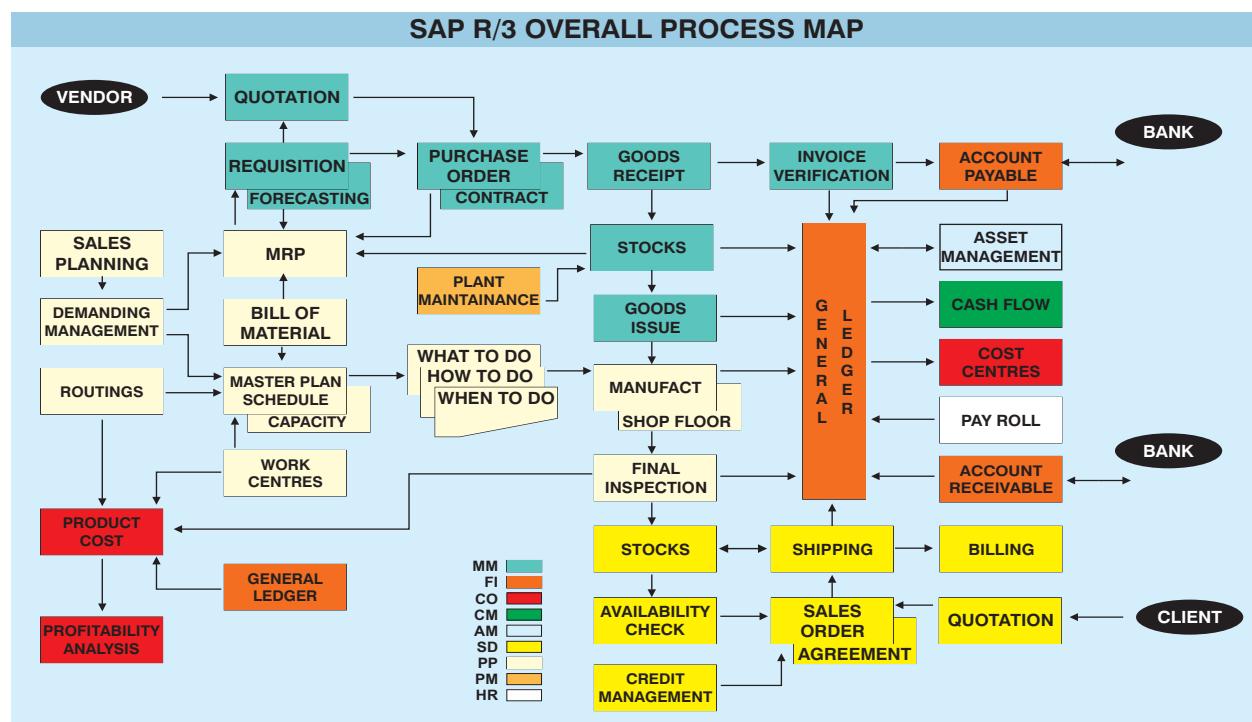
**Sales & Distribution (SD):** Sales-related activities are carried out by sales organisation assigned to the respective company code. The basic functions in SD are pricing, availability checking, tax determination, credit check, account determination and billing. The term pricing is described as calculation of prices to customers and costs for internal purposes. Prices are calculated with the help of the condition technique. A condition represents a set of circumstances that apply when a price is calculated, e.g. in case of particular order of a quantity on a day by a customer, the variable factors are customer, product, order quantity, and the date to determine the final price of the product to bill the customer. This information will be stored as part of master data. Availability check is the process of confirming the goods to deliver on a particular date taking into account all the processing activities before that delivery, e.g. if the goods are available on hand then it will automatically confirm that it is ready for immediate delivery. In case of goods which are under production, it will confirm the planned delivery date based on the different activities in the production schedule. Tax will be determined based on the tax procedures defined in the system. Credit management includes automatic credit checks based on different criteria. This check can be done either at the time of entering the order or delivery. Account determination is a process of determining the GL accounts automatically by the system, e.g. credit of revenue account such as domestic and import revenue will be separately posted to different accounts. In case of discount and freight, it will be posted to different GL account. This can be done through internal configuration in the SAP. Debit of customer will happen due to the selection of reconciliation account at the time of creating the customer master data. Billing represents the final processing stage for a business transaction in sales and distribution. Information on billing is available at every stage of order processing and delivery processing. Billing can also be planned.

It can be either a periodic billing or milestone billing, e.g. rental contract as periodic billing and engineering and construction project income on milestone basis. As part of its business activities, a company has a great deal of contact with different persons to carry out different activity, e.g. the goods can be sold to one party and shipped to another party which can later be billed to a third party. These functions are dealt by partner functions in the SAP and will be created as a part of master data for a particular customer.

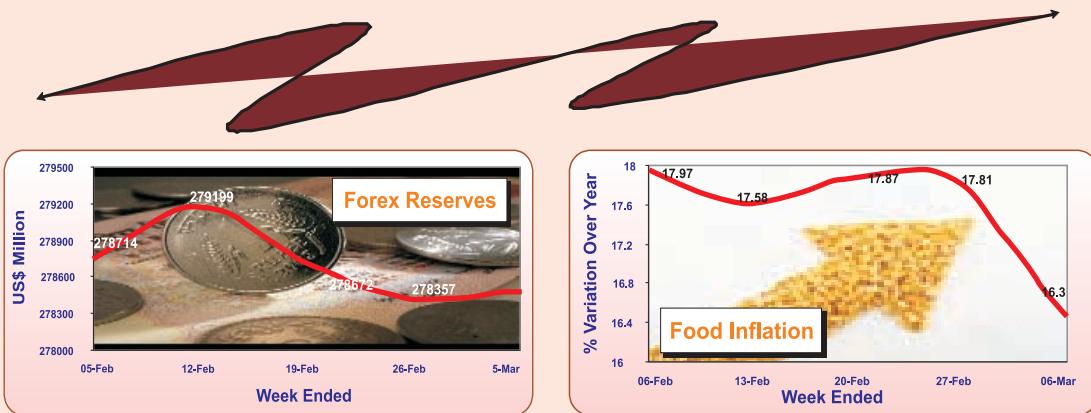
**Production Planning (PP):** It deals with the production-related activities. While planning the production, it is necessary to identify the bill of materials and the activities required to complete the production process. Bill of material is nothing but structured list of the components that makes up a product. Work centre is another term commonly used in the PP, where operations are carried out, e.g. machines or group of machines, production lines, etc., through different machines for a different length time to get a final product. The steps through which the raw material is taken to get a final finished product under different operation can be called as routing, e.g. in garment industry, a fabric is taken through different operations such as cutting, stitching and packing to get a final product of readymade shirt meant for sale. In every operation, an estimated number of quantities which can be

produced for a period of 8 hours are arrived. With this cost calculation can be done. Initially it can be on estimated basis. During the month end actual cost is re-determined based on the actual costs spent in the respective cost centre. Material requirement planning (MRP) is another area which guarantees the material availability required for production. This process involves the monitoring of stocks and, in particular, the automatic creation of purchase requisition for purchasing the material externally and planned production order to produce the goods internally. Production order is a fundamental part of the PP that is fully integrated with other components in the SAP, e.g. SD, MM and CO. Upon creation of production orders, activities such as bill of material and routing will be transferred to the production order. It also generates the capacity requirement for work centre and the planned cost for the production order.

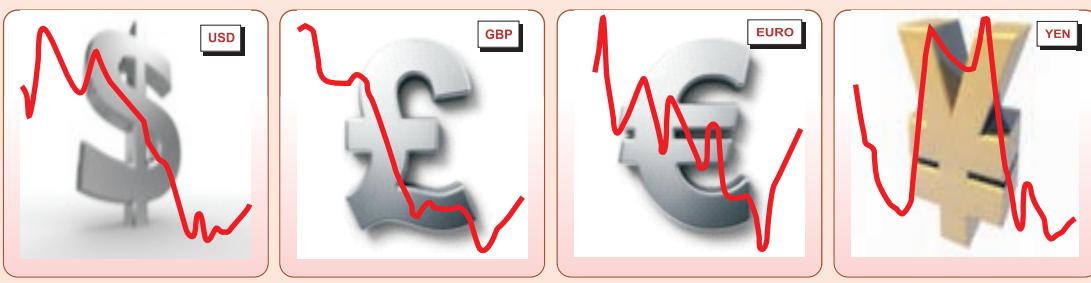
Thus, important SAP functionalities have been explained briefly for an overall understanding of the issue. A well-illustrated diagram, as given below, gives the bird's eye view on the SAP functionalities in an integrated fashion. It also depicts the business flow and its dependencies with other components of the SAP with an arrow diagram. Separate colour shades shows the component involved in the process:



