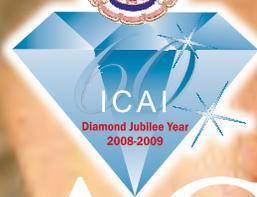


Volume 57 No.04 October 2008

THE CHARTERED ACCOUNTANT

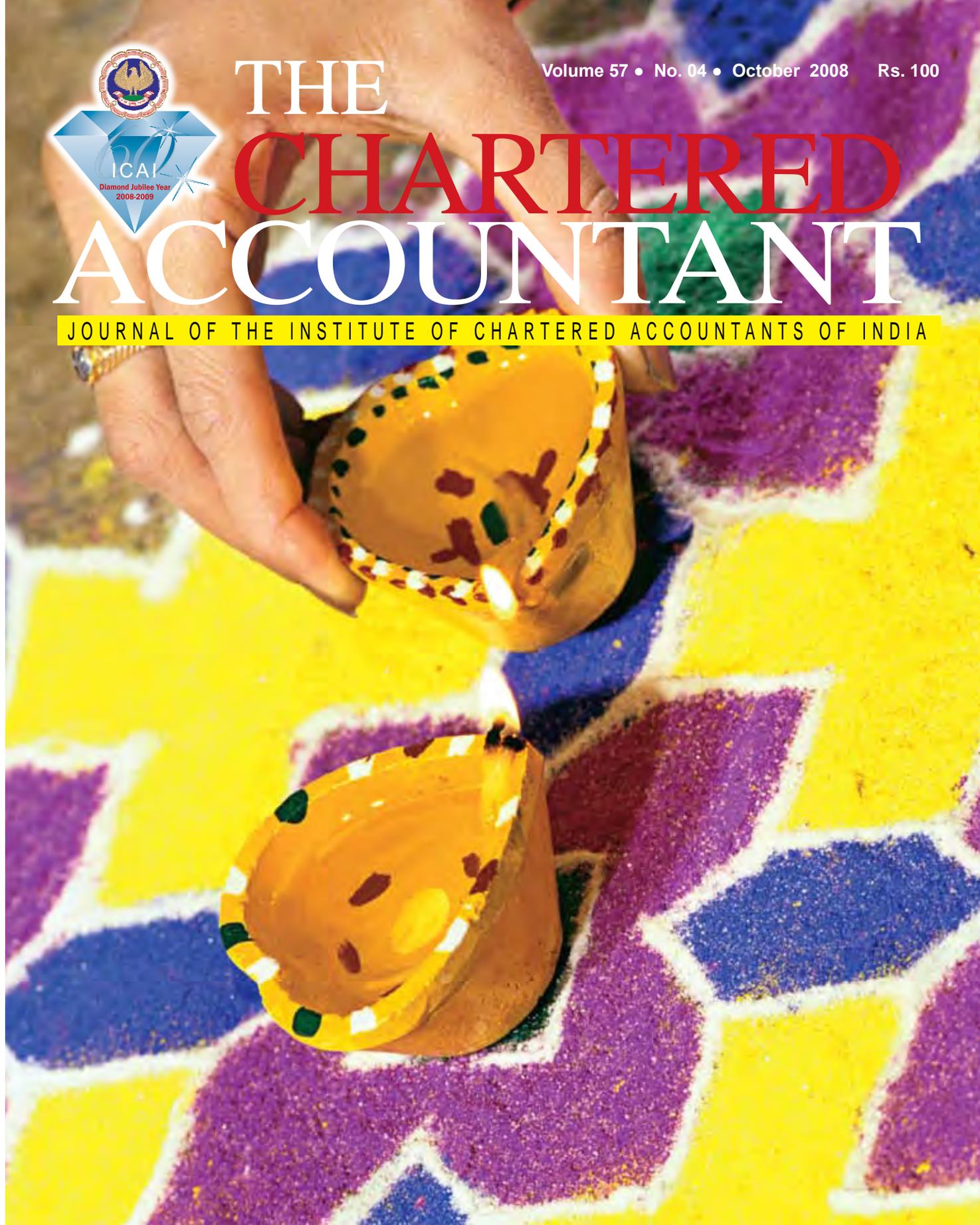
Rs.100



# THE CHARTERED ACCOUNTANT

Volume 57 • No. 04 • October 2008 Rs. 100

JOURNAL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA



Hedge Accounting Under AS 30

Auditing of Digital Firm

Centre of Excellence at Jaipur

Certificate Course on Valuation

CFO and Better Corporate Governance

Celebrating 60<sup>th</sup> Year of Excellence

## GLOBAL FINANCIAL CRISIS FOR US?

Over the past few weeks, collapse of two of the world's most respected financial institutions, i.e. *Lehman Brothers*, a 158-year-old American investment bank giant, bankruptcy and *Merrill Lynch*'s acquisition by Bank of America, along with the financial crisis of AIG (American International Group) has critically shaken the entire financial world. Lehman Brothers confirmed plans to sell its investment management division to generate \$3 billion. It also announced an expected loss of \$3.9 billion. Merrill Lynch agreed to be bought by Bank of America for \$50 billion. However, the Bush administration proposed a *big package for big problem* and insisted that Congress must move quickly to approve the *mother of all bailouts* of financial institutions in US, i.e. a \$700 billion proposal to buy a mountain of bad mortgage debt in an effort to unfreeze the nation's credit markets. In terms of broader capital flows, one can therefore expect a lot of volatility in these markets as steadiness is likely to be witnessed only when all this confusion in global financial institutions gets sorted out. *Goldman Sachs* and *Morgan Stanley*, the last surviving big investment banks on Wall Street, have decided to become regulated banks.

Financial crises are terrifying when underlying economic fundamentals are out of line with established theory, leading to bursts of unjustified optimism and/or pessimism. A pin-pointed reference has also been made to selection of accounting policies as per the IFRS propagated by IASB. It is the responsibility of the powers to bring sense to the market. Financial markets are funny beasts. Every financial crisis is different, but all of them do end eventually.

However, in contemporary Indian economy, rupee may undergo some instability due to the exit of the foreign funds. These negative developments indicate that the credit crunch will increase and capital flows to emerging markets like India are likely to be affected. This global crunch may impact credit availability in the Indian market. Since domestic companies would not be able to pull together overseas funds adequately, the major impact will be on funding of infrastructure sector projects and we may witness an upheaval in infrastructure pricing that has already borne the brunt of higher interest rates on housing loans. Since India's microeconomic story remains intact, the crunch in foreign investments as an impact of this global financial crisis would ultimately correct itself. This crisis shall have implications on the accounting profession too. As a result of this credit crunch, the performances of companies will be under stress and in response these companies might opt

to present a rosier pro-optimistic picture of their financial status than what they actually are. The common man has to understand such moves of the companies resulted from the crisis and eventually identify the real picture behind it. It is a challenge of the time.

Finance Minister P. Chidambaram has reassured that Indian public sector banks are well regulated and, therefore, immune from such crises as they have virtually peanut exposure to Lehman Brothers except ICICI Bank. State-owned banks like State Bank of India, Bank of India and Bank of Baroda have very negligible and indirect exposure to Lehman ranging from \$5-10 million and the amount of exposure is minuscule relative to the size of their strong balance sheets. Our public sector banks have no direct exposure to G-7 mortgage markets either and, therefore, this construct has protected us in the past and would continue to insulate us from global financial woes and turmoil.



These are the days of irrational pessimism, which in a way is similar to the irrational optimism that existed in the recent past.

The way to survive this crisis is to stay focused on the fundamentals. From a fundamental perspective, India's financial system has a lot going for it. As this phase of extreme pessimism abates a bit, global investors are likely to reward India for the robustness of its system. However, it would not be a distant idea to learn some lessons from this crisis. Another viewpoint is that India is going through a classic cyclical slowdown. By and large, companies have in-built operating leverage that will come into play when the cycle turns and it will turn, sooner or later. Although RBI has announced a series of measures to increase liquidity and attract foreign currency, this crisis has brought some pressures to bear on the domestic money and forex markets.

Barclays has acquired North American operations of Lehman and has offered jobs to 10,000 employees in North America. It has pledged a \$2.5 billion bonanza in the New York office. Therefore, let us, on the lighter side, garner support from the following laws of physical sciences: the philosophy behind *Law of Conservation of Energy* says we are in a cycle of constant, i.e. we will be forced to get back on track; and *Theory of Relativity* says nothing is absolute, i.e. everything's existence is relative and crisis develops in the state of *stability* and vice versa.

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Printed and published by Vijay Kapur on behalf of the Institute of Chartered Accountants of India (ICAI). Editor: CA. Ved Jain  
Published at ICAI Bhawan, PO Box No. 7100, Indraprastha Marg, New Delhi-110002 and printed at Spenta Multimedia, Peninsula Spenta, Mathuradas Mill Compound, N. M. Joshi Marg, Lower Parel, Mumbai - 400013.

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\* Members will get one hour CPE Credit - Unstructured Learning for reading this Article / Standard.

## Dear Esteemed Colleagues,

By the time you read this message, we will all be free from the hectic schedule of audit assignments and have some good time to celebrate the festivals of Durga Pooja, Id-ul-Fitr and Deepawali. I take this opportunity to wish you a very happy and joyous Durga Pooja, Id-ul-Fitr and Deepawali, and wish that the festivals may bring you and your family Happiness, Peace and Prosperity.

## Centre of Excellence at Jaipur – A Proud Moment

You will recall that in my first communication to you in March 2008 issue, I had articulated my dream of making CAs a class of matchless professionals and of setting up the *Centres of Excellence* with the same objective in mind, where training by way of about three-month residential courses involving management and communication skills could be provided. I am delighted to inform you that the foundation stone of the ICAI's first residential *Centre of Excellence* has been laid at Jaipur by the Union Minister of Corporate Affairs Shri Prem Chand Gupta. Chief Minister of Rajasthan Smt. Vasundhara Raje as Chief Guest graced the auspicious occasion along with a galaxy of other luminaries of our country. It is a dream come true and that too within such a short span of time. I can assure you that work on this project will go on at a very fast pace and we should be in a position to inaugurate the Jaipur Centre of Excellence by next year.

This *Centre of Excellence*, spread over an area of 25 acres, has been planned to be a landmark in the field of education, training and research in accountancy in India. It will not only hone and sharpen the talent, aptitude and core competencies of CAs in accounting, other related areas and soft skills, but it would also serve as the prime place for all accountancy-related global activities in times to come. It will also be a place, where economic and financial policies could be deliberated upon. In the Diamond Jubilee year of its service to the nation, this *Centre of Excellence* is yet another feather in the ICAI's cap.

## CPT Online Examination

Another of my dream projects was to hold CPT online examination in order to make Chartered Accountancy in India a cost-effective course and also to provide a global edge to it. I am happy to inform you that the first CPT online examination will be held on December 7, 2008, in 11 cities, viz. Ahmedabad, Bengaluru, Chennai, Hyderabad, Jaipur, Kanpur, Kolkata, Mumbai, Nagpur, New Delhi and Pune. Since the number of seats available in these cities is limited, the

eligible candidates will have to exercise their option of appearing at online Test by visiting the ICAI website. The offer will open on October 6, 2008, and will be on the first-come-first-served basis. I may also add that the CPT online examination will be conducted in addition to the existing paper-pencil examination to be held on December 14, 2008. However, candidates, who opt for the online examination, shall not be eligible to appear at the paper-pencil examination. Once this archetype is conducted successfully, we can look forward to conducting CPT online examination on a regular basis in future.

## Convocation for Successful CAs

In my last communication, I had said that we were planning to start organizing convocations at all our regional headquarters twice a year to give away the Certificate for passing CA Final Examinations, Certificate of Membership and Certificate of Practice. We have now finalised the dates. The first convocation will be held on November 2, 2008, in Delhi followed by that in other regions. I request all new members of the Institute to attend the convocations in formals as prescribed. Besides the Certificates, the candidates will also get a set of ICAI publications, an Institute tie and a lapel pin to formalise their entry into the fraternity. I am sure such convocations will help forge a strong bond of camaraderie among members and also bring them closer to the Institute.

## Landmark Initiative in Public Finance

You will recall that as a part of our new drive to use chartered accountants' expertise to address various issues relating to public finance, both at central and state levels, we had set up a new committee, Public Finance Committee of the Council at the centre level and also for each of the states to analyze and review public finance, budgetary expenditure, welfare schemes and the end use of funds. It is indeed gratifying to observe that this Corporate Social Responsibility (CSR) initiative has made important headway over the past few months and the Institute is fast joining hands with central and state governments in implementing economic policies and assisting them to ensure greater accountability and improve the quality of deployment of public money.

Leaders like CA. K. Rahman Khan, Deputy Speaker, Rajya Sabha, Shri Yashwant Sinha, former Union Minister for Finance, and Shri Rupchand Pal, Chairperson, Committee on Public Undertakings & Member, Standing Committee of Finance of the Parliament of India, have lent their active support to this initiative by visiting the Institute and participating in the delibera-

tions of the Committee. The other dignitaries who we have approached for the purpose include Governor of Karnataka CA. Rameshwar Thakur, Governor of Assam S.C. Mathur, Governor of Andaman & Nicobar Mr. Bhopinder Singh, Finance Minister of West Bengal Mr. Aseem Das Gupta, Chief Minister of Assam Mr. Tarun Gogoi, Chief Minister of Mizoram Mr. P.U. Zoramthanga, former Chief Minister of Jharkhand Mr. Madhu Koda, Chief Minister of Meghalaya Dr. Donkumar Roy, Chief Minister of Delhi

Mrs. Sheila Dikshit. The Committee has also been conducting a study in insurance and risk management in Kerala on request by the State Insurance Department.

I firmly believe that chartered accountants can prove to be immensely useful in this initiative in public finance. This will both

be a challenge as well as an opportunity. Let each one of us take this up as part of our obligation to society.

### Imbibing Best International Practices

While there have been worldwide initiatives by international accounting bodies for speedy convergence with International Financial Reporting Standards, the Auditing & Assurance Standards Board cannot lag far behind. Convergence with the international auditing standards is a membership obligation for us, as we are the founder member of the International Federation of Accountants (IFAC). The Auditing & Assurance Standards Board (AASB) is already in the process of issuing a revised draft of auditing and assurance standards, in line with those of the International Auditing and Assurance Standards Board (IAASB) under its Clarity Project. These revised standards will reflect the contemporary thinking of the international auditing profession. By December 2008, we shall have almost all the revised auditing standards aligned with those issued by IAASB.

### National Debate Competition: An ICAI Initiative

As part of Diamond Jubilee Celebrations this year, it has been decided to organise a National Debate Competition for students of classes XI and XII in different parts of the country. The purpose of this debate is to create awareness among students about their career and the various options available to them. The Debate Competition has already started creating a stir among the participants who are becoming aware of

the economic and educational issues of our country. I do not believe in direct teaching, but in creating a system that actuates learning. Here I would like to recall Einstein's words who in effect said that genuine knowledge originated from direct experience and extensive interaction. The debate competition is being

conducted at three levels starting from the Branch level to the Regional level followed by a mega All India Level. I am quite enthusiastic about the Competition which besides creating awareness about the CA profession among students will help sensitise them to topical issues and create awareness among them on societal and other national concerns.

### ICAI Awards

Chartered accountants working in industry have proved themselves to be the Valued Trustees of World Class Financial Competencies, Good Governance and Competitiveness. They are playing a significant role of value addition to the corporate world and in turn helping the economic development of the country. In order to recognise the exemplary contribution of those members in industry who have demonstrated excellence in their professional lives, and have created value to their company's stakeholders on a sustainable basis, the Institute plans to honour them and give away the awards on the 25<sup>th</sup> of January 2009



ICAI President CA. Ved Jain presenting a bouquet to Smt. Vasundhara Raje, Chief Minister of Rajasthan

at Mumbai. The awards are in three categories, viz. Business Achievers, Chief Financial Officers (CFO's) and Professional Achievers. The awards recognise the achievements of outstanding CAs whose personal lives, professional achievements, and community service exemplify the objectives of their alma mater. It will also be a very special occasion for the awardees because perhaps the highest recognition for a man is to be honoured by his or her alma mater. I would urge our members in industry to participate in this programme. Details of the programme are published elsewhere in the Journal.

## Vision 2021

As you may be aware, the Institute is working on Vision 2021. The issues presently being considered pertain to the size of taxation, consulting and audit services and their scope in the next decade, the changing profile and growth of the profession, segmentation and emerging structural models in Small and Medium Enterprises (SMEs), etc. The results of the primary research conducted on opportunities and challenges pertaining to service products of the profession; its segmentation to match the economic indicators and the role of regulatory regime in the country in 2021 are being examined. The analysis is in progress. Under study are the impact of indicators and influencers on the economic scenario of 2021 to anticipate prevailing opportunities and challenges in the year 2021 in line with the Indian economy becoming a developed economy by then and India emerging as a leading global player.

## Making CA Fraternity a Close-knit Family

In my last communication, I had shared with you information about the new initiatives being taken to improve services to members and students. I am happy to say that the impact of these new initiatives has been beyond our expectations. In just 15 days of starting the facility of creating email in their own name by members and students, more than 12,000 members and more than 17,000 students have obtained such email ids. Besides, a large number of members have updated their data relating to their professional and residential addresses, telephone and mobile numbers and email ids etc online. These steps will help in bringing each member and student closer to the Institute and increase their involvement and participation in the Institute's activities. The response to the e-newsletter for members abroad has also been very good. The information provided therein will help in generating a feeling of belongingness among all our brothers and sisters settled abroad.

May I take this opportunity to request you all to share your thoughts, expertise and areas in which you specialise including the areas of concern by writing articles for the Institute's journal! Members who are settled abroad could share their experiences in that particular country including the opportunities available to Indian members and also what needs to be done if one is looking for opportunity in that country. Similarly, members in industry could share their experience of that industry, issues concerning that industry and also the opportunities for members. These initiatives could in my opinion go a long way in making the chartered accountant fraternity a closely knit family where each member cares for others and therefore shares his or her ideas with them.

## Help Flood Victims

It is a matter of deep sadness that a tragedy has struck the states of Bihar & Orissa and we need to do all we can to alleviate misery and provide help to the needy. Particularly the Kosi floods have rendered lakhs of people homeless, hungry and diseased besides destroying crops, cattle and property worth millions of rupees.

I request all colleagues, firms of Chartered Accountants and students to come forward and donate generously to reduce human misery. You may contribute online at ICAI website [www.icaai.org](http://www.icaai.org) or send in your contribution, by way of Demand Draft/Cheque drawn in favour of 'The Secretary, ICAI (Bihar Flood Relief Account)' to The Secretary, The Institute of Chartered Accountants of India, ICAI Bhawan, Indraprastha Marg, New Delhi 110002. Let us pay back some of the debt that we all owe to society.

Friends, I have been trying my best to address issues that concern all of us. Yet there may still be areas which in your opinion need to be attended to. Please therefore send in all your suggestions, big and small, so that I can consider and implement them. In fact, many of the initiatives taken up so far by me have been the result of suggestions received from esteemed colleagues like you.

May the festive season bring in lots and lots of good cheer and prosperity for you and your family! May love of people for people grow in such trying times as these! May humanity emerge a winner!



**CA. Ved Jain**  
New Delhi,  
September 26, 2008

**Praise for our New Initiatives**

I am very happy to note that as an initiative in the direction to unstructured learning, our Institute has given CPE credits for reading articles in the Journal. It will be really convenient for members in industry in availing themselves of CPE credits. I have observed that over the years our Journal has become an indispensable tool for CAs in updating their knowledge in emerging areas of concern. I feel proud being a member of the CA fraternity

- CA. Amit Khurana, Pune

I have been a regular reader of the Institute's journal for many years. I have immensely gained and enlightened myself through various articles of the Journal. The initiative to provide members with their own e-mail id and to start certificate courses on IFRS and Valuation is an excellent service of the Institute. I am eagerly waiting to enroll in these courses. I sincerely extend my heartiest congratulations to the Editorial Board for continuously bringing out enriching and wide-ranging articles. I feel extremely proud to be a member of the institute.

- CA. Ramabadrans Satish, Member, Muscat

Step to conduct Chartered Accountancy exams on alternate days will improve the performance of our students. Convocation for successful CA finalists is another milestone for the Institute that will give our young members an understanding that they have been inducted into an extraordinary league.

- CA. Rakesh Chawla, Una (Himachal Pradesh)

**Journal and Its Contents Praised**

First of all, I would like to congratulate your team for giving a beautiful presentation of July issue. Our Journal has become more useful to members and students of the Institute, as it contains a lot on the matters on practical side. Accept my appreciations for this.

- Nishant Monani, CA. Student

I am really happy to find constant change and improvement in the quality and variety of articles in the Journal. I must congratulate all the past presidents, and staff for doing this change.

- CA. Arun K. Shah, Member

I have received the September issue of the Journal. It is very useful both as a CA entrance

student and a commercial tax trainee. The information provided about tax and banking & finance is very useful. Information provided by our journal is powerful.

- Afsal Babu, CA Student

**Readers Suggest**

It will be better if the system of assignment, i.e. solved paper submission scheme, available under old CA curriculum is restarted, as through this students get an opportunity to get themselves evaluated against Institute's evaluation standards. Further, inspirational and success stories of successful CAs may be included, which will boost our morale.

- Nitin Mahajan, CA Student, Jalandhar

In the year of Diamond Jubilee celebrations, the September 2008 issue was one of the many initiatives that are being taken by the ICAI to spread knowledge and awareness about convergence with IFRS among members. The Institute should organize seminars and symposia on a regular basis to prepare its members and students for the transition towards convergence, thereby making convergence a reality by 2011.

- Sumit Kr. Dhanuka, CA. Student, Mumbai

**August Issue was Useful**

I have always found the Journal informative and helpful. The August 2008 issue was particularly praiseworthy. As student I have been benefited by Legal Update and TDS from Rent under Section 194-I-Some Contradictions. I also appreciated the article Islamic Finance: An Overview by CA. Ashutosh Verma. I am also happy with the content and the style of the Journal.

- Mohd. Ramaan, CA Student, Delhi

The Article *Global Best Practices in Indian Banking* in August issue of the Journal was informative and interesting. The focus on risk management and corporate governance in banking sector marked the business acumen on the banks performance. The views on anti-money laundering and KYC Norms talked of measures to prevent misuse of banking systems. The effort made on transparency and disclosure throws light on adoption on best business practices. I thank the Journal for efforts made to provide information on general economic issues.

- CA Jaya Lakshmi Ramanchandran, Member, Kuwait

**Write to the 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](mailto:eboard@icai.org), [nadeem@icai.org](mailto:nadeem@icai.org) or write to: The Editor, The Journal Section, ICAI Bhawan, C-1, Sector 1, Noida (U.P.) 201 301.

- Editor

## Past President of the ICAI CA. Sohanraj Pukhrajji Chhajed Passes Away



The accountancy profession in India lost one of its leading lights when Past President of the Institute of Chartered Accountants of India CA. Sohanraj Pukhrajji Chhajed passed away on 18<sup>th</sup> September, 2008 in Mumbai. He was 69. He was President of the ICAI during the year 1999-2000 and was a Council member of ICAI for six consecutive terms (1982-2001).

Late CA. S.P. Chhajed was an active member of the profession. He was widely known for his core simplicity, spontaneity and forthrightness. Late CA. Chhajed was a strong proponent of ethics in the profession. The whole profession stands by the aggrieved family of late CA. S.P. Chhajed on this irreparable loss and prays for the peace of the departed soul.

### LATEST AT A GLANCE

#### Members

- First Convocation of the ICAI will be held on November 2, 2008 at New Delhi.
- ICAI Awards 2008 under three categories namely CA Business Achiever, CFO, CA Professional Achiever will be given. Last date for receipt of nominations by the committee is November 30, 2008.
- SEBI has directed stock brokers/clearing members to carry out complete internal audit on a half yearly basis by independent qualified Chartered Accountants.
- Application form for empanelment to function as invigilator at examination centers conducting the chartered accountants examinations is available on the ICAI website.
- Certificate Course on Valuation has been launched.

#### Students

- Articled assistants registered and undergoing

graduation or any other course on or before 31<sup>st</sup> March, 2008 need not submit Form No.112. However, articled assistants registered on or after 1<sup>st</sup> April, 2008 and under going graduation or any other course shall be required to obtain specific permission by submitting Form No.112.

- The students belonging to the PE-II stream who have already been registered for Professional Competence Course have been permitted to appear in the extended Professional Education (Examination –II) to be held in November, 2008 and May, 2009.
- The students belonging to the Professional Education (Course –II) stream who have submitted their papers for switching over to Professional Competence Course have been permitted to appear in the extended Professional Education (Examination –II) to be held in November, 2008 and May, 2009.

## Centre of Excellence at Jaipur: Foundation Stone Laid on September 11, 2008



*Bhoomi Pujan and Foundation Stone Laying Ceremony for the Centre of Excellence at Jaipur: ICAI President CA. Ved Jain sharing the dais with the Union Minister of Corporate Affairs Shri Prem Chand Gupta, Chief Minister of Rajasthan Smt. Vasundhara Rajee, ICAI Vice President CA. Uttam Prakash Agarwal and ICAI Central Council Members CA. Anuj Goel, CA. Jaideep Narendra Shah and CA. Vijay Garg*

**H**on'ble Union Minister of Corporate Affairs, Shri Prem Chand Gupta laid the Foundation Stone of the first residential *Centre of Excellence* of The Institute of Chartered Accountants of India (ICAI) at Jaipur on September 11, 2008. Hon'ble Chief Minister of Rajasthan, Smt. Vasundhara Rajee was the Chief Guest. Shri S. N. Gupta, *Chairman of the Public Grievances and Redressal Committee*, Government of Rajasthan, also graced the occasion with his presence. The function was also attended by Shri Anurag Goel and Shri Jitesh Khosla from the Ministry of Corporate Affairs.

In his welcome address, the *Director and Acting Secretary* of the Institute, Shri T. Karthikeyan expressed that it was a milestone and a landmark achievement for the Institute. He also stated that along with economic development, higher education of masses is necessary not only for sustained economic development, but also for reaching greater heights in all fields.

The ICAI *President*, CA. Ved Jain indicated that the ICAI is a globally distinguished accounting body. He said that the need for a residential programme had got developed due to an increased pace of

globalization that needed proficiency not only in accounting and allied fields, but also in soft skills. The *Centre* will offer Residential Programmes and impart training to students and members for continuing professional education by covering various topics in corporate communication, strategic management, professional business development and management, and so on. He informed that the *Centre* would conduct various comprehensive management programmes and post-qualification certification courses in the areas of derivatives, treasury and foreign exchange management, international taxation, corporate governance, IFRS, financial analysis, etc. The *Centre* would be a true research hub in accounting and related areas that would help in developing knowledge and tools for capacity building of professionals, industry and the government. He also said that it would not only enhance and expedite the process of making Chartered Accountants a class of matchless professionals, but also cater to the training requirements of overseas accountants.

*Union Minister of Corporate Affairs*, Shri Prem Chand Gupta laid emphasis on the role of Chartered

Accountants by reiterating the trust by authorities from banks, income tax and investment institutions on financial documents. He also inferred that the establishment of this *Centre* would lead to excellence that was required in this competitive environment, by providing necessary training to professionals and students to meet the present challenges.

*Hon'ble Chief Minister of Rajasthan* Smt. Vasundhara Raje remarked that a large number of CAs qualify every year in Rajasthan. She said that the government's decision to get into this partnership for establishing this *Centre* in Jaipur was aimed at

the growth of both the Institute and the State. It was her wish that an acclaimed academic institution like the ICAI should make an entry in Rajasthan. She reiterated that growth in financial services sector was as essential as in IT sector. The Chief Minister emphasized and reminded the Institute of its social responsibility that while setting up

the *Centre*, surrounding areas including the existing villages would get benefits like education and scholarships.



ICAI Vice President CA. Uttam Prakash Agarwal presenting a bouquet to Shri S. N. Gupta, Chairman, Public Grievance and Redressal Committee, Government of Rajasthan

The function was concluded with a vote of thanks by the Vice President of the ICAI, CA. Uttam Prakash Agarwal. He extended his gratitude to the Hon'ble Union Minister of Corporate Affairs, Shri Prem Chand Gupta and Hon'ble Chief Minister of Rajasthan, Smt. Vasundhara Raje for realising the dream of setting up the *Centre of Excellence* in Jaipur. He said that it was personally a matter of great pride, as he belonged to Rajasthan and that the *Centre of Excellence* would provide policy inputs to the

Government on continuous basis for alignment of legal and administrative framework. He thanked the State Government for providing land at concessional rates that enabled the ICAI to build the *Centre*. He also promised the State Government that the Institute will work in association with the people of Rajasthan as its social responsibility.

## Invitation to Attend First Convocation

We are pleased to inform the members that the first ICAI Convocation, to give away *Certificate of Passing CA Final Examination*, *Certificate of Membership* and *Certificate of Practice* to our newest group of professional brethren, will be held on 2<sup>nd</sup> November, 2008 at New Delhi. All members are requested to attend the same and be a part of the new initiative of the ICAI which is envisaged to promote professional camaraderie and bonhomie. More details about the programme will be hosted on the website shortly.

## Common Proficiency Test (CPT) Online Examination – 7<sup>th</sup> December, 2008

It is for the information of the candidates that in addition to the existing Paper-pencil mode Common Proficiency Test scheduled to be held on 14<sup>th</sup> December, 2008 at various Centres throughout the Country, CPT Online Examination will also be held on 7<sup>th</sup> December, 2008 (Sunday) on experimental basis in 11 Cities viz. Ahmedabad, Mumbai, Pune, Nagpur, Chennai, Bangalore, Hyderabad, Kolkata, Kanpur, Jaipur and New Delhi. Candidates who have been registered for CPT Course on or before 1<sup>st</sup> October, 2008 and have already passed or appeared in the Senior Secondary Examination (10+2 examination) or its equivalent of a recognized Institution and are interested to take the Common Proficiency Test Online Examination on 7<sup>th</sup> December, 2008, are required to fill up Online Application Form hosted on [www.icaixam.icaai.org](http://www.icaixam.icaai.org)

## Hedge Accounting Under AS 30\*

To manage the risks, the entities enter into various derivative transactions. The list of different types of derivatives changes frequently as banks come up continuously with new ones. The Institute of Chartered Accountants of India has issued Accounting Standard (AS) 30, "Financial Instruments: Recognition & Measurement" in line with IAS 39 issued by International Accounting Standards Board which deals with hedge accounting. AS 30 is recommendatory for listed and large entities from 1<sup>st</sup> April, 2009 and mandatory from 1<sup>st</sup> April, 2011. This article gives an insight of the principles and rules for hedge accounting and deals with other related issues.

### Announcement on Accounting for Derivatives

Looking at the current economic environment, the Council of the Institute of Chartered Accountants of India at its meeting held on March 27-29, 2008, made an announcement that the entities not opting for earlier adoption of AS 30, keeping in view the principle as enunciated in AS 1, Disclo-

sure of Accounting Policies, are required to provide for losses with respect to all outstanding derivative contracts at the balance sheet

date by marking them to market and make a separate disclosure of the losses provided. Those entities that have adopted the standard early have to disclose the amounts recognised in the financial statements.

*Can an entity that has gains from derivative transactions recognise those gains?*



— CA. Manish Iyer

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\* Members will get one hour CPE Credit - Unstructured Learning for reading this article.

To ease the administrative burden of recalculating and amortising the effective interest whenever there is a change in fair value of the hedged item, the standard provides an option that the effective interest rate may be recalculated and the amortisation of the same may begin when the hedged item ceases to be adjusted for the designated hedged risk.