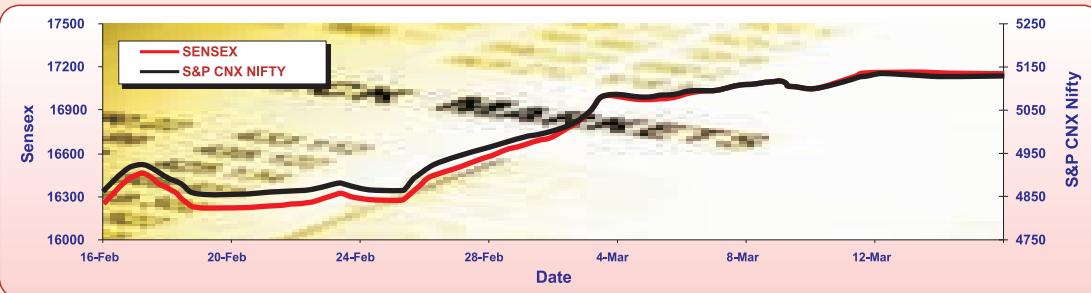
# Economic Indicators



Indian Rupee vs. Major Foreign Currencies (February 16, 2010 to March 15, 2010)



## Stock Markets



## Selected Indicators

Item	Unit/Base	2010						
		Feb. 27	Jan. 22	Jan. 29	Feb. 5	Feb. 12	Feb. 19	Feb. 26
Cash Reserve Ratio	per cent	5.00	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	11.50-12.50	11.00-12.00	11.00-12.00	11.00-12.00	11.00-12.00	11.00-12.00	11.00-12.00
Deposit Rate	Per cent per annum	7.75-9.00	6.00-7.50	6.00-7.50	6.00-7.50	6.00-7.50	6.00-7.50	6.00-7.50
Call Money Rate (Low/High)	Per cent per annum	2.00/4.50	1.00/3.50	1.00/3.35	1.00/3.40	1.75/3.40	2.00/3.40	1.75/3.75

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).

#### ► Indirect Tax Collections Decline 12%

The stimulus may have helped India Inc tide over the financial crisis faster than other countries but at the same time, it is giving a tough time to the apex indirect tax body, Central Board of Excise and Customs (CBEC), which is under pressure to mop up about Rs 40,000 crore with only March left for the fiscal year to end. Despite economic recovery being visible, the task of even meeting the revised indirect tax collection estimates—excise, customs and service tax—is immense, with the April-February collections this fiscal witnessing an a decline of over 12% compared to same period last year. The government has collected only Rs. 2,09,973 this fiscal till February, which is 12.26% less than what it collected in corresponding period last year.

**Source:** [www.cainindia.org](http://www.cainindia.org)

#### ► Select LLPs May Get 49 Per Cent FDI

Foreign investors may soon be able to set up the Limited Liability Partnerships (LLPs) in India, as the government is all set to allow foreign direct investment in this new form of business organisation. Initially, FDI up to 49 per cent may be allowed in the LLPs in select sectors such as manufacturing. This could help make this form of business organisation more popular. So far, only 914 LLPs have been registered in the country. A discussion paper on the FDI framework for LLP may be soon in the pipeline. The budget for 2010-11 proposes to exempt capital gains on account of the transfer of assets from or conversion of a company into an LLP from tax if the total sales, turnover or gross receipts of the company does not exceed Rs. 60 lakh in any three preceding years.

**Source:** <http://economictimes.indiatimes.com/news/economy/>

#### ► Service Exports Get Simpler and Less Taxing

With the deletion of the conditions of 'provided from India' and 'used outside India' from the Export Rules in Budget 2010, the finance minister has brought in simplification to the Export of Service Rules (Export Rules) that prescribe the conditions to determine when a service qualifies as exports. After being introduced in March 2005, these were amended in April 2006 to add another condition to the service for its qualification as exports that the service should be 'delivered and used outside India', which changed to 'service provided from India' in March 2007. Later in 2009, the Central Board of Excise and Customs (CBEC) had clarified that the term 'used outside India' should be understood in the context of the characteristic of the particular category under the Export Rules in which that service falls.

**Source:** <http://economictimes.indiatimes.com/news/economy/>

#### ► States Extend ARM to Improve Fiscal Deficit

States across the country are bracing for a return to fiscal prudence through *additional revenue mobilisation* (ARM) to bring order to their finances. Punjab plans to bill its farmers for electricity after decades of free service to agriculture. Haryana and Chhattisgarh may hike VAT, while Assam may impose a new tax of 1 per cent on vehicle registrations. New Delhi may have a congestion charge on vehicles entering the city. The pay commission recommendations have particularly hit poorer states, e.g. West Bengal, Himachal Pradesh and Uttarakhand, hard with about 25 and 40 per cent hike in salaries and pension respectively. Despite this, West Bengal and Orissa won't support the ARM because of the elections next year and rising prices of essential goods respectively. Tamil Nadu's payment to employees grew by more than 25 per cent as a result.

**Source:** <http://www.hindustantimes.com/business-news/>

#### ► Government to Divest Stake in SBI

The government has sought parliamentary approval to cut its stake in the top lender State Bank of India to 51 per cent from 55 per cent, seeking to raise \$1.2 billion at current market prices from the key reform move. The government had earlier said it would move to cut its holdings in state-run banks while retaining majority control, but has faced political and union opposition. The government owns 59.41 per cent of the State Bank of India and already has lawmakers' approval to trim it to 55 per cent. Finance Minister Pranab Mukherjee introduced in parliament a bill seeking approval for the SBI to raise capital by a public issue or private placement of shares or through a rights issue.

**Source:** <http://www.indianexpress.com/news/>

#### ► CBEC Directs DGFT to Stringently Monitor Exim Licence Norms

Norms for issuing export licences should be tightened, the CBEC has told the Directorate-General of Foreign Trade (DGFT). The directive is believed to have come immediately after a probe by the Directorate of Revenue Intelligence (DRI) showed up inconsistencies in exports of textiles, gems and jewellery to West Asian destinations. The Revenue Department has estimated the loss due to such fraudulent operations at around 2 per cent of the total revenue. The DRI report showed misuse of export-import regulations in transferring items to sister companies, so as to claim export promotion benefits, duty drawback benefits and duty concessions. Licence-holders were found to be using the code for fraudulent transfers. CBEC wanted DGFT to make physical verifications of the place and conduct periodic reviews through random checking, which would help in alerting the Customs Department in case of any divergence.

**Source:** <http://economictimes.indiatimes.com/news/economy/>

(... to be Continued)

#### ►► Finance Minister's Daughter Wants Eve-Teasers Taxed

Finance Minister Pranab Mukherjee's daughter Sharmista wrote an open letter asking him to tax up to 95 per cent of the income of the eve-teasers. She is an exponent of Kathak dance form. She asked the Finance Minister to seriously consider her suggestions regarding certain tax incentives as well as levying new taxes. Her letter also highlights the problems that women face in our country, particularly in Delhi. She opined that 90 to 95 per cent income tax should be levied on the people of Delhi and NCR who want to push women-driven vehicles off the road and on all road-side Romeos and eve-teasers across the country. Sharmistha asked her father to exempt performing artistes from the income from their performances.

**Source:** <http://economictimes.indiatimes.com/News/>

#### ►► Indian Workforce Most Mobile in the World

Indian employees are most eager in the world to change jobs in the next six months, a survey said. The 'work monitor' survey shows the extent to which employees are thinking of changing their jobs in the short-term compared with other countries in the world. India's mobility index is 140, the highest in the world, followed by Mexico, China and Turkey. The lowest employee mobility is seen in Luxembourg, Italy and Hungary.

**Source:** <http://timesofindia.indiatimes.com/biz/india-business/>

#### ►► Secondary Education is in Limelight Finally

Expenditure on health and education remain on marginal upward trend, both as a percentage of the GDP and in absolute terms. While spend on education is at 3.23 per cent of the GDP, that on health is 1.45 per cent. However, as interesting developments in the education sector, long-pending reforms are being put in place through the Rashtriya Madhyamik Shiksha Abhiyan, based on the Sarva Shiksha Abhiyan model. The government has put in place a scheme providing interest subsidy education loans for students from families having annual income less than Rs 4.5 lakh and pursuing professional courses. This is likely to benefit 5 lakh students every year.

**Source:** <http://economictimes.indiatimes.com/News/>



### ► IFAC Informs to Withdraw 2009 Third Annual Global Leadership Survey Report

The International Federation of Accountants (IFAC) has posted a notice to alert its members, recognised regional organisations, acknowledged accountancy groupings, and the public of the withdrawal of the report on the 2009 Third Annual Global Leadership Survey. The report was issued on January 15, 2010. The report has been withdrawn to incorporate additional responses and update the list of respondents. The report will be re-issued within the next few weeks. In case of queries or doubts, the Director of Governance and Operations Alta Prinsloo or the Deputy Director of Communications Sylvia Barrett may be contacted at [altaprinsloo@ifac.org](mailto:altaprinsloo@ifac.org), or, [sylvia.barrett@ifac.org](mailto:sylvia.barrett@ifac.org) respectively.

**Source:** <http://www.ifac.org/>

### ► IPSASB Publishes Standard on Intangible Assets; Improvements to Standards

The International Public Sector Accounting Standards Board (IPSASB) has published a new International Public Sector Accounting Standard (IPSAS) that covers the accounting for and disclosure of intangible assets: IPSAS 31, Intangible Assets. It fills a gap in the IPSASB literature and adds some guidance on public sector-specific issues, including intangible heritage assets. It is primarily drawn from the International Accounting Standards Board's (IASB) IAS 38, Intangible Assets. The IPSASB has also published Improvements to IPSASs, to conform with minor changes to International Financial Reporting Standards (IFRSs). Both the publications can be downloaded free of charge from the site ([web.ifac.org/publications](http://web.ifac.org/publications)).

**Source:** <http://www.ifac.org/>

### ► IASB Issues Limited Exemption Amendment to IFRS 1

The IASB has issued a minor amendment to IFRS 1 First-time Adoption of International Financial Reporting Standards. The amendment relieves first-time adopters of IFRSs from providing the additional disclosures introduced in March 2009 by Improving Disclosures about Financial Instruments (Amendments to IFRS 7). It thereby ensures that first-time adopters benefit from the same transition provisions that Amendments to IFRS 7 provides to current IFRS preparers. The effective date of the amendment Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters (Amendment to IFRS 1) is 1 July 2010, with earlier application permitted.

**Source:** <http://www.iasb.org/>

### ► Trustees Appoint Two Leading Financial Executives to the IASB

The Trustees of the International Accounting Standards Committee (IASC) Foundation announced today the appointment of two leading financial executives to the IASB: Dr Elke König, former member of the executive board and chief financial officer (CFO) of Hannover Re Group (Germany) and Darrel Scott, CFO of the FirstRand Banking Group (South Africa), who will begin their five-year terms as full-time members of the IASB in July and October 2010 respectively. Dr König has served as a senior financial executive in the insurance industry, while Mr Scott serves on various Governance, Risk, Operation and Strategic Committees of the Group. Mr Scott is also a member of the IASB's International Financial Reporting Interpretations Committee (IFRIC).

**Source:** <http://www.iasb.org/>

### ► Trustees Clarify Position on IFRS Adoption and Convergence

In a letter to the Financial Times that published the story, IASB softens stance on convergence. Chairman of the Trustees of the IASC Foundation, Gerrit Zalm, has responded to it that the constitutional emphasis on the objective of IFRS adoption globally represents a weakening of the Trustees' support for ongoing convergence efforts. He has expressed his shock over the interpretation of recent enhancements to the governance of the IASC Foundation, which, according to him, reinforce the commitment to the convergence. The Trustees strongly support the plan that the IASB has established with the US Financial Accounting Standards Board (FASB).

**Source:** <http://www.iasb.org/>

### ► US Economy to Keep Growing In 2010

The United States economy is expected to continue growing in 2010 despite the fragility of the global recovery, Deputy US Treasury Secretary has said recently. Growth of the world's biggest economy is expected to cool this year after a burst of activity late last year as challenges remain in bank lending and policy-making. Although the US economy

(... to be Continued)

faces considerable challenges due to weak recovery, it is still expected to grow by 2.9 per cent this year after an estimated contraction of 2.4 per cent in 2009. The US administration was committed to put public finances on a sustainable track in the years ahead

**Source:** <http://economictimes.indiatimes.com/news/international>

#### ► IASC Foundation Trustees Announce Further Governance Enhancements

The Trustees of the IASC Foundation, the oversight body of the IASB, has announced enhancements to their governance arrangements. These changes, which are aimed at enhancing public accountability, stakeholder engagement and operational effectiveness, complete the second part of the IASC Foundation's five-yearly Constitution Review. The Trustees reached their conclusions at their meeting in Brazil on 26 and 27 January 2010. After more than a year of global public consultation, they have agreed to some major changes in the Constitution including introduction of three-yearly public consultations on the IASB's technical agenda and an emphasis on adoption of the IFRSs. The new Constitution will be put into effect on 1 March 2010.

**Source:** <http://www.iasb.org/News/>



# ACCOUNTANT'S BROWSER

## 'PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE'

Index of some useful articles taken from Periodicals/Newspapers received during February-March 2010 for the reference of Faculty/Students & Members of the Institute.

### **1. ACCOUNTING**

Accounting for Economic Performance by Ashima Sood. *Eco & Pol. Weekly*, Feb. 13, 2010, pp.34-40.

Accounting Treatment of Debtors Factoring by Ricky Van Der Walt. *The Accounting world*, Feb. 2010, pp.39-42.

Comprehensive Income: Who's Afraid of Performance Reporting? by Linda Smith Bamber et al., *The Accounting Review*, Vol.85/1, 2010, pp.97-126.

Corporate Reporting & Accounting Standards in Global Scenario Relevance of Fair Value Measurement by Heena Sunil Oza. *Accounting world*, March 2010, pp.30-34.

Derivatives Accounting: An Introduction by Vikas Shrotriya. *Accounting World*, Feb. 2010, pp.26-30.

Effect of IFRS on the Tourism & Hospitality Industry by Atul Bansal. *Accounting World*, Feb. 2010, pp.43-51.

Financial Instruments Measurement: A Critical Evaluation of Fair Value Accounting by Debasish Sur & Kaushik Chakraborty. *Accounting World*, March 2010, pp. 40-49.

GAPs in GAAP by Dolphy D'souza. BCAJ, Feb. 2010, pp.85-86.

IFRS 9: Financial Instruments: The New "Avatar" by Jamil Khatri & Akeel Master. BCAJ, Feb. 2010, pp.79-84+88.

Information Content & Value Relevance of Depreciation: A Cross-Industry Analysis by S.H. Kang & Y. Zhao. *The Accounting Review*, Vol.85/1, 2010, pp. 227-260.

Lean Accounting: Cost Management Tools for Competitive Advantage: Lean & Target Costing for Today's Industry by A. Lakshminarasimha & Vivek Krishna K. *Accounting world*, March 2010, pp.17-23.

Market Reaction to the Adoption of IFRS in Europe by Christopher S. Armstrong etc. *The Accounting Review*, Vol.85/1, 2010, pp. 31-61.

Output of Defence Expenditure: A New

Accounting Method by Somi Tandon. *Eco. & Pol. Weekly*, Feb. 13, 2010, pp.73-74.

Simplification of Financial Reporting: The IFRS for SMEs by Yeo Ek Khuan & A. Chua. *Singapore Accountant*, Feb. 2010, pp.37-41.

Valuation & Reporting Practices of Human Resource Accounting in India by C.K. Sonara. *Accounting world*, March 2010, pp.50-55.

### **2. AUDITING**

Auditor Liability & Client Acceptance Decisions by Volker Laux & D. Paul Newman. *The Accounting Review*, Vol.85/1, 2010, pp.261-285.

Group-Based Compensation in Professional Service Firms: An Empirical Analysis of Medical Group Practices by Mina Pizzini. *The Accounting Review*, Vol.85/1, 2010, pp.343-380.

### **3. INFORMATION TECHNOLOGY**

XBRL: The Road Ahead by Pratik Niyogi. *Accounting World*, Feb. 2010, pp.31-38.

### **4. INVESTMENT**

Disclosure Quality, Cost of Capital & Investor Welfare by Pingyang Gao. *The Accounting Review*, Vol.85/1, 2010, pp.1-29.

### **5. LAW**

Challenges in the Implementation of Right to Education Act-2009 by S.S. Farwaha & Vandana Malik. *University News*, Feb. 15-21, 2010, pp.19-21.

Comparative Study of the Companies Act, 1956, & The Companies Bill, 2009 by Suvir Sharma. *Company Law Journal*, Vol.1, 2010, pp.41-45.

Right to Education Act & Public-Private Partnership by Pankaj Jain & R. H. Dholakia. *Eco. & Pol. Weekly*, Feb. 10, 2010, pp.78-80.

### **6. EDUCATION**

Academic Libraries in the Light of TQM

by Chanda Arya. *University News*, Feb. 22-28, 2010, pp.15-17.

E-Resources @ UGC-infonet Digital Library Consortium: A Breakthrough by R.K. Bhatt. *World Digital Libraries*, Vol.2/2, pp.145-160.

Management of Preserving Resources in Digital Library in Indian Scenario: Challenges & Perspectives by S.K. Pandey. *University News*, Feb. 15-21, 2010, pp.4-13.

Use of Library Services in Technological Changing Environment: A Survey by M. Vijayakumar & B.U. Kannappanavar. *World Digital Libraries*, vol.2/2, pp.101-112.

### **7. MANAGEMENT**

Applying Corporate Governance Codes to Entrepreneurial Firms by Tan Wee Liang & Tan Teck Meng. *Singapore Accountant*, Feb.2010, pp.28-31.

Are Corporate Managers Savvy About Their Stock Price? Evidence From Insider Trading After Earnings Announcements by Adam Kolasinski. *J. Account. Public Policy*, Vol.29, 2010, pp.27-44.