An entity that recognises gains from derivative transactions would be deemed to have adopted AS 30 early. Selective application of AS 30 is not possible. Hence, there is no prohibition on entities recognising gains on derivative transactions provided they also apply the categorisation, recognition, derecognition, initial and subsequent measurement, impairment and all other provisions of AS 30.

### What is a Derivative

Under AS 30, a derivative is a financial instrument or other contract within the scope of AS 30 that satisfies all the following conditions:

1. Whose value changes in response to changes in an underlying price or index: an interest rate, foreign exchange rate, a commodity price, a security price, a credit rating, or an index of any of the above;
2. That requires no initial investment, or significantly, less than the investment required to purchase the underlying instrument; and
3. That is settled at a future date.

Some commodity-based derivatives are not considered a derivative under AS 30. A commodity contract is treated as an AS 30 instrument if any of the following three conditions is satisfied:

1. The entity has a practice of settling similar contracts net in cash, or by entering in offsetting contracts, or by selling the contracts; or
2. The entity has a practice of taking a delivery and selling shortly after the delivery so as to profit from short-term fluctuations in price or dealer's margin; or
3. Where the contract permits either party to settle net in cash, through other financial instrument, by exchanging financial instruments, by selling the contracts or through the non-financial items that are the subject of the contract and are readily convertible to cash, unless the contract is entered into and continues to be held for the purpose of receipt or delivery in accordance with the entity's normal purchase, sale or usage requirements.

### Hedge Accounting

As stated in Para 95 of AS 30, hedge accounting recognises the offsetting effects on profit or loss of changes in the fair values of the hedging instrument and the hedged item. Thus, there are four aspects related to hedge accounting:

1. There has to be a hedged item.
2. There has to be a hedging instrument.
3. There has to be a relationship between the hedged item and the hedging instrument.
4. The relationship should be effective so as to offset the effects on profit or loss of changes in the fair value of the hedging instrument and the hedged item.

### Hedged Item

A hedged item is the element of financial statements that is designated as being hedged. The fundamental principle to qualify as a hedged item is that the hedged item should create an exposure to risk that could affect the Profit and Loss Account.

The following can be a hedged item:

1. A recognised asset or liability;
2. An unrecognised firm commitment;
3. A highly probable forecasted external transaction;
4. Net investment in a foreign operation (on a consolidated basis only);
5. A group of assets, liabilities, firm commitments, highly probable forecasted external transactions, or net investments in foreign operations, as long as they share the risk exposure that is designated as being hedged. However, the change in fair value attributable to the hedged risk for each individual item in the group shall be expected to be approximately proportional to the overall change in fair value of the group of items attributable to the hedged risk. Therefore hedge accounting is not possible if a put option on BSE index is purchased to hedge the fair value of portfolio of shares of the BSE index. This

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is because, the fair value of the individual items does not move in an approximately proportional manner to the fair value of the portfolio as a whole;

6. A non-financial asset, such as inventory, or a non-financial liability for the risk of changes in the fair value in its entirety for all risks, or for a hedge of foreign exchange risks only;
7. One or more selected contractual cash flows, or portions of them or a percentage of the fair value, of a financial asset or a financial liability, provided that effectiveness can be measured;
8. An amount of asset or an amount of liabilities in a fair value hedge of the interest rate exposure of a portfolio of financial asset and / or financial liabilities. Designation of a net amount is not possible;
9. An intra-group monetary item in the consolidated financial statement if it results in an exposure to foreign exchange gains or losses that are not fully eliminated on consolidation. The standard states this is possible only when the item is transacted between two group entities that have different functional currency. Footnote no. 19 to AS 30 defines functional currency as the currency of the primary economic environment in which the entity operates;
10. A highly probable forecast intra-group transaction, in consolidated financial statements and in a foreign exchange cash flow hedge, provided that:
  - i. The transaction is highly probable and meets all other hedge accounting criteria (with exception of the requirement that it involves a party external to the group) , and
  - ii. The hedged foreign exchange transaction is denominated in a currency other than the functional currency of the entity entering into it and the foreign exchange risk affects consolidated Profit and Loss Account.

The following cannot be a hedged item:

1. Held-to-maturity instruments with respect to interest rate risk or prepayment risk: With respect to credit risk or Foreign

Retrospective tests are performed so that the entity can prove that the hedging relationship was effective during the reporting period. In order to pass the test, the retrospective test should result in an effectiveness of 80% - 125%. AS 30 does not specify any particular method(s) for testing the effectiveness of the hedge retrospectively.

- Exchange risk these can be a hedged item;
2. A derivative: Only exception is an embedded purchase option that is hedged with a written option;
  3. The other counterparty to the item is not external to the entity. However, intra-group monetary items can be hedged items with respect to Foreign Exchange risk in the consolidated financial statements if it results in an exposure to Foreign Exchange gains or losses that are not fully eliminated on consolidation;
  4. Transaction in own equity instrument; and
  5. An equity method investment.

provided that:

- i. The risks being hedged can be identified clearly;
- ii. The effectiveness of the hedge can be demonstrated; and
- iii. It is possible to ensure that there is specific designation of the hedging instrument and the different risk positions.

### *Hedging Relationship*

Para 96 of AS 30 states three types of hedging relationships:

1. Fair Value Hedge
2. Cash Flow Hedge
3. Net Investment Hedge

### *Hedging Instrument*

A hedging instrument is a designated derivative. A non-financial asset or liability can be a hedging instrument only for a hedge of foreign exchange risks only.

The following can be hedging instruments:

1. A derivative that involves an external party, except for most written options. A written option can only be designated as hedging instrument in a tunnel or a collar, that is, in combination with a purchased option and all the following conditions are met:
  - i. No net premium is received either at inception or over the life of the options; and
  - ii. Except for the strike prices, the critical terms and conditions of the written options and the purchased option are the same. Also the notional of the written option is not greater than that of the purchased option;
2. An external non-derivative financial asset or liability, but only for hedges of Foreign Exchange risk;
3. A proportion of the notional of the derivative instrument;
4. Two or more derivatives, or portion of their nominal, can be viewed in combination as the hedging instrument if none of them is a written option;
5. A single hedging instrument may be designated as a hedge for more than one type of risk

### **1. Fair Value Hedge**

The objective of the fair value hedge is to offset in Profit and Loss Account the change in the fair value of the hedged item with the change in the fair value of the derivative. The hedging instrument in a fair value hedge relationship is recognised as under:

- i. If the hedging instrument is a derivative, losses or gains from remeasuring the derivative at fair value are recognised in Profit and Loss Account.
- ii. If the hedging instrument is a non-derivative, the amount recognised in Profit and Loss Account related to the hedged item is the gain or loss from remeasuring in accordance with AS 11, the foreign currency component of its carrying amount.

Complications arise when there is an accounting mismatch, i.e. the hedging instrument is measured at fair value whereas the hedged item is measured on a basis other than fair value. For recognition of such hedged items in a fair value hedge, the standard envisages three situations:

- a. *Hedge item measured at cost or designated as available for sale financial asset:*

In this case, the carrying amount of the hedged item is adjusted for the loss or gain attributable to the hedged risk with the corresponding gain or loss recognised in Profit & Loss Account.

b. *Hedged items measured at amortised cost:*

In this case, the adjustment of the carrying amount affects the effective interest rate of the hedged item. To ease the administrative burden of recalculating and amortising the effective interest whenever there is a change in fair value of the hedged item, the standard provides an option that the effective interest rate may be recalculated and the amortisation of the same may begin when the hedged item ceases to be adjusted for the designated hedged risk. In the case of a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities, the adjustment made to the carrying amount of the hedged item is amortised fully by maturity of the financial instrument or, in the case of a portfolio hedge of interest rate risk, by expiry of the relevant re-pricing time period.

c. *Hedged item being an unrecognised firm commitment:*

In this case, the subsequent cumulative change in the fair value of the unrecognised firm commitment attributable to the hedged risk is recognised as an asset or a liability with a corresponding gain or loss recognised in Profit & Loss Account. If the firm commitment is to acquire an asset or liability, the carrying amount of the asset or liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the commitment attributable to the hedged risk that was recognised in the Balance Sheet.

Effect on Profit & Loss Account of Fair Value Hedge  
 = Changes in the Fair Value of the Hedging Instrument  
 + Changes in the Fair Value of the Hedged Item in respect to the risk being hedged

## 2. Cash Flow Hedge

A cash flow hedge is a hedge of the exposure to variability in cash flows that:

- a. Is attributable to a particular risk associated with a recognised asset or liability, or a highly probable external forecast transaction; and

b. Could affect reported Profit & Loss Account

The accounting for a cash flow hedge depends on its effectiveness. The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in a separate reserve called Hedging Reserve in Reserves and Surplus which is not a free reserve. Any ineffective portion of the fair value movement on the hedging instrument is recorded immediately in Profit and Loss Account.

When ineffectiveness is present, the amount of gains or losses on the hedging instrument that can be deferred in the Hedging Reserve Account is limited to the lesser of either the cumulative change from the inception of the hedge in the fair value of the actual hedging instrument or the cumulative change from the inception of the hedge in the fair value of the hedged item. The gain or loss accumulated in Hedging Reserve Account is transferred to Profit and Loss Account in the same period or period the hedged item affect Profit and Loss Account as an adjustment of the related line item. An entity may account a hedge of foreign exchange risk of a firm commitment as a fair value hedge or as a cash flow hedge.

### 3. Net Investment Hedge

A net investment hedge is a hedge of the foreign currency exposure arising from the reporting entity's interest in the net assets of a foreign operation. The hedging instrument may be either a derivative or a non-derivative. The accounting treatment of net investment hedge is as under:

- a. The effective portion of the gain or loss on the hedging instrument is recognised in Hedging Reserve Account. Gains or losses relating to the ineffective portion of the hedge are recognised immediately in Profit & Loss Account.
- b. On disposal or liquidation of the foreign operation, the balance in the Hedging Reserve Account and the balance of Foreign Exchange Translation Reserve is transferred to Profit & Loss Account.

#### *Hedge Effectiveness:*

To be able to apply hedge accounting, very strict criteria must be met at inception of the hedge and throughout the life of the hedging relationship. The management is also required to make a formal documentation and test the relationship prospectively and retrospectively at the inception and at the end of each reporting period until the hedging relationship terminates.

#### Hedge Accounting Criteria:

1. The hedging relationship must be documented in detail
2. The hedge should be expected to be highly effective in the ratio of 80% - 125%
3. For cash flow hedges, the forecasted transaction must be highly probable
4. The effectiveness of the hedge is measureable reliably
5. The effectiveness of the hedging relationship is assessed on an ongoing basis, and the relationship must be deemed to be highly effective in the ratio of 80% - 125% throughout the life of the hedging relationship.

### Documentation of Hedge Relationship

AS 30 requires that for a hedging relationship to qualify for hedge accounting, the management of the entity should have formal hedge documentation at inception of the hedge.

The formal documentation must specify the following:

1. The entity's risk management objective and strategy for undertaking the hedge
2. The type of hedge relationship
3. The specific risk being hedged, e.g., foreign exchange risk, interest rate risk, credit risk etc.
4. The terms of the hedging instrument and the method of measurement at fair value
5. The hedged item in sufficient detail
6. Methods of assessing effectiveness and whether the tests will be performed cumulatively or period to period basis.

### Methods of Testing Effectiveness

Testing a hedge relationship for effectiveness to prove hedge accounting is the most challenging task. Effectiveness is the extent to which changes in the fair value in case of fair value hedge or cash flows in case of cash flow hedge of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

AS 30 requires two separate tests of effectiveness to be applied:

1. Prospective Test
2. Retrospective Test

*Prospective Test:*

The prospective test must be performed at inception and at least at each balance sheet date. The prospective test should result in effectiveness within the range 80% - 125%. Prospective Test can be performed in one of the three ways:

1. Critical Terms Method or the Hypothetical Derivative Method:
2. Regression and Correlation analysis:
3. Monte-Carlo Simulation:
4. Volatility Risk Reduction (VRR) Method.

*Retrospective Test:*

AS 30 requires retrospective test to be performed at each reporting date. Retrospective tests are performed so that the entity can prove that the hedging relationship was effective during the reporting period. In order to pass the test, the retrospective test should result in an effectiveness of 80% - 125%. AS 30 does not specify any particular method(s) for testing the effectiveness of the hedge retrospectively. Normally, ratio analysis method is used to test hedge effectiveness retrospectively:

$$\text{Ratio} = \frac{\text{Change in fair value of hedging instrument}}{\text{Change in fair value of hedged item}}$$

### Effects in Profit & Loss Account

If the hedge is highly effective, the change in fair value of the hedging instrument is allocated, in accordance with the hedge documentation as under:

- a. *Effective Portion:* This is shown in the same line item as the hedged item
- b. *Ineffective Portion:* Recorded in Other Income and Expenses
- c. *Excluded Portion (e.g. Time Value of Option):* Recorded in Other Income or Expenses

The main advantage of proving effective hedge is that the entity can treat the changes in foreign exchange rates as part of sales or cost of sales rather than including them under other income and losses. Though there are some entities that report foreign exchange gains and losses as part of Cost of Sales However, such a practice is not in accordance with AS 11 and AS 30.

### Termination of Hedging Relationship

Para 102 of AS 30 deals with termination of the hedging relationship by entities prospectively. It gives three situations as under:

1. The hedging instrument expires or is sold, terminated or exercised (for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy);
2. The hedge no longer meets the criteria for hedge accounting; or
3. The entity revokes the designation

Apart from the above, hedging relationship may also get terminated if the hedged item expires before the expiry of the hedging instrument or when the forecast transaction is no longer expected to occur.

*Effect of Hedge Relationship Termination:*

Termination Event	Fair Value Hedge	Cash Flow Hedge
Hedging instrument expires, is sold, terminated or exercised	Hedged item not to be further fair valued. Any previous adjustments to the carrying amount of the hedged item are amortised over the remaining maturity of the hedged item	Balance in hedging reserve account remains in that account until the forecast transaction impacts balance sheet or profit and loss account as per the entity's policy
Hedge fails highly effective test	As above	As above
Voluntary termination by the entity	As above	As above
Forecast transaction still expected to occur, although not highly probable	Not applicable	As above

Forecast transaction no longer expected to occur	Not applicable	Balance in hedging reserve account is reclassified immediately to profit and loss account
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### Example of hedge accounting for highly probable import purchase with forward foreign exchange contract

On 19 May 2008, A Ltd., a company having its functional currency in INR expects to purchase goods from a US supplier to the extent of USD 150 million. The purchase was expected to occur on 31 October 2008 and the amount was to be paid to the supplier on 31 December 2008. The payable was exposed to the risk that the INR could become weaker in value in relation to the USD. To hedge this exposure, on 19 May 2008, A Ltd. entered into a foreign exchange forward contract with the following terms:

Foreign Exchange Forward Terms	
Contract Date	19 May 2008
Counterparties	A Ltd. and SILSILIA Bank
Maturity	31 December 2008
A Ltd. buys	USD 150 million

A Ltd. sells	Rs.6600 million
Forward Rate	Rs.44.00
Settlement	Physical Delivery

It is assumed that the spot and forward rates on the relevant dates were as follows:

Date	Spot Rate	Forward for 31 December 2008
19 May 2008	42.00	44.00
30 June 2008	42.80	44.30
30 September 2008	43.20	44.70
31 October 2008	43.50	44.80
31 December 2008	45.00	45.00

The effect of time value was considered to be not significant.

A Ltd. documented the hedging relationship as under:

Risk Management Objective and strategy for undertaking the hedge	The objective of the hedge is to protect the INR value of USD 150 million highly probable purchase against unfavourable movements in the USD/INR exchange rate. This hedging objective is consistent with A Ltd.'s overall Foreign Exchange risk management strategy for reducing the variability of its Profit and Loss Account
Type of hedge	Cash Flow Hedge
Risk being Hedged	Foreign Exchange risk. The variability in INR value of the highly probable purchase
Hedging Instrument	The foreign exchange forward contract no. 176/08/XU/02 dated 19 May 2008 with SILSILIA Bank the credit risk of which is considered to be very low
Hedged Item	USD 150 million purchase expected to take place on 31 October 2008

<p>Assessment of Hedge Effectiveness</p>	<p>Hedge effectiveness will be assessed by comparing changes in the fair value of the hedging instrument to changes in the fair value of the expected cash flow. The forward points of both the hedging instrument and the expected cash flow are included in the assessment.</p> <p><b>Prospective Test:</b></p> <p>A prospective test will be performed at hedge inception and at each reporting date. Due to the fact that the terms of the hedging instrument and those of the expected cash flow match, the hedge is expected to be highly effective. The credit risk of the counterparty will be monitored continuously.</p> <p><b>Retrospective Test:</b></p> <p>A retrospective test will be performed at each reporting date at maturity of the hedging relationship using the ratio analysis method. The hedge will be assumed to be highly effective on retrospective basis if the ratio is between 80% - 125%</p>
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Table showing Fair Value calculation of the hedging instrument:

	19/5/08 (1)	30/6/08 (2)	30/9/08 (3)	31/10/08 (4)	31/12/08 (5)
Initial Value in USD (a)	150,000,000	150,000,000	150,000,000	150,000,000	150,000,000
Forward Rate for 31/12/08 in INR/USD (b)	44.00	44.30	44.70	44.80	45.00
Forward Contract Value in INR (c)	6600,000,000	6600,000,000	6600,000,000	6600,000,000	6600,000,000
Value in INR as per the Forward rate (d) = (a) * (b)	6600,000,000	6645,000,000	6705,000,000	6720,000,000	6750,000,000
Forward Fair Value (e) = (d) - (c)	NIL	45,000,000	105,000,000	120,000,000	150,000,000
Forward fair value value changes (f)	NIL	45,000,000 (f2 = e2 - e1)	60,000,000 (f3 = e3 - e2)	15,000,000 (f4 = e4 - e3)	30,000,000 (f5 = e5 - e4)

Table showing Fair Value calculation of expected cash flow:

	19/5/08 (1)	30/6/08 (2)	30/9/08 (3)	31/10/08 (4)	31/12/08 (5)
Expected cash flow in USD (a)	150,000,000	150,000,000	150,000,000	150,000,000	150,000,000
Forward Rate for 31/12/08 in INR/USD (b)	44.00	44.30	44.70	44.80	45.00

Initially Expected Cash Flow in INR (c)	6600,000,000	6600,000,000	6600,000,000	6600,000,000	6600,000,000
Cash Flow in INR (d) = (a) * (b)	6600,000,000	6645,000,000	6705,000,000	6720,000,000	6750,000,000
Cash Flow Fair Value (e) = (c) - (d)	NIL	(45,000,000)	(105,000,000)	(120,000,000)	(150,000,000)
Cash Flow Fair value changes (f)	NIL	(45,000,000) (f2 = e2 - e1)	(60,000,000) (f3 = e3 - e2)	(15,000,000) (f4 = e4 - e3)	(30,000,000) (f5 = e5 - e4)

Table showing Retrospective Tests as per Ratio Analysis Method:

	30/6/08 (2)	30/9/08 (3)	31/10/08 (4)	31/12/08 (5)
Forward Contract fair value change	45,000,000	60,000,000	15,000,000	30,000,000
Expected cash flow fair value change	(45,000,000)	(60,000,000)	(15,000,000)	(30,000,000)
Ratio	100%	100%	100%	100%

### Journal Entries

1. To record the forward contract trade on May 19, 2008:

No entries in the financial statements were required as the fair value of the forward contract was zero

2. To record the closing of the reporting period on June 30, 2008:

	Dr.	Cr
Fair Value of Forward Contract no. 176/08/XU/02	45,000,000	
Hedging Reserve Account		45,000,000

3. To record the closing of the reporting period on September 30, 2008:

	Dr.	Cr
Fair Value of Forward Contract no. 176/08/XU/02	60,000,000	
Hedging Reserve Account		60,000,000

4. To record the receipt of goods and the end of the hedging relationship on October 31, 2008:

	Dr.	Cr
Imported Inventory	6525,000,000	
US Supplier Payable		6525,000,000
Fair Value of Forward Contract no. 176/08/XU/02	15,000,000	
Hedging Reserve Account		15,000,000
Hedging Reserve Accounts	120,000,000	
Imported Inventory		120,000,000

The above assumes that the policy of the entity is to adjust the amount of the asset or liability initially recognised with the changes in fair value of hedging instrument accumulated in hedging reserve account. The entity may defer the reclassification of Fair value changes recorded in hedging reserve account till the inventory affects cost of sales.

5. To record the settlement of the payable on December 31, 2008:

	Dr.	Cr
Foreign Exchange loss on payable	225,000,000	
US Supplier Payable		225,000,000
Fair Value of Forward Contract no. 176/08/XU/02	30,000,000	
Gain on Fair Value change of forward contract no. 176/08/XU/02		30,000,000
US Supplier Payable	6750,000,000	
Bank Account		6750,000,000
Bank Account	150,000,000	
Fair Value of Forward Contract no. 176/08/XU/02		150,000,000

Extract of profit and loss account for the period ended December 31, 2008, assuming all the inventories have been consumed and sold:

Sales	7000,000,000
Cost of Sales	6405,000,000
<b>Gross Profit</b>	<b>595,000,000</b>
Other Gains & Losses (-225, 000,000 + 30,000,000)	-195,000,000
EBIT	400,000,000

Had no hedging been done or the hedge was not proved or proved prospectively but was ineffective in retrospective test, profit and loss account for the period ended December 31, 2008, would be as under:

Sales	7000,000,000
Cost of Sales	6525,000,000

<b>Gross Profit</b>	<b>475,000,000</b>
Other Gains & Losses (-225,000,000 + 150,000,000)	-75,000,000
EBIT	400,000,000

### Transitional Provisions

As on April 1, 2011, all listed and large entities should:

1. Measure all derivatives at fair value.
2. Eliminate all deferred losses and gains, if any, arising of derivatives that were reported as assets or liabilities under the previous accounting policy. Any resulting gain or loss after providing for deferred tax effect should be recognised in General Reserve or if the amount in the General Reserve is not sufficient or there is no General Reserve to the balance of profit and loss account.
3. Not reflect hedging relationship other than the three types mentioned above.
4. Not continue any hedging relationship that does not meet the conditions for hedge accounting as per AS 30. For example, an entity has a highly probable sale to a US client of USD 150 million and to protect itself from strengthening INR it enters into a purchase USD put option contract where it has the option to sell USD 150 million with a bank. Now, to save it from paying the premium it simultaneously enters into a written USD call option contract where it is obliged to purchase USD 250 at the rate prevailing on the date of exercise of the option by the bank. Such a contract is called a tunnel. As the nominal of written option is higher than the nominal of the purchase option, the written option cannot be designated as a hedging instrument. Thus, the entity on April 1, 2011, should derecognise the hedging reserve account to the extent that it represents fair value changes in the entire written option contract or a proportion of the written option contract that is attributable to the excess of the nominal of the written call option over the nominal of the purchased option or, the entire contract if no hedging strategy is established. □

# Resource Consumption Accounting



Resource consumption accounting, an emerging management accounting method, takes advantage of an enterprise resource planning system's ability to track, maintain, and group the most detailed information and to effectively integrate operational/logistical and monetary information. It is a dynamic, integrated and comprehensive cost management system. It combines German cost management principles with activity-based costing.

## Introduction

**R**esource consumption accounting (RCA) is an emerging management accounting method that blends the advantages of German managerial accounting's emphasis on resources with those of the activity/ process view provided by activity-based costing (ABC) — all couched in an enterprise-wide deci-

sion-support system. This system goes far beyond cost accounting to provide superior underlying information, i.e. broader availability and greater accuracy, which is fully integrated throughout the organisation across various reporting and planning systems.

RCA takes advantage of an enterprise resource planning (ERP) system's ability to track, maintain and group the most detailed information, and to

**Dr. K. Raji Reddy, Mr. P. Ashok Kumar & Mr. N. Anoj Kumar**

*(Dr Reddy is an Assistant Professor and Mr. Ashok Kumar is a research scholar in the Department of Commerce and Business Management of Kakatiya University, Warangal. Mr Anoj Kumar is a Lecturer in Commerce.)*

...organisations need a cost management system that reflects these changes in a timely manner. Organisations react to an environment that is increasingly complex by becoming more complex. As organisations grow they hire more employees, increase workforce diversity, sell more products/services, acquire more resources and use more activities.

effectively integrate operational/ logistical and monetary information. This detail will support the most precise analyses at the lowest levels, e.g. for a machine or its operators, yet it easily can be aggregated to provide summary-level strategic data or data grouping at virtually any other level. The main purpose of the Clopay Plastic Products Company case study was to examine the changes in cost assignment and the ensuing benefits of implementing relevant RCA principles in one factory of a larger manufacturing company. Resource consumption rates developed during the case study used German based Grenzplankostenrechnung (GPK) cost assignment logic, an integral component of RCA. Additional RCA principles include selective use of ABC in cost-assignment methods, replacement cost depreciation, and theoretical capacity as the denominator in standard rate calculations.

## Operations of RCA

RCA is dynamic in that changes in the environment are reflected in the cost model in a timely manner. RCA is integrated with all relevant organisation systems. RCA is comprehensive in that it focuses on resources but readily includes ABC, ABM, variable costing, absorption costing, actual costs, standard costs set in a formal process, a complete set of segmented income statements, activity-based resource planning, primary costs, secondary costs and so on.

RCA is an approach that allows the integration of cost management methods that have often been applied in isolation. RCA uses a comprehensive approach to management accounting information systems. RCA is typically applied as part of an ERP system effort to achieve the best combination of cost management principles implemented in an integrated fashion. RCA is a dynamic, integrated, and comprehensive cost management system. It combines German cost management principles with ABC. This combination involves features that achieve a significant improvement over other cost management systems.

The environment that organisations operate in is increasingly dynamic and complicated. Changes in technology, competition, politics, etc. occur frequently. As a result, organisations need a cost management system that reflects these changes in a timely manner. Organ-

isations react to an environment that is increasingly complex by becoming more complex. As organisations grow they hire more employees, increase workforce diversity, sell more products/services, acquire more resources and use more activities. Interrelationships among resources and activities become more complicated. Accordingly, organisations need a cost management system that comprehensively models this complexity and the interrelationships involved.

## Applications of RCA

RCA can be used with at least three different approaches:

1. RCA system can be used,
2. RCA principles can be implemented incrementally and
3. RCA principles can be used subjectively without any changes in the cost management system.

Although RCA was designed to be implemented in a comprehensive manner, some consultants have reported success with limited application of RCA principles to improve performance in select areas. The use of these three approaches of implementing RCA should be considered if an organisation has any of the following problems:

1. Unpredicted wasted resources, e.g. actual excess/ idle (E/I) capacity, or an inability to forecast resource-to-resource needs and resource utilisation, e.g. planned E/I capacity,
2. Complaints by product and service-line managers of over-costing due to unfair inclusion of idle capacity costs not caused by their products or service-lines,
3. Managers, working with an inconsistent view of the nature of cost, encountering the output-side fixed-cost-death-spiral when they make profit optimisation decisions, e.g. product rationalisation,
4. Not enough resources or an inability to determine where resources should be deployed, e.g. shifting people and equipment between departments,

Currently, there are many different versions of ABC and methods of implementation that can result in significantly different results from one application to another. While embracing the fact that resource consumption is fundamental to cost incurrence, RCA recognises the benefits of ABC systems that are properly applied.

5. Undercoating of the actual level of future resource spending and subsequent process and output costs due to inadequate consideration of the economic dynamics of fixed, step-fixed, and proportional (variable) costs,
6. Outsourcing decisions not having the desired results, e.g. encountering the input-side fixed-cost-death-spiral with existing information, or
7. An inability to take appropriate corrective action due to a lack of comparison between the plan and the actual.

## Pillars of RCA

RCA is based on three central concepts or *pillars* that provide important benefits. These three pillars include specific perspectives regarding resources, the use of a quantity-based approach, and the nature of costs. There are several facets or dimensions to each of these three central concepts.

*Firstly*, RCA is fundamentally resource focused, yet it is comprehensive in scope. Resource pools in RCA include all resources including costs to serve resources. RCA recognises that some resources exist to serve other resources. Therefore, their cost should be assigned to those resources. This requirement of RCA results in fully costed resources. Drivers are identified for all resource pool-to-consumer relationships including both activities and other resource pools as consumers of those resources. This requirement strives to achieve a cause-and-effect relation to properly reflect operational costs in cost assignment. The resource focus in RCA makes specific requirements for accounting for capacity. These requirements include:

1. Defining and managing capacity where it resides—on the resource,
2. Making excess/idle capacity visible through full disclosure, but not arbitrarily allocating it to products or other cost objects and
3. Consistent use of a capacity-supplied concept (e.g., theoretical or practical capacity) for de-

nominator volume.

RCA also allows for a process or activity-based focus by defining specific procedures for implementing ABC. Procedures required are designed to provide a consistent method of ABC implementation that applies sound cost management principles. Currently, there are many different versions of ABC and methods of implementation that can result in significantly different results from one application to another. While embracing the fact that resource consumption is fundamental to cost incurrence, RCA recognises the benefits of ABC systems that are properly applied. RCA accounting requires resource-to-activity cost assignment but uses simultaneous allocation mechanisms to do so. This technique accounts for nonreciprocal and reciprocal resource-to-resource and resource-to-activity interrelationships.

*Secondly*, RCA uses quantifiable output measures for resource pools. RCA decouples dollar or cost value relationships from the relationships defining resource consumption. RCA measures all resource outputs in quantifiable units rather than dollars. Only then are the cost assignments made to resource quantities.

This decoupling of the output quantification process from the dollar valuation process provides a consistent perspective regarding the understanding of resource consumption versus application of cost. According to Sedgley & Jackiw<sup>1</sup>, 'Dollars...do not feature in the relationship definition; they merely serve to value quantities once the relationship has been defined.' Moreover, 'A cost model that utilises the quantity-based method to express the complete flow of the relationship...is referred to as a quantity structure.'

The quantity-based approach of RCA provides an unambiguous distinction between the consumption of resources and the assignment of costs. Distinguishing these pieces can facilitate variance analysis by separating consumption quantity versus value. Continuous data tracking of *actual* consumption only requires accounting for quantities defined in the relationship.

<sup>1</sup>The 123s of ABC in SAP (2001), John Wiley & Sons.

RCA assumes that E/I capacity should be attributed to the person or level responsible for controlling or influencing it. Using a capacity-supplied concept provides a complete disclosure of the resources available to management. Thus, the degree to which capacity has actually been used, when compared to this available amount, presents a readily visible accounting for unused resources.

Capacity analysis is facilitated since resource costs are assigned only when used.

Thirdly, RCA recognises two important dimensions of the nature of costs:

1. The initial/inherent nature of costs in that they are either fixed or proportional in their resource consumption patterns. Strategy and organisational choices determine whether costs are fixed or proportional when they are initially incurred.
2. The potential nature of proportional costs may change at the point of resource consumption. Resources supplied in a proportional manner can be consumed in a pattern consistent with fixed cost treatment. Thus, the method of cost assignment should treat proportional costs as either proportional or fixed as consumption patterns dictate. In contrast, the inherent nature of a fixed cost does not change with consumption patterns.

## Capacity Management and Costing in RCA

RCA recognises that resources are fungible (changeable) with respect to activities and therefore capacity resides on resources, not on activities. E/I capacity is reported as a variance that is highlighted in reporting, but it is never allocated to individual product units. It may be traced to a higher group or plant level. Resources *supplied* minus resources *used* equals *unused* resources or E/I capacity.