CSR: The Heart of Corporate Governance by CSR. *Quality Times*, Feb. 2010, pp.11-14.

Disaster Risk: Risk Management – Case Study by Vishnu Kanhere. BCAJ, Feb. 2010, pp.77-78.

Emerging Trends in Corporate Governance Practices by A. Vinayagamoorthy. *Accounting World*, March 2010, pp.35-39.

### **8. TAXATION & FINANCE**

Foreign Exchange Issues in International Taxation by Gregory May et al., *Bulletin for International Taxation*, Feb. 2010, pp.77-97.

Public Finance: Central Government Finance by CMIE. *Monthly Review of the Indian Economy*, Feb. 2010, pp.34-38.

Tax Reform & Its Effect on Tax Audits: The Example of Egypt by M.M. Abdellatif. *Bulletin for International Taxation*, Feb. 2010, pp.120-130

**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**

**Last Date of Registration for  
Post Qualification Course in International Trade Laws & WTO  
For November 2010 Part I Examinations**

**Attention of the members is drawn to the Post Qualification Course in 'International Trade Laws and World Trade Organisation' of ICAI intended to equip the members with the specialised skills necessary for developing the dedicated practice in the area of services related to International Trade Laws & WTO.**

Registration for the Course is open throughout the year. Candidates shall be eligible to appear for Part I Examination to the Course only after six months of registration and specified minimum attendance at PCPs. **Therefore, for appearing in the November, 2010 Examinations for Part I of the Course, the last date for taking registration in the Course is APRIL 30, 2010.**

For obtaining registration, the Prospectus for the Post Qualification Course in 'International Trade Laws and World Trade Organisation', priced at

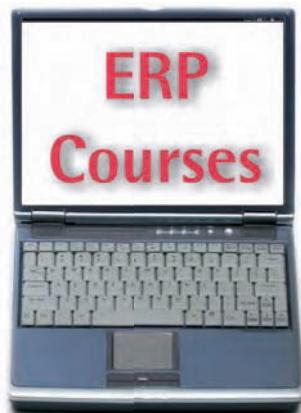
Rs. 150/- (Rs. One Hundred Fifty only), can be obtained from the Institute's sale counters at New Delhi and the Regional Offices at Mumbai, Chennai, Kolkata & Kanpur and the Branches of the Institute. Copy of Prospectus can also be obtained by post from the Postal Sales Department of the Institute at ICAI Bhawan, A-94/4, Sector 58, NOIDA – 201 301 (U.P) by sending a Demand Draft of Rs. 150/- plus postal charges (Rs. 9 within New Delhi & Rs. 20 for Rest of India, if required by Courier; or Rs. 40/-, if required by registered post) favouring 'The Secretary, The Institute of Chartered Accountants of India' payable at New Delhi.

For any further information regarding the Course, please visit the website of the Institute <http://www.icai.org>.

**Secretary, CECL & WTO**

Enterprises today are increasingly deploying ERP solutions to get information for decision making and better manage their operations. Chartered Accountants, whether in industry or profession are increasingly playing a lead role in ERP implementations - Functional Consultants in the Finance Domain.

The Committee on Information Technology has identified IT Enabled Services (ITES) as the next growth opportunity for the profession and has started offering ERP Courses from leading ERP Vendors in the Country offering the benefits of convenient timings and reduced costs and industry



### SAP FA & MA Course

- ◎ eLearning Course at SAP Authorised Training Centres
- ◎ Flexi Timings
- ◎ 200 Hours in 4 Months
- ◎ 20 Structured CPE Hours
- ◎ Fee: Rs. 96K Each

### Microsoft Dynamics NAV

- ◎ Instructor Lead Training
- ◎ Fin-I Module of 2.5 Days @ Rs.9K, 15 CPE Hours & Working Copy of Software. Bring your laptop for practice.
- ◎ Contact your POU to start a batch

Further details of these courses are available on the Committee Portal at <http://cit.icai.org> and Institute website at [www.icai.org](http://www.icai.org).

You can also contact [erp@icai.org](mailto:erp@icai.org) for assistance.



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.

**For the Kind Attention of Members  
Guidance Note on Audit of Banks**

This is to bring to your kind notice that the Auditing and Assurance Standards Board (AASB) of the Institute of Chartered Accountants of India (ICAI) has decided to continue with the 2009 edition of the Guidance Note on Audit of Banks for the financial year ended March 31, 2010. Accordingly, 2009 edition of the Guidance Note on Audit of Banks would be relevant

for the banks audits conducted on or after March 31, 2010. Additional implementation Guidance on any relevant aspects of bank audits for the year ended March 31, 2010, if necessary, will be hosted at the website of the Institute. Members are, therefore, requested to keep a watch at the website of the Institute for further necessary guidance.

**For the Kind Attention of Members  
Queries Relating to Audit of Banks and Bank Branches Relating to FY 2007-08**

The Institute, in March 2008, had constituted an expert panel to address issues faced by the members of the Institute during their bank audit assignments for the year ended March 31, 2008. For the benefit of the members, the text of some of the queries sent by the members and the responses thereto given by the expert panel at that time has been uploaded at the website of

the Institute.

**The members may note that the responses are the personal opinion of the expert panel and do not necessarily reflect the views of the Institute of Chartered Accountants of India. Further, the expert panel or the Institute does not accept any responsibility for any action taken by the members on the basis of these responses.**

**For the Kind Attention of Members  
Bank Audits for the FY ended 31.03.2010**

The bank audit season is around the corner. Banking being an industry typical in terms of its geographical and customer spread, volume of transactions as well as the types of products and services offered coupled with the time constraints for completing the audits, the members face a number of issues in their bank audit assignments. To help the members in fast resolution of those issues, the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India is constituting a panel of experts to address queries of the members relating to audits of banks and bank branches for the year ended March 31, 2010.

**The expert panel would receive queries only from March 22, 2010 to April 10, 2010.** Members may send their queries during these dates at [bankauditfaq@icai.org](mailto:bankauditfaq@icai.org). Members are, however, requested to note that the responses given by the expert(s) would be the personal views and opinions of the expert(s) concerned. The Auditing and Assurance Standards Board or the Institute of Chartered Accountants of India may not necessarily subscribe to the views and opinions of the expert(s) nor do they accept any responsibility for the actions taken by the members based on the responses of the expert(s).

## IMPORTANT ANNOUNCEMENT

The Ministry of Commerce and Industry has invited comments from the ICAI in respect of trade distortive effects encountered by the members of the ICAI (service exporters) because of the subsidies being provided in the services sector by the other countries to their domestic service suppliers.

Members who have come across such trade distortive effects if any encountered by them in export of services may like to share such details with the ICAI by writing to: [ctlwto@icai.in](mailto:ctlwto@icai.in); [cecl@icai.in](mailto:cecl@icai.in) preferably by April 15, 2010.

**Secretary,  
CECL & WTO**

## Classifieds

- 4776** Mumbai based CA firm requires 3 to 5 years experienced Chartered Accountants with audit or taxation experience. Remuneration not a constraint. Contact: 23515414, [nisark@vsnl.net](mailto:nisark@vsnl.net)
- 4777** C.A. having experience in Finance, Auditing, International taxation, also having working experience with Audit Firm having office at Nehru Place, New Delhi, would like to join or represent any CA firm. Kindly contact Email:[dayalagarwal@rediffmail.com](mailto:dayalagarwal@rediffmail.com)
- 4778** Required proprietorship CA Firms exceeding 5 years old having office at locations viz. Ludhiana, Jalandhar, Bhatinda, Amritsar, Patiala, Chandigarh and Dehradoon for merger and opening branch for 31 years old firm having offices at New Delhi, Kanpur & Jaipur. Contact : J K Sarawgi & Company, 141, Siddhartha Enclave, New Delhi-110014, 9871599182 ; [jkscom@gmail.com](mailto:jkscom@gmail.com).
- 4779** Bombay Based Midsize CA Firm seeks professional work on Sub-Contract/ Retainership/Assignment basis in the Area of Taxation/Internal/Statutory/Tax Audit. Proposals of Mergers from Mumbai based CA Firms are also invited. E-mail: [cachris.associates@gmail.com](mailto:cachris.associates@gmail.com); Contact:9820503576.
- 4780** Delhi based FCA with experience in the industry seeks Audit/Other Assignments on subcontract/ empanelment/partnership/ employment basis from Audit Firms and corporate. Write/email: [scsuman@gmail.com](mailto:scsuman@gmail.com). Phone: 9811332765.
- 4781** FCA with 20 years experience in industry and last 3 years in practice seeks placement/partnership with CA firms in any major city. Please e-mail: [cacvuv@gmail.com](mailto:cacvuv@gmail.com)
- 4782** Kochi based firm requires performance oriented Chartered Accountants and semi qualified persons for their offices at Kochi & Kollam. Preference will be given to those who had qualified SAP/DISA/CISA. Candidates should have experience in auditing of computerized accounts. E-mail: [mail@kvco.in](mailto:mail@kvco.in); Mobile: 09447070400.
- 4783** CA Firm for Delhi/NCR requires Chartered Accountants, preferably DISA/Retd. PSU Executives (finance)/Senior CA Lady Members expd. ICAI Audit/Compliance/Tax /ROC Matters. Accountant/Tax Executives (3-4 yrs exp pref with CA). Sr. Semi Qualified/ CA Articles exp. Tally, E-Tax Returns & ROC matters. Email: [ca\\_vacancy@yahoo.com](mailto:ca_vacancy@yahoo.com)
- 4784** Delhi based CA Firm having two partners, seeking professional work on job work/ partnership basis, [guptabaranwalco@gmail.com](mailto:guptabaranwalco@gmail.com), 9958548109, 9999888955, 011-45142451.
- 4785** Wanted Qualified/Semi Qualified CAs/ Audit & Article. Serva Associates, Chartered Accountants, Delhi Office Ph:011-42502244-3562, E-mail: [serva.associates@gmail.com](mailto:serva.associates@gmail.com)
- 4786** Midsized Firm having offices at Chennai, Bangalore and Madurai seeks professional work on sub contract/retainership/ assignment basis in the areas of Taxation, Internal/Management Audit. E-mail: [srijayan1980@gmail.com](mailto:srijayan1980@gmail.com). Contact Cell No.: 09442572990

## Additional Disclosures by Banks in Notes to Accounts

RBI/2009-10/347  
DBOD.BPBC.No. 79 /21.04.018/2009-10



March 15, 2010

The Chairmen/Chief Executives of  
All Commercial Banks  
(excluding RRBs)

Dear Sir,

### Additional Disclosures by banks in Notes to Accounts

The Reserve Bank has been taking several steps from time to time to enhance the transparency in the operations of banks by stipulating comprehensive disclosures in tune with the international best practices. On a review of the existing disclosures, it has been decided to prescribe the following additional disclosures in the 'Notes to Accounts' in the banks' balance sheets, from the year ending March 2010:

- I. Concentration of Deposits, Advances, Exposures and NPAs
- II. Sector-wise NPAs
- III. Movement of NPAs
- IV. Overseas assets, NPAs and revenue
- V. Off-balance sheet SPVs sponsored by banks

The prescribed formats are furnished in Annex.

Yours faithfully

**(B.Mahapatra)**  
Chief General Manager

### **Annex**

#### **I. Concentration of Deposits, Advances, Exposures and NPAs**

(Amount in Rupees Crores)

Total Deposits of twenty largest depositors	
Percentage of Deposits of twenty largest depositors to Total Deposits of the bank	

#### **Concentration of Advances\***

(Amount in Rupees Crores)

Total Advances to twenty largest borrowers	
Percentage of Advances to twenty largest borrowers to Total Advances of the bank	

\* Advances should be computed as per definition of Credit Exposure including derivatives furnished in our Master Circular on Exposure Norms DBOD.No.Dir.BC.15/13.03.00/2009-10 dated July 1, 2009

**Concentration of Exposures\*\***

(Amount in Rupees Crores)

Total Exposure to twenty largest borrowers/customers	
Percentage of Exposures to twenty largest borrowers/customers to Total Exposure of the bank on borrowers/customers	

\*\*Exposures should be computed based on credit and investment exposure as prescribed in our Master Circular on Exposure Norms DBOD.No.Dir.BC.15/13.03.00/2009-10 dated July 1, 2009

**Concentration of NPAs**

(Amount in Rupees Crores)

Total Exposure to top four NPA accounts	
---	--

**II: Sector-wise NPAs**

Sl. No.	Sector	Percentage of NPAs to Total Advances in that sector
1	Agriculture & allied activities	
2	Industry (Micro & small, Medium and Large)	
3	Services	
4	Personal Loans	

**III. Movement of NPAs**

Particulars	Amount in Rs. Crores
Gross NPAs* as on 1st April of particular year (Opening Balance)	
Additions (Fresh NPAs) during the year	
Sub-total (A)	
Less:-	
(i) Upgradations	
(ii) Recoveries (excluding recoveries made from upgraded accounts)	
(iii) Write-offs	
Sub-total (B)	
Gross NPAs as on 31st March of following year (closing balance) (A-B)	

\*Gross NPAs as per item 2 of Annex to DBOD Circular DBOD.BPBC.No. 46/21.04.048/2009-10 dated September 24, 2009

**IV. Overseas Assets, NPAs and Revenue**

Particulars	Amount (in Rupees Crores)
Total Assets	
Total NPAs	
Total Revenue	

**V. Off-balance Sheet SPVs sponsored (which are required to be consolidated as per accounting norms)**

Name of the SPV sponsored	
Domestic	Overseas

## Committee on Financial Markets and Investors' Protection Request of Proposals for Development of Study Material

The Committee on Financial Markets and Investor's Protection (CFM&IP) is one of the Non-Standing Committees of the Institute. In view of emerging diversities, needs and complexities in relation to Foreign Exchange, the Committee conducts a **Certificate Course on Forex and Treasury Management** for professional development of members of ICAI. This certificate course covers foreign exchange market, money market, bond market operations and related financial products besides providing overview of the structure and key functions of the treasury. The emphasis is on developing skill sets which would be required for making sound financial decisions in an international context. The detailed syllabus and the course content are available on the website at [http://www.icai.org/resource\\_file/13463course\\_curriculum\\_forex.pdf](http://www.icai.org/resource_file/13463course_curriculum_forex.pdf).

**The Committee invites proposals from the faculty/expert/resource persons who can assist the Committee in preparation of study material for the above said Course. Chartered Accountants, Bankers, treasury Managers, MBAs from IIMs and other leading management institutes and other professional bodies having relevant**

experience may apply for the above. You are requested to send your detailed profile along with the details of published papers/synopsis of module selected by them for offering at the address given below. You may also submit a broad outline of proposed background material. Suitable remuneration will be paid for development of back ground material.

Chairman,  
Committee on Financial Markets and Investors' Protection  
The Institute of Chartered Accountants of India,  
A-94/4 Sector 58  
Noida – 201301  
M: 9811040004

Secretary,  
Committee on Financial Markets and Investors' Protection  
The Institute of Chartered Accountants of India,  
A-94/4 Sector 58  
Noida – 201301  
Ph: (0120) 3045926  
M: 9310542607  
E-Mail: cfmip@icai.org

## Non-Receipt of Journal

This is for the information of Members/students/subscribers who fail to receive *The Chartered Accountant* journal despatched to them either due to unintimated change of address or postal problems. Please inform the respective Regional Office immediately

after you change the address to ensure regular and timely delivery of journals to you. Other queries and complaints in this regard can also be sent by email at [journal@icai.org](mailto:journal@icai.org) (for members), [eb@icai.org](mailto:eb@icai.org) (for students) or contact at **0120-3045921**.

## ICAI Campus Placement Programme – February & March, 2010

In the year 2008, the world economy witnessed beginning of recession. Credit crunch, sub-prime defaults and reduction in the jobs of the western world had ripple effect all over the world including India. The sensex plunged and the growth rate reduced. However, the fears of Indian economy entering into a phase of recession were found to be untrue. By the end of 2009, the Indian economy started showing clear signs of buoyancy and strength.

This was also reflected in the improvement in the jobs that are being offered by the companies. The campus placement programme organised for the benefit of newly qualified chartered accountants by The Institute of Chartered Accountants of India through its Committee for Members in Industry is also showing better performance. Several leading multinational and Indian Companies competed with each other to select young chartered accountants.

The first phase of the interview process started on 4th of March, 2010 at Bangalore, Chennai, Kolkata, Mumbai and New Delhi and completed on 9<sup>th</sup> March, 2010. After conclusion of the first phase, the next phase of campus interviews would be conducted during 23<sup>rd</sup> - 27<sup>th</sup> March 2010, at different centres including Ahmedabad, Chandigarh, Coimbatore, Indore, Ernakulam, Kanpur, Nagpur, Pune, Surat, Hyderabad, Jaipur.

Ninety-four companies are participating in the programme seeking more than 1600 chartered accountants. Overwhelming response is received from all the centres. A total of 2906 candidates have registered for the campus interviews.

Prominent organisations including multinational corporations, public limited companies, public sector undertakings, banks, etc are participating in this mega event. To name a few - BPCL, Coal India, HCL, Infosys, GMR, L&T, Morgan Stanley, SBI, Shipping Corporation, Tata Sons, TVS Motors, UTI, Vedanta Resources, Wipro are participating in the event.

Entities are selecting chartered accountants and providing them lucrative offers. In the first phase itself 1032 candidates have been offered jobs. The remaining students will have opportunity to get jobs in the second phase. A comparison about the performance of first phase of campus placement programme with the preceding placement programme organised in the months of August

and September 2009 shows that there is 29.02 per cent rise in the ratio jobs offered vis-à-vis attended candidates. The comparative figure of comparison with the campus placement programme held in Feb-March, 2009 is 167.53 per cent.