Emphasis is on making E/I capacity visible so that both E/I and productive capacity can be managed. RCA assumes that E/I capacity should be attributed to the person or level responsible for controlling or influencing it. Using a capacity-supplied concept provides a complete disclosure of the resources available to management. Thus, the degree to which capacity has actually been used, when compared to this available amount, presents a readily visible accounting for unused resources. Management can then use this information to manage capacity by relating it to resource acquisition decisions. Tying responsibility for capacity utilisation to resource acquisition decisions can then be used to promote accountability.

RCA is defined as an operational system. This implies that the accounting system or accountants do not have sole discretion to *determine*, i.e. calculate, the operational plan, e.g. capacity level and production possible, or the denominator volume used. The capacity level to use and the way to define/measure it is likely an issue that should involve operations and/or engineering personnel working together with cost management personnel.

## Activity-based Resource Planning

The quantity structure combined with recognition of the inherent nature of costs provides the foundation for not only product/service costing but also budgeting and planning. This budgeting and planning dimension of RCA is called Activity-based Resource Planning. It involves following steps:

1. Establish resource pool-level unit standards for resources,
2. Establish resource output consumption unit standards for consumers,
3. Determine planned resource output demand and
4. Convert planned resource output demand into monetary equivalents.

These four steps are the reverse of costing output and RCA software takes this into consideration. Therefore, the same software can be used for both outputs costing and budgeting.

## Conclusion

As companies attempt to adapt to increasing operating complexity, they need a cost management system that comprehensively models this complexity and the interrelationships involved. RCA meets this need and represents a substantial improvement over other cost management systems. RCA provides a comprehensive remedy to antiquated, piecemeal cost systems. Just as many companies are implementing enterprise-wide (ERP) systems to integrate information, RCA provides an integrated solution for comprehensive, enterprise-wide cost management. □

## ACCOUNTING OF FOREIGN INCOME ON CASH BASIS.

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

### A. Facts of the Case

1. A Government of India enterprise under the Ministry of Steel, is executing engineering and consultancy jobs and preparing various reports like feasibility report, project report, etc., for clients in India and abroad. According to the querist, the company is following accrual basis of accounting as per the Companies Act, 1956. Accordingly, revenue is recognised on accrual basis and as per the applicable accounting standards.

2. The querist has informed that long back, the company used to follow accrual basis of accounting in case of foreign consultancy jobs also, in line with domestic jobs. However, due to various reasons prevailing in the countries like Nigeria, Iran, Bangladesh, etc., where most of the clients were located, receipt of payment from the clients became uncertain. The querist has further informed that the company had to make provision for bad debts/write off the bad debts frequently as per the audit observations on the ground of uncertainty of realisation. However, constant follow up for realisation of the payment continued and in some cases, the company realised the payment after an abnormally long period. Recognition of income due to receipt of these payments used to create confusion as to whether these should be treated as current year's income or

prior period income. According to the querist, though the amounts were insignificant but occurrence of such events was not insignificant. However, to avoid frequent provisioning of bad debts/write off in a particular period due to uncertainty and subsequently recognising it as income in future, the company started following the practice of recognition of foreign income on receipt basis.

3. The querist has informed that the company has also disclosed the basis of accounting in case of foreign consultancy jobs in the notes to the accounts. The company is following the same practice consistently every year. However, this is not specifically mentioned in the accounting policy of the company for revenue recognition. The querist has mentioned that the company provides only consultancy services and is not involved in export of any plant or machinery whatsoever. Income from foreign services is also insignificant and low which is even less than 1% of the company's total turnover.

4. The querist has further clarified that in respect of foreign consultancy jobs, the company gets orders from various overseas clients with specific fees, terms of payment, etc. The company raises invoices from time to time as per the orders. Therefore, no uncertainty either with respect to the measurement of the payment that

is to be received from the client or in respect of the creditworthiness of the client is envisaged at the time of receipt of order. However, due to various reasons, uncertainty arises at a later date.

### B. Query

5. The querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (a) Whether the company can continue the same practice, i.e., cash basis of accounting for foreign consultancy jobs or should it follow the accrual basis of accounting.
- (b) Whether there is any deviation/violation of the Companies Act, 1956 or any Accounting Standard.

### C. Points considered by the Committee

6. The Committee notes section 209(3) of the Companies Act, 1956, which states as follows:

“(3) For the purposes of subsections (1) and (2), proper books of account shall not be deemed to be kept with respect to the matters specified therein,—

- (a) if there are not kept such books as are necessary to give a true and fair view of the state of affairs

of the company or branch office, as the case may be, and to explain its transactions; and

- (b) if such books are not kept on accrual basis and according to the double entry system of accounting.”

7. The Committee also notes ‘accrual’ as one of the fundamental accounting assumptions for the preparation and presentation of financial statements as given in Accounting Standard (AS) 1, ‘Disclosure of Accounting Policies’. It notes its definition as per paragraph 10 of AS 1 as follows:

“c. *Accrual*

Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. ...”

The Committee notes that the Guidance Note on Accrual Basis of Accounting, issued by the Institute of Chartered Accountants of India (ICAI), recognises that the accounting treatment contained in the Guidance Notes, Accounting Standards, etc., issued by the ICAI are primarily based on accrual accounting. Thus, adoption of accounting treatment recommended in these documents would ensure that an enterprise has followed accrual basis of accounting. Accordingly, the Committee is of the view that the company would be deemed to have followed accrual basis of accounting for revenue recognition if it follows the principles for recognition of revenue as laid down in Accounting Standard (AS) 9,

‘Revenue Recognition’.

8. The Committee notes that AS 9 lays down the following three conditions for recognition of revenue:

- (a) Performance of the act giving rise to revenue.
- (b) Measurability of the revenue.
- (c) Collectability of the revenue.

With respect to the effect of uncertainties on revenue recognition, the Committee notes paragraphs 9.1 to 9.3 of AS 9, which provide as follows:

“9.1 Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.

9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

9.3 When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.”

9. The Committee notes on the basis of the information provided by the querist in paragraph 4 of the Facts of the Case that the uncertainty with regard to collectability of foreign income arises subsequent to the receipt of the order. The Committee is of the view that when the three conditions for recognition of revenue read with paragraphs 9.1 to 9.3 of AS 9 reproduced above are met in respect of the foreign consultancy jobs, the company should recognise revenue in its books of account. If uncertainty as to its collection arises subsequent to recognition of revenue, it would be appropriate to create a provision for bad and doubtful debts. However, if the collectability of revenue is not reasonably certain at the time of raising claim therefor, recognition of revenue should be postponed. In such cases, revenue should be recognised when it becomes reasonably certain that ultimate collection will be made. The assessment with respect to collectability should be made separately for each transaction.

10. The Committee notes that owing to reasons given by the querist in paragraph 2 above, i.e., frequent provisioning on account of frequent occurrences of uncertainty of collection and insignificance of the amounts involved, the company resorted to cash basis of accounting in respect of the foreign income, i.e., in effect it departed from the provisions of AS 9 in respect of foreign income. The Committee notes that mere difficulties arising on account of frequent provisioning of bad debts/write-offs of such debts is not a sufficient reason to allow foreign income to be accounted for on cash basis and is contrary to the requirements of AS 9, the fundamental accounting assumption of

accrual and section 209(3)(b) of the Companies Act, 1956.

11. In respect of the other reason of recognising foreign income on cash basis, viz., the insignificance of the amount of foreign income, the Committee notes from the Preface to the Statements of Accounting Standards, issued by the Institute of Chartered Accountants of India, which states, inter alia, that, “The Accounting Standards are intended to apply only to items which are material.” The same principle has also been specifically stated in paragraph 3 of the Annexure A ‘General Instructions’ to the Companies (Accounting Standards) Rules, 2006, notified by the Central Government. Further, the Committee notes ‘materiality’ as one of the considerations for selection and application of accounting policies as defined in AS 1 and certain excerpts from paragraphs 3 and 5 of Auditing and Assurance Standard (AAS) 13, ‘Audit Materiality’, issued by the Institute of Chartered Accountants of India which are reproduced below:

*“Materiality*

Financial statements should disclose all “material” items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements.”

“3. Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality depends on the size and nature of the item, judged in the particular circumstances of its misstatement. ...”

“5. The concept of materiality recognises that some matters, either individually or in the aggregate, are relatively important for true and fair presentation of financial information in conformity with recognised accounting policies and practices. The auditor considers materiality at both the overall financial information level and in relation to individual account balances and classes of transactions...”

12. From the above, the Committee is of the view that though ‘accrual’ is one of the fundamental accounting assumptions, the materiality threshold is applicable to this accounting assumption also. If an information is not material, on the consideration of materiality as mentioned in the above paragraph, its accounting would not have any effect on the decisions of the users of the financial statements. Accordingly, it needs to be determined under the specific

facts and circumstances of the company concerned as to whether the revenue from foreign consultancy jobs, either individually or in aggregate, can influence the decisions of the users of the financial statements. For this purpose, apart from the volume of transactions and quantum of turnover, other factors such as nature of the item, impact on profit/loss, etc., should also be considered. The assessment of what is material is a matter of professional judgement to be determined on each balance sheet date.

**D. Opinion**

13. On the basis of the above, the Committee is of the following opinion in respect of the issues raised in paragraph 5 above:

(a) The company should follow accrual basis and not the cash basis of accounting to account for income from foreign consultancy jobs unless the said income is not considered material as discussed in paragraphs 11 and 12 above.

(b) Recognition of income from foreign consultancy jobs on cash basis, in the case under consideration, is contrary to the requirements of the Companies Act, 1956, AS 1 and AS 9, unless the said income is not considered material as discussed in paragraphs 11 and 12 above.

1. The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2. The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in twenty five volumes which are available for sale at the Institute’s office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
3. Recent opinions of the Committee are available on the website of the Institute at URL: [http://www.icai.org/category.html?c\\_id=146](http://www.icai.org/category.html?c_id=146)

## AUDITING OF DIGITAL FIRM\*

A digital firm is the one whose nearly all the organisation's significant business relationships with customers, suppliers and employees are digitally enabled and mediated. Core business processes are accomplished through digital networks spanning the entire organisation or linking multiple organisations. Auditing computerised system is not just a simple extension of traditional auditing. It requires multidisciplinary knowledge. The article explores the concept.

*"Information technology and business are becoming inextricably interwoven. I don't think anybody can talk meaningfully about one without the talking about the other"--Bill Gates*

Business world has been transformed by the innovations in Information Technology (IT) from the internet to wireless networks to digital phones and cable system. Whether the business is small or big they depend on technology for competitive advantage. *Financial systems are computer based and integrated with Sales and Marketing, Purchase, Cost Control, Manufacturing and other systems. All*



**— R Soundara Rajan**  
(The author is Company Secretary, Engineers India Ltd., New Delhi. He can be reached at rs.rajan@eil.co.in)

these changes coupled with equally significant organisational redesign, have created the conditions for a fully digital firm (Lauden KC et al 2007). A digital firm is the one whose nearly all the organization's significant business relationships with customers, suppliers and employees are digitally enabled and mediated. Core business processes are accomplished through digital networks spanning the entire organisation or linking multiple organisations. Auditing such a digitalised firm has recognised the

\* Members will get one hour CPE Credit - Unstructured Learning for reading this article.

The rate at which the technology is developed and introduced outstrip the rate at which audit methodologies are developed. The concept of risk based auditing and the knowledge of auditors of the business risk and the mitigation procedures go a long way in their service to stakeholders. In view of the modern requirement, it is not optional but becomes mandatory to have IT specialist as a part of audit team for effectiveness and assure data integrity and asset safeguarding.

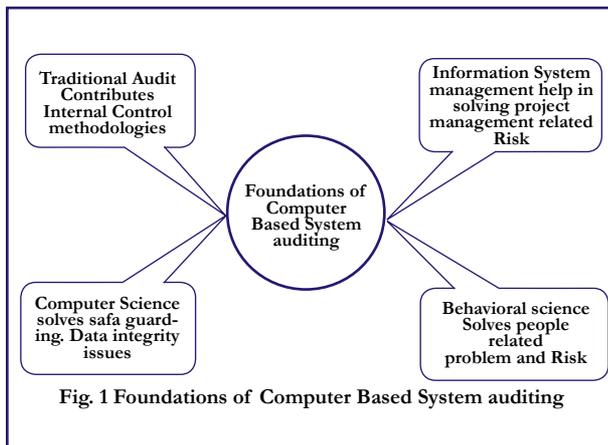
following two basic aspects. First, auditors realised that computers had impacted their *ability to perform the attest function*. Secondly, both corporate and information processing management recognised computers were valuable resources *that needed controlling like any other valuable resources within organisation* (Ron Weber 1988).

### Foundations For Computer-based Systems Audit

*“In the domain of modern auditing where computer technology is used extensively, we have an Achilles Heel. Our methodologies for control and Audit of computer systems are still in the infancy.”*  
--Ron Weber

Auditing computerised system is not just a simple extension of traditional auditing. It requires multidisciplinary knowledge in areas such as:

- Traditional auditing
- Information System Management
- Behavioural Science and
- Computer Science



**Traditional Auditing** contributes the fundamentals of *internal control practices and control philosophy*. **Information system management** provides methodologies for *successful design and implementation* of computer based system. **People problems** provide the maximum risk of system failure. Behav-

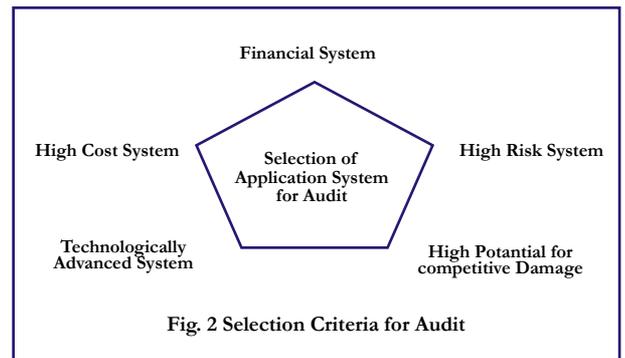
oural Science provides the solution for the same. **Computer science** provides the basis for *asset safeguarding, data integrity, system efficiency and effectiveness*, which are the basic corner stones for audit assurance.

### Selection Criteria for Audit

*“The first rule of any technology used in a business is that automation applied to an efficient operation will magnify the efficiency. The second is that automation applied to an inefficient operation will magnify the inefficiency”*-- Bill Gates

Time and cost cannot make the auditing hundred per cent. A careful selection of the sample application makes the audit effective. Perry (1974), suggests the following criteria for selecting the application for audit :

- **Financial System** – Auditor gives attention to that system which provides financial control over the assets of the corporation – Accounts Receivables, Payroll, Invoicing, etc.
- **High Risk System** –
  - which are susceptible to various kinds of losses, frauds, embezzlement or
  - the failure which may cripple the organisation or
  - highly integrated and error in the system permeate to other systems.



- **High Potential for Competitive damages**- Strategic Planning Systems
- **Technologically Advanced Systems**- Decentralised, Distributed, integrated Database systems

Audit for compliance is not the end but only a beginning. They should play reforming role and work for the value of stakeholders and business continuity. Manual processes should be automated for better control and compliances. Compliance audit is the beginning and only one part of audit assurance. The auditors have to expand their domain and the way of working.

- **High Cost complex Systems**

Besides all these, the auditors select those systems for auditing where the problems are apparent.

Ron Weber in his preface to “EDP Auditing –Conceptual Foundation and Practice” points out that, “*To be a good auditor you have to be better at business than your client.* In the domain of modern auditing where computer technology is used extensively, we have an Achilles Heel. Our methodologies for control and Audit of computer systems are still in the infancy.” Further the rate at which the technology is developed and introduced outstrip the rate at which audit methodologies are developed. The concept of risk based auditing and the knowledge of auditors of the business risk and the mitigation procedures go a long way in their service to stakeholders. *In view of the modern requirement, it is not optional but becomes mandatory to have IT specialist as a part of audit team for effectiveness and assure data integrity and asset safeguarding.*

### Understanding Risks

*“While it is futile to try to eliminate risk and questionable to try to minimize it, it is essential that the risk taken be the right risk”*  
- Peter Drucker (1975) , *Management, W. Heinemann Ltd.*

Software has been the most troubling technology of the 20th century. Capers Jones, Chairman Software Productivity Research Inc. [Jon98] points out that, “Major software projects have the highest probability of being cancelled or delayed of any known business activity. Once deployed, software projects often display excessive error densities and low levels of reliability. In addition, software is achieving a very bad public reputation because of several highly publicised disasters. A careful programme of risk analysis can reduce the probability of major software disasters, and also shorten average development cycles at the same time”.

Risk always involves two characteristics:

- Uncertainty:** the event that may happen or not happen
- Loss:** the unwanted consequences or loss that

happen when the risk becomes the reality.

Hence the understanding and identification of risk, analysis of risk, the level of uncertainty and the associated loss are essential for organisation sustainability and growth.

### Categorisation of Risks

*“First, risk concerns future happenings. Today and yesterday are beyond active concern, as we are already reaping what was previously sowed by our past actions.”-- Charette RN*

**According to Charette (1989)** , the risks are classified as *Known Risk, Predictable Risk and Un-predictable Risk.*

**Known Risk** is the risk which can be uncovered after careful evaluation of

- project plan, business and technical environment in which the project is being developed,
- and other reliable information sources such as unrealistic schedule, lack or poor documentation of Scope, poor infrastructure and delivery environment.

Predictable risk is the risk which can be predicted using past data such as turn over of employee, absenteeism, communication with client, support services, meeting of deadlines, penalties, realism of schedule etc. Unpredictable risk is difficult to predict in advance.

**According to Pressman (1997)** the risk can be broadly classified as Technological Risk and Business Risk. The project risk is basically contributed by the factors such as project complexity, size, and degree of structural uncertainty. This may lead to wrong estimation, quality and cost of project. The risk may further be broadly classified into

- Technological Risk
- Business Risk

Technical risks arise due to wrong specification / scope and implementation of wrong technology leading to obsolescence. If this risk becomes a

<sup>1</sup>The 123s of ABC in SAP (2001), John Wiley & Sons.

reality the implementation of the project would be difficult and impossible. Technical risk identifies potential design, interface and maintenance problems. Business Risk threatens the viability of the software project or product. The top candidates identified by him are:

- a) Market Risk- Building an excellent product or system that no one really wants
- b) Strategic Risk- Building a product that no longer fits into the overall business strategy of the company
- c) Management Risk- Losing the support of senior management
- d) Budget Risk – Losing budget or personnel risk.

In addition to the above classifications the risks can be categorized as Generic risk and Product specific risk.

- a) Generic risks are potential threat to all software projects. For example attrition of employees is generic risk.
- b) Product specific risk is specific to the product and is identified with technology and environ-

ment specific to the product.

Let us remember and recall the words of **Gilb T (1988)** before we start the audit process, **“If you don’t actively attack the risk, they will actively attack you”**

### Overview of the Steps of Computer Based System

*"Large software projects will never be without some risk, but if risks can be brought down to acceptable levels, that will be a good beginning"- Capers Jones, 1998*

The first step in the audit process is to understand the business and the associated risk. The risks have to be identified and documented. One method of identifying the risk is to create a risk register. It usually includes:

- Risk Identification number
- Description of the risk
- Probability of occurrence
- Impact
- Responsible Department and person
- Mitigation methods

Table 1: <b>RISK REGISTER</b>						
Risk Id No.	Description of Risk	Probability of Occurrence	Grading High/Med/Low	Responsible Dept	Person Responsible	Mitigation Methods

The register should be *maintained and updated regularly* as existing risks are re-graded in the light of the effectiveness of the mitigation strategy, and new risks are identified. Risks can be prioritized through a number of methods. Some projects have used A-B-C or *High-Medium-Low* lists. Risk identification and prioritisation activities are only useful if actions are defined and executed to mitigate risks. Aggressive, proactive risk mitigation actions for top priority risks are essential to achieve the benefits of Software Risk Management.

The next step is the review of the controls to minimize the risk (Fig. 3). The controls can be broadly classified into Management Controls and Application Controls. **Controls are set up to reduce the poten-**

**tial loss and risk.** Internal controls acts on the risk in two ways:

- Reduce the probability of occurrence of loss
- Reduce the amount of the loss

Auditors should first evaluate the management control. Management control attempts to ensure the implementation of the system in a controlled manner. *It is a generic type of control applied to all cross section of applications.* Absence of management control is a serious concern for the audit purpose. It may not be worthwhile to evaluate application control if there is a fundamental weakness exists on management control. They are *vertical controls* and flow the hierarchical lines (Ron Weber).

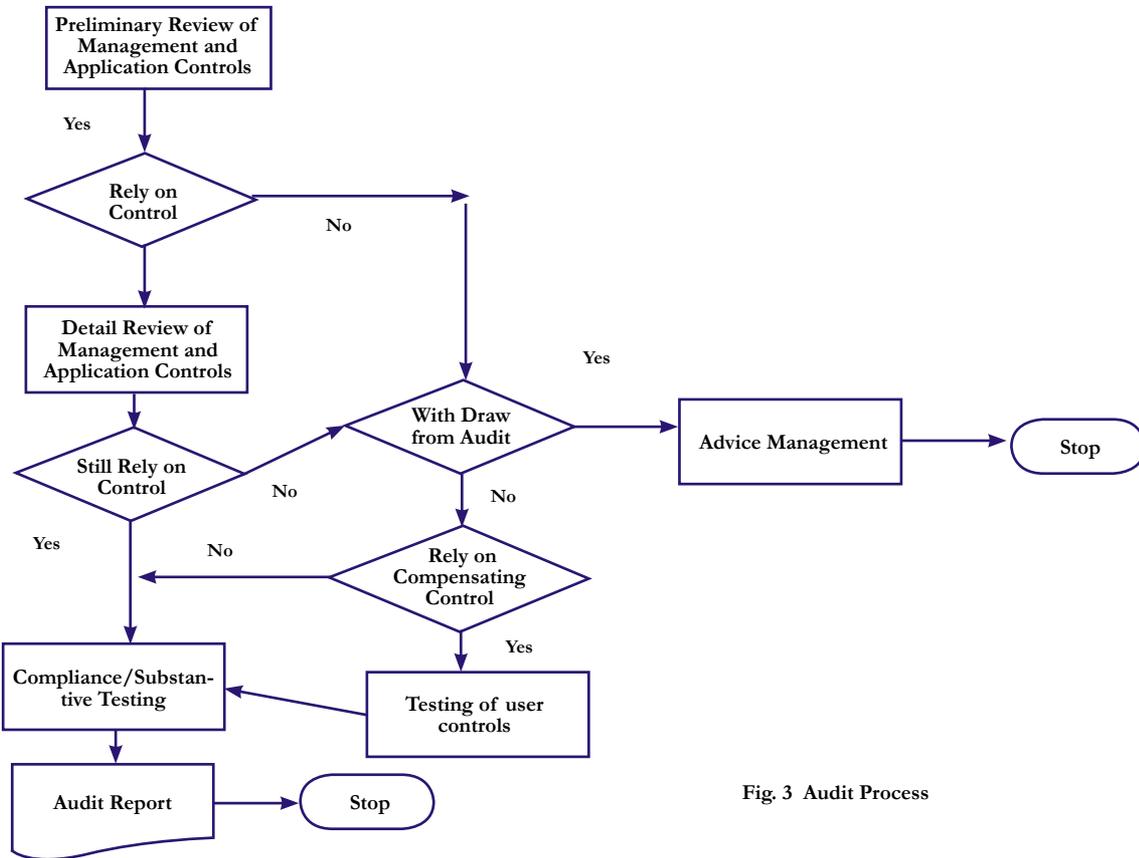
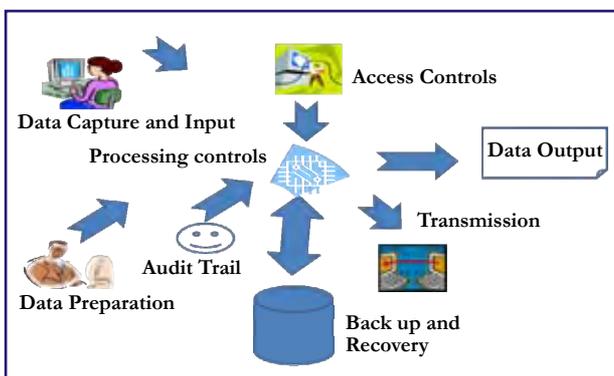


Fig. 3 Audit Process

Management controls is exercised on three levels. Top management is responsible for long run policy decisions. EDP management is responsible for planning and controlling of computer activities. It translates the long run policies into short term goals and objectives. System Development management is responsible for design and implementation of application systems. Normally programming and database management forms part of the same. Operation management controls the operation and day-to-day activities and forms.

Application management starts from data capture and spans up to back up and recovery. It has the various stages and controls are exercised on all stages (see Fig. 4).

- Data Capture
- Data Preparation
- Access control
- Input
- Transmission
- Processing
- Output
- Audit trail and
- Back up and recovery.



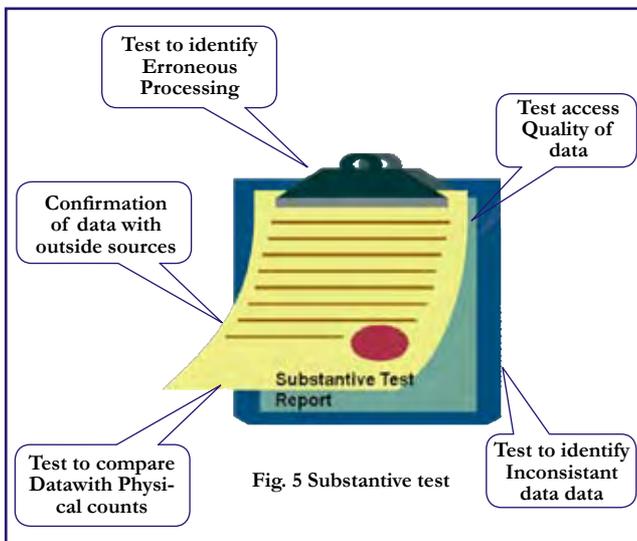
The specific controls depend on the application and the likely risk/losses. Application controls are relevant to that application and they are *horizontal controls*. They follow through the data flow through the organisation and cut across the organizational lines of authority and

responsibility (Ron Weber). The controls can be either **Preventive** (which stop errors occurring) or **Detective** (identifies once the errors occur) or **Corrective** controls (attempts to correct the error once occurred). The understanding the nature of controls helps the auditor in their final recommendations.

During the compliance testing the auditors review whether the system of internal control exists and work reliably. Auditors must use computer based techniques and tools to collect necessary evidence. Sometimes the auditors may decide not to rely on internal control systems as there may be controls exercised by users to compensate any weakness in the internal controls. Even though there may be weakness in transit of data to EDP center the users may reconcile their control totals with produced outputs.

In the substantive testing phase, the auditor has to obtain substantive evidence to make the final judgment. **Davis** et al (1981) identify the following types of test that can be used in computer based system (Fig. 5) for the final judgment.

- Test to identify erroneous processing
- Test to access the quality of data
- Test to identify inconsistent data
- Test to compare data with physical count
- Confirmation of data with outside sources



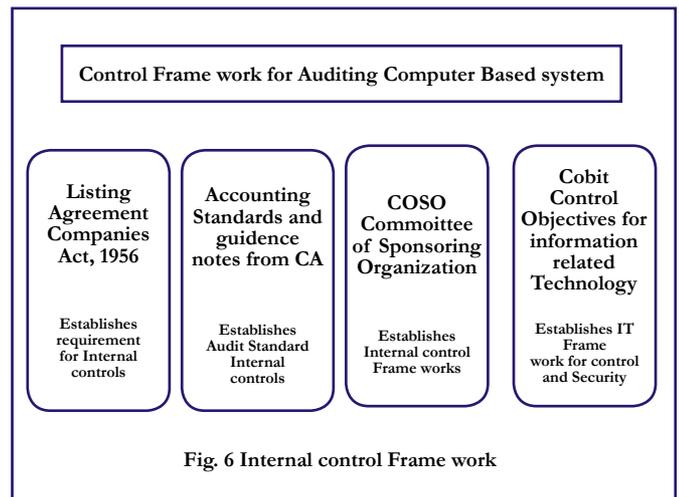
Throughout the audit the auditors have to make some difficult decisions. For judging the adequacy and reliability of internal controls, the auditors may use com-

puter based audit tools to collect evidence for this purpose and aggregate all the evidence.

### Audit Framework

Audit has become an important tool for top management and board for ensuring proper governance. Normally the auditors are accustomed to traditional compliance audit. Compliance is the form of standardisation different industry sectors have to adhere when doing business. Compliance should be supported by IT to ensure the availability of technology that can enable people to adhere to compliance and the suggested technology should be easy to use. Compliance is controlled by regulators through statutory regulations. There are different regulations in the business world such as:

- Regulations around financial controls such as Listing Agreement, CARO, Basel II, Auditing standards issued by the institute etc.
- Regulations around fraud such as anti money laundering legislations, Income-tax Act etc.
- Regulations around privacy and data production
- Regulations around Governance such as Corporate governance clause 49, Companies Act, 1956



Pillars of trust worthy computing are essential to have robust internal control and good governance. Control framework starts from Listing Agreement, which establishes the requirement for internal control. Recent amendments of clause 49 require the compliance certification from CEO and CFO on the integrity of financial reports. Some of the features of the requirements are:

- a. CEO, CFO
  - i. must review all financial reports
  - ii. are responsible for the internal accounting controls
  - iii. has to report any deficiency in the control or any fraud to the audit committee
  - iv. must indicate the material changes in internal accounting controls and systems.
- b. Financial reports does not contain any misrepresentation
- c. Information in the financial report are fair

All financial reports must include an internal control report stating that management is responsible for adequate “internal control” structure and effectiveness of the control. Every organisation has its own internal control department which supports the top management for certification. The management may employ outside consultants for certifying the effectiveness of internal control. Companies are required to disclose on real time basis information concerning material changes in its financial condition and operations through internal audit.

- d. Statutory auditors should be supported by Internal Auditors.

Due to complex business scenario and environment the organisations face uncertainty and challenges. How much uncertainty can be accepted is the question addressed by Enterprise Risk Management (**ERM**). Framework provided by Committee of Sponsoring Organization (**COSO**) provides the necessary internal control frame work for managing risk. **Control objectives for information related Technology (CobiT)** provides the necessary frame work for the Information Technology (**IT**) governance (see fig. 6).

## Conclusion

The need of modern complex business is the change of attitudes, mind, opinions and actions. Auditors generally limit their audit to the following aspects:

- Determine the existing **system of controls** and ensure that they are in harmony with the **organisation structure** and are **cost effective**.
- Review the **reliability** and **integrity** of finan-

cial and operating information.

- Review each control in terms of cost and benefit.
- Review the **systems established** to ensure **compliance** with policies, plans, procedures, laws and regulations

The audit normally includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. To ensure there are no misstatements, the audit further assesses the accounting principles used and significant estimates made by the management. The Audit is based on Companies (Auditor’s Report) order (CARO).

In the above process the auditors rely on the internal audit observations and sample test cases. In modern business, audit of digitised firm requires the auditors to be IT literate and their team should be supported by IT specialist. Recognizing this fact the institute has initiated *post membership certification programme in IT audit*. All practising auditors should get certified through this programme. Auditors should not only familiar with auditing standards and guidelines issued by the institute, but also understand the international control frame works such as **COSO** and **CobiT**.