The pay packages that are being offered by the companies prove beyond doubt the increasing requirement of the chartered accountants in the corporate world. Companies are paying high salaries to attract the young talent. The best offer in the first phase of the campus placement programme was made by Olam International to 11 candidates, which is \$ 1.5 Lakh (about Rs. 70 Lakh) for international posting. In spite of this lucrative offer only seven candidates actually accepted the offer.

For a domestic posting best offer was made by Axis Bank and ITC Ltd. The response given by the entities willing to participate at these centres for recruitments has been very encouraging and assures the success of programme.

Best offers made by the organisations in the first phase of the placement session is as follows:

### Top Remunerations Offered - International Posting

Name of Company	CTC Offered	Total Job Offers Made
Olam International	1,50,000 US \$ (Approx Rs 70 Lacs per annum)	11
Tolaram Corporation Pvt. Ltd.	Rs 20.75 Lacs per Annum	7
Topaz Energy and Marine	Rs 12 Lacs per Annum	4

### Top Remunerations Offered - Domestic Posting

Name of Company	CTC Offered	Total Job Offers Made
Axis Bank	Rs 10.82 Lacs per Annum	1
ITC Limited	Rs 10.61 Lacs per Annum	8
BPCL	Rs 9.5 Lacs per Annum	15

Tremendous response received to the recruitment and selection process has proved beyond doubt the need and the acceptance of the chartered accountants in the Industry. It has also allayed the fears of impact of global recession on Indian economy. It clarified why young students are eager to pursue this course.

### **Summary of the job offers and acceptance in the first phase of campus placement programme**

Centre Name	Candidates Registered	Number of Interview Teams	Total No of Jobs Offered	Total No of Jobs Accepted
New Delhi	1348	30	438	329
Chennai	154	23	93	77
Mumbai	623	23	268	260
Bangalore	165	16	105	99
Calcutta	328	17	128	113
<b>Total</b>	<b>2618<sup>^</sup></b>	<b>109</b>	<b>1032</b>	<b>878</b>

<sup>^</sup> Total candidate registered for both the phases is 2906 as on 10th March, 2010. The students who are not able to be selected in the first phase will have opportunity to get selected in the second phase of the campus placement programme.

### **Comparison of placement programme over preceding two placement programmes**

	Feb-Mar, 2009	Aug-Sep, 2009	Feb-Mar, 2010
Number of Candidates Registered	3842	3662	2906
Number of Interview Teams	95	134	207
Number of Organisations	54	72	94
Number of Jobs Offered	510	1008	1032*
Percentage of Jobs Offered vis-à-vis Attended Candidates	13.27 %	27.52%	35.51*%

### **Growth in placements in March, 2010 over preceding two placement programmes**

	In Comparison to Feb-Mar, 09	In Comparison to Aug-Sep, 09
Number of Interview Teams	217.89%	154.48%
Number of Organisations	174.07%	130.56%
Number of Jobs Offered*	202.35%	102.38%
Percentage of Jobs Offered vis-à-vis Attended Candidates*	267.53%	129.02%

\* The figures and analyses has been made on the basis of the performance in the first phase of the placement programme being organised in the month of February and March, 2010. The figures of the preceding two campus placement programme is for the both the phases together.

# Standard on Auditing (SA) 710 (Revised)\* Comparative Information - Corresponding Figures and Comparative Financial Statements

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<sup>1</sup>," which sets out the authority of SAs and 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>2</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>3</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 April 1, 2011.

### **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 shall also follow the relevant requirements of SA 560 (Revised)<sup>4</sup>.
- 9. As required by SA 580 (Revised)<sup>5</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

\* Earlier known as SA 710 (AAS 25), "Comparatives".

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> SA 510 (Revised), "Initial Audit Engagements - Opening Balances".

<sup>3</sup> Typically, financial reporting frameworks in India use the corresponding figures approach for general purpose financial statements.

<sup>4</sup> SA 560 (Revised), "Subsequent Events," paragraphs 14-17.

<sup>5</sup> SA 580 (Revised), "Written Representations," paragraph 14.

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>6</sup>. (Ref: Para. A7a)

#### *Comparative Financial Statements*

15. When comparative financial statements

are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed. (Ref: Para. A8 A9)

16. When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with SA 706<sup>7</sup>. (Ref: Para. A10)

#### *Prior Period Financial Statements Audited by a Predecessor Auditor*

17. If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:

- (a) That the financial statements of the prior period were audited by a predecessor auditor;
  - (b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and
  - (c) The date of that report, unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.
18. If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be informed. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended financial statements of the prior period, the auditor shall report only on the current period. (Ref: Para. A11)

#### *Prior Period Financial Statements Not Audited*

19. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph that the comparative financial statements 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>8</sup>.

\*\*\*

## **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.

##### *Misstatement in Prior Period Financial Statements (Ref: Para. 12)*

<sup>6</sup> SA 510 (Revised), paragraph 6.

<sup>7</sup> SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", paragraph 8.

<sup>8</sup> SA 510 (Revised), paragraph 6.

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 on 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 re-issuance 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>9</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.

<sup>9</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.

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.

#### **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  
Firm's Registration Number<sup>10</sup>

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>11</sup>)  
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

<sup>10</sup>The attention of the members is drawn to the decision relating to inclusion of the firm's registration number, wherever applicable, in the audit report, taken by the Council of the Institute of Chartered Accountants of India at its 292nd meeting held on January 13, 2010 and the related Announcement is published in February 2010 issue of the Journal.

<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.

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  
Firm's Registration Number<sup>13</sup>

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>14</sup>)  
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>15</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.

**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

<sup>13</sup> See footnote 10.

<sup>14</sup> Partner or Proprietor, as the case may be.

<sup>15</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.

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  
Firm's Registration Number<sup>16</sup>

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>17</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>18</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.

#### **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  
Firm's Registration Number<sup>19</sup>

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>20</sup>)  
Membership Number

Place of Signature  
Date

<sup>16</sup> See footnote 10.

<sup>17</sup> Partner or Proprietor, as the case may be.

<sup>18</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>19</sup> See footnote 10.

<sup>20</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

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<sup>1</sup>", which sets out the authority of SAs and 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>2</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 April 1, 2011.

#### *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>3</sup>. (Ref: Para. A1-A4)

7. 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>4</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. SA 200 (Revised) requires the auditor to comply with all SAs relevant to the audit<sup>5</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>6</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 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 SA 700 (Revised)<sup>7</sup>. (Ref: Para. A13)

#### *Description of the Applicable Financial Reporting Framework*

12. SA 700 (Revised) requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework<sup>8</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. 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

<sup>1</sup> Published in the July, 2007 issue of the Journal

<sup>2</sup> SA 805, "Special Considerations - Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement".

<sup>3</sup> SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", paragraph 13(a).

<sup>4</sup> SA 210 (Revised), "Agreeing the Terms of Audit Engagements", paragraph 6 (a).

<sup>5</sup> SA 200 (Revised), paragraph 18.

<sup>6</sup> SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", paragraph 11(c).

<sup>7</sup> SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements".

<sup>8</sup> SA 700 (Revised), paragraph 15.

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)

\*\*\*

#### **Application and Other Explanatory Material**

##### **Special Purpose Frameworks<sup>9</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 organization 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 organization 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 para-

graph 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 authorized or recognised standards setting organization 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 organization that is authorized or recognized to promulgate standards for special purpose financial statements. In that case, those standards will be presumed acceptable for that purpose if the organization follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. Some law(s) or regulation(s) 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>10</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 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. 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>11</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

<sup>9</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>10</sup> SA 210 (Revised), paragraph 18.

<sup>11</sup> SA 200 (Revised), paragraphs 14, 18 and 22-23.

of users as a group<sup>12</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>13</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.

#### **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.

- *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 Ltd. 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 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

<sup>12</sup> SA 320 (Revised), "Materiality in Planning and Performing an Audit", paragraph 2.

<sup>13</sup> SA 260 (Revised), "Communication with Those Charged with Governance".

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  
Firm's Registration Number<sup>14</sup>

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>15</sup>)  
Membership Number

Place of Signature  
Date

#### *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 sub-section (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  
Firm's Registration Number<sup>16</sup>

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>17</sup>)  
Membership Number

Place of Signature  
Date

<sup>14</sup> The attention of the members is drawn to the decision relating to inclusion of the firm's registration number, wherever applicable, in the audit report, taken by the Council of the Institute of Chartered Accountants of India at its 292nd meeting held on January 13, 2010 and the related Announcement is published in February 2010 issue of the Journal.

<sup>15</sup> Partner or Proprietor, as the case may be.

<sup>16</sup> See footnote 14.

<sup>17</sup> Partner or Proprietor, as the case may be.

# Standard on Auditing (SA) 805

## Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement

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 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 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>2</sup> also applies to the audit. (Ref: Para. A1-A4)
2. 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>3</sup>).
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 single financial statements or of specific elements, accounts or items for periods beginning on or after April 1, 2011. 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 April 1, 2011.