Audit for compliance is not the end but only a beginning. They should play reforming role and work for the value of stakeholders and business continuity. Manual processes should be automated for better control and compliances. Compliance audit is the beginning and only one part of audit assurance. **The auditors have to expand their domain and the way of working.** Let us move from compliance audit to risk based audit and migrate from **traditional static cyclic audit approach to continuous comprehensive real time audit approach**. Before starting our journey of audit for sustainability and risk, let us recall the words of **Charette RN**:

*“First, risk concerns future happenings. Today and yesterday are beyond active concern, as we are already reaping what was previously sowed by our past actions. The question is, can we, therefore, by changing our actions today create an opportunity for a different and hopefully better situation for ourselves tomorrow. This means, second, that risk involves change such as changes in mind, opinion, action or places.. Third risk involves choice and the uncertainty that choice itself entails. Thus paradoxically, risk, like death and taxes, is one of the few certainties of life.”* □

## NOTIFICATIONS/CIRCULARS

### Significant Notifications/Circulars issued During the Month of August, 2008

#### DIRECT TAXES

##### I. Circulars

##### 1. Circular No. 7/2008, dated 1-8-2008

The Central Board of Direct Taxes has, in exercise of the powers conferred under section 119(1) of the Income-tax Act, 1961, directed that corporations which are established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen and whose income qualifies for exemption from income-tax under section 10(26BBB), would be given exemption from Tax Deduction/Collection at Source on their receipts for a period of 3 years from the date of issue of this order. It may be noted that this exemption is not on contractual payments made by them to other parties including sub-contractors etc.

For details visit:

<http://law.incometaxindia.gov.in/TaxmannDit/DisplayPage/dpage1.aspx?md=1>

##### II. Notifications

##### 1. Notification No. 86/2008 [f. no. 142/8/2008-tp], dated 13-8-2008

The Central Government has, in exercise of the powers conferred by clause (v) of the *Explanation* to section 48 of the Income-tax Act, 1961, specified 582 as the Cost Inflation Index for the financial year 2008-09.

##### 2. Notification No. 88/2008/F.NO. 275/43/2008-IT(B), dated 21-8-08

The Central Board of Direct Taxes has, in exercise of the powers conferred by clause (a) of the *Explanation* to section 194] of the Income Tax Act, 1961, notified the services rendered by following persons in relation to the sports activities as Professional Services for the purpose of the section 194]:

- a. Sports Persons,
- b. Umpires and Referees,
- c. Coaches and Trainers,

- d. Team Physicians and Physiotherapists,
- e. Event Managers,
- f. Commentators,
- g. Anchors and
- h. Sports Columnists.

##### 3. Notification No. 90/2008, dated 28-8-2008

Section 90A(1) provides that an agreement may be entered into by any specified association in India with any specified association in the specified territory outside India which may be adopted by the Central Government by way of notification in the official Gazette, for granting relief of tax, or as the case may be, for avoidance of double taxation. The Central Government has now notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

##### 4. Notification No. 91/2008, dated 28-8-2008

Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India for granting relief of tax or as the case may be, for avoidance of double taxation. The Central Government has now notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such

agreement.

For details visit:

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

#### INDIRECT TAXES

##### EXCISE

##### I. Notifications

##### Notification No. 32/2008- Central Excise (N.T.) dated 28<sup>th</sup> August, 2008

The Central Government by exercising the powers conferred by rule 18 of the Central Excise Rules, 2002 read with rule 14 of the Pan Masala Packing Machines (Capacity Determination And Collection of Duty) Rules, 2008, grants rebate of duty on the excisable goods, on their exportation out of India on or after 1st July, 2008, to any country except Nepal and Bhutan, subject to the conditions, limitations and procedures.

For details visit:

<http://www.cbec.gov.in/excise/cx-act/notfns-2k8/cent32-2k8.htm>

##### CUSTOMS

##### I. Notifications

##### 1. Notification No. 100 /2008-CUSTOMS (N.T.) dated 13.08.2008

The Central Government by exercising the powers conferred by section 5(1) of the Customs Tariff Act, 1975 makes the rules, namely the Customs Tariff [Determination of Origin of Products under the Duty Free Tariff Preference Scheme for Least Developed Countries] Rules, 2008. These rules shall come into force from 13.08.2008.

For details visit:

<http://www.cbec.gov.in/customs/cs-act/notifications/notfns-2k8/csnt100-2k8.htm>

##### 2. Notification No. 103/2008 - CUSTOMS (N.T.) dated 29.08.2008

Determines the rates of drawback as specified in the Schedule subject to the notes and conditions

For details visit:

<http://www.cbec.gov.in/customs/cs-act/notifications/notfns-2k8/csnt103-2k8.htm>

## II. Circulars

### **Circular No. 13 /2008-Cus. dated 29.08.2008**

The revised All Industry Rates of Duty Drawback has been announced vide notification No. 103 /2008-Cus (NT) dated 29.08.2008. The rates of drawback have been made effective from 01.09.2008.

For details visit:

<http://www.cbec.gov.in/customs/cs-circulars/cs-circulars08/circ13-2k8-cus.htm>

## SERVICE TAX

### I. Circulars

**1. Circular No.104/07/2008-ST dated 06.08.2008** has been issued which provides the issues and clarifications regarding service tax levy on goods transport by road services.

For details visit:

<http://www.servicetax.gov.in/circular/st-circular08/st-circ-104-2k8.htm>

## OTHER ACTS

### SEBI

### I. Circulars

#### **1. MIRSD/ DPSIII/ Cir-26/ 08, dated 22 - 08 - 2008**

#### **Internal Audit for stock brokers/clearing members**

In continuation with the Circular No.F.1/5/SE/83 dated May 31, 1984 of Government of India, Ministry of Finance, Department of Economics Affairs, Stock Exchange Division, you are advised to direct your stock brokers/clearing members to carry out complete internal audit on a half yearly basis by independent qualified Chartered Accountants. The scope of such audit shall cover, inter alia, the

existence, scope and efficiency of the internal control system, compliance with the provisions of the SEBI Act, 1992, Securities Contracts (Regulation) Act 1956, SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, circulars issued by SEBI, agreements, KYC requirements, Bye Laws of the Exchanges, data security and insurance in respect of the operations of stock brokers/clearing members. The first such audit period should be from October 1, 2008 to March 31, 2009. The exchanges shall ensure compliance of the above mandatory requirements by all the stock brokers/clearing members. This circular is being issued in exercise of the powers conferred by Section 11 (1) of Securities and Exchange Board of India Act, 1992 to protect the interest of investors in securities and to promote the development of, and to regulate, the securities market.

#### **2. SEBI/CFD/DIL/ESOP/4/2008 /04/08. dated 04 - 08 - 2008**

In exercise of the powers conferred under sub-section (1) of Section 11 of the Securities and Exchange Board of India Act, 1992, it has been decided to amend the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. (i) It has been decided to clarify that a director, nominated by an institution as its representative on the Board of Directors of a company, is eligible to participate in the ESOS of the company, if the contract / agreement entered into between the nominating institution and the director so appointed specifically provides for acceptance of ESOS of the company by such director and a copy thereof is filed with the company. (ii) It has been decided to bring the accounting treatment prescribed by SEBI, for options granted under graded vesting, in line with the accounting treatment provided by ICAI in this regard. The amendments made vide this circular shall come into force with immediate effect.

For details visit:

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

## RBI

### I. Notifications

#### **Notification No. FEMA 177 /RB-2008, dated August 01, 2008**

In exercise of the powers conferred by clause (h) of sub-section 2 of Section 47 of the Foreign Exchange Management Act, 1999 (42 of 1999) the Reserve Bank of India makes amendments in Regulations 2 and 3 and inserted a new regulation 5A in the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000.

For details visit:

<http://www.rbi.org.in/scripts/NotificationUser.aspx>

### II. Circulars

#### **1. Circular No. DBOD.No.Leg. BC. 34 /09.07.005/2008-09 dated August 22, 2008**

The Reserve Bank of India vide its circular DBOD.No.Leg. BC. 34 /09.07.005/2008-09 dated August 22, 2008 has required all scheduled commercial banks (excluding RRBs) banks to *inter alia* ensure that:

“(x).....the amounts lying in inoperative accounts ledger are properly audited by the internal auditors / statutory auditors of the bank.

(xi) Interest on savings bank accounts should be credited on regular basis whether the account is operative or not. If a Fixed Deposit Receipt matures and proceeds are unpaid, the amount left unclaimed with the bank will attract savings bank rate of interest.”

#### **2. Circular No. DNBS (PD). CC.126/03.10.042/2008-09 dated August 5, 2008**

In exercise of power under Sections 45K and 45L of the RBI Act, 1934 the Reserve Bank of India has issued guidelines as regard to Prevention of Money Laundering Act, - Obligation of NBFCs in terms of Rules notified there under it was advised that NBFCs should also report information in respect of all transactions referred to in Rule 3 to the director, Financial Intelligence Unit-India (FIU-IND).

For details visit: [www.rbi.org.in](http://www.rbi.org.in)

## LEGAL DECISIONS

### DIRECT TAXES

#### Section 4 of the Income-tax Act, 1961 – Charge of Income-tax [Assessment Years - 1995-1996 to 1997-1998]

Additional income derived from sale of free sugar is capital receipt. Closing stock of incentive sugar has to be valued at levy price and not at cost price.

#### Commissioner of Income Tax-I Coimbatore vs. Bannari Amman Sugars Limited, Coimbatore (MAD), 21<sup>st</sup> July, 2008

The assessee claimed that incentives given by way of free sale of sugar was capital in nature and was not assessable as income. It was also contended that closing stock should be valued on the basis of levy price and not at cost price. The Assessing Officer held that since the assessee by claiming the incentive as capital receipt and interest payments as revenue expenditure, has claimed double deduction, which is not permissible, the income from free sale of sugar was revenue receipt.

*The High Court upheld the ratio in assessee's own case in Commissioner of Income Tax, Tamilnadu I, Madras vs. Tamilnadu Sugar Corporation Ltd (TC.NOs.777 and 778 of 1995) wherein it was held that incentives given by way of free sale of sugar was capital in nature and was not assessable as income and closing stock should be valued on the basis of levy price and not at cost price.*

*The appeals were dismissed.*

#### Section 10(20) of the Income-tax Act, 1961 - Local Authority. [Assessment Year - 2003-2004]

Agricultural Produce Market Committee is neither a Municipal Committee nor a District Board under the Explanation to Section 10(20) and therefore, is not entitled to exemption.

#### Agricultural Produce Market Committee, Narela, Delhi vs. Commissioner of Income Tax & Anr. (Supreme Court), 21<sup>st</sup> August, 2008

The Appellant-Committee (AMCs) is established under the Delhi Agricultural Produce Marketing (Regulation) Act, 1998. The appellant has to provide facilities for marketing of agricultural produce apart from performing other functions and duties such as superintendence, direction and control of markets for regulating the marketing of agricultural produce. The appellant's claim for exemption as a Local Authority under Section 10(20) was denied by the Assessing Officer.

*The Supreme Court held that under Section 3(31) of the General Clauses Act, 1897, "local authority" was defined to mean "a municipal committee, district board, body of port commissioners or other authority legally entitled to the control or management of a municipal or local fund. The words "other authority" in Section 3(31) of the 1897 Act has been omitted by Parliament in the Explanation/definition clause inserted in Section 10(20) of the 1961 Act vide Finance Act,*

*2002. Therefore, it would not be correct to say that the entire definition of the word "local authority" is bodily lifted from Section 3(31) of the 1897 Act and incorporated, by Parliament, in the said Explanation to Section 10(20) of the 1961 Act. This deliberate omission is important. It may be noted that various High Courts had taken the view prior to Finance Act, 2002 that AMC(s) is a "local authority". That was because there was no definition of the word "local authority" in the 1961 Act.*

*The Supreme Court after analyzing various decisions came to the conclusion that Appellant-Committee is neither a Municipal Committee nor a District Board under the Explanation to Section 10(20) and therefore, is not entitled to exemption under Section 10(20) after insertion of the Explanation vide Finance Act, 2002 w.e.f. 1.4.03.*

*The appeals were dismissed.*

#### Section 35E read with Section 37(1) of the Income-tax Act, 1961 – Deduction for expenditure on prospecting, etc. for certain minerals [Assessment Years - 1998-99 and 1999-2000]

Whether expenditure towards development and prospecting charges is to be treated as capital nature and thus liable for disallowance?

#### Rajasthan State Mines and Minerals Ltd. vs. Commissioner of Income Tax, Jaipur (Supreme Court) 25<sup>th</sup> August, 2008

The appellant is a Public Sector Undertaking. For the assessment years 1998-99 and 1999-2000 claim of the assessee for the expenditure towards development and prospecting charges was disallowed by the Assessing Officer treating it as capital expenditures.

*The Supreme Court observed that the High Court in the impugned judgment proceeded to invoke the provisions of Section 37(1). It is not in dispute that had the High Court considered the claim of the appellant in the light of Section 35E(2), it might have arrived at a different conclusion.*

<sup>1</sup>These cases have been compiled and contributed by www.Indlaw.com. Readers are invited to send their comments on the selection of cases and their utility at [board@icai.org](mailto:board@icai.org). For the convenience of readers full text of these cases have been hosted on the website of the institute at the link: [http://www.icai.org/icairoot/departments/editorial\\_board/dept\\_editorial\\_board\\_index.jsp?icaideptid=20](http://www.icai.org/icairoot/departments/editorial_board/dept_editorial_board_index.jsp?icaideptid=20)

Edited by Journal Section, ICAI.

*Therefore, the impugned judgment was set aside and the matter was remitted back to the High Court for considering*

*the appellant's appeal afresh on merit.*

*The appeals are disposed of accordingly.*

**Section 42 of the Income-tax Act, 1961 – Mineral Oil - Special provision for deductions in the case of business for prospecting, etc. [Assessment Year 1999-2000]**

*Assessee, a foreign company engaged in the business of oil exploration was awarded contract for development of Concessional Blocks in India was entitled to claim deduction for foreign exchange losses on account of foreign currency translation*

**Commissioner of Income-tax, Dehradun & Anr. vs. Enron Oil & Gas India Ltd. (Supreme Court), 2<sup>nd</sup> September, 2008**

In 1993, Government of India, through Petroleum Ministry invited bids for the development of concessional blocks. The respondent-assessee (EOGIL) offered its bid for the concession. Accordingly, a consortium of EOGIL and RIL was awarded the contract for development of Concessional Blocks. Respondent was designated as an Operator. Subsequent to the award of the concession, EOGIL along with RIL and ONGC executed Production Sharing Contract (PSC) with Government of India. Under the said PSC, each co-venturer remitted money, known as cash call to the bank account of the Operator in USA. The expenditure for the joint venture is made out of the said account. EOGIL filed its return of income for Assessment Year 1999-2000 declaring its taxable income of Rs. 71,19,50,013 under Section 115JA and debited its P&L account by exchange loss of Rs. 38,63,38,980. The A.O. disallowed this loss on the ground that it was a mere book entry and actually no loss stood incurred by the assessee.

*The Supreme Court Held that:*

*An analysis of the PSC indicates that both the Government and the Contractor are entitled to their "take" in oil and not in money. That is why the contract is called as Production Sharing Contract and for that purpose it becomes necessary to translate costs into oil barrels. This is done by dividing the monetary value of costs by the agreed price of oil.*

*Analysing Section 42(1), it becomes clear that the said section is a special provision for deductions in the case of business of prospecting, extraction or production of mineral oils. Section 42(1) inter alia provides for deduction of certain expenses. Section 42 becomes operative only when it is read with the PSC. Expenses deductible under Section 42 had to be determined as per the PSC. This implied that expenses had to be accounted for only as contemplated by the PSC.*

*If so read, it is clear that the primary object of the PSC is to ensure a fair "take" to the Government. The said "take" comprised of profit oil, royalty, cesses and taxes. In view of the special accounting procedure prescribed by the PSC, Accounting Standard 11 had to be ruled out.*

*The capital contribution had to be converted under the PSC at one rate whereas the expenditure had to be converted at a different rate. This exercise resulted into loss/profit on conversion. Under the PSC, the respondent had to convert revenues, costs, receipts and incomes. If EOGIL had a choice to prepare its accounts only in USD, there would have been no loss/profit on account of currency translation. It is because of the specific provision in the PSC for currency translation that loss/profit accrued to EOGIL. Moreover, in PSC it was inter alia provided that any realized or unrealized gains or losses from the exchange of currency in respect of Petroleum Operations shall be credited or charged to the Accounts. Therefore, it would be wrong to say, as stated by the A.O., that the currency translation losses incurred by EOGIL, during the years in question, was only a notional loss/ book entry.*

*In PSC, the foreign company provides the capital investment and cost and the first proportion of oil extracted is generally allocated to the company which uses oil sales to recoup its costs and capital investment. The oil used for that purpose is termed as "cost oil". Often a company obtains profit not just from the "profit oil", but also from "cost oil". Such profits cannot be ascertained without taking into account translation losses. Moreover, as stated above, taxes are embedded in the profit oil. If these concepts are kept in mind then it cannot be said that "translation losses" under the PSC are illusory losses.*

*The appeal was dismissed.*

**Section 44 of the Income-tax Act, 1961 — Insurance business**

*There is no rigid time frame for grant of permission by the Committee for filing appeals.*

**Commissioner of Income Tax, Delhi-VI vs. Oriental Insurance Company Limited (Supreme Court), 18<sup>th</sup> July, 2008**

The assessee is an insurance company covered by the Insurance Act, 1983. The High Court held that since the Supreme Court had set the time frame of one month, there is no scope for any deviation therefrom.

*The Supreme Court held that there is no rigid time frame indicated by Supreme Court. The emphasis on one month's*

*time was to show urgency. If there is some delay in approaching the Committee that does not make the action illegal. There is no scope for lethargy. It is to be tested by the Court as to whether there was any indifference and lethargy and in appropriate cases refuse to interfere.*

*Further, it is to be noted that where permission has been*

*granted by the Committee there is no impediment on the Court to examine the matter and take a decision on merits. But where there is no belated approach as noted above, the matter has to be decided. Court has to decide whether because of unexplained delay and lethargic action it would*

*decline to entertain the matters. That would depend on the factual scenario in each case, and no straight jacket formula can be adopted.*

*The appeals were allowed.*

### Section 80P of the Income-tax Act, 1961 – Deductions – Income of Co-operative Societies

#### Deduction under Section 80P(2)(a)(i)

#### Commissioner of Income Tax, Chennai vs. Modern Engineers Construction Cooperative Society Ltd. (Supreme Court), 4<sup>th</sup> September, 2008

Claim of deduction in terms of Section 80P(2)(a)(i) was negated by the assessing officer on the ground that the income reflected by the assessee can neither be attributed to actual labour of the members nor can be treated as arising out of collective disposal of its labour.

*The Supreme Court observed that the High Court seems to have proceeded on the factual premises as if the dispute*

*related to interest received from members. This confusion appears to have arisen because the High Court mixed up the factual position of some other case which related to credit society engaged in Banking. On that score alone, the High Court's order is indefensible.*

*Therefore, order of the High Court was set aside and the matter was remitted back for a fresh consideration.*

### Section 263 read with Sections 271C and 274 of the Income-tax Act, 1961 – Revision – Of orders prejudicial to revenue

#### Where the Assessing Officer failed to pass a reasoned order

#### Toyota Motor Corporation vs. Commissioner of Income tax (Supreme Court), 25<sup>th</sup> August, 2008

According to the assessee all relevant aspects were placed for consideration and if the officer did not record reasons, assessee can not be faulted. What the High Court has done is to require the Assessing Officer to pass a reasoned order. The High Court was of the view that the Tribunal could not have substituted its own reasoning which were required to be recorded by the Assessing Officer.

*The Supreme Court inclined to interfere with the order of the High Court and observed that when the matter be taken up by the Assessing Officer on remand, it shall be his duty to take into account all the relevant aspects including the materials, if any, already placed by the assessee, and pass a reasoned order.*

*The appeal was dismissed.*

### Section 271(1)(c) of the Income-tax Act, 1961 – Penalty – For concealing particulars of income

During period 1.4.1976 to 1-4-2003 Penalty was leviable even in a case where addition of concealed income reduces the returned loss and Explanation 4 to Section 271(1)(c) is clarificatory and not substantive

#### Commissioner of Income Tax-I, Ahmedabad vs. Gold Coin Health Food Pvt. Ltd. (Supreme Court), 18<sup>th</sup> August, 2008.

The issue is whether penalty under Section 271(1)(c) can be levied if the returned income is a loss.

*The Court observed that Explanation 4(a) to Section 271(1)(c) intended to levy the penalty not only in a case where after addition of concealed income, a loss returned, after assessment becomes positive income but also in a case where addition of concealed income reduces the returned loss and finally the assessed income is also a loss or a minus figure. During 1.4.1976 to 1.4.2003, penalty was leviable even in a case where addition of concealed income reduces the returned loss.*

*In a case where on account of addition of concealed income the returned loss stands reduced and even if the final assessed income is a loss, still penalty was leviable thereon even during the period 1.4.1976 to 1.4.2003. Even in the Circular No. 204 dated 24.7.1976, the position was clarified by Central Bureau of Direct Taxes (CBDT). It is stated that in a case where on setting of the concealed income against any loss*

*incurred by the assessee under any other head of income or brought forward from earlier years, the total income is reduced to a figure lower than the concealed income or even to a minus figure the penalty would be imposable because in such a case "the tax sought to be evaded" will be tax chargeable on concealed income as if it is "total income".*

*Law is well settled that the applicable provision would be the law as it existed on the date of the filing of the return. It is of relevance to note that when any loss is returned in any return it need not necessarily be the loss of the concerned previous year. It may also include carried forward loss which is required to be set up against future income under Section 72 of the Act. Therefore, the applicable law on the date of filing of the return cannot be confined only to the losses of the previous accounting years.*

*Hence, Explanation 4 to Section 271(1)(c) is clarificatory and not substantive.*

*The appeals were disposed of.*

*Judicial Analysis:* View expressed by the Supreme Court in

Virtual Soft Systems Ltd. vs. Commissioner of Income-tax, Delhi (2007) 289 ITR 83 / 2007 (9) SCC 665 is not correct

**INDIRECT TAXES**

**Custom & Excise**

**Sections 2(34) read with Sections 4, 5 and 28 of the Customs Act, 1962 — Proper Officer**

Once power has been exercised under Section 4, only the proper officer notified for that area could exercise the powers under the Act and the Commissioner (Preventive) would have no jurisdiction

**Commissioner of Customs, Mumbai vs. Noble Asset Company Limited, Mumbai and others (BOM), 4<sup>th</sup> August, 2008**

The Respondent No.1 carries on business of owning and operating mobile offshore drilling units. It filed a Shipping Bill for export of a Rig given on contract. The Customs Authorities detained the said Rig under Section 110, Customs Act, 1962 and issued a detention memo. The Rig was released on furnishing a Bank Guarantee. Respondent No.1 exported the Rig to Sharjah. A show cause notice was served, which was later confirmed.

*The High Court held that in view of the Sections 2(34), 4, 5 and 28 it is only the proper officer assigned those functions by the Board or Commissioner of Customs who alone can exercise the powers in the matter of confiscation of goods. In other words it is such officers who can exercise jurisdiction. The power has to be exercised in terms of Section 124 by the proper officer of customs by giving a notice in writing with the prior approval of the officer of Customs not below the rank of a Deputy Commissioner of Customs and complying with the other provisions.*

*Further, considering the provisions of the Customs Act, 1962 and the Notifications dated 7th July, 1997 and 1st November, 2002 issued by the Central Government in exercise of the powers conferred by sub-section (1) of Section 4 it would be clear that in so far as designated areas in the EEZ and continental shelf concerned, under Section 4 of the Customs Act, 1962 the Government of India has appointed officers for the designated zones and once proper officers have been appointed for the designated zone it would mean the exclusion of the power of the other officers who have not been so designated.*

*Once the power has been exercised under Section 4, then it is only the proper officer who can only exercise the powers in respect of the areas in respect of which the jurisdiction has been conferred on them and to that extent the Commissioner (Preventive), Mumbai would have no jurisdiction. Neither practice would confer jurisdiction nor consent would confer jurisdiction.*

*The Appeal was dismissed.*

**Section 88 of the Finance Act, 1988 — Kar Vivad Samadhan Scheme**

An assessee cannot be denied the benefit extended under a scheme due to dislocation caused by the Postal Department.

**East Coast Hospitals Limited, Pondicherry vs. Assistant Commissioner of Customs (Group 5B), Chennai and others (MAD), 29<sup>th</sup> July, 2008**

The petitioner was running a Hospital. It sought exemption under Notification No.64/88/Customs dated 1.3.1988, which was denied. The Central Government in the mean time introduced the Kar Vivad Samadhan Scheme under section 88, Finance Act, 1988 by which an assessee was given an opportunity to make a declaration to the designated authority in respect of the tax arrears. Accordingly the petitioner gave a declaration. The declaration has been accepted by the authorities and the Certificate in Form 2-B was also sent to them. However, the Certificate in Form 2-B was lost by the postal department. The respondents were also not able to

show the original cover and the entry made on the reverse side of the cover.

*The High Court observed that when a Scheme grants benefit to an assessee and provides modality for availing such a benefit and the petitioner having submitted the due declaration, the respondents have also granted a Certificate and, only because of the dislocation caused by the Postal Department, they cannot be denied to avail the benefit of the said Scheme.*

*The writ petitions were disposed of.*

**Section 5A of the Central Excises and Salt Act, 1944 — Power to grant exemption from duty of excise**

New condition laid down by a circular can not restrict or whittle down the scope of an exemption notification

**Sandur Micro Circuits Limited vs. Commissioner of Central Excise, Belgaum (Supreme Court), 13<sup>th</sup> August, 2008**

The issue is what is the effect of a circular issued by Central Board of Excise and Custom, where the Circular was in direct conflict with a Notification.

*The Supreme Court held that by issuing a circular a new*

*condition restricting the scope of the exemption notification or restricting or whittling it down, cannot be imposed.*

*The appeals were dismissed.*

### Service Tax

**Section 73 read with Sections 70 & 71A of the Finance Act, 1994 read with Rule 1 of the Service Tax Rules, 1994 - Recovery of Service Tax [Period 16.11.1997 to 1.6.1998]**

Service receiver was not required to file any return under Section 70 prior to 2003

**Commissioner of Central Excise, Vadodara-I vs. Gujarat Carbon & Industries Ltd. (Supreme Court), 18<sup>th</sup> August, 2008**

The respondents engaged the services of transport operators. Show Cause Notice was issued under Sections 76 and 77 for contravention of Sections 70, 76 and 81. However, the Notice was dropped relying on *Laghu Udyog Bharti & Ors. v. Union of India* 1999 (112) ELT 365. However, in some cases, the orders were reviewed under Section 84 on the ground that Section 117, Finance Act, 2000 validates retrospectively Rule 1(1)(d)(xii) of the Service Tax Rules, 1994. The Tribunal quashed the order demanding service tax holding that the service receiver was not required to file any re-

turn under Section 70 prior to 2003.

*The Supreme Court observed that during the relevant period Section 73 takes in only the case of assesseees who were liable to file return under Section 70. The liability to file return is cast on the assesseees only under Section 71-A which was introduced in the Finance Bill, 2003. During the period in question no notice could have been issued under Section 73 for non-filing of return under Section 70.*

*The appeals were dismissed.*

**Section 80 of the Finance Act, 1994 — Penalty not to be imposed in certain cases**

Invocation of Section 80 is justified where there is no suppression of the value of service

**Commissioner of Service Tax, New Delhi vs. A.T. Kearney Limited (CESTAT-New Delhi), 28<sup>th</sup> March, 2008**

The respondents were providing management consultancy. The adjudicating authority, invoking Section 80 did not impose any penalty on the ground that there was no willful suppression of the value of service provided by the respondent. The Commissioner reviewed the order and after hearing the respondents also held in favour of the respondents.

*The Tribunal held that service tax, which was charged at a lower rate in only two invoices was due to a clerical mistake and that was later enhanced. Therefore, there was no suppression of value of the service provided by the respondents. Hence, there was no infirmity in the impugned order whereby provisions of Section 80 were invoked.*

*The appeal was dismissed.*

### Sales Tax /VAT

**Section 5A of the Kerala General Sales-tax Act, 1963 — Levy of purchase tax**

Heating red oil to specified degree and then filtering it to remove impurities does not amount to consumption/use of red oil in the manufacture of sandalwood oil.

**Punjab Aromatics vs. State of Kerala (Supreme Court ), 30<sup>th</sup> April, 2008**

The appellant purchased “red oil” from unregistered dealers and converted it into “sandalwood oil” by removing water content and other impurities. The case of the Department is that the assessee is not selling red oil as such; that the commodity purchased (i.e. red oil) by the assessee has undergone manufacture when it is heated to a specified degree and the same is filtered by which impurities are removed and, therefore, according to the Department, conversion of red oil into sandalwood oil attracts levy under Section 5A.

*The Supreme Court observed that the “test of irreversibility” is an important criterion to ascertain as to when a given process amounts to manufacture. In the instant case that test is not satisfied.*

*The Tribunal in the instant case has examined the process and has come to the conclusion that sandalwood oil (final product) can be brought back to the original state, namely, red oil by adding impurities, therefore, the process is reversible. Therefore, red oil is not subsumed into sandalwood oil. Keeping in mind this basic test, it is clear that red oil is not consumed/used in the manufacture of sandalwood oil. Hence, Section 5A(1)(a) or (b) has no application. In the circumstances, it cannot be said that red oil and sandalwood oil are two separate and distinct products as held by the High Court overruling the judgment of the Tribunal.*

*The appeal was allowed.*

**Section 5(3) of the Central Sales-tax Act, 1956 read with Section 5A of the Kerala General Sales-tax Act, 1963 — When is a sale or purchase of goods said to take place in the course of import or export [Assessment Year - 1998-1999]**

Matter remitted as factual foundation was missing.

**Alagendran Exports Pvt. Ltd. vs. State of Kerala (Supreme Court), 12<sup>th</sup> August, 2008**

The appellant-Company is engaged in the business of export of cashew kernels from the registered dealers. The contention of the appellant is that since the purchases were covered

by declarations in Form 18A, the transactions stood covered by Section 5(3) of the Central Sales Tax Act, 1956 (1956 Act) and hence not liable to tax within the State of Kerala. The

Assessing Officer held that since the goods were either stock transferred or effected vide deemed export sales, the purchases were liable to tax under Section 5A, Kerala General Sales Tax Act, 1963 (1963 Act) and that the appellant had not produced any evidence to show local purchase.

*The Supreme Court observed that the Assessing Officer did not decide whether the purchases made by the appellant were in the course of export in terms of Section 5(3) of the 1956*

*Act. It is the duty of the AO to collate the facts and ascertain whether the purchased cashew kernels were effected in the course of export. In this case, that factual foundation is missing. Therefore, the matter was remitted back to the Deputy Commissioner (Appeals) on the ground that the factual foundation was missing in the case.*

*The appeal was allowed.*

### **Section 29 of the U.P. Trade Tax Act, 1948 - Refunds**

**A dealer can not make adjustment while depositing tax on the basis that certain amounts had been deposited in excess for some other assessment period.**

#### **Commissioner of Sales-tax, U.P. vs. Hind Lamps Ltd. (Supreme Court), 31<sup>st</sup> July, 2008**

For the assessment years 1969-70 to 1971 -72 the dealer had filed appeals for refunds before the Assistant Commissioner (Judicial) Sales Tax, which were allowed and the matter was remanded for re-consideration of the Assessing Authority. The dealer adjusted aforesaid amounts from the amounts payable as tax in respect of three months in 1977. According to the dealer since the matter was remanded by the appellate authority any amount paid beyond the admitted tax has to be construed as refundable. The Assessing Officer refused to give credits of the amounts in his order on the ground that there was no provision for such adjustment and the dealer cannot itself adjust the amounts, if any, refundable to him.