#### *Objective*

5. 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:

- (a) The acceptance of the engagement;
- (b) The planning and performance of that engagement; and
- (c) Forming an opinion and reporting on the single financial statement or on the specific element, account or item of a financial statement.

#### **Definitions**

6. For purposes of this SA, reference to:

- (a) “Element of a financial statement” or “element” means an “element, account or item of a financial statement”;
- (b) “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
- (c) 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*

7. SA 200 (Revised) requires the auditor to comply with all SAs relevant to the audit<sup>4</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 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>5</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>6</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. SA 200 (Revised) states that SAs are written in the context of an audit of financial statements; they are to be adapted

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> SA 800, “Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks”.

<sup>3</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>4</sup> SA 200 (Revised), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, paragraph 18.

<sup>5</sup> SA 210 (Revised), “Agreeing the Terms of Audit Engagements”, paragraph 6(a).

<sup>6</sup> SA 210 (Revised), paragraph 10(e).

as necessary in the circumstances when applied to audits of other historical financial information.<sup>7</sup><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 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, 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.

\*\*\*

#### *Application and Other Explanatory Material*

##### *Scope of this SA (Ref: Para. 1)*

A1. 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. 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 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>14</sup>.

#### *Considerations When Accepting the Engagement*

##### *Application of SAs (Ref: Para. 7)*

A5. 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

<sup>7</sup> SA 200 (Revised), paragraph 2.

<sup>8</sup> SA 200 (Revised), paragraph 13(f), 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>9</sup> SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements".

<sup>10</sup> SA 705, "Modifications to the Opinion in the Independent Auditor's Report", paragraph 15.

<sup>11</sup> SA 200 (Revised), paragraph 13(g).

<sup>12</sup> SA 200 (Revised), paragraph 13(f).

<sup>13</sup> SA 200 (Revised), paragraph 2.

<sup>14</sup> The Exposure Draft of SAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information" has been published in the March, 2010 issue of the Journal.

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>15</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>16</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 authorised or recognised standards setting organisation 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>17</sup>. In accordance with SA 700 (Revised)<sup>18</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 authorised or recognised 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>19</sup>, SA 550 (Revised)<sup>20</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>21</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.

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

<sup>15</sup> SA 200 (Revised), paragraphs 14, 18 and 22-23.

<sup>16</sup> SA 570 (Revised), "Going Concern".

<sup>17</sup> SA 200 (Revised), paragraph 8.

<sup>18</sup> SA 700 (Revised), paragraphs 35-36.

<sup>19</sup> SA 240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements".

<sup>20</sup> SA 550 (Revised), "Related Parties".

<sup>21</sup> SA 200 (Revised), paragraph 2.

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. 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>22</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 SA 706)<sup>23</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>24</sup>.

#### **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.

- 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:*

- *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.*

#### **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.

#### **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>22</sup> SA 700 (Revised), paragraph 13(e).

<sup>23</sup> SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", paragraph 6.

<sup>24</sup> SA 510 (Revised), "Initial Audit Engagements—Opening Balances", paragraph A5, and SA 705, paragraph A16.

### *Management's<sup>25</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.

<sup>25</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>26</sup> The attention of the members is drawn to the decision relating to inclusion of the firm's registration number, wherever applicable, in the audit report, taken by the Council of the Institute of Chartered Accountants of India at its 292nd meeting held on January 13, 2010 and the related Announcement is published in February 2010 issue of the Journal.

<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.

For XYZ and Co.  
Chartered Accountants  
Firm's Registration Number<sup>26</sup>

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 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

Firm's Registration Number<sup>30</sup>  
 Signature  
 (Name of the Member Signing the Audit Report)  
 (Designation<sup>31</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>32</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.*

**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>33</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

<sup>30</sup> See Footnote 26.

<sup>31</sup> Partner or Proprietor, as the case may be.

<sup>32</sup> SA 800 contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

<sup>33</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>34</sup> See Footnote 26.

<sup>35</sup> Partner or Proprietor, as the case may be.

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  
 Firm's Registration Number<sup>34</sup>

Signature  
 (Name of the Member Signing the Audit Report)  
 (Designation<sup>35</sup>)  
 Membership Number

Place of Signature

Date

## Request to Contribute in the Journal

Members and other experts are requested to contribute for various sections and features of The Chartered Accountant journal. The write-ups covering the topical issues and latest updates will be preferred.

Every article should be of about 3000 words and shall also have an executive summary of about 100 words and complete references/bibliography of the sources referred. Please note that a declaration about originality of the article, author’s good quality passport size photograph, ICAI e-mail ID

and complete contact details (postal address and contact numbers) should also accompany the article. As a token of appreciation, an honorarium of Rs.5000/- is payable for every article selected by the Editorial Board and published. Besides, for members of the Institute, a CPE credit of four hours is also granted.

The articles can be sent to us by e-mail at eboard@icai.org/journal@icai.org or by post to The Editor, The Chartered Accountant, Journal Section, ICAI Bhawan, A-94/4, Sector -58, Noida - 201301.

# Standard on Auditing (SA) 810

## Engagements to Report on Summary Financial Statements

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<sup>1</sup>", which sets out the authority of SAs and 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 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*

2. This SA is effective for engagements for periods beginning on or after April 1, 2011.

### Objectives

3. 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

4. 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>2</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>3</sup>. Different jurisdictions may use different terminology to

describe such historical financial information.

### Requirements

#### *Engagement Acceptance*

5. The auditor shall, ordinarily, accept an engagement to report on summary financial statements in accordance with this SA only when the auditor has been engaged to conduct an audit in accordance with SAs of the financial statements from which the summary financial statements are derived<sup>4</sup>. (Ref: Para. A1)
6. Before accepting an engagement to report on summary financial statements, the auditor shall: (Ref: Para. A2)
  - (a) Determine whether the applied criteria are acceptable; (Ref: Para. A3-A7)
  - (b) Obtain the agreement of management that it acknowledges and understands its responsibility:
    - i. For the preparation of the summary financial statements in accordance with the applied criteria;
    - ii. To make the audited financial statements available to the intended users of the summary financial statements without undue difficulty (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, 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 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:
    - (i) From whom or where the audited financial statements are available; or
    - (ii) 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.

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", paragraph 13(f).

<sup>3</sup> SA 200(Revised), paragraph 13(f).

<sup>4</sup> In some cases however the auditor may be required by a law or a regulation governing the entity to report on summary financial statements even for such accounting periods for which the former was not engaged to conduct the audit in accordance with SAs of the financial statements pertaining to such accounting periods. For example, in case of the report of the auditor of the company to be included in a prospectus under Clauses 1, 2, 3 of Part IIIB of Schedule II to the Companies Act, 1956, such auditor might not necessarily have been the auditor of all or some of the financial statements of the company in respect of the accounting periods relating to which financial information has been reported upon by him/ her in the aforementioned report.

- (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)
- (a) The summary financial statements are consistent, in all material respects, with the audited financial statements, in accordance with [the applied criteria]; or
  - (b) 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:
- (a) Apply the procedures described in paragraph 8 and any further procedures necessary to enable the auditor to express the prescribed opinion; and
  - (b) 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.

11. 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*

12. 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)

13. 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>5</sup> has been completed.

#### *Auditor's Report on Summary Financial Statements*

##### *Elements of the Auditor's Report*

14. The auditor's report on summary financial statements shall include the following elements:<sup>6</sup> (Ref: Para. A15)
- (a) A title clearly indicating it as the report of an independent auditor. (Ref: Para. A11)
  - (b) An addressee. (Ref: Para. A12)
  - (c) An introductory paragraph that:
    - (i) 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)
    - (ii) Identifies the audited financial statements;

(iii) 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;

(iv) If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, states that the summary financial statements and the 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; and

(v) A statement indicating that the summary financial statements do not contain all the disclosures required by the financial reporting framework applied in the preparation of the audited financial statements, and that reading the summary financial statements is not a substitute for reading the audited financial statements.

- (d) A description of management's responsibility for the summary financial statements, explaining that management is responsible for the preparation of the summary financial statements in accordance with the applied criteria.
- (e) A statement that the auditor is responsible for expressing an opinion on the summary financial statements based on the procedures required by this SA.
- (f) A paragraph clearly expressing an opinion. (see paragraphs 9-11)
- (g) The auditor's signature along with the firm registration number, wherever applicable,<sup>7</sup> and the membership number assigned by the Institute of Chartered Accountants of India (ICAI).
- (h) The date of the auditor's report. (Ref: Para. A14)
- (i) The place of signature.
- 15. 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)
- 16. The auditor shall date the auditor's report on the summary financial statements no earlier than: (Ref: Para. A14)
- (a) The date on which the auditor has obtained sufficient appropriate

<sup>5</sup> SA 560 (Revised), "Subsequent Events".