*The Supreme Court observed that the expression used is "found to be refundable". In other words, it must be as a result of adjudication. The amount has to be found to be refundable. In the instant case, there is no such adjudication. Even otherwise, the power of adjustment lies with the au-*

*thority under the Statute. While granting refund, he has to first find out whether there is any amount which has to be adjusted against tax or other amounts outstanding against the dealer under the Act or the Central Act and the balance has to be refunded. This power of adjustment lies only with the authority under the Statute. The dealer cannot make any adjustment on his own, and not certainly under the proviso to sub-section (1) of Section 29 as has been held by the High Court. The Explanation I makes the position further clear that the date of refund shall be deemed to be the date on which first intimation regarding preparation of the refund voucher is sent to the dealer in the prescribed manner. Obviously, therefore, date of refund is relatable to the intimation regarding the preparation of the refund voucher. Explanation II shows that the expression "refund" includes the adjustment which is permissible under the proviso to sub-section (1).*

*The appeal was allowed.*

### **Rule 28(A) read with Rule 11 of the Haryana General Sales Tax Rules, 1975 - Exemption.**

**High Court was not justified in setting aside the demand as having completely lost sight of Rule 11(b).**

#### **State of Haryana & Ors. vs. A.S. Fuels Pvt. Ltd. & Anr. (Supreme Court), 20<sup>th</sup> August, 2008.**

In the instant case, the High Court held that cancellation of exemption certificate after its validity period was over did not attract Rule 28(A)(10)(v) as it was clearly not a case of cancellation of exemption certificate because it was done after expiry of the period. The High Court did not examine whether Rule 28(A)(10)(v) in so far as it empowers the department to withdraw the tax exemption certificate was valid or not.

*The Supreme Court observed that under sub-rule 8(b) when the eligibility certificate is withdrawn, the exemption/ entitlement certificate is also deemed to have been withdrawn from the first day of its validity and the unit shall be liable to payment of tax, interest or penalty under the Act as if no entitlement certificate had been ever granted to it. A bare reading of Sub-rule 11(a) shows that the benefit of tax exemption/deferment under the rule shall be subject to the condition that the beneficiary/industrial unit after having availed all the benefit shall continue its production for at least next five years not below the average production for the preceding five years. Clause (b) of the sub-rule is of considerable sig-*

*nificance; it shows that in case the unit violates any of the conditions laid down in clause (a) it shall be liable to make in addition to the full amount of the benefit availed of by it during the period of exemption/deferment, payment of interest chargeable under the Act as if no tax exemption/deferment was ever available to it. In other words in case of non-continuance of production for next five years, the result is that it shall be deemed as if there was no tax exemption/entitlement available to it. The proviso permits to the dealers to explain satisfactorily to the DETC that the loss in production was because of the reasons beyond the control of the unit. The materials have to be placed in this regard by the party. The High Court seems to have completely lost sight of Sub-rule 11(b). In any event, the High Court had permitted the authorities to go before the Screening Committee to get the eligibility certificate cancelled. Undisputedly that has been done, and the appeal against cancellation has been dismissed.*

*The appeals were allowed.*

**OTHER ACTS**

**Companies Act**

**Sections 529A and 530 of the Companies Act, 1956 - Overriding preferential payments**

In liquidation proceedings, the party at whose instance the proceeding is initiated does not enjoy any preferential claim any proceeds from the sale of the assets must be disposed of in terms of Sections 529A and 530

**DCM Financial Services Limited vs. Neel Kamal Plastics Limited and Another (Supreme Court), 13<sup>th</sup> August, 2008**

The Debtor Company had a number of creditors. Some of its creditors instituted proceedings for recovery of their dues before different courts and authorities. The appellant moved the Punjab & Haryana High Court for putting the debtor company to liquidation and dispose of property X. In another proceeding instituted before the Debts Recovery Tribunal, Delhi, the Debtor Company was able to sell its property X. However, a restraint order was passed by the Punjab & Haryana High Court. In yet another proceeding, a sister concern of the Debtor Company sold its property X to the common vendor. The Punjab & Haryana High Court was told that the Delhi High Court had permitted sale of the properties of the Debtor Company and its sister concern, on condition that out of the sale proceeds payment would first be made to the Income Tax Department. The appellant filed another application before the Punjab and Haryana High Court for vacating the restraint order. The order was vacated

and the Appellant was able to secure a substantial amount under a private arrangement. Later, the Punjab & Haryana High Court, on being apprised of all the facts, took the view that the order was obtained from it on a complete misrepresentation of the orders passed by the Delhi High Court, and asked the appellant to deposit in court the sum that it had received in connection with the sale of the property.

*The Supreme Court observed that once a proceeding gets underway under the Companies Act the party at whose instance the proceeding is initiated does not enjoy any preferential claim and any proceeds from the sale of the assets of the company must be disposed of in terms of the scheme as provided under Sections 529A and 530. The money received by the appellant was legally bound to come to the court.*

*The appeal was dismissed.*

**Section 458A read with Sections 543 of the Companies Act, 1956 - Exclusion of certain time in computing periods of limitation**

Section 458A has to be read with Section 543(2) while computing the period of limitation in misfeasance proceedings.

**Ajay G. Podar vs. Official Liquidator of J.S. & W.M. & Ors. (Supreme Court), 22<sup>nd</sup> July, 2008.**

On 2.12.83 an order of winding up was passed by the High Court and accordingly Official Liquidator was appointed. The period of five years referred to in Section 543(2) expired on 1.12.1988. Misfeasance proceedings were filed on 1.12.89. The appellant contended that the proceedings stood filed beyond limitation as prescribed under Section 543(2).

*The Supreme Court observed that Section 543(2) deals with limitation for applications/claims mentioned in Section 543(1) which includes misfeasance proceedings whereas the computation of the period of five years is contemplated by Section 458A. There is no conflict between Section 458A and Section 543(2) of the Companies Act. Section 458A ex-*

*cludes the period between the date of commencement of winding up of the company and the date on which the winding up order is passed plus one year therefrom. Therefore, it is a case of exclusion and not extension of the period of limitation of five years prescribed under Section 543(2) of the Companies Act.*

*Further, since the misfeasance proceedings had been filed in the name of the company and on behalf of the company, Section 458A is applicable. Section 458A dealing with computation of the period of limitation, has to be read with Section 543(2).*

*The appeal was dismissed.*

**FERA/FEMA**

**Section 19 of the Foreign Exchange Management Act, 1999 - Appeal to Appellate Tribunal**

Assertion about undue hardship should be supported by the fact that the particular burden is out of proportion to the nature of the requirement itself.

**Monotosh Saha vs. Special Director, Enforcement Directorate (Supreme Court), 21<sup>st</sup> August, 2008**

The appellant Acquired foreign exchange in contravention of Section 8(1) of the Foreign Exchange Regulation Act, 1973. Penalty was imposed on the appellant. The appellant filed an application for dispensing with the requirement of pre-deposit. The Tribunal passed an order directing deposit of 60% of the penalty amount. On appeal, the High Court held that no case for hardship was made out either before the Tribunal hence, no case made out for complete waiver.

*The Supreme Court observed that :*

*It is true that on merely establishing a prima facie case, interim order of protection should not be passed. But if on a cursory glance it appears that the demand raised has no leg to stand, it would be undesirable to require the assessee to pay full or substantive part of the demand. Petitions for stay should not be disposed of in a routine matter unmindful*

of the consequences flowing from the order requiring the assessee to deposit full or part of the demand. There can be no rule of universal application in such matters and the order has to be passed keeping in view the factual scenario involved. Merely because this Court has indicated the principles that does not give a license to the forum/ authority to pass an order which cannot be sustained on the touchstone of fairness, legality and public interest. Where denial of interim relief may lead to public mischief, grave irreparable private injury or shake citizens' faith in the impartiality of public administration, interim relief can be given.

Further, while dealing with a case of waiver of pre-deposit,

two important points, i.e. consideration of undue hardship and imposition of conditions to safeguard the realization of penalty have to be kept in mind.

It was further held that a mere assertion about undue hardship would not be sufficient and it must be shown that the particular burden is out of proportion to the nature of the requirement itself. Also, the Tribunal has to consider materials to be placed by the assessee relating to undue hardship and also to stipulate condition as required to safeguard the realization of penalty. For the balance amount, the appellant shall furnish security to safeguard the realization of penalty.

The appeal was disposed of.

### Negotiable Instruments Act

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

Burden has to be discharged by the accused in the trial.

#### Malwa Cotton & Spinning Mills Ltd. vs. Virsa Singh Sidhu and Ors. (Supreme Court), 13<sup>th</sup> August, 2008

In the present case, cheques were issued between December 2000 and February 2001. Although, respondent No.1 claimed to have resigned on 2.4.1999. The Form No.32 which was required to be filed with the Registrar of Companies, was filed on 5.7.2001 i.e. much after the cheques were issued. The High Court quashed the proceedings under Section 482 of the Code of Criminal Procedure, 1973 primarily on the ground that respondent No.1 had resigned from the Directorship before the cheques were issued. According to the appellant whether in fact the respondent No.1's claim to have resigned was factually correct would have been established in trial.

The Supreme Court observed that in the instant case fac-

tual disputes are involved. What was the effect of delayed presentation before the Registrar of Companies is essentially a matter of trial. Whether respondent No.1 had intimated the company and whether there was any resolution accepting his resignation are matters in respect of which evidence has to be led. Therefore, the High Court was not justified in its view.

Further the Supreme Court relying on S.V. Muzumdar vs. Gujarat State Fertilizer Co. Ltd. and Anr. 2005 (4) SCC 173, held that the burden i.e. the Respondent no. 1 was not in-charge of day to day affairs of the company, has to be discharged by the accused in the trial.

The appeals were allowed.

#### Section 142 of the Negotiable Instruments Act, 1881 read with Section 420 of the Indian Penal Code - Cognizance of Offences

A substantive law, in absence of an express provision, cannot be given a retrospective effect or retroactive operation.

#### Subodh S. Salaskar vs. Jayprakash M. Shah & Anr. (Supreme Court), 01 August 2008.

The facts involved in the instant case are that two post dated cheques were issued by the appellant on 6.12.1996 and 28.09.2000 which were presented on 10.01.2001. Those were returned by the bank alleging that no such account in the name of the appellant was in operation. A notice was served on 17.01.2001 and later a complaint petition under Section 138 was filed on 20.04.2001. An amendment application for adding Section 420 of the Indian Penal Code was allowed by the lower Courts.

The Supreme Court held that:

The legal notice admittedly was issued on 17th January, 2001.

It was sent by speed post. It was supposed to be served within a couple of days. A bare perusal of the statements of the complaint petition, clearly demonstrate that although the actual date of service of notice was allegedly not known, the complainant proceeded on the basis that the same was served within a reasonable period; otherwise in absence of service of notice or deemed service thereof, the question of non-compliance of clause (c) of the proviso appended to Section 138 would not arise and consequently the complaint petition would not be maintainable.

The complaint petition admittedly was filed on 20.04.2001. The notice having been sent on 17.01.2001, if the presump-

tion of service of notice within a reasonable time is raised, it should be deemed to have been served at best within a period of thirty days from the date of issuance thereof, i.e., 16.02.2001. The accused was required to make payment in terms of the said notice within fifteen days thereafter, i.e., on or about 2.03.2001. The complaint petition, therefore, should have been filed by 2.04.2001. Ex facie, it was barred by limitation. No application for condonation of delay was filed. No application for condonation of delay was otherwise maintainable. The provisions of the Act being special in nature, in terms thereof the jurisdiction of the court to take cognizance of an offence under Section 138 was limited to the period of thirty days in terms of the proviso appended thereto. Section 142(b) confers a jurisdiction upon the court to condone the delay. It is, therefore, a substantive provision and not a procedural one. If the proviso appended to Clause (b) of Section 142 contained a substantive provision and not a procedural one, it could not have been given a retrospective effect. A substantive law, as it is well-settled, in absence of an express provision, cannot be given a retrospective effect or retroactive operation.

Therefore, there cannot be any doubt whatsoever that the courts below committed a manifest error in applying the proviso to the fact of the instant case. If the complaint peti-

tion was barred by limitation, the learned Magistrate had no jurisdiction to take cognizance under Section 138. The direction to issue summons on the appellant, therefore, being illegal and without jurisdiction was a nullity.

The cheques were post dated ones. Admittedly they were issued in the year 1996. They were presented before the bank on a much later date. They were in fact presented only on 10.01.2001. When the cheques were issued, the accounts were operative. Even assuming that the account was closed subsequently the same would not mean that the appellant had an intention to cheat when the post dated cheques were issued. Even otherwise the allegations made in the complaint petition, even if given face value and taken to be correct in its entirety do not disclose commission of an offence under Section 420 of the Indian Penal Code. They do not satisfy the ingredients of the suit provision. It is, therefore, in the fact situation obtaining in the instant case, difficult to hold that the provisions of Section 420 of the Indian Penal Code were attracted.

The court had no jurisdiction to allow the amendment of the complaint petition at a later stage. Therefore, the High court was not correct in taking the aforementioned view in the facts and circumstances of the present case.

The appeal was allowed.

## DISCIPLINARY CASE

*Summary of a disciplinary case - the Institute of Chartered Accountants of India Vs. Shri V.C. Agarwal<sup>1</sup> (Chartered Accountant Reference No. 2 of 2001) decided on 13.08.2004 by the Bombay High Court under Section 21(6) of the Chartered Accountants Act, 1949.*

### Facts of the case:

The Institute of Chartered Accountants of India (hereinafter referred to as the 'Institute') received the "information" against Shri V.C. Agarwal (hereinafter called the 'Respondent'). Shri Sanjay Kumar, Asstt. Commissioner of Income-tax, Circle 5(7), Mumbai, vide his letter dated 31st May, 1991 informed, inter alia, that in the case of assessment proceedings of M/s. Walmek Import & Exports Private Limited, Mumbai (hereinafter referred to as 'Company'), it was observed that the books of accounts for the assessment year 1988-89 of the said assessee were audited by the Respondent and the regular audit report along with return of income was also filed by the Respondent. On perusal of the Bank Statement of the said Company, cash deposits of over Rs.60 lakhs were noticed and the assessee in the said matter was found to be a Hawala Broker. Based on the assessment order dated 21st March 1991, it was observed that no trading activity as shown by the assessee, was carried out by the Company and the cash deposits in the bank on various dates showed that the assessee company was receiving money from unidentified sources for which no explanation was rendered. The Respondent, accordingly failed to bring attention to the heavy cash sales entered into by the assessee-company in his audit report submitted in Form 3CD in terms of Section 44AB of the Income-tax Act, 1961 for the previous year 1987-88. The above matter was treated as 'information' against the Respondent under Section 21 of the Chartered Accountants Act, 1949 (hereinafter referred to as the 'Act').

The Council of the Institute *prima*

*facie* opined that the Respondent was guilty of professional and/or other misconduct and referred the case to the Disciplinary Committee for enquiry. The Disciplinary Committee on perusal of the documents on record, after recording the evidence of the witness came to the conclusion that the Respondent was guilty of professional misconduct within the meaning of Clauses (5), (6), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 in terms of Section 21 read with Section 22 of the said Act.

The Council on consideration of the report of the Disciplinary Committee along with the written representation made by the Respondent accepted the report of the Disciplinary Committee and accordingly found that the Respondent was guilty of professional misconduct within the meaning of Clauses (5), (6), (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 in terms of Section 21 read with Section 22 of the said Act. The Council recommend to the High Court that the name of the Respondent be removed from the Register of Members for a period of six months. As required under Section 21(5) of the Act, the matter was forwarded to the Bombay High Court with the recommendations of the Council.

The Judgement of the Division Bench of the Bombay High Court comprising of Hon'ble Mr. Justice R.M. Lodha and Hon'ble Mr. Justice J.P. Devadhar is summarized below.

### Decision of the Hon'ble Court:

The Hon'ble Court observed that the Respondent though filed his written statement, but he chose not to appear before the Disciplinary Com-

mittee. The Court further observed that, it appears that the Respondent did not seriously challenge that the audit of the books of accounts of the assessee M/s Walmek Imports and Exports Ltd. was not thorough and lacked requisite scrutiny. It is admitted fact by the Respondent that while auditing the books, he found cash deposits in banks and raised the question to his client. However he was satisfied with the answer of his client that the said cash was a result of cash sales without going deeper into the aspect. The Court was of the view that the Respondent as an auditor failed to discharge his duties responsibly and was thus guilty of professional misconduct. Since the Court concurred with the reasoning of the Disciplinary Authority, it decided not to deal with this aspect at length.

The Court accordingly confirmed the finding recorded by the Disciplinary Committee and accepted by the Council that the respondent was guilty of professional misconduct within the meaning of Clauses (5), (6), (7) and (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949 in terms of Section 21 read with Section 22 of the said Act.

On overall consideration of the entire material, the Hon'ble Court observed that the Respondent did not appear before it to show cause why the recommendation of the Council be not accepted and in his written statement, he mentioned that he was prepared to surrender his Certificate of Practice. Accordingly, the Hon'ble Court accepted the recommendation of the Council and ordered that the name of the Respondent be removed from the register of members for a period of six months.

<sup>1</sup>For full text of the Judgment please see Institute's publication viz. Disciplinary Case Vol.VIII, Part I, p. 783

# CFO AND BETTER CORPORATE GOVERNANCE

The role of Chief Financial Officer (CFO) has undergone a paradigm shift in recent years. Today a CFO is seen as a strong programme manager and strategy consultant who ensures goal congruence between the corporate strategy and business model to support the strategy. Now the CFOs are not only playing the role of transaction manager, communicator and strategist but also fast emerging as a crucial strategic partner of CEO in any organisation. The increasing complexities of modern businesses have put CFOs and their ever-increasing responsibilities in sharper focus. This article explores the role the CFOs can play in ensuring better governance.

**W**e have all seen that over the past few years, finance function, especially, in the medium to large enterprises have "inverted" the pyramid. It used to be more transaction processing and less decision support but now transaction processing has become a commodity and the focus is more on value-added decision support services. These shifts have brought competitive advantage to

some of the early adopters. However, in past few years there has been tremendous increase in business environment complexities arising from internal factors like need for transparency, better shareholder value, cost pressure and operational efficiency, and external factors like 'corporate governance matters', Sarbanes-Oxley, IAS 38 & 39, Basel II etc. The increasing business complexities have necessitated a sharper focus on efficient and innovative decision support services.



– Dr. T. Satyanarayana Chary

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Indeed, the position of CFO now requires an interrelation type of person who can work with the whole team, not just in accounting or banking; someone who understands operations from the shop floor to the boardroom, whose leadership skills can be mixed with a commitment to teamwork, who has an agility with tax laws, planning, investor relations and a knack for keeping abreast of what's driving business the business within the company and among competitors.

This situation calls for a significant role to be played by CFO, as the occupant of this position is increasingly becoming a strong programme manager and strategy consultant who ensures goal congruence between the corporate strategy and business model to support the strategy.

The role of CFO has changed considerably in recent years. Finance function is increasingly becoming a process system that is helping to shape the future role of the CFO. It is no longer good enough for CFOs to be simply the smartest number cruncher as the growing competition, a sharper focus on corporate governance and technological innovation all play a part in the way CFOs impact an organisation. It is beyond doubt that the CFO's are now also playing the role of transaction manager, communicator and strategist. The CFO is fast emerging as a crucial strategic partner of CEO in any organisation. In some larger businesses CFOs even head the major business units to help shape corporate strategy, drive alignment across the organisation and achieve success.

Thus, the ever increasing responsibilities of CFOs and the multiple skills required to undertake those responsibilities have made hiring a CFO an increasingly complex process. While a company's auditors used to be fertile hunting ground for future CFOs, this source is now out of bounds.

So how does today's CFO juggle ever-tighter reporting requirements with broad financial responsibilities, the challenges of IT systems and his strategic role? Indeed, the position of CFO now requires an interrelation type of person who can work with the whole team, not just in accounting or banking; someone who understands operations from the shop floor to the boardroom, whose leadership skills can be mixed with a commitment to teamwork, who has an agility with tax laws, planning, investor relations and a knack for keeping abreast of what's driving the business business within the company and among competitors.

As a consequence finance is playing a role in developing responsive management architectures, Government structures and is increasingly serving as a

key integrator across the organisation of process, technology and people as well as expanding the role of CFO to Investor regulations and reputation management, Risk management, Global Marketing, Remuneration Policies and Corporate Governance.

Corporate governance stipulates parameters of accountability, control and reporting functions of the board of directors and encompasses the relationship among various participants in determining the direction and performance of the corporation. It also calls for establishing a proper and a viable relationship amongst the various participants of a corporation, the board, management team, shareholders and other stakeholders.

Appropriate corporate governance around the roles and responsibilities of the finance function is a driver of overall financial effectiveness. CFOs of companies with a finance governance statement in place are better positioned to achieve higher scores in a number of areas than those without such statements. These areas include, but are not limited to, internal controls, financial forecasts, and effective business planning and budgeting. The need for a more sophisticated and proactive finance function to help the overall governance of the company to manage its businesses as well as the rapid growth and continuous change is critical. So CFOs should give appropriate thought to the following for the better governance in their business organisations.

1. Designing and fine-tuning a more responsive "Rolling Forecast" budgeting process.
2. Breeding new economy businesses from within and releasing value through Mergers and Acquisitions and planning, negotiating and overseeing strategic alliances.
3. Dynamically balancing investments between old and new economy ventures will be essential to fueling growth and shareholder value.
4. Leading the effort to align the strategic plan with a new operating mode, change the organisation structure, build the information systems and infrastructure, and develop the reporting

and measures require to enable the enterprise to operate as smaller, independent business units.

5. Evolving financing strategy to cope with the era of deregulation, globalisation and liberalisation by taking into account the factors as global perspective, adaptability to new structure, industry foresight, self-reliance, innovation and strategic awareness.
6. Review finance processes to identify issues that prevent both quality financial reporting and a more effective finance function by examining process inefficiencies, financial system architecture, data quality and people skills and capabilities.
7. Improve the overall budgeting and forecasting capabilities by structuring a more systematic and comprehensive budgeting process to support flash and rolling forecasts.
8. Enhance the current cost management environment for better decision support by introducing enhanced management accounting systems; *i.e.* product and customer profitability analysis, etc.
9. Implement a more balanced performance measurement system.
10. Implement a more clearly documented internal control framework to encourage a proactive approach in risk management.
11. Assess the company's finance governance statement against best practice to ensure the CFO reporting structure clearly supports both business growth and external reporting.
12. On the investment front, the CFO of a company has to manage its investments - typically inter-corporate deposits or ready forward deals in Government securities or the US-64 scheme of Unit Trust of India.
13. Managing properly the disclosure of unusual events and trends that can impact on company's stock price.
14. Invest in business intelligence solutions to develop business performance management architectures that provide real time information.
15. Implement a resilient governance structure that provides the necessary transparency to enable better control and risk management.
16. Shift the traditional fixed cost base of the finance function to a more variable cost base.

The role of a CFO is increasingly becoming crucial in supporting growth and the overall corporate governance of organisations. CFOs are increasingly being seen as strategic partners of CEOs. So they need to enable themselves with the help of a clear finance governance statement to align finance function with business priorities. The whole finance function, when it is aligned such a way, can work as a tool to achieve the expected corporate growth by maintaining adequate controls and efficiency as in terms of governance practices. So, CFOs must have strong financial reporting and governance processes in place to support business decisions and respond to market and stakeholder demands by taking steps to improve finance governance to achieve financial effectiveness. □

# Clean Development Mechanism and Carbon Credit: A New Challenge for Indian Industries



Over the past few years, companies are increasingly becoming aware of the detrimental effects of global warming and some of them are actively addressing the problem by taking initiatives in an organised manner. This article attempts to focus on the initiatives taken by the Indian companies in context of trading carbon credit through Kyoto Protocol's Clean Development Mechanisms (CDM) for achieving quick payback, high return, clean climate and greener environment all at once. The article also highlights the problem, India is facing in obtaining carbon credits through CDM and the future prospects of CDM projects, market for carbon credit, growth of carbon funds and carbon trading in India.

**G**lobal Warming is the buzz word these days. Over the last century anthropogenic activities carried out in the developed countries and economies in transition have contributed towards the increase in the concentration of Green House Gases (GHGs) in the atmosphere. Carbon dioxide (the most important amongst the Green House Gases) emissions from burning of fossil fuels are the major contributor to Greenhouse gases that cause the Global Warming leading to climate change. The developed and developing economies are responsible for about 75%

of the total global stock of GHGs. Thus, the responsibility of mitigating GHG emissions for stabilising atmospheric concentration of GHG's primarily lies on these countries. If it is not done, a series of climate changes will have serious impact on the lives of all citizens in this planet, both in the developed and developing countries. The developing countries will find all the more difficult to attain sustainable development as climate change will bring about potential threat to resources, worsen existing problems, develop new problems and make solutions more difficult and expensive.

Given the severity of the problem it is quite evident that India



– Debrupa Chakraborty

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India at present is the world leader in the matter of reduction of GHG through the adoption CDM, constituting about 31% of the total world's carbon trade through CDM amounting to at least \$5-\$10 billion over the next few years. Out of the 988-emission reduction projects registered worldwide by the CDM executive Board (the U.N. Body responsible for approving CDM projects) up to 10<sup>th</sup> April, 2008, as many as 324 projects are located in India.

has a pivotal role to play in fighting climate change and in controlling emissions. Having 17.4% of the world's population, India accounts for 4.6% of global Carbon dioxide (CO<sub>2</sub>) emission (as in 2004). However, the emission growth rates are on the rise due to the fact that India is a developing economy. In the developing stage, both the population and economic growth are associated with increased energy demand. Then again, energy supply in India is highly dependent on coal – a major contributor to GHG emissions. Power generation sector and the energy intensive industries of the country like steel; paper and pulp, cement, fertilizer, chemical etc. (being primarily reliant on coal) are the major emitters of GHGs and other pollutants. Therefore, Indian industries play a very significant role in meeting the challenge of reducing GHG emissions whereby they can achieve higher productivity, greater access to global market and enhancement in its international competitiveness all at the same time.

The industries in the developing countries like India can achieve emission reductions by adopting the following two key steps: -

### Step I – Quantifying the Carbon Footprint

A Carbon footprint is a measure of the impact that human activities have on the environment in terms of the amount of GHGs produced, measured in units of CO<sub>2</sub>.

Industries first need to understand the source and level of the GHG emitted from the production processes undertaken by them and thereafter they can begin tracking these emissions and its impact on environment. In this way the industries can find out their carbon footprint. Along with this, Carbon Audit, as adopted by some industries, help them to find out inefficient and costly energy practices and thereupon take necessary steps to adopt methods to combat climate change resulting from GHG emissions. Calculation of carbon footprint helps the companies to mitigate the impact of climate change arising from business activities.

### Step II – Reducing Carbon Footprint Through Reduction in Emission

Once the amount of emission has been quantified, adoption of one or more of the following four means can help achieve reduction in emissions: -

- *Adopting Energy Conservation and improving Energy Efficiency*

Energy Conservation requires reduction in energy needs e.g. lighting areas only when they are occupied. Energy Efficiency can be improved by using more energy efficient lamps to provide the desired lighting. The efficiency can be improved by proper selection and use of more energy efficient equipments.

- *Installing Cleaner Technology or Fuel Switching*

This option is intended towards the use of less carbon intensive fossil fuels such as natural gas and nuclear energy so as to move away from the use of coal.

- *Shifting to renewable sources of energy generation or green energy*

Renewable technologies provide energy on sustainable basis as they rope together energy resources that are unlimited in supply.

The following are the types of renewable energy resources commonly used by the industries: solar, hydropower, geothermal, ocean and modern biomass systems.

- *Alternative Products*

Use of Green or environment-friendly products by the industries not only help them to protect the environment and ensure safety to the workers but also encourage them to use eco-friendly production processes and generate income to a number of people. In India, the entire transport system is based on petroleum fuel, a non-renewable source of energy with high percentage of CO<sub>2</sub> emission. Alternative fuels like Ethanol, Propane, Methanol, Bio-Diesel and Electricity can be used in place of petroleum. However, the Government needs to take the initiative in encouraging the manufactures to implement these in reality by proper legislation or else!!

But undertaking any of the aforesaid means involve a lot of capital investment and the amount of investment is even much more in the developed countries where the levels of industrialisation are higher and adopting cleaner or energy efficient technologies are far more costlier than in the developing countries. To overcome this problem from the point of view of both the developed and developing countries the 'flexibility mechanisms' like "Clean Development Mechanism" (CDM) included in the Kyoto Protocol on climate change provides a market based plan for carbon trading between the developed economies and developing nations.

As regards to the emission certificates anticipated from registered projects, India ranks second next to China despite being the leader in the CDM market. The reason for this is the large ratio of small and medium sized CDM projects in India and high project rejection rate from United Nations Framework Convention on Climate Change (UNFCCC)'s Kyoto Protocol. In spite of all these difficulties a large number of Indian companies are opting for CDM projects.

### **Kyoto Protocol and CDM**

The Kyoto Protocol is an international treaty signed by 142 countries for reducing GHG emissions by 5.2% below 1990 levels between 2008-2012. The Protocol came into force from 16<sup>th</sup> February, 2005. As of 15<sup>th</sup> January, 2008, as many as 178 countries have ratified the protocol. The Protocol provides for 'CDM' that enable countries who are signatories to the said protocol to achieve the targets fixed for emission reductions by acquiring GHG reduction credits from developing or developed countries. CDM provides mutual benefits to both the developed and developing countries.

The CDM works this way: For each tonne of CO<sub>2</sub> that an industry in the developing world saves by adopting cleaner technology or energy efficiency or shifting to non-conventional sources of energy generation, the United Nation's body on climate change gives a certificate called Certified Emission Reduction (CER) to the concerned industry. The company receiving the CER can sell the surplus credits (collected by surpassing the emission reduction targets) if any, to entities in the developed countries either immediately or through a future market at a price that is mutually agreed upon by both the parties involved in the deal. In the process the entities in the developed countries find it cheaper to buy "offsetting" certificates rather than achieving emission reductions in their own backyard.

### **Concept of Carbon Credit**

The Canadian Environmental Literacy Project defines Carbon Credit as an action that helps to reduce the atmospheric concentration of CO<sub>2</sub>, such as fossil fuel conservation and planting trees. Carbon Credits are measured in units of CER's. Each Certified Emission Reduction (CER) is equivalent to one tonne of CO<sub>2</sub> reduction. Each carbon credit represents one tonne of CO<sub>2</sub> equivalent savings that offset 1 tonne of CO<sub>2</sub> equivalent at the place where it is emitted or elsewhere in any part of this planet. On top of that, surplus carbon credit can be sold in the international market. Developed countries (whose GHG emission exceeds the target fixed by the Kyoto Protocol) can either reduce their emission levels or borrow or buy the sur-

plus carbon credits that are sold by the developing countries in the global market.

This is how the trading in carbon credit takes place in the world market. In the matter of CDM projects and obtaining carbon credits from the said projects at the global level, India is emerging as a leading player.

### **CDM Projects and Emerging Market of Carbon Credit in India**

Carbon Credits are certificates earned by projects that reduce GHG emissions. Carbon credits are earned as a part of the CDM.

Under CDM India, by acting as the host country for CDM projects will qualify to encash carbon credits from the donor countries (developed countries) by contributing to the ultimate objective of GHG reductions.

India at present is the world leader in the matter of reduction of GHG through the adoption CDM, constituting about 31% of the total world's carbon trade through CDM amounting to at least \$5-\$10 billion over the next few years. Out of the 988-emission reduction projects registered worldwide by the CDM Executive Board (the U.N. Body responsible for approving CDM projects) up to 10<sup>th</sup> April, 2008, as many as 324 projects are located in India. Out of the last 10 projects registered by the U.N. CDM Executive Board, 2 are from India. Indian CERs are selling in the international markets at a range of \$5-\$10 each. CERs issued from 198 Indian projects amount to 39,201,264 [up to 10<sup>th</sup> April, 2008]

Indian enterprises have already made investments that will generate more than 379 million CERs and have the potential to generate 421 million CERs by 2012 provided that the projects approved by the Indian National CDM Authority (Authority responsible for granting approval to CDM projects) get approved by the United Nation CDM Executive Board. The CDM projects from which these CER's are expected to be achieved are mainly in the areas of renewable energies, energy efficiency, fuel switching, municipal solid waste and others. A list of some 122 CDM projects registered by the CDM Executive Board in India as on 15<sup>th</sup> November, 2006 is given underneath:

CDM projects give Indian companies the opportunity of going green by reducing its carbon footprint and earning carbon credits all together. India has emerged as the leading player in CDM and one of the largest sellers of carbon credit in the global market. The CDM projects are mainly in the areas of energy efficiency, fuel switching, industry processes, municipal solid wastes and renewable energy.

Project Category	No. of Projects	Expected Annual CO <sub>2</sub> e reduction up to 2012 (in 1,000 t)
<b>Renewable energies</b>	<b>83</b>	<b>2802</b>
Biomass/Biogas	51	1810
Small Hydro-power	16	449
Solar Energy	1	1
Wind Power	15	542
<b>Energy Efficiency</b>	<b>34</b>	<b>2123</b>
Cement Industry	9	869
Other	5	7422
Industrial Gases	2	7227
<b>Fuel Switch</b>	<b>2</b>	<b>155</b>
Landfill Gas	1	40
<b>Total</b>	<b>122</b>	<b>12, 348</b>

CO<sub>2</sub>e – Carbon dioxide Equivalent

Source: – [UNFCCC Website; UNEP Riso Center].

In India there are hundreds of companies that have registered their projects with CDM and many more are still awaiting registration. The biggest industrial players in India - Reliance, Tata, and ITC- are all putting their efforts to make the most out of it. Name of a few companies (as on 05.09.2006) from the list of CDM registered company are given below:

Name of the Companies	Nature of the Registered CDM Project
<b>Tata Steel</b>	<b>Waste heat recovery - based power project</b>
Kesoram Industries	Steam Engine Upgradation
Jayashree Textiles	Energy Efficiency
<b>ACC Cement</b>	<b>Blended Cement</b>
<b>Birla Corporation</b>	<b>Blended Cement</b>
JK Cement	Waste heat recovery - based power project
JCT	Small scale biomass

Reliance Industries Ltd. (RIL)	Energy Efficiency
USWL	Cogeneration
<b>Shree Cement</b>	<b>Optimal Utilization of Clinker</b>
TamilNadu Power Limited (TNPL)	Methane Extraction, Fuel conservation
<b>Rana Sugars</b>	<b>Bagasse- based cogeneration</b>
Ultra Tech Cement	Production of Pozzolana Cement
United Phosphorous	Natural gas as fuel
Nahar Spinning	Rice- husk-based Cogeneration

Source: – [[http://news.moneycontrol.com/mccode/news/article/news\\_article.php?antono=233759](http://news.moneycontrol.com/mccode/news/article/news_article.php?antono=233759)]

If the Indian companies meet 1/5<sup>th</sup> of the carbon emission reduction demand, it works out to be 200 million tonnes of CO<sub>2</sub> reduction and with this Indian entities are expected to earn 2 billion euros by the year 2012. With Australia ratifying the Kyoto Protocol (on the first day of the United Nation's Climate Conference at Bali, Indonesia on 3<sup>rd</sup> December, 2007) India now has a new market on the horizon for its over expanding carbon credit sector.

But India's journey for acquiring carbon credit through CDM is not devoid of delays and difficulties.

The CDM Executive Board, which is responsible for giving the CDM projects the final go-ahead, did not become operational until February, 2005 and even after becoming operational it suffered delays and obstructions in its work due to the shortage of its on site monitoring staff.

The auditing process for the proposed scheme was also criticized for not having independent oversight, particularly in the matter of calculation of GHG reductions, things proved to be problematic.

As regards to the emission certificates anticipated from registered projects, India ranks second next to China despite being the leader in the CDM market. The reason for this is the large ratio of small and

Complications continue to hinder India's efforts of earning more carbon credits from CDM projects. However, regardless of all the difficulties and hindrances, India continues to be the leader in the matter of registered CDM projects and its journey to become the leading destination of carbon credit in the world looks quite promising.

medium sized CDM projects in India and high project rejection rate from United Nations Framework Convention on Climate Change (UNFCCC)'s Kyoto Protocol.

In spite of all these difficulties a large number of Indian companies are opting for CDM projects.

### **Budding Carbon Funds and Carbon Trading in India**

**Carbon Funds:** With the increasing number of companies in India registering their projects with CDM and for encouraging more companies to join in, a number of Venture capital firms like IFCI Venture Capital Fund, Green India Venture Capital Fund are coming forward with the scheme of setting up exclusive Carbon Funds. These funds aim at providing the initial funds for the viable CDM projects, which consequently have the potential of generating meaty amount of carbon credits. The latest entrant in this field is Green Ventures International (it is a Commodity Asset Management Company in New York) with its \$300 million India Carbon Fund.

This fund is the first of its kind in India because the fund will buy CERs or carbon credits from companies operating under CDM and sell them to buyers in Europe. Apart from these capital funds, financial institutions and banks are also considering the idea of creating carbon funds going by the number of CDM projects registered from India and the carbon credits it is expected to generate.

**Carbon Trading:** Looking at the bright prospect of the Indian Companies in the international carbon credit market, Rabo India Finance (a wholly owned subsidiary of Rabobank International) has launched a Carbon Credit-Trading product. It will help the companies to buy carbon credits, locate buyers and sell carbon credits to the final buyer. It will also provide a 'credit wrap' *i.e.* a guarantee that will ensure the delivery contracted carbon credits to the overseas buyers. According to a news report, after Chicago Climate Change Exchange and the European Climate Exchange, MCX (Multi Commodity Exchange of India) is likely to be the third exchange in world with a license to trade in carbon credits. The MCX is taking the stride to enter the carbon credit business in a big way and is planning to set up a *sub-registry* for facilitating the carbon trading in a more efficient way.

The Sub-Registry will keep accounts of Certified Emission Reductions Receipts (CERs) issued by

United Nations Framework Classification (UNFC) for Fossil Energy and Mineral Resources for reducing the release of greenhouse gases in the atmosphere. The *Sub-Registry* will act as a trustworthy custodian of CERs. This action will make carbon trading simpler for Indian companies which at present have to sell these receipts of CERs only through UNFC.

In the European spot market, a tonne of the greenhouse gas is priced at around \$8. On the MCX, however, the recently launched carbon credit is being traded at Rs 1,170 a tonne for December, 2007 delivery.

### **Conclusion**

Global climate change is one of the major threats facing the mankind. CO<sub>2</sub> emission resulting from human induced activities and industrialisation is the main cause behind global warming and subsequently global climate change. To become carbon neutral (*i.e.* reducing emission of CO<sub>2</sub> along with other GHGs) several initiatives have already been undertaken at many levels, both national and international. The most prominent amongst which is the Kyoto Protocol, an international agreement setting targets on the companies and Governments to reduce emission levels. Among three mechanisms offered by the Kyoto Protocol, CDM looks to be the most prominent and suitable mechanism (as it is the only mechanism where the developing countries can participate in the protocol and make their bit of contribution towards the mitigation of climate change) for the developing countries like India. CDM projects give Indian companies the opportunity of going green by reducing its carbon footprint and earning carbon credits all together.

India is fast becoming the leading destination for carbon credit projects through CDM. With the increase in the number of projects and enhancement in the company's earnings, confidence and faith in CDM is increasing. India has emerged as the leading player in CDM and one of the largest sellers of carbon credit in the global market. The CDM projects are mainly in the areas of energy efficiency, fuel switching, industry processes, municipal solid wastes and renewable energy.

But complications continue to hinder India's efforts of earning more carbon credits from CDM projects.

However, regardless of all the difficulties and hindrances, India continues to be the leader in the matter of registered CDM projects and its journey to become the leading destination of carbon credit in the world looks quite promising. □

## Enhancing Audit Quality

*Continuing with the observations of the Reviewers noticed during the conduct of Peer review and published in the earlier issues of the journal, for the information of members and to empower them in their day-to-day work, given below are some more observations.*

### Office Systems and Procedures with regard to Compliance of Attestation Services Systems and Procedures

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|---|---|--|
| <ul style="list-style-type: none"> <li>• The Practising Unit (PU) firm has not maintained any register for availability of expertise and/or experienced individuals for consultation.</li> <li>• The PU does not have their own library at the office from where major activities are carried out.</li> <li>• Regular meetings are held at regular intervals for discussing various issues but no records are there in support of it.</li> <li>• Checklists found in the files are not filled in some cases and in other cases filled in part only.</li> <li>• Staff files having necessary information about date of appointment, experience, training programme under-</li> </ul> | <ul style="list-style-type: none"> <li>gone during employment and periodic evaluation of performance, etc. not found.</li> <li>• Register containing the List of Clients which may provide information about the kind of services being rendered to the client among other things not found.</li> <li>• Checklist for Auditing &amp; Assurance Standards, guidance notes, etc. not prepared to ensure compliance with all the standards while performing a particular audit/attestation engagement.</li> <li>• No written guidelines on the responsibility at each level on the expected performance and qualifications necessary for advancement to the next level.</li> <li>• No system to evaluate staff performance on periodical basis.</li> <li>• Working papers of all attes-</li> </ul> | <ul style="list-style-type: none"> <li>tation work have been kept separately which should be kept in audit file of respective clients and such working papers should have formal presentation so that the same can be suitably presented as evidence, if and when required.</li> <li>• Manual for policies and procedures not documented and maintained.</li> <li>• The latest available materials from the Institute on technical standards may be kept in the library.</li> <li>• For the period under review, no appointment letter from the client is seen.</li> <li>• No practice of having discussions with staff and no minutes or register showing the details of the meetings being maintained.</li> <li>• No list or index available showing the classification and comprehensiveness of reference books. □</li> </ul> |
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### Museum of the Institute

Attention of members are invited that it has been decided to have a museum of the Institute which can enable students and members to explore collections for inspiration, learning and enjoyment. You are therefore requested to provide any such item, viz., historic press clippings, mementoes, any document whose heritage needs to be shared with others, classic photographs and ancient paintings related to the Institute and the profession, handicrafts having any link with the culture heritage of our Institute, stamps, video shoots, posters etc, or an item which according to you may be preserved and displayed in the said museum for the inspiration of our coming generations.

In case the material to be sent is delicate/bulky and, thus, needs extra care, you may inform us and the suitable arrangement for collecting the same shall be made.

- President

**ICAI to help CBI in economic offences**

With economic offences seeing an increase, the CBI has written to the Institute of Chartered Accountants of India (ICAI) to probe the growing number of white collar crimes. "The CBI has already written to ICAI to provide expertise as and when required," says the new CBI Director Ashwani Kumar. Now the agency is looking forward to have some chartered accountants who will coordinate with agency officials to probe the entire ramifications of economic offences.

**SEZ firms have to pay tax on domestic services – Ministry**

Indian companies with units in Special Economic Zones (SEZ) will have to pay tax on services they offer to domestic clients, the finance ministry said on Wednesday, 17<sup>th</sup> September, 2008, aimed at checking evasion. India offers tax exemptions to firms based in SEZs as part of efforts to boost exports and attract investment. But some firms are misusing the facility to offer services from their SEZ units to domestic clients. The finance ministry said in a statement companies and developers of SEZ would have to pay tax on services such as supply of manpower, technical testing and analysis to their domestic clients. The service tax, which is charged at 12.36 percent, will be exempted if exported or offered to clients within these tax-free industrial zones.

**New tax course in FY09: CBDT**

The Central Board of Direct Taxes has been re-engineering allocation of its 80% of manpower for putting in place a Consolidated Processing Centre to process income tax returns that will shortly come up in Bangalore followed by other such cities, indicated Member CBDT. Although Union Finance Minister will not make customary budget presentation in February 2009 as it will be an election year and preceded by a vote on account for which date has yet to be finalized, it will execute New Tax Course in fiscal 2008-09 itself to enable businesses remain competitive in India. Announcing this at ASSOCHAM organized 5th International Tax Conference, Member Legal CBDT, Ajai Singh assured Indian Inc. that his Ministry would put in place a simpler new tax course in this fiscal itself to ensure that business remain competitive and cross border disputes are barely referred to jurisprudence for resolution. In the new tax course, the transfer pricing issue would be sorted out in a manner so that level playing field is ensured for multinational corporations operating in India vis-à-vis domestic corporates, said Singh. With proposed tax course in place, a new global transfer pricing strategy would be evolved to satisfy all elements, organizations and concerned stakeholders so that it is resolved for good.

**Cabinet approves changes to Companies Bill, 2008**

The Union Cabinet on Friday 29<sup>th</sup> August, 2008 gave its approval for introduction of the Companies Bill, 2008 in the Parliament to replace the Companies Act, 1956, the existing statute for regulation of companies in the country and considered to be in need of comprehensive revision in view of the changing economic and commercial environment nationally as well as internationally.

Source: <http://pib.nic.in/release/release.asp?relid=42061>

**Record of Company Audit Assignment**

A Chartered Accountant in practice as well as firm of Chartered Accountants in practice shall maintain a record of the audit assignments accepted by him or by the firm of Chartered Accountants, or by any of the partners of the firm in his individual name or as a partner of any other firm, as far as possible. A member of the Institute in practice shall not hold at any time appointment of more than thirty (30) audit assignments of Companies under Section 224 and / or Section 228 of the Companies Act, 1956 and out of thirty the number of audit assignments of public companies each of which has a paid-up share capital of 25 lakhs or more, shall not exceed ten.

**Sportspersons brought under 'Professional Services', to pay more tax**

Sportspersons have been unconditionally brought under the ambit of tax deductions at source (TDS) at a higher rate of 10.3 per cent, with the Central Board of Direct Taxes (CBDT) now categorizing their services in relation to sports activities as 'Professional Services'. The TDS net under Professional Services (Section 194J) has also been cast wide to include umpires and referees, coaches and trainers, team physicians and physiotherapists, event manager, commentators, anchors and sports columnists, official sources said.

Source: Hindu Business Line

**Companies cut conversion price to resolve FCCB tangle**

Foreign Currency Convertible Bonds (FCCB), which in a bull market were seen as a low-cost option for Indian companies to raise funds, are now turning out to be milestones around their necks. Faced with ballooning debt after the stock prices have plunged, companies are trying to sweeten the conversion option by lowering the prices at which FCCB holders can swap their bonds for shares.

Source: Hindu Business Line

### Hedge fund closures rising

The pace of hedge fund liquidations is on track to reach 700 this year, up 24% from the 563 funds that closed in 2007 but below the previous high of 848 shuttered funds in 2005, according to second-quarter data from Hedge Fund Research (HFR). HFR reported that 350 hedge funds closed in the first half of 2008 vs. 305 funds in the first six months of last year. New hedge fund launches totaled 487 in the same period, HFR researchers said in a report. At that pace, 2008 will have the lowest number of new fund debuts since 2001.

Source: <http://www.financialweek.com>

### FASB rule changes may be too little, too late for some

Wall Street may be in a state of shock over the weekend's events. But for the Financial Accounting Standards Board (FASB), it's business as usual. FASB was already working on issues that very much relate to the current crisis on Wall Street. For instance, on Friday, 12<sup>th</sup> September, 2008 the board released amendments to FAS 133 regarding accounting for credit derivative instruments and hedging activities. That change will require greater financial disclosure from sellers of credit default swaps for reporting periods ending after Nov. 15. The premise for the amendment to FAS 133 goes back to March, when the board issued FAS 161, which was intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance and cash flows.

Source: <http://www.financialweek.com>

### IFAC's IPSASB Proposes Modifications to Borrowing Cost Accounting

The International Public Sector Accounting Standards Board (IPSASB), an independent standard-setting board within the International Federation of Accountants (IFAC), is seeking comments on its proposed changes to IPSAS 5, *Borrowing Costs*, set forth in exposure draft (ED) 35, *Borrowing Costs (Revised 200X)*. Most notably, ED 35 proposes amendments to reflect that in many circumstances the capitalization of borrowing costs as part of the cost of an asset is not appropriate for public sector entities. This view, a departure from both IPSAS 5 and International Accounting Standards Board's International Accounting Standard 23, *Borrowing Costs*, is an evolution from public sector consideration of the issue. The ED proposes that entities recognize borrowing-related expenses, such as interest or loan origination fees, during the period in which they are incurred. The ED also proposes, however, that where entities borrow funds specifically to acquire, construct or produce a qualifying asset, the entity has the option to capitalize those costs as part of the cost of that asset.

Source: [www.ifac.org](http://www.ifac.org)

### 2010 World Congress of Accountants

More than 6000 international business leaders are expected to attend the four-day 2010 World Congress of Accountants (WCOA) from Saturday 8 to Tuesday 11 November in Kuala Lumpur. CPA Australia division was announced as one of three gold sponsors of the event at a recent International Federation of Accountants (IFAC) board dinner in Malaysia. The announcement further strengthens the relationship between CPA Australia and the Malaysian Institute of Accountants (MIA), who are part organisers of the event. CPA Australia Malaysia division has more than 8200 members and is an active participant of IFAC in developing the accounting profession in the Asia-Pacific region.

Source: [www.cpaaustralia.com.au](http://www.cpaaustralia.com.au)

### IRS Taxpayer Privacy Protection a 'Work in Progress'

The Internal Revenue Services still has problems with protecting the privacy of taxpayers' personally identifiable information on the printed documents it mails, according to a new report. The report, from the Treasury Department's inspector general, calls the protection effort a "work in progress." The IRS ships packages primarily via the U.S. Postal Service and the United Parcel Service. In fiscal year 2007, the IRS sent over 150 million pieces of mail to taxpayers through the postal service and more than 3 million packages via UPS. The report recommends that the IRS modify some of its processes and expand a study of shipping procedures that it has planned. The IRS indeed has several initiatives underway to improve its handling of hardcopy taxpayer information and IRS management generally agreed with TIGTA's recommendations.

Source: [www.webspa.com](http://www.webspa.com)

### **SEC Wants More Fair Value Disclosures**

The Securities and Exchange Commission has issued an addendum to an earlier letter it has sent to the CFOs of some public companies asking them to provide additional information about their fair value measurements, including credit risks and broker quotes. The new letter, which the SEC sent on September 16, supplements a letter, the commission sent back in March that identified various disclosure issues that CFOs should consider when preparing the Management's Discussion and Analysis section of their 10-Q quarterly reports. The additional items come in response to suggestions the SEC received at its recent public roundtables, but others seem to be in response to the expanding credit crisis. The March letter primarily went to the CFOs of financial institutions, but according to the Center for Audit Quality, the SEC has indicated the new letter is going to a wider variety of organizations.

Source: [www.webspa.com](http://www.webspa.com)

### **SEC Charges Pasta Executives with Accounting Fraud**

The Securities and Exchange Commission charged American Italian Pasta Co. and its former senior executives with participating in a fraudulent accounting scheme to artificially increase the company's stock price.

Source: [www.webspa.com](http://www.webspa.com)

### **IASB provides update on response to the credit crisis, issues draft report from expert advisory panel**

The IASB on 16<sup>th</sup> September, 2008 has released an update on a range of projects that collectively address issues highlighted by the current dislocation in credit markets, commonly referred to as the credit crisis. It has also published a draft report of the discussions of the expert advisory panel set up by the IASB to consider the application of fair value when markets are no longer active.

Source: [www.iasb.org](http://www.iasb.org)

### **IASB and FASB publish update to 2006 Memorandum of Understanding**

The IASB and the US Financial Accounting Standards Board (FASB) on 11 September 2008 published an update of their 2006 Memorandum of Understanding (MoU). The boards are issuing this update to report the progress they have made since 2006 and to set the goal of completing their major joint projects by 2011. In giving a report of the progress of projects laid out in the MoU, the boards have again affirmed their commitment to developing a common set of high quality standards. Each believes that such standards would improve the quality, consistency and comparability of financial information for investors and capital markets around the world.

Source: [www.iasb.org](http://www.iasb.org)

### **ASBJ and IASB meet to review progress in achieving convergence in accounting standards**

The Accounting Standards Board of Japan (ASBJ) and the International Accounting Standards Board (IASB) have held their eighth meeting in London to accelerate convergence between Japanese generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRSs). Representatives of the ASBJ explained the progress of the items listed in its project plan of December 2007 based on the Tokyo Agreement. Those present confirmed that the convergence project to eliminate major differences between Japanese GAAP and IFRSs in use (as defined by the July 2005 CESR assessment of equivalence) by the end of 2008 is progressing in line with the project plan. In addition, the representatives of the ASBJ described its continuous effort towards convergence in the light of the IASB's work plan.

Source: [www.iasb.org](http://www.iasb.org)

### **PIOB Issues Third Report on Public Interest Oversight**

The Public Interest Oversight Board (PIOB) has issued its third public report on its independent oversight of IFAC's public interest activities, including international standard setting for auditing, ethics and education, and the Member Body Compliance Program. The full report, which summarizes the PIOB's activities during the past year, is available on its website: [www.piob.org](http://www.piob.org).

Source: [www.ifac.org](http://www.ifac.org)

### **CFA Institute advocates 'IFRS convergence'**

CFA Institute, the global association of investment professionals, has identified six initiatives from the final report of the SEC's Advisory Committee on Improvements to Financial Reporting (CIFiR) that it will focus on to further advance the investor perspective. The six initiatives on which the CFA Institute will focus are: i. Joint Financial Statement Presentation Project, ii) IFRS Convergence, iii) XBRL, iv) Key Performance Indicators (KPIs), v) Quarterly Press Releases, vi) Websites and Summaries.

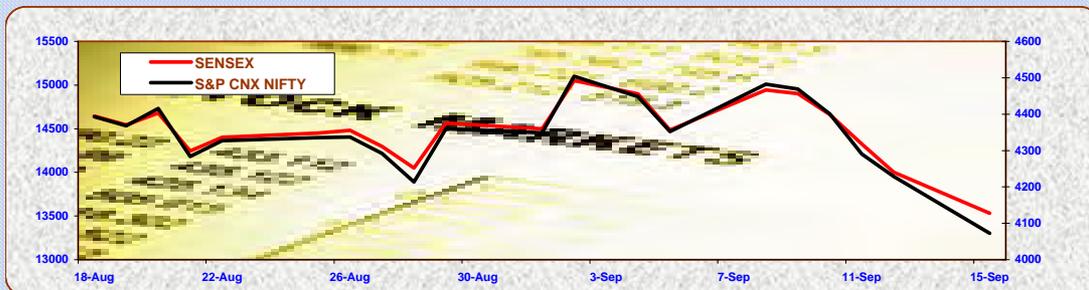
Source: [www.iasplus.com](http://www.iasplus.com)

### **CEBS advice to EC on liquidity risk management**

The Committee of European Banking Supervisors has submitted to the European Commission the second part of its advice on liquidity risk management. The advice consists of an analysis of specific issues listed by the Commission and challenges not currently addressed in the EEA and includes 30 recommendations.

Source: [www.iasplus.com](http://www.iasplus.com)

## Economic Indicators



## Selected Indicators

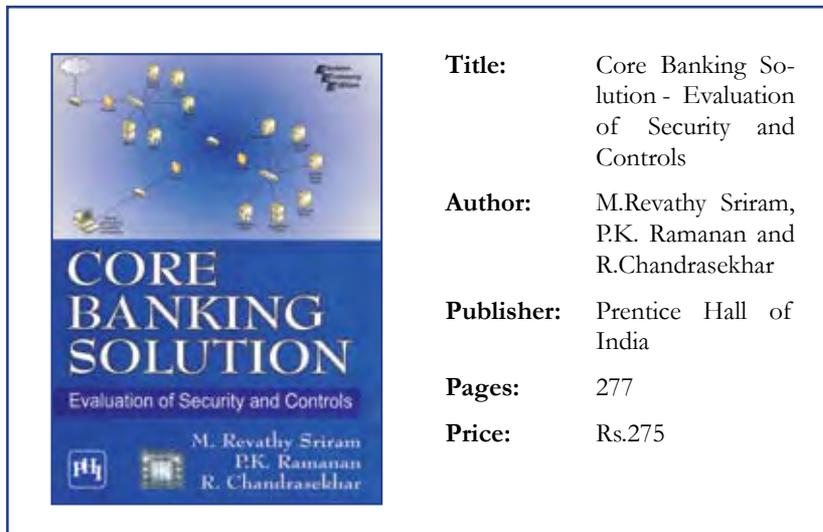
Item	Unit/Base	2007	2008					
		Aug. 31	Jul. 25	Aug. 1	Aug. 8	Aug. 15	Aug. 22	Aug. 29
Cash Reserve Ratio	per cent	7.00	8.75	8.75	8.75	8.75	8.75	8.75
Bank Rate	Per cent per annum	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Prime Lending Rate	Per cent per annum	12.75-13.25	12.75-13.25	12.75-13.25	12.75-13.25	13.25-14.00	13.25-14.00	13.25-14.00
Deposit Rate	Per cent per annum	8.00-9.50	8.75-9.50	8.75-9.50	8.75-9.75	8.75-9.75	8.75-10.00	8.75-10.00
Call Money Rate (Low/High)	Per cent per annum	2.50/8.40	5.80/10.25	4.00/9.40	7.25/9.50	6.00/9.50	7.75/11.50	4.55/10.04

Readers are Invited to contribute write-ups or any relevant and interesting piece of information for this feature at [ebboard@icai.org](mailto:ebboard@icai.org).

## CORE BANKING SOLUTION EVALUATION OF SECURITY & CONTROLS

The 277 page book is a brave attempt to make concise, a new topic of Core Banking to address multi dimensional curiosity of the multitudes. Appropriately, the book is divided into two sections as represented on the cover. In the first section, the reader is taken in a whirlwind tour to introduce him to various elements of core banking such as Technology behind Core banking, various administrative requirements and policies. In the second section, the reader is shown how to evaluate the controls.

Some charts like ATM network gives a birds eye view of the complex mechanism of ‘clearing’ needed in ATM transactions. The technical intricacies of ATM operations are described to a level that should give any auditor confidence if appropriately followed by the Bank being audited. Fig 8.1 shows a flow chart for allotment of ATM card and PIN number to the customer. Perhaps the authors did not verify the popular and more secure procedures of Indian Banks of delivering only one element of the ATM entitlement to the account holder –either the card or the PIN number while the other is delivered at the Branch. Three chapters namely 17, 18 and 19 discussing the evaluation methodology of controls of operating system, modules of core Banking and ATM operations are appreciable attempts to make the reader presumably an auditor to roll up his sleeves and attempt the technical job of ‘testing’ without any extra knowl-



<b>Title:</b>	Core Banking Solution - Evaluation of Security and Controls
<b>Author:</b>	M.Revathy Sriram, P.K. Ramanan and R.Chandrasekhar
<b>Publisher:</b>	Prentice Hall of India
<b>Pages:</b>	277
<b>Price:</b>	Rs.275

edge or expertise!

This whirlwind tour akin to a group tour, only whets the appetite and does not satisfy the serious reader. Policies are mentioned by the title and only a single line or two is invested to describe it. Serious readers would have loved to see sample policy for a better perspective. At one place, the authors mentioned Disposal of media describing ‘paper shredders’ and users leaving their seat. Under Core Banking, use of paper is severely reduced. Care during disposal of old hardware and media is left unanswered. Even the topic of ‘Secure disposal of equipment’ mentions the care to be taken to have back-up but leaves the question of security unanswered as the purchaser walks away with the data of the Bank!

The book is sprinkled with limited discussion on various matrices and

tables which are popularized by an international training body. More relevant instructions of Reserve Bank of India are mentioned to a limited extent. Readers who are Bankers would have appreciated if these instructions were central theme of the book. Network security is the new vulnerable area which is covered in a separate chapter. The reader is exposed to what seems like an extract from a submitted report which is a practical exposure but absence of discussion removes the practicality achieved so far.

All in all, this book is on a rare subject. Those wishing to know about the subject and do not know who to ask, should take this book as their first step in understanding of the subject.

**Book reviewed by – CA. Nitant Trilokekar. He can be reached at [nitanttrilokekar@yahoo.com](mailto:nitanttrilokekar@yahoo.com)**

## CORPORATE GOVERNANCE: CHALLENGES & NECESSITY FOR EMERGING INDIA

Governance can be defined as the process and structure used to direct and manage the business and affairs of an organisation with the goals of ensuring its financial viability and enhancing stakeholder value. The corporate scandals in US, governance-related problems in a number of European organisations and consequential fallout of corporations, have contributed to the steady growth of awareness of corporate governance and its role in the global economy.

In this context, the book *Corporate Governance-Challenges & Necessity for Emerging India* will help the shareholders, managers, directors and other stakeholders of an organization to objectively assess and compare various corporate governance practices prevalent in India. Author CA. Bimal R. Bhatt, in his book on corporate governance, has tried to trace Indian history by going back to Vedic era, pre- and post-liberalisation to the time where India has become a part of global economy and expressed his deep concern for maintaining a balance between society, ethics and economics.

The author begins with identifying some of the core corporate values in India by providing citations of their vision and mission statements. He discusses the concept of corporate governance drawing references from SEBI's clause 49 of listing agreement and most of the chapters are woven around the requirements as underlined in the clause. The book contains a detailed discussion on the clauses ranging from board of directors, audit committee, management discussion and analysis to require-



**Title:** Corporate Governance: Challenges & Necessity for Emerging India  
**Author:** Bimal R. Bhatt  
**Publisher:** Hitakakadi Inc., Baroda  
**Pages:** 512  
**Price:** Rs.695

ment on adherence to accounting standards and disclosures, supplemented with examples from select companies and ends with the author's analysis and conclusion. The author has made an attempt to highlight the need of corporate governance rating and detailing the parameters, which are considered by institutions like ICRA and CRISIL, for rating corporations on their governance and value-creation attempts. The author has cited some examples of investor education and code of conduct, which may serve as a practice guide for stakeholders and ultimately to the management. Also, he stresses on the role of the Statutory Auditors relating to the reporting under Companies (Auditor's Report) Order (CARO) 2003. The author has made a worthy attempt to involve readers by asking them to grade their ethical and governance practices against a checklist that may help them in evaluating: *How ethical they are? How good is their governance practice?*

The author could have attempted to underline the emerging role of professionals like Chartered Ac-

countants, in helping corporations to implement best practices in governance and reaping the benefits thereon. Also an elaborate discussion needed on issues like third party accountability is gaining momentum these days, where role of auditors, valuers, lawyers, etc., have an important role in assisting the board of directors in discharging their responsibilities. Also, areas such as governance concerns in family-based business, changing face of the board (key issues faced), improving effectiveness of audit committee and similar practical issues of present time could have been discussed in the book.

Overall, it's a good compilation of definitions, circulars, checklists, examples, references, quotes, etc., which are comprehensive and will be of interest to students and beginners on the subject of corporate governance in the Indian context.

**Book reviewed by – CA. Harinderjit Singh, Central Council Member and Chairman, Auditing and Assurance Standards Board of the ICAI. He can be reached at [hsingh@icai.org](mailto:hsingh@icai.org)**

## ACCOUNTANT'S BROWSER

**“PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE”**

Index of some useful articles taken from Periodicals/Newspapers received during August-September 2008 for the reference of Faculty/Students & Members of the Institute.