<sup>6</sup> Paragraphs 17-18, which deal with circumstances where the auditor's report on the audited financial statements has been modified, require additional elements to those listed in this paragraph.

<sup>7</sup> The attention of the members is drawn to the decision relating to inclusion of the firm's registration number, wherever applicable, in the audit report, taken by the Council of the Institute of Chartered Accountants of India at its 292nd meeting held on January 13, 2010 and the related Announcement is published in February 2010 issue of the Journal.

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

(b) 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)**

17. 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 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 SA 710 (Revised) requires the auditor to include in the auditor's report on the audited financial statements<sup>8</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

<sup>8</sup> SA 710 (Revised), "Comparative Information—Corresponding Figures and Comparative Financial Statements".

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 regulation. Similar to the case of financial statements, as explained in SA 210 (Revised)<sup>9</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 recognised 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

<sup>9</sup> SA 210 (Revised), "Agreeing the Terms of Audit Engagements", paragraphs A3 and A8-A9.

regarded as corresponding figures or as comparative financial information. 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. SA700(Revised)<sup>10</sup>containsrequirements 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>11</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 5 of ISA 810 requires the auditor to accept an engagement to report on summary financial statements in accordance with this SA only when the auditor has been engaged to conduct an audit in accordance with SAs of the financial statements from which the summary financial statements are derived. In India, in some cases, the auditor may be required by a law or a regulation

governing the entity to report on summary financial statements even for such accounting periods for which the former was not engaged to conduct the audit in accordance with SAs of the financial statements pertaining to such accounting periods. For example, in case of the report of the auditor of the company to be included in a prospectus under Clauses 1, 2, 3 of Part IIB of Schedule II to the Companies Act, 1956, such auditor might not necessarily have been the auditor of all or some of the financial statements of the company in respect of the accounting periods relating to which financial information has been reported upon by him/her in the aforementioned report, accordingly, the word "ordinarily" has been added in the Paragraph 5 to cover these situations and also added the correspondingly footnote no. 5.

2. Paragraph 14 of ISA 810 deals with the elements of the summary financial statements that also include the auditor's address. Since the 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.
3. Paragraph 14 of ISA 810 deals with the elements of the summary financial statements that also include auditor's signature. Since as per the Revised SA 700, "Forming an Opinion and Reporting on Financial Statements", the partner/proprietor signing the audit report also needs to mention the firm registration number, wherever applicable, and 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 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.

**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

<sup>10</sup> SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", paragraphs 46-47.

<sup>11</sup> SA 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements".

## STANDARDS

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 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, 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  
Firm's Registration Number<sup>12</sup>

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>13</sup>)  
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>14</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 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  
Firm's Registration Number<sup>15</sup>  
Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>16</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>17</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

<sup>12</sup> See footnote 7.

<sup>13</sup> Partner or Proprietor, as the case may be.

<sup>14</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> See footnote 7.

<sup>16</sup> Partner or Proprietor, as the case may be.

<sup>17</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".

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 realisable 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  
Firm's Registration Number<sup>18</sup>

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>19</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

<sup>18</sup> See footnote 7.

<sup>19</sup> Partner or Proprietor, as the case may be.

financial statements of ABC Company Ltd. for the year ended March 31, 20X1<sup>20</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 Statements" 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  
Firm's Registration Number<sup>21</sup>  
Signature

(Name of the Member Signing the Audit Report)  
(Designation<sup>22</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 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>23</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  
Firm's Registration Number<sup>24</sup>

Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>25</sup>)  
Membership Number

Place of Signature  
Date

<sup>20</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>21</sup> See footnote 7.

<sup>22</sup> Partner or Proprietor, as the case may be.

<sup>23</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>24</sup> See footnote 7.

<sup>25</sup> Partner or Proprietor, as the case may be.



# CROSS

V O R D | 046

(Based on Union Budget 2010-11)

**ACROSS**

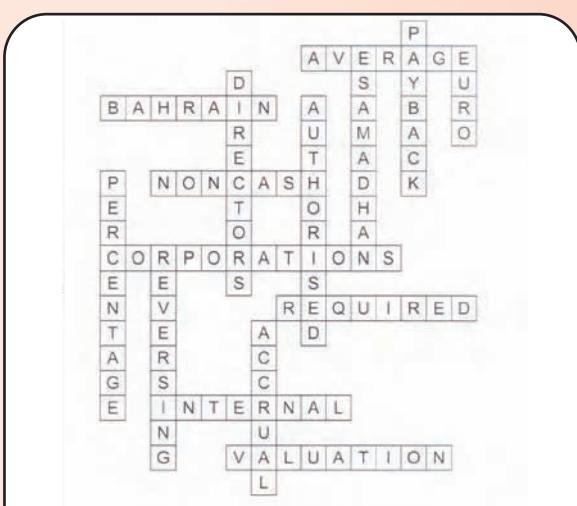
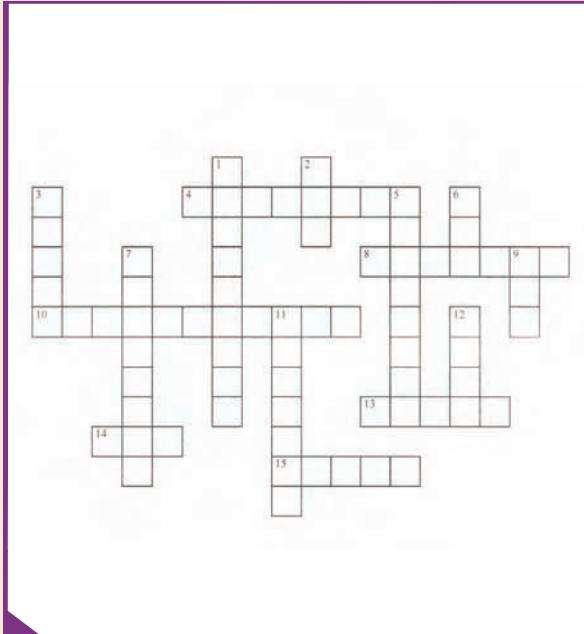
4. A \_\_\_\_\_ Based Subsidy policy for the fertiliser sector has been approved by the Government.(8)
8. Extension of existing interest subvention of 2 per cent for one more year for exports covering handicrafts, \_\_\_\_\_, handlooms and small and medium enterprises.(7)
10. A new initiative, \_\_\_\_\_ will be available for persons who join New Pension Scheme (NPS).(11)
13. The basic duty of 5 per cent on \_\_\_\_\_ petroleum has been restored.(5)
14. Rate of \_\_\_\_\_ increased to 18% of book profits.
15. Allocation for \_\_\_\_\_ doubled in 2010-11 to Rs.500 crore.

**DOWN**

1. Current \_\_\_\_\_ for domestic companies has been reduced to 7.5 % from 10%.(9)
2. \_\_\_\_\_ tax for income upto Rs 1.6 lakh.(3)
3. Deduction of an additional amount of Rs. 20,000 allowed for investment in long-term infrastructure \_\_\_\_\_ as notified by the Central Government.(5)
5. It is proposed that \_\_\_\_\_ of assets as a result of conversion of small companies into Limited Liability Partnerships will not be subject to capital gains tax.(8)
6. Advance Estimates for \_\_\_\_\_ growth for 2009-10 pegged at 7.2 per cent.
7. The Income Tax department has introduced '\_\_\_\_\_', a pilot project which provide a single window system for registration of all applications including those for redressal of grievances as well as paper returns.(8)
9. It was proposed for setting up \_\_\_\_\_ more Centralised Processing Centres during the year for processing of tax returns.(3)
11. RBI shall be giving additional \_\_\_\_\_ licences.(7)
12. As per budget double digit \_\_\_\_\_ inflation is a major concern.(4)

**Note:**

Members can claim one hour CPE Credit – Unstructured Learning through self-declaration for attempting above Crossword. Solutions can be sent to Journal Section, ICAI Bhawan, A - 94/4, Sector-58, Noida 201301.

**SOLUTION Crossword**

045



1

CA. Hemant Shah lost his wallet with 15000/- rupees in it during his visit to Mumbai. The wallet was found by one Mr. Pravin, who was an honest man. Inside the wallet along with the money, there was one visiting card with name, qualification and mobile phone number of Mr. Shah. With some difficulty, Mr. Pravin could finally contact CA. Hemant Shah and confirmed about the loss of wallet by CA. Hemant Shah. Mr. Pravin also got CA. Hemant Shah's Surat's address. As Mr. Pravin was planning to come to Surat for some work, he decided to return the wallet in person. A period of THREE MONTHS had lapsed from the day the wallet was lost. Finally Mr. Pravin came to CA. Hemant Shah's house and returned the wallet. CA. Hemant Shah took hold of the wallet counted the cash and coolly thanked Mr. Pravin. Wife of CA. Hemant Shah was overwhelmed by the honesty of this man. She told her husband 'Why don't you reward this gentleman with some cash for his honesty?' The husband replied 'I have already waived off the interest for the three months on Rs. 15000. Is that not an enough reward?'