### 1. ACCOUNTING

Accounting Standards Applicable to Small Medium Sized Companies (SMCs) – Brief Compilation by Pramod Kedia & Subodh Kedia. *ACAJ*, July 2008, pp. 243-261.

Compliance of Accounting Standard 2 – Inventory Valuation by L. Venkatesan. *The Management Accountant*, August 2008, pp. 592-593.

Excellence in Communication! Advance Persuasion Skills for Accountants by Demetris Stylianides. *Accountancy Cyprus*, June 2008, pp.62-64.

Gaps in GAAP – Accounting for MAT Credit by Dolphy D'Souza. *BCAJ*, August 2008, pp.615-641.

Improvement to International Financial Reporting Standards, 2008 – Part 1 by Yiannis Leonidou Deloitte. *Accountancy Cyprus*, June 2008, pp. 46-52.

Should Executive Options be Expensed? by Joshua Ronen. *Journal of Accounting Auditing & Finance*, Summer 2008, pp.437-470.

Voluntary Disclosure of Advertising Expenditures by Ana Simpson. *Journal of Accounting Auditing & Finance*, Summer 2008, pp. 403-436.

### 2. AUDITING

Auditors' Liability Conundrum by ICAEW. *Accountancy*, August 2008, pp. 112-113.

What Do We Mean by an Assurance Statement? *Assure View* 2008, pp.6-8.

### 3. ECONOMICS

Asset-liability Management in Banks – A study of maturity gap analysis for measuring interest rate risk in Banks by C.P. Mall & Shalini Srivastava. *Banking Finance*, August 2008, pp.18-24.

Global Financial Turbulence & Financial Sector in India: A Practitioner's Perspective by Y.V. Reddy. *RBI Bulletin*, August 2008, pp. 1407-1420.

Monetary & Regulatory Policies: How to Get the Balance with Markets Right by Y.V. Reddy. *RBI Bulletin*, August 2008, pp. 1403-1406.

### 4. INVESTMENT

Analysts' Heterogeneous Earnings Fore-

casts & Stock Recommendations by Steven Lustgarten & Charles Tang. *Journal of Accounting Auditing & Finance*, Summer 2008, pp.377-401.

Delisting of Shares by Pranjita Barman. *CLA* (2), 2008, pp. 66-71.

Forensic & Valuation Services: How Reasonable is Your Royalty? Glenn S. Newman etc. *Journal of Accountancy*, September 2008, pp.56-66.

### 5. LAW

Amalgamation of an Indian Company & an Overseas Company by K.R. Chandratre. *Chartered Secretary*, August 2008, pp.1063-1066.

Competition Laws & Regulatory Mechanism in India – An Interface by Dibyojyoti Sarkar. SEBI & *Corporate Laws*, August 18- August 24, 2008, pp. 12-22.

Entry of Foreign Law Firms by Vikrant Pachnanda. *Company Law Journal*, Vol. 3, 2008, pp. 71-79.

### 6. MANAGEMENT

Best Cities for Business. *Business Today*, September, 7, 2008, pp. 70-74.

Control Self Assessment – A Case Study by Deepjee Singhal & Manish Pipalia. *BCAJ*, August 2008, pp.621-622.

Deficient Public Infrastructure & Private Costs: Evidence for the Water Sector by Lekha S. Chakraborty. *Eco. & Pol. Weekly*, August 2, 2008, pp.65-69.

Developing a CRM Strategy in your Firm by Walfried M. Lassar etc. *Journal of Accountancy*, August 2008, pp. 68-73.

Fighting for Talent by Cesar Bacani. *CFO Asia*, September 2008, pp.16-21.

Identity Management Collaborative & Continuous by Mark Dunn. *Accountancy SA*, August 2008, pp.30-31.

Leadership Role of the Chairman a Thought Leadership Issue by Roy Andersen. *Accountancy SA*, August 2008, pp.20-21.

Managing Corporate Divestiture Transactions by William J. Gole & Paul J. Hilger. *Journal of Accountancy*, August 2008, pp.48-51.

Ownership Structure & the Private Benefits of Control: An Analysis of Chinese

firms by He Weifeng etc. *Corporate Governance*, Vol.8/3, 2008, pp. 286-298.

Perspective of Professional Management Education by Ishwar Dayal. *Paradigm*, January-June 2008, pp.1-4.

Strategic Competitive Advantages & Value Net Organisation: Conceptual Considerations & Organisational Recommendations for two-or multi-sides Service Markets by Helmut Dietl. *Paradigm*, January-June 2008, pp.5-11.

Three Conceptual Models of Board Role Performance by C.H. Ong & David Wan. *Corporate Governance*, Vol.8/3, 2008, pp.317-329.

### 7. TAXATION & FINANCE

Are non-profit making organisations liable to service tax? Sagar Shah. *PCAS Journal*, July 2008, pp.74-81.

Can an Educational Institution Address itself to Concerns other than Education? by K. Srinivasan. *Corporate Law Adviser*, Vol.85, 2008, pp.33-38.

Circumstances Under Which Penalty can be Avoided/ Reduced in Service Tax – Opus Media Entertainment's Case is an Example by R. Muralidharan. *Service Tax Journal*, August (2nd) 2008, pp.73-78.

Effectiveness of Publicity Campaign on Value Added Tax in India by R. Sthanumoorthy. *International Vat Monitor*, July-August, 2008, pp.275-280.

International Tax Considerations by Pieter L. de Ridder & Josine S.A. Van Wanrooij. *Asia-Pacific Tax Bulletin*, July-August 2008, pp.293-295.

New Scheme of Assessment in Case of Search or Requisition on or After 1st June, 2003 by Sunil H. Talati. *ACAJ*, July, 2008, pp. 234-242.

Recent Trends in Revenue Generation by Hardayal Singh. *BCAJ*, August 2008, pp.557-562.

Remittance of Unlawfully Charged VAT Under EU Law by Joep J.P. Swinkels. *International Vat Monitor*, July-August 2008, pp. 253-261.

Taxation of Foreign Enterprises by William Chan etc. *Asia-Pacific Tax Bulletin*, July-August 2008, pp. 281-292. □

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](mailto:library@icai.org)



CA. Ved Jain, President, ICAI in a meeting with Chief Minister of Delhi Smt. Sheila Dikshit on September 9, 2008, offered consultancy in the Public Finance including Fiscal Management of the State Government. CA. Subodh Kumar Agrawal, Chairman, Committee on Public Finance, and other Council Members CA. Vinod Jain, CA. Vijay Gupta and CA. J.N. Shah were also present in the meeting.

CA. Ved Jain, President ICAI, giving presentation on *Doing Business in India- Legal & Regulatory Perspective*, an event organised by London Society of Chartered Accountants, ICAEW.



The Chief Minister of Goa, Mr. Digamber Kamat in a Meeting with ICAI officials. Seated from Left to Right are: CA. Gautam Verlekar, Chairman, Goa Branch; CA. K. Raghu, Chairman, CPE Committee; CA. Ved Jain, President, ICAI; CA. Uttam Prakash Agarwal, Vice-President, ICAI; and CA. Preeti Mahatme, Central Council Member.

## International Conference on “Accounting Profession: Shining Bridge between Global Economies” at Jaipur

Organised by International Affairs Committee  
Jointly Hosted by : Jaipur Branch of CIRC and NIRC

### Theme

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

Date & Time	Venue	CPE Hour
20-22 November, 2008 9:30 AM -5:30 PM	Birla Auditorium, Jaipur	18 hrs

### Discussion Sessions

- Session I: Changing Dimensions of Accounting and Reporting :Issues and Strategies
- Session II: Adapting to Emerging International Horizons
- Session III: BFSI Sector and Accountancy Profession
- Session IV: Harmonisation of Profession Beyond Frontiers
- Session V: Auditing- Adding Value to Governance
- Session VI: IFRS: Preparing Industry for Compliance
- Session VII: Leveraging Information Technology: For Better Tomorrow
- Session VIII: Contemporary Issues
- Session IX: Landscaping Indian Financial Sector on Global Canvas
- Panel Discussion: Stakeholder Promotion in growing equity cult era

### REGISTRATION DETAILS

Category	Up to 20th October, 2008	After 20th October, 2008
Member FCA	Rs. 2700	Rs. 3200
Member ACA	Rs. 2500	Rs. 3000
CA Student	Rs. 2000	Rs. 2500
*Accompanying Person	Rs. 1000	Rs. 1500
*Children (Above 5 years)	Rs. 750	Rs. 1250
Corporate Delegate	Rs. 5000	Rs. 5000
Foreign Delegate	US\$ 200	US\$ 200

### Contact Persons and Contact details

- CA Vjiay Garg, Central Council Member, Conference Director
  - CA Sudhir Bhansali, Chairman CIRC (+91-9413801080)
  - CA Sudhir Agarwal, Chairman NIRC (+91-9811021049)
  - CA Pawan Parashar, Chairman Jaipur Branch (+91-9828022660)
  - Sanjay Goel Incharge, Jaipur Branch (+91-9352995574)
- Ph: +91-141-3989398,3044203,3044200 (ICAI – Jaipur) Fax: :+91-141-3044215  
jaipurinternationalconference@gmail.com
- www.icai.org

## Diamond Jubilee Seminar on Emerging Paradigm for Accountants at Agra Organised by Committee on Trade Laws and WTO

### Theme

Diamond Jubilee Seminar on Emerging Paradigm for Accountants being organized by Committee on Trade Laws and WTO and hosted by Agra Branch of CIRC of the Institute of Chartered Accountants of India at ICAI Bhawan, Akbara Road, Artoni, AGRA

### Date & Time

Thursday, 2nd October, 2008 (09.30 hrs. to 17.45 hrs.)

### Venue

ICAI Bhawan, Akbara Road, Artoni, AGRA

### CPE Hours

6 Hours for the Members of the ICAI

### Inaugural Address: CA. Uttam Prakash Agarwal, Vice President ICAI

### Topics to be Discussed

### Speakers

Networking, Merger, Demergers of CA Firms and Code of Ethics – Challenges & Opportunities before the Profession

CA. Amarjit Chopra

Professional Opportunities for Chartered Accountants in International Trade Laws and WTO

CA. Anuj Goyal

Direct Tax Issues - International Taxation & Tax Planning (FBT/TDS etc.)

CA. Girish Ahuja

Motivation and Communication Skills

Mr. Mradul Tandon

**Fees:** Members : Rs.500/-; Non Members Rs. 1000/-.(Rs. NIL for the contributories of the members meeting fund of Agra Branch) - Payment may be made by Cheque / Demand Draft in favour of “Agra Branch of CIRC of The Institute of Chartered Accountants of India” payable at Agra.

### CONTACT DETAILS

#### Seminar Chairman & Chairman, Committee on Trade Laws & WTO:

□ CA. Anuj Goyal, Central Council Member & Chairman, Committee on Trade Laws & WTO, ICAI (Mobile No: 9810041371, 093122 58364)

#### Seminar Coordinator:

□ CA. Sandeep Kapoor, Chairman, Agra Branch of CIRC of the ICAI (Mobile: 09412254238)

#### For registration and further details, please contact:

□ Agra Branch of CIRC of the Institute of Chartered Accountants of India, 77, M. K. Tower, 1st Floor, Sanjay Place, AGRA – 282002. Ph. No. 0562-2856598, 4040598, Email: [agra@icai.org](mailto:agra@icai.org); [sandeepkushagra@gmail.com](mailto:sandeepkushagra@gmail.com); [icaiaagra@gmail.com](mailto:icaiaagra@gmail.com)

□ Secretariat of Committee on Trade Laws and WTO, The Institute of Chartered Accountants of India, ICAI Bhawan, PO Box 7100, I P Marg, New Delhi – 110002. Ph: 011 – 30110499, 39893989 (Extn. 499), 09350571873, Email: [ctlwto@icai.org](mailto:ctlwto@icai.org); Website: <http://www.icai.org>

## Workshop on

## International Financial Reporting Standards (IFRS)

Organised by Continuing Professional Education Committee & Hosted by Hyderabad Branch of SIRC of ICAI

### Date

Friday & Saturday, 24<sup>th</sup> & 25<sup>th</sup>  
October 2008

### Venue

Hotel Fortune, Katriya Towers, Near  
Yashoda Hospital, Somajiguda, Hyderabad

### CPE Credit Hours

12 Hours

#### Technical Session I

Introduction to IFRS - Conceptual Framework, Convergence with IFRS - ASB's Progress and Plans

#### Technical Session II

Challenges in adoption of IFRS, First Time Adoption of IFRS, Issues in Change over to IFRS

#### Technical Session III

IAS 1 - Presentation of Financial Statements, IAS 2 - Inventories, IAS 7 - Cash Flow Statements

#### Technical Session IV

IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors, IAS 10 - Events after the Balance Sheet Date, IAS 19 - Employee Benefits

#### Technical Session V

IAS 16 - Property, Plant and Equipment, IAS 38 - Intangible Assets, IAS 23 - Borrowing Costs

#### Technical Session VI

IAS 37 - Provisions, Contingent Liabilities and Contingent Assets, IAS 12 - Income Taxes, IAS 18 - Revenue

#### Technical Session VII

IAS 11 - Construction Contracts, IAS 33 - Earnings Per Share, IAS 24 - Related Party Disclosures

**Eminent speakers who are experts in this field would address in this Workshop.**

**Fees:** Members : Rs. 2,500/- , Non-Members : Rs. 3,000/-

Cheque/DD to be drawn in favour of “Hyderabad Branch of SIRC of ICAP” payable at Hyderabad and should be sent to: Hyderabad Branch of SIRC of ICAI, “ICAI Bhawan”, 11-5-398/C, Red Hills, HYDERABAD – 500 004.

### Contact Persons and Contact Details

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Workshop Chairman  
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CA. J. Venkateswarlu  
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Workshop Director  
E-Mail: [jv9009@hotmail.com](mailto:jv9009@hotmail.com)

CA. B. Chakrapani  
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E-Mail: [bchakrapani@yahoo.com](mailto:bchakrapani@yahoo.com)

## EVENTS ORGANISED BY THE COMMITTEE ON INTERNAL AUDIT

<b>Workshops on Due Diligence</b>	
<b>Objectives</b>	These proposed workshops may be helpful for the professional advisors. This would help them to know what information is needed for due diligence, where and how to get it.
<b>Date</b>	<b>18 and 19<sup>th</sup> November, 2008</b>
<b>Proposed Locations</b>	New Delhi, Mumbai, Kolkata, Chennai and other major cities
<b>Venue</b>	Venue of the workshops are being finalised and would be announced shortly
<b>Topics be Discussed*</b>	
1. Approach to Due Diligence	4. Due Diligence for Franchisee Arrangements
2. Due Diligence for Mergers and Acquisitions	5. Challenges and Risks Covered in Due Diligence Process
3. Due Diligence for Venture Capital Investments	6. Work Approach for Due Diligence
<b>CPE Hours: 12 Hours</b>	<b>Fees: Rs 5,000/-.</b>
<b>Workshops on Concurrent Audit of Banks</b>	
<b>Objectives</b>	The Committee on Internal Audit is planning to launch the workshops on Concurrent Audit of Banks with a view to provide guidance on significant issues involved in concurrent audit of banks to the members and others.
<b>Date</b>	<b>1<sup>st</sup> week of the December 2008</b> (Exact date and time of the workshops are being finalised and would be announced shortly)
<b>Proposed Locations</b>	New Delhi, Mumbai, Kolkata, Chennai and other major cities
<b>Venue</b>	Venue of the workshops are being finalised and would be announced shortly
<b>Topics to be Discussed*</b>	
<ul style="list-style-type: none"> <li>• Understanding the Banking Business and its Legal Framework- Evaluation of Banking Institutions, Organizational and Operational Structure of Banks, Internal Control through Inspection and Internal Audit, Legal Framework</li> <li>• Domain of Concurrent Audit- Evolution of Concurrent Audit in Banks, General Guidelines on Concurrent Audit, Concurrent Audit Procedures covering Advances, Deposits, KYC, Housekeeping, Compliances, Investments, Forex etc.</li> <li>• General Guide on Inspection audit, Revenue audit, Stock and Debtors audit, DP audit, Risk based audit</li> </ul>	
<b>CPE Hours : 12 Hours</b>	<b>Fees: Rs. 3500/-</b>
<b>50 hours Training Programmes on Internal Audit</b>	
<b>Objectives</b>	Having regard to the increasing role of internal audit in promoting and supporting sound governance practices in the corporate world, it is proposed to conduct specialized Training Programmes on internal audit.
<b>Date</b>	<b>19<sup>th</sup> November, 2008</b>
<b>Proposed Locations</b>	New Delhi, Mumbai, Kolkata, Chennai and other major cities
<b>Venue</b>	Venue of the training programmes are being finalised and would be announced shortly.

<b>Topics to be Discussed*</b>	
1. Evolution of internal auditing: past, present and future - Legal Framework for internal audit, Relationship between financial, operational, management, performance, and other audits, Significance of professional standards and code of ethics 2. Standards on Internal Audit 3. Managing internal audit activity	4. Risk analysis and management; Risk based Internal Audit 5. Internal Control Framework – Understanding and Evaluation 6. Internal Audit of specific functions 7. Specialized internal audit – due diligence; investigation; fraud detection; concurrent audit. 8. Internal ssauditor and corporate governance
<b>CPE Hours :To be announced later</b>	<b>Fees: Rs. 15,000/-</b>
<b>CONTACT PERSON AND CONTACT DETAILS:</b> Secretary, Committee on Internal Audit, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box. No. 36, C-1, Sector-1, Noida-201301 Phone: (0120) 3054845, E-mail: <a href="mailto:cia@icai.in">cia@icai.in</a> , <a href="mailto:auditing@icai.in">auditing@icai.in</a>	
<b>* Speakers are being finalised and would be announced shortly.</b>	

<b>Workshop on “Economic &amp; Commercial Laws” at Ahmedabad</b> <b>Organised by Committee on Economic &amp; Commercial Laws</b> <b>Hosted by Ahmedabad Branch of WIRC of ICAI</b>		
<b>Theme</b> The workshop will provide an overview and insight into the Professional Opportunites in various Economic & Commercial laws for the benefit of the members.		
Date & Time	Venue	CPE Hours
18 <sup>th</sup> October and 19 <sup>th</sup> October 2008 Time 9 A.M to 6.15 P.M	Shantinath Hall, Ahmedabad Branch of WIRC of ICAI, ICAI Bhawan,123, Sardar Patel Colony, Naranpura, Ahmedabad – 380 014.	12 Hours
Topics to be Discussed		Speakers
Renewable Energy and Carbon Credit Trading Part-I		CA. Rajkumar Adukia
Private Equity Funding – Legal Aspects		CA. Anup Shah
Challenges in Mergers & Acquisition		Shri Nitin Potdar
ESOPs and Sweat Equity		CA. Anup Shah
Renewable Energy and Carbon Credit Trading Part- II		CA. Pradip K. Modi
Due Diligence for Commercial Exercise		CA. Sanjeev Shah
Commodity Exchange – Challenges & Opportunities		Leading officers from Multiple Commodity Exchange,Ahmedabad
Legal Drafting & Conveyance		Eminent speaker will address
<b>Fees:</b> Rs 1,500/- for Members, Rs. 1,000/- for Students and Rs. 2,000/- for Non-Members		
Contact Persons and Contact Details		
<ul style="list-style-type: none"> <li>• CA. Rajkumar S. Adukia,Chairman, CECL, 9820061049, 9323061049, <a href="mailto:rajkumarfca@gmail.com">rajkumarfca@gmail.com</a></li> <li>• CA. Parag R. Raval, 98243 39200, <a href="mailto:parag@gkcco.com">parag@gkcco.com</a></li> <li>• CA. B.M. Agarwal, Chairman-WIRC, 98201 88573, <a href="mailto:brij@bnmca.com">brij@bnmca.com</a></li> <li>• CA. Yamal A. Vyas, Chairman, Ahmedabad Branch, 98253 11777, <a href="mailto:yamalavyas@yahoo.com">yamalavyas@yahoo.com</a></li> </ul>		

## Seminar on Enriching Knowledge and Maintaining Excellence

Date	Venue	CPE Credit
17 <sup>th</sup> October 2008	Hotel Crown Plaza, New Friends Colony, New Delhi	6 hours
<b>Discussion Sessions</b>	<ul style="list-style-type: none"> <li>• IFRS: Managing Transition</li> <li>• Role of Professionals in Sustainability and Carbon Credits</li> <li>• Role of CFOs in Enterprise Risk Management &amp; Corporate Governance</li> <li>• Corporate Structuring For Value Creation and Growth</li> </ul>	
<b>Resource Persons</b>	Eminent Speakers will address the Seminar	
<b>Fees</b> ICAI Members - Rs.1,500/- , Non-Members - Rs.1,800/-, Members of NIRC Study Groups – Rs.1,250/- Fees payable by DD/Cheque in favor of Secretary, ICAI payable at Delhi/New Delhi and send it to Dr. Surinder Pal, Secretary, Committee for Members in Industry, The Institute of Chartered Accountants of India, "ICAI Bhawan", Indraprastha Marg, New Delhi – 110 002. For further information logon to <a href="http://www.icaai.org.in">www.icaai.org.in</a> ; <a href="http://www.cmii.icaai.org">www.cmii.icaai.org</a>		
<b>CONTACT DETAILS</b>		
<b>Programme Chairman</b>	CA. Sanjeev Maheshwari, Chairman, Committee for Members in Industry Mob. 098211 19043, Email: <a href="mailto:casanjeevmaheshwari@gmail.com">casanjeevmaheshwari@gmail.com</a>	
<b>Programme Director</b>	CA. Harinderjit Singh, Member, Committee for Members in Industry Email: <a href="mailto:harinderjit.singh@in.pwc.com">harinderjit.singh@in.pwc.com</a>  CA. Sudhir Kumar Agarwal, Chairman, Northern India Regional Council, Mob: 98110 21049, Email: <a href="mailto:sudhiricaai@yahoo.com">sudhiricaai@yahoo.com</a>	
<b>Programme Coordinator</b>	Dr. Surinder Pal, Secretary, Committee for Members in Industry The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No.7100, Indraprastha Marg, New Delhi – 110 002, Ph. 011-30110442; Fax N. 011-30110583, Email: <a href="mailto:spal@icaai.in">spal@icaai.in</a> ; <a href="mailto:cmii@icaai.in">cmii@icaai.in</a>	

## Conclave of Accounting & Auditing Professionals at Pune

*Organised by: Auditing and Assurance Standards Board*

*Hosted by: Pune Branch of WIRC of ICAI.*

Date	Venue	CPE Hours
Friday, 10 <sup>th</sup> October, 2008	Hotel Sagar Plaza, 001, Bund Garden Road, Pune – 411 001	6 Hours
<b>Topics to be discussed</b>		<b>Speakers</b>
Convergence of Indian Auditing and Assurance Standards with International Auditing Standards		CA. Harinderjit Singh, Chairman, AASB
Risk Based Audits – Recent Trends		CA. Khurshed Pastakia
Challenges in adoption of IFRS, First Time Adoption of IFRS, Issues in Change over to IFRS		CA. Shrenik Baid
IAS 39 - Financial Instruments: Recognition and Measurement		CA. Sunder Iyer
<b>Fees</b>	Rs. 1100/- for Members, Rs. 1500/- for Non-Members, 750/- for CA Students. (Includes the cost of breakfast, lunch and study materials) (Cheque to be drawn in favour of Pune Branch of WIRC of ICAI)	
<b>Contact Persons and Contact Details</b>		
<ul style="list-style-type: none"> <li>• <b>Chairman</b> - CA. Harinderjit Singh, Chairman, AASB</li> <li>• <b>Chief Coordinator</b> – CA. Krishanlal J. Bansal, Co-opted Member, AASB (Mob: 9371010904)</li> <li>• <b>Conveners</b> –               <ol style="list-style-type: none"> <li>(1) CA. Dinesh Gandhi, Chairman, Pune Branch of WIRC of ICAI. (Mob: 9822547432)</li> <li>(2) CA. Milind Gramopaddhye, Vice Chairman, Pune Branch of WIRC of ICAI. (Mob: 9823015622)</li> </ol> </li> </ul> <p>ICAI Bhavan, 5th Floor, 28-A, Ambar Chamber, Appa Balwant Chowk, Budhwar Peth, Pune-411002. Ph.No. 91-20-24451636            Fax: 91-20-24489732, E-mail: <a href="mailto:pune@icaai.in">pune@icaai.in</a>, Web Site: <a href="http://www.pune-icaai.org">www.pune-icaai.org</a></p>		

# I I Awards 2008

**“The Highest Recognition for a man is to be honored by his alma mater”**

The Chartered Accountants have performed exceedingly well in various fields and the Indian Industry has placed substantial faith on their ability to deliver. To honour this exemplary work of Chartered Accountants in Industry the ICAI has instituted CA Awards which recognise the achievements of CAs in profession, personal life and in community service.

## AWARDS CATEGORIES

Award Sub Categories	CA Business Achiever	CFO	CA Professional Achiever
a.	CA Business Achiever – Financial Services	Manufacturing	Manufacturing
b.	CA Business Achiever – Corporate	Financial Sector	Financial Sector
c.	CA Business Achiever – SME	Service Sector	Service Sector
d.	CA Business Achiever - Others	Information Technology, Media, Communication and Entertainment Enterprises	Information Technology, Media, Communication and Entertainment Enterprises
e.		Infrastructure and Construction	Infrastructure and Construction
f.		Public Sector	Public Sector
g.		Others	Others
h.		Woman	Woman

## CATEGORY CRITERIA

Awards will be given in various categories. These will include the following :

### I CA Business Achiever

This Category is for CEO’s/Directors (or individuals holding equivalent positions in their organization) in the following subcategories:

#### A) Financial Services

All Enterprises in Financial Sector (including NBFC’s, Capital Market, etc..) are covered under this category.

#### B) Corporate

All Large enterprises (including Manufacturing, Trading, Other Service Sector, etc..) are covered under this category. Enterprise with annual turnover in excess of Rs.500 crores or more than 200 employees will be considered as a Large Enterprise.

#### C) SME

All Medium/Small enterprises (including Manufacturing, Trading, Other Service Sector, etc..) are covered under this category Companies not covered in category of “Corporate” above are covered under this category.

#### D) OTHERS

All enterprises in any area other than the above listed categories are covered under this category.

## II CFO

This category is for professionals in Senior Management capacity. This includes positions such as CFO’s, Business Vertical Heads, Chief Risk Officer, Chief Treasury Officer and such other equivalent positions.

## III CA Professional Achiever

This category is for Managers, who have achieved excellence in their careers and are not covered in the categories stated above and is intended to honour the achievements of CAs in the early or middle part of their careers.

### Subcategories:

Each of the Outstanding CFO and CA Professional Achiever awards will be given separately in various subcategories. These subcategories will include the following :

- i. **Manufacturing** (including Processing, Mining, Plantations, Oil and Gas enterprises, etc..)
- ii. **Financial Sector** (including Banking, Financial Institutions, Insurance, NBFC’s, Mutual Funds, etc..)
- iii. **Service Sector** (including Hotels, Consultancy, Transport, Stock Exchanges, R & D, Private Hospitals, etc..)
- iv. **Information technology, Media, Communication and Entertainment Enterprises** (including IT enabled Companies, KPO’s, Media, etc..)
- v. **Infrastructure and Construction** (including Power Generation and Supply, Port Trusts, Metro, Roads, Real Estates, etc..)
- vi. **Public Sector** (including Government Organisations, Regulators, etc..)
- vii. **Others** (Section 25 companies, Educational Institutions, NGO’s, Charitable Hospitals, etc..)
- viii. **Woman** (This is an additional category for woman open for all the sectors given above. A woman CFO / Professional Achiever can also apply / be considered in any of the above categories.)

## EVALUATION PARAMETERS

The Steering Committee will finalise the parameters for evaluation. An illustrative list of parameters to be considered for each category are given below :

- A. CA Business Achiever – Financial/Corporate/SMEs / Others
  - Leadership
  - Innovation
  - Best Practices
  - Contribution To Community
  - Track Record And Accomplishments
- B. CFO and CA Professional Achiever
  - Achievements
  - Professional And Personal Qualities
  - Knowledge And Experience

## THE AWARDS PROCESS

The Steering committee will ensure that the entire process of awards maintain highest level of credibility and professionalism. The whole process shall be divided into three stages viz. Inviting Nominations, Shortlisting and Final Selection. Jury, consisting of eminent personalities, shall be formed for judging the awards. An experienced CA firm will be appointed to carry out the process audit.

A Nomination committee will be constituted to invite nominations directly through applications or through Internal/Independent Research.

### Applications can be made by -

01. Chartered Accountant himself
02. Employer
03. Any other member of ICAI
04. Others, which the Nomination committee may deem fit.

The Nomination committee will examine, review and evaluate the nominations. Short Listing shall be based on the indicative evalua-

tion parameters and the aggregate of scores thereon. Decision regarding short listing by the committee would be treated as final. List of top 5 nominations in each category as selected by the Nomination Committee will be sent to the jury for final selection.

The jury will consider the criteria used for short listing by the Nomination committee along with other criteria as they deem fit. They may conduct personal interviews with the finalists, if required. The jury will determine the winner of each category based on these results. The decision of the jury will be final.

## NOMINATION GUIDELINES

1. Nominations shall be given only for members in Industry.
2. A member of Steering committee, Nomination committee, Process auditors and the jury can neither be a nominee nor can he nominate any person.
3. Minimum period of service in current employment should be 2 years.
4. Multiple nominations will be ignored.
5. Steering committee reserves its rights to reject nomination without providing reasons thereof.
6. The Financials of the Company to be provided as of 31st March, 2008.
7. The Individual Mile Stones to be given upto 30th September, 2008
8. The last date for receipt of nominations by the committee is 30th November, 2008

## NOMINATION FORM

For detailed format visit ICAI web-site at – [www.icaai.org](http://www.icaai.org) or [www.cmii.icaai.org](http://www.cmii.icaai.org)

### For further Information:

**CA Sanjeev Maheshwari – Chairman, CMII of ICAI**

(M) 098211 19043 – Email : [sanjeev.maheshwari@icaai.org](mailto:sanjeev.maheshwari@icaai.org)

**Dr. Surinder Pal – Secretary, CMII of ICAI**

(M) 093507 99931 – Email : [spal@icaai.org](mailto:spal@icaai.org)

## CLASSIFIEDS

**4667** Required Chartered Accountants on partnership/ employment assignment/retainership/sub- contract basis, semi- qualified and articulated assistants anywhere in India. Remuneration no bar. Apply to box no: 4667, C/o The Chartered Accountant, The Institute of Chartered Accountants of India, ICAI Bhawan, C-1, Sector-1, Noida-201301.

**4668** CA Firm requires retired and freshly qualified CAs on partnership or full time employment basis. Apply to box no. 4668, C/o The Chartered Accountant, The Institute of Chartered Accountants of India, ICAI Bhawan, C-1, Sector-1, Noida-201301.

**4669** Delhi & Gurgaon based Chartered Accountant firm requires qualified Chartered Accountants preference for 2 years experience for the Gurgaon office attractive remuneration, Umesh Chand & Co. Website: [www.uccglobal.in](http://www.uccglobal.in) Email: [sunita.umesh@gmail.com](mailto:sunita.umesh@gmail.com)

**4670** Delhi based firm invites offer for networking/ partnership/ merger with practicing FCAs at NCR delhi, chandigarh & hyderabad. Retired and lady members may also join. Contact [rkjagota@gmail.com](mailto:rkjagota@gmail.com). Phone 9811084340.

**4671** Merger/Alliance invited from those having eye on longer-term interest by a Chartered Accountant firm for expanding base. Email: [sharan\\_ca83@live.in](mailto:sharan_ca83@live.in)

**4672** Required CA firm for merger. Also required partners to open branch anywhere in India. Retired members can apply. Contact to Shri A. Mohapatra, Plot No.- 739, Tankapani Road, Bhubaneswar- 751014 or E-mail: [sksk4798@gmail.com](mailto:sksk4798@gmail.com)

**4673** Ahmedabad based CA firm with DISA Partner seeks work all over India on Contract / Outsourcing / assignment basis. Contact: Malav 098254 47466 or mail at [malav\\_mehtaca@yahoo.com](mailto:malav_mehtaca@yahoo.com)

## APPEAL FROM THE PRESIDENT, ICAI To All Members and Students

**My dear colleagues and students,**

As you are aware, the Kosi River, at times called the ‘Sorrow of Bihar’ and has now turned out to be the “Indian Katrina”, changed its course after almost two centuries following a breach in an embankment upstream in Nepal, inundating 14 districts of Bihar. Supaul district has been the worst hit followed by Madhepura, Araria and Saharsa. The Kosi River still remains untamed showing no signs of receding water levels. The first four districts were the worst affected where over 2.27 million people in 755 villages were reeling under its impact. Thousands of families have been forced to live under the open sky or on embankments, roads, rooftops and bridges waiting for help.

The flood situation has been the most horrible in the living memory, leaving thousands dead and rendering homeless and destroying crops, cattle and property worth billions. Our brothers, sisters and children, who have become unfortunate victims of this catastrophe are in dire need of helping hand and will have to begin their lives from scratch when the flood waters recede. The sheer scale of this national calamity has dwarfed all efforts to offer relief and succour. It is at such times that the bond of oneness that makes us into a nation should show itself. There is an urgent need to provide relief to the suffering millions. Whilst the Central and Bihar Governments are making their best efforts in rescuing people, supplying food, medicines, clothes, and shelter, the magnitude of devastation is such that additional aid and resources are required urgently to provide required relief.

ICAI has always risen to such occasions of national calamity and in keeping with that tradition, on behalf of the ICAI and on my own behalf, I exhort honourable colleagues, firms of Chartered Accountants and students, to generously contribute their share for this noble cause which would go a long way in repaying our debt to the Society at large.

We would be grateful to receive your contribution, by way of Demand Draft/Cheque drawn in favour of “The Secretary, ICAI (Bihar Flood Relief Account) at ICAI Bhawan, Indraprastha Marg, New Delhi - 110002

Your timely support will help reduce the sufferings of the people in the flood-affected state of Bihar.

**CA. Ved Jain**



### 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 write-up shall have an executive summary of about 100 words, author’s e-mail ID, complete postal address, contact numbers, a declaration about originality of the article along with a good quality passport size photograph (soft copy as well as hard copy). 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.in](mailto:eboard@icai.in)/ [journal@icai.in](mailto:journal@icai.in) or by post to The Editor, The Chartered Accountant, Journal Section, ICAI Bhawan, C-1, Sector -1, Noida - 201301

*Persistence is to the character of man as carbon is to steel.*

## ICAI e-Initiatives\*

# ICAI providing Corporate e-mail Services to its Members and Students

With reference to the message of the President in September 2008 issue of the Journal, regarding the adoption of Gmail corporate services, the Institute has offered to provide ICAI e-mail ids to its members & students. Google Apps provides essential services for effective communication and collaboration.

The Institute is providing mail boxes of a capacity of 7 GB for each account holder with search tools to facilitate fast information, instant messaging and calendar tools that are available in the e-mail interface with our branding. All members and students can now create their e-mail id in the format, e.g. [name@icai.org](mailto:name@icai.org). These free services are powerful, easy-to-set-up, easy-to-use and require no maintenance. We can access the e-mail services of the Institute from <http://mail.icai.org> after registering our e-mail id on [www.icai.org](http://www.icai.org). We can use SMTP & POP3 services to download mails into mail clients such as outlook express, Microsoft Outlook and Lotus Notes as follows:

Server port numbers for outgoing mail (SMTP) would be 465 and for incoming mail (IMAP) would be 993. Incoming mail server can be set to IMAP server and Incoming mail (IMAP) shall be [imap.gmail.com](mailto:imap.gmail.com) and outgoing mail (SMTP) shall be [smtp.gmail.com](mailto:smtp.gmail.com). Please refer to **Settings** tab after you login to the web mail interface and look at **Forwarding and POP/IMAP settings** for further details in this regard.

We can call or send instant messages to our contacts for free anytime, anywhere in the world using Google Talk. File sharing and voicemail is included also included. We can organize our schedules and share events, meetings and entire calendars with others using Calendar. We can access to the calendars and events published by the Institute on the web.

Co-workers can create documents, spreadsheets and presentations and share online files without having to keep track of multiple versions of the same attachment using Google Docs. Start page is a central place for our users to preview their inboxes and calendars, access essential content, and search the web. Google sites keep related documents, web content and other information in one place, on one site.

Following are the important URLs:

<a href="http://mail.icai.org">http://mail.icai.org</a>	–	Mail access
<a href="http://calendar.icai.org">http://calendar.icai.org</a>	–	Calendar access
<a href="http://docs.icai.org">http://docs.icai.org</a>	–	Docs access
<a href="http://sites.icai.org">http://sites.icai.org</a>	–	Sites access

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\* Matter for ICAI e-Initiatives has been contributed by Shri K.Venkata Ramana, Addl. Secretary (IT). He can be reached at [venkataramana@icai.in](mailto:venkataramana@icai.in)

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## MEF Last Date Extended

The last date for submission of application on the website [www.meficai.org](http://www.meficai.org) has been extended to 6th October, 2008 and the last date for receipt of duly signed hard copy of declaration (alongwith the acknowledgement of soft submission of application) at the Institute's Delhi office has been extended to 16<sup>th</sup> October, 2008.

Please upload MEF Application well before the last date & do not wait for last date for submission of hard copy.

*Natural abilities are like natural plants; they need pruning by study*

## Invitation for Research Proposals

Research Committee invites applications for Research Projects from members and others for carrying out research in the field of accounting and other affiliated fields for e.g. accounting for chain departmental stores, accounting in health care industry, accounting for electricity generation and distribution companies, accounting in aviation industry, accounting for shipping companies, management control systems, approaches to social cost-benefit analysis in the Indian context, etc. The Committee would provide financial support for the approved Research Projects.

### The Eligibility Criteria

- (a) The applicant must be a member of the Institute of Chartered Accountants of India with a research aptitude having at least 10 years of post-qualification experience either in the practice of the profession or as an employee with a reputed manufacturing/service organisation; or
- (b) The applicant must be holding a post-graduate degree from a recognised University or an institute of national repute and must have at least 10 years research and/or teaching experience;

Applications from persons having an experience less than as stated above may also be considered on the basis of merit.

### The Evaluation Criteria

Only those research proposals will be accepted that result in formulation of guidance material in the form of Technical Guide, Studies, Monographs for the members of the Institute in accounting and allied areas, such as the following:

- the issues on which no accounting standards are available or

- the issues that may arise in the implementation of accounting standards and other pronouncements in the industry-specific situations.

### Duration

The duration of research project should not exceed 3 months from the date of the approval of the research proposal unless a longer period is otherwise justified.

### Documents to be submitted with the research proposal

The proposal should be accompanied by a

- Complete bio-data including experience in the relevant field of interest.
- Synopsis of the project explicitly specifying the objective, scope and issues that would be addressed in the final proposed document. It should also contain a justification for the proposal and the detailed chapter plan.

The proposal should also indicate the estimated expenditure and expected honorarium for this purpose. The amounts in this regard would be remitted on the final acceptance of the draft by the Research Committee.

Research proposals complete in all respects should be sent to the Secretary, Research Committee, at the following address:

**The Institute of Chartered Accountants of India,  
ICAI Bhawan, Post Box No.7100,  
Indraprastha Marg, New Delhi  
e-mail: [research@icai.in](mailto:research@icai.in)  
Telephone: 011- 30110458**

## ICAI Starts Toll Free Lines to Serve Members, Students Better

With a view to serve the members and students better, Institute of Chartered Accountants of India is starting two toll-free telephone lines - one dedicated to the members and another dedicated to students to answer their queries and resolve their problems vis-à-vis the Institute if any.

The toll free number for Members will be 18002002500 while the toll free numbers for students will be 18002002501. Members & Students will be happy to note that the calling party (Members & Students) calls free of charge and the subscriber (The Institute) pays for the call charges. Duration of every call shall only be for 3 minutes. Hence Members & Students are requested to frame the QUERY & be specific before making a call.

These lines will become operational from 1<sup>st</sup> September 2008. All the calls received on these telephone numbers will be recorded to ensure good quality of services and necessary follow-ups and resolution of problems.

*The world cares very little about what a man or woman knows; it is what a man or woman is able to do that counts.*

## Branch Notification

(To Be Published in Part III, Section 4 of The Gazette of India)

### NOTIFICATION

(Chartered Accountants)

2<sup>nd</sup> September, 2008

No.1-CA(7)/122/2008

In partial modification of Notification No. 1-CA(7)/115/2008 dated 31<sup>st</sup> March, 2008 notifying setting up of a branch of Western India Regional Council at Pimpri-Chinchwad, it is hereby notified that the following towns/cities, besides Pimpri and Chinchwad, shall now fall under the jurisdiction of the said branch:-

- |                  |                  |
|------------------|------------------|
| 1. Khadki        | 2. Pimpri MIDC   |
| 3. Bhosari       | 4. Chinchwadgaon |
| 5. Akurdi/Nigadi | 6. Dehu Road     |
| 7. Lonavala      | 8. Talegaon      |
| 9. Kamshet       | 10. Rajgurunagar |
| 11. Chakan       | 12. Junnar       |
| 13. Narayangaon  |                  |

(T. Karthikeyan)

Director & Acting Secretary

## For the Kind Attention of Members

In order to ensure better delivery of journal to members, the Editorial Board has decided to give them an option to get their copy of journal 'The Chartered Accountant' at their residential address in case they so desire. In view of the above, those members who desire to receive their journal at their residential address may send a duly signed request for the same at their respective regional offices. Members may note that they may exercise this option for the purpose of journal only and they will continue to receive all other communications from the Institute at their professional address as entered in Institute's records..

## Last Date of Registration for Post Qualification Course in International Trade Laws & WTO for May 2009 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 May, 2009 Examinations for Part I of the Course, the last date for taking registration in the Course is October 31, 2008.**

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 C-1, Sector I, 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,  
Committee on Trade Laws & WTO

*If we did the things we are capable of, we would astound ourselves.*

## Corporate Laws Committee

### Empanelment of Faculty for Certificate Course on Valuation and preparation of Study Material

The Council of the Institute of Chartered Accountants of India has, while appreciating the emerging diversities and complexities in valuation job, decided to launch Certificate Course on Valuation for its members. The Institute is having its Headquarters at I.P. Marg, New Delhi-110 002 and has five Regional Councils at Mumbai, Chennai, Kolkata, New Delhi, Kanpur and more than 117 branches across the country. The Institute has also its Chapters outside India. The objective of this Course is to enhance the knowledge as well as competency level of the members of the Institute to position them as leaders in the global service market. The Course is targeted at the members, either already or prospectively, in Valuation, Strategic Financial Management and Cross Border Transactions. The Government, Regulators including the SEBI, RBI, the entire business world including the MNCs across the globe, investors and other stakeholders would be the potential beneficiaries.

Apart from the comprehensive theoretical aspects, this course, first of its kind in India, will sharpen the expertise and excellence of our members through multiple case studies across the industry and service sector like pharmaceuticals, retail, manufacturing, banking, insurance, valuation, mining, infrastructure, private equity valuation, and cross-border transactions.

The Course will be conducted at New Delhi, Mumbai, Kolkata, Chennai, Kanpur and other mega cities. The registration for New Delhi will start on 1<sup>st</sup> October 2008.

The Corporate Laws Committee is in the process of preparing a panel of faculty/expert/resource persons who can assist the Committee in teaching/preparation of study material for the Course. Chartered Accountants and other professionals having relevant experience for more than 10 years may apply for the above and are requested to send their Resume at the following address within 10 days:

Secretary, Corporate Laws Committee,  
The Institute of Chartered Accountants of India,  
ICAI Bhawan, I.P. Marg,  
New Delhi-110 002.  
Contact No. (011) 30110471, 30110461  
E-Mail: [corporatelaws@icai.in](mailto:corporatelaws@icai.in)

## Appeal for Contribution for the Newly Set Up Chartered Accountants Students Benevolent Fund

Recognising the need for providing assistance to the needy students and extending scholarships for meritorious ones, besides extending beneficial schemes like Insurance, the Council of the Institute has recently set up a Fund namely 'Chartered Accountants Students Benevolent Fund' [CASBF]. The beneficiaries of the Fund will be students registered with the Institute. The formalities for the registration of the Trust and seeking exemption under Section 80(G) of the Income Tax Act are in hand.

Esteemed Members of the Institute are requested to kindly contribute generously for the cause of the welfare of the students of our profession so as to help needy and meritorious students to achieve their life time dream of becoming a Chartered Accountant. The contributions can be sent through cheque/demand draft in favour of Chartered Accountants Students Benevolent Fund payable at New Delhi at the following address

The Member Secretary  
Chartered Accountants Students Benevolent Fund  
The Institute of Chartered Accountants of India  
ICAI BHAWAN  
Indraprastha Marg, New Delhi – 110 002 (INDIA)

The contribution will be duly acknowledged and the certificate for exemption under Section 80(G) will be issued separately in due course of time.

For any clarification, please address your queries to [casbf@icai.in](mailto:casbf@icai.in) / [mss@icai.in](mailto:mss@icai.in) , Tel. No. 011-30110426, 30110553.

CA. Ved Jain  
President, ICAI  
03<sup>rd</sup> September, 2008

*"I can't do it" never yet accomplished anything; "I will try" has performed wonders.*

## Corporate Laws Committee Certificate Course on Valuation

The Council of the Institute of Chartered Accountants of India has, while appreciating the emerging diversities and complexities in valuation job, decided to launch Certificate Course on Valuation for its members. The Course has been designed to empower our members to be the leaders in the global service market. The Course is targeted at the members, either already or prospectively, in Valuation, Strategic Financial Management and Cross Border Transactions.

The objective of the Course is to enable the members to gain acumen, deeper understanding and expertise on the valuation job. Apart from the comprehensive theoretical aspects, this course, first of its kind in India, will sharpen the knowledge and excellence of our members through multiple case studies across the industry and service sector.

The registration for the course will start from 1<sup>st</sup> October 2008 and is opened till 15<sup>th</sup> October 2008. The registration will be on first come first serve basis. The classes for the New Delhi centre will commence from 15th November 2008. The dates and venue for the Mumbai centre will be announced shortly. In case, sufficient numbers of registrations are not received for the Kolkata, Chennai, Kanpur centre, the applicants have the option to join the course at New Delhi or Mumbai centre.

**Details of the Course Contents and registration form have been hosted on the website of the Institute at [www.icai.org/post.html?post\\_id=3428&c\\_id=219](http://www.icai.org/post.html?post_id=3428&c_id=219)**

## Proposed Monograph on Revenue Recognition for Arrangements with Multiple Deliverables

Now-a-days companies offer multiple solutions involving multiple products, services, or rights to use assets to suit their customer requirements. The delivery and the performance of such arrangements may occur at different points in time or over different periods of time. In some cases, the consideration of such arrangements can be in the form of a fixed fee or a variable fee or a combination of fixed and variable fee that may often be based on future performance of such arrangements. This Exposure Draft of the Monograph, prepared by the Research Committee, provides the criteria to establish whether the separate deliverables in a Multiple Deliverable Arrangement qualify as separate Units of Accounting and provides guidance on how the arrangement consideration should be measured, allocated and recognised in respect of separate units of accounting.

The Research Committee of the ICAI invites comments on any aspects of the exposure draft. The Exposure Draft of the Monograph has also been hosted on the website of the Institute i.e. [www.icai.org](http://www.icai.org) and the corresponding url link is [http://www.icai.org/resource\\_file/12880ANNOUNCE150908.pdf](http://www.icai.org/resource_file/12880ANNOUNCE150908.pdf).

Comments would be most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Research Committee, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to be received not later than **October 20, 2008**. Comments can also be sent by e-mail at [tdte@icai.in](mailto:tdte@icai.in) or at [research@icai.in](mailto:research@icai.in)

## Committee on Government Accounting

ICAI has formed a new Committee, “Committee on Government Accounting”. The Committee is set up to review, explore and suggest various aspects of reforms in Government Accounting System at Central, State, District Level, Local Bodies and Gram Panchayat Level. The Members can refer to the Composition, Terms of Reference and Action Plan of the Committee on the website of ICAI. Considering the enormous potential and growing opportunities in the emerging areas of professional work the Committee desires to maintain a data base of members who have worked with Government Organizations and have experience in dealing with Audit of Government Organizations, Local Bodies etc. Members are requested to kindly send their names as well as their brief bio-data (detailed profile is not presently required) giving specifically their experience with the Government Departments. The Committee also invites write up's and suggestions which would be beneficial to the Institute for a upgrading the knowledge of the Members. Members are requested to kindly provide the same at the following address:

**The Chairman**

**Committee on Government Accounting**

**The Institute of Chartered Accountants of India**

**52, 53, 54 Institutional Area, Vishwas Nagar, Shahdara,**

**Near Karkardooma Court,**

**Delhi – 110032, Phone: 91-11-30210635; Fax: 91-11-30210683**

**Website: [www.icai.org.in](http://www.icai.org.in) ; Email: [ykg@icai.in](mailto:ykg@icai.in) or [cga@icai.in](mailto:cga@icai.in)**

*Throughout the centuries there were men who took first steps down new roads armed with nothing but their own vision.*

## Committee on Trade Laws and WTO of ICAI Invitation to Participate in Research Projects

The Committee on Trade Laws and WTO of the Institute of Chartered Accountants of India intends to undertake studies/research projects in various fields and on issues of relevance to International Trade Laws and WTO in the following fields. The basic objective of these studies/research projects is to provide guidance to the Chartered Accountants in practice and in service and others concerned.

- Study on International Commercial Arbitration
- Study on Cross-border Acquisitions & Mergers

In pursuance of its goals, the Committee on Trade Laws and WTO is presently looking for experts having experience in the relevant areas for preparing the drafts of the research projects and invites the members of the Institute to participate in the research projects in the above fields.

### The Eligibility Criteria

- a) The applicant must be a member of the Institute of Chartered Accountants of India with a research aptitude having at least 10 years of post-qualification experience either in the practice of the profession or as an employee with a reputed manufacturing/service organization; or
- b) The applicant must be holding a post-graduate degree from a recognized University or an Institute of national repute and must have at least 10 years research and/or teaching experience;

Applications from persons having an experience less than as stated above may also be considered on the basis of merit.

### Duration

The duration of research project should not exceed 3 months from the date of the approval of the research proposal unless a longer period is otherwise justified.

### Documents to be submitted with the research proposal

The proposal should be accompanied by:-

- Complete bio-data including experience in relevant field of interest.
- Synopsis of the project explicitly specifying the objective, scope and issues that would be addressed in the final proposed document. It should also contain a justification for the proposal and the detailed chapter plan.

The proposal should also indicate the time frame to complete the project, along with the estimated expenditure and expected honorarium for this purpose. Reimbursement of incidental expenses upto Rs. 6,000/- (Rs. Six Thousand only) and/or payment of honorarium ranging from Rs. 10,000/- (Rs. Ten Thousand only) to Rs. 24,000/- (Rs. Twenty Four Thousand only) will be fixed keeping in view the nature of the research project, extent of research, size of draft (including reproduced pages) and the qualifications and experience of the person concerned. The payment/reimbursement will be made only upon the approval of the final draft by the Committee. A Researcher is expected to commit specific working hours per day/per week for the research project allotted to him. The Institute will be the sole owner of the copyright on the publication on the subject. The name of the author would, however, be prominently displayed in the publication.

Should you like to be associated with any of the above research projects, you may kindly write and/or send proposals (complete in all respects) to Secretary, Committee on Trade Laws and WTO, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi - 110 002 or by e-mail at [ctlwto@icai.org](mailto:ctlwto@icai.org).

**Chairman,  
Committee on Trade Laws and WTO**

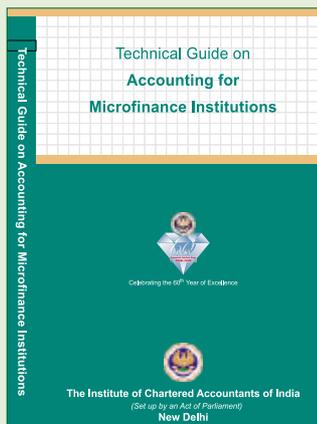
## 59<sup>th</sup> Annual Report and Audited Annual Accounts of the Institute for the year 2007 – 2008.

Members of the Institute are hereby informed that full text of the 59<sup>th</sup> Annual Report and Audited Annual Accounts for the year 2007 - 2008 together with 'Activities in Detail' will be hosted on the Institute's Website (<http://www.icai.org>) for general information of the Members in the month of September/October, 2008. With a view to making available, free of cost, the hard copy and/or soft copy of the Annual Report and Accounts to interested members, it has been decided to seek their consent/willingness. Accordingly, you are requested to kindly indicate your willingness for the same to Shri Mahender Kumar, Deputy Secretary [email: [councilaffairs@icai.org](mailto:councilaffairs@icai.org)]. It may please be noted that a copy of the Abridged version of said Annual Report and Accounts would in any case be sent to all members, after its publication in the Gazette of India, as required.

*Great things are not done by impulse, but by a series of small things brought together.*

## NEW PUBLICATIONS

### Technical Guide on Accounting for Microfinance Institutions



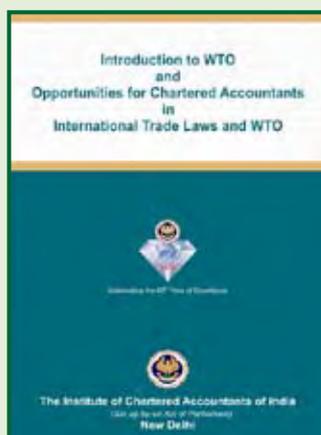
Microfinance institutions (MFIs) provide vital financial services to the economically deprived members of the society. Microfinance sector is a growing industry with many MFIs operating in the country. Large amount of grants and funds entering the microfinance sector and involvement with the poor and their money, warrant a high level of transparency of operations of MFIs by way of sound accounting and financial reporting by MFIs. Therefore, to address this need, the Research Committee of the Institute of Chartered Accountants of India has issued a new publication **'Technical Guide on Accounting for Microfinance Institutions'**. The publication primarily provides an accounting and financial reporting framework for the presentation of true and fair view of the state of affairs and the operating results of the activities of MFIs in their financial statements.

In this publication, guidance has been provided regarding the application of the Accounting Standards formulated by the Institute of Chartered Accountants of India. It has also recommended the formats of financial statements for MFIs and the disclosures of relevant non-financial information by MFIs.

The preparers and the auditors of financial statements of MFIs would find this publication useful for addressing the accounting issues involved in the microfinance sector.

Price	Rs. 150/-
Postal Charges	Rs. 19/- (plus Rs. 17/-, if required by registered parcel)
Available at	Sale counters of the Institute of Chartered Accountants of India at New Delhi, Chennai, Mumbai, Kolkata and Kanpur. Copies can also be obtained by post. To order by post, send your request along with a demand draft for the amount of the price of the publication plus the postal charges in favour of "The Secretary, The Institute of Chartered Accountants of India", payable at New Delhi, to the Postal Sales Department, The Institute of Chartered Accountants of India, ICAI Bhavan, C-1, Sector-1, Noida-201301- (U.P.)

### Introduction to WTO and Opportunities for Chartered Accountants in International Trade Laws and WTO



No. of pages: 186.

Price: Rs. 150/- (with CD)

Postal Charges:

Courier : Rs. 25/-

Registered Post: Rs. 39/-

Unregistered Parcel: Rs. 22/-

The Committee on Trade Laws and WTO of the Institute of Chartered Accountants of India has undertaken various studies/research projects in different fields and on issues of relevance to International Trade Laws and WTO. The basic objective of these studies/research projects is to provide guidance to the Chartered Accountants in practice and in service and others concerned in the field of International Trade Laws and WTO.

**Salient features of the publication are:**

- Provides guidance to Chartered Accountants

in practice and in service and others concerned to have an insight in respect of nuances of the World Trade Organisation giving historical background of the trade negotiations leading to birth of WTO, functions, guiding principles, structure & decision making of WTO etc;

- Provides comprehensive explanation of the WTO Agreements;
- Comprehensively lists the various professional opportunities for chartered accountants in the field of International Trade Laws and WTO;
- CD contains soft copy of the publication and Annexures.

**Available at:** Sales Counters at New Delhi and the Regional Offices at Mumbai, Chennai, Kolkata and Kanpur. Copies can also be obtained by post. To order by post, send your request along with a demand draft for the amount of the price of the publication plus the postal charges in favour of "The Secretary, The Institute of Chartered Accountants of India", payable at New Delhi, to the Postal Sales Department, Noida Stores, The Institute of Chartered Accountants of India, ICAI Bhawan, A-94/4, Sector-58, NOIDA-201 301-(U.P.) India.

*If life were measured by accomplishments, most of us would die in infancy.*

## NEW PUBLICATIONS

### THE AUDITING AND ASSURANCE STANDARDS BOARD

#### Handbook of Auditing Pronouncements

- Authoritative text of auditing pronouncements as on April 1, 2008.
- Availability of technical literature in auditing at one place
- One stop reference for members as well as all professionals and academicians
- Two distinct volumes one, for Standards and Statements and another for Guidance Notes
- Contents of both volumes given in each volume for cross reference

#### Volume I: Compendium of Standards and Statements

- Compendium of Statements on Auditing and containing the text of 35 Engagement and Quality Control Standards.
  - Contents of each Statement and Standard given at the beginning for quick reference and overview.
  - Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements"
  - Standard on Auditing(SA)240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"
  - Standard on Auditing(SA)300 (Revised), "Planning an Audit of Financial Statements"
  - Standard on Auditing (SA)315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment"
  - Standard on Auditing (SA)330, "The Auditor's Responses to Assessed Risks"
  - Comparative Position with International Engagement Standards and Reconciliation thereof.
- Additions since the 2007 edition:**
- Re-numbering and Re-classification of all the existing Auditing and Assurance Standards (AASs) according to the revised Preface.
  - Contains the text of the following documents issued by the Auditing and Assurance Standards Board (AASB) under the Clarity Project:
    - Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services
    - Framework for Assurance Engagements

#### Volume II: Compendium of Guidance Notes

- Contains the text of 32 Guidance Note on auditing aspects.
- Contents of each Guidance Note given at the beginning for quick reference and overview.

#### ORDERING INFORMATION

The publication can be obtained from the sales counter at the Regional offices or at the Head office of the Institute. Copies can also be obtained by post. To order by post, send a demand draft for the amount of price of the publication (add the charges indicated below for the desired mode of delivery) in favour of "The Secretary, The Institute of Chartered Accountants of India, New Delhi", payable at New Delhi, to the Postal Sales Department, The Institute of Chartered Accountants of India, A-9/4, Sector 58, NOIDA - 201301 (UP). **POSTAL CHARGES:** By Courier: Within Delhi - Rs 20, Rest of India - Rs 111. By Registered Post: All India - Rs 150. By Unregistered Post: All India - Rs 133.



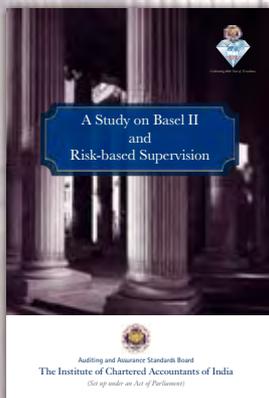
Vol. I - Pages 889  
Vol. I - Pages 632  
(includes CD)  
Price: Rs. 900  
(Box pack)

#### BOX PACK

Both the Volumes are offered in a Box Pack including a CD Rom, containing the text of all the Statements and Standards as well as Guidance Notes included in the two Volumes. Volumes are not available separately.

## A Study on Basel II and Risk-based Supervision

Pages 64  
Price: Rs. 150



### Significant Features of the Study are...

- ✓ Explains the significant principles of the Basel II Framework in a clear and lucid manner with graphs, tables & diagrammatic representations.
- ✓ Divided into five chapters: An Overview, The Three Pillar Structure, Credit Risk, Operational Risk, Implementation of Basel II.
- ✓ Implementation Approach explained in simplified manner through an Illustrative Standard Framework.

#### ORDERING INFORMATION

The publication can be obtained from the sales counter at the Regional offices or at the Head office of the Institute. Copies can also be obtained by post. To order by post, send a demand draft for the amount of price of the publication (add the charges indicated below for the desired mode of delivery) in favour of "The Secretary, The Institute of Chartered Accountants of India, New Delhi", payable at New Delhi, to the Postal Sales Department, The Institute of Chartered Accountants of India, A-9/4, Sector-58, NOIDA-201301-(U.P)

**POSTAL CHARGES:** By Courier - Within Delhi: Rs 12, Rest of India Rs 22. By Registered Post - All India: Rs 36. By Unregistered Post: All India Rs 19.

*Leadership is practiced not so much in words as in attitude and in actions.*

## New Publications

### Committee on Internal Audit

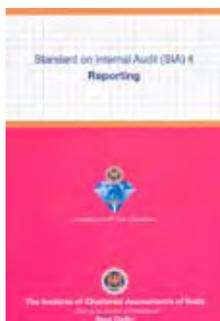


#### **Framework for Standards on Internal Audit**

(Pages: 6 + 2 Initial pages + 2 Cover pages)

(Price: Rs. 25/-)

The Committee on Internal Audit is issuing the Framework for Standards on Internal Audit which would provide a frame of reference for the internal audit standards being issued by the Institute. The objective of the Framework is to promote the professionalism in the internal audit activity. The Framework comprises of four components viz the Code of Conduct, the Competence Framework, the Body of Standards and the Technical Guidance.

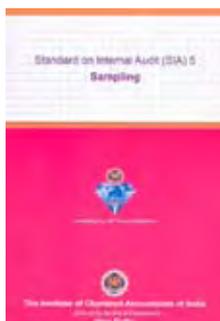


#### **Standard on Internal Audit (SIA) 4, Reporting**

(Pages: 10 + 2 Initial pages+ 2 Cover pages)

(Price: Rs. 25/-)

The purpose of the Standard on Internal Audit (SIA) 4, *Reporting* is to establish standards on the form and content of the internal auditor's report issued as a result of the internal audit performed by an internal auditor of the systems, processes, controls including the items of financial statements of an entity. This SIA describes the basic elements of an internal audit report such as opening, objectives, scope paragraphs, and executive summary. This SIA also deals with the different stages of communication and discussion of the report and describes the reporting responsibilities of the internal auditor when there is a limitation on the scope. The Standard also lays down the reporting responsibilities of the internal auditor when there is restriction on usage and circulation of the report.



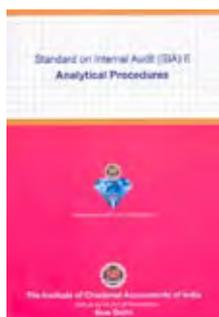
#### **Standard on Internal Audit (SIA) 5, Sampling**

(Pages: 18 + 2 Initial pages+ 2 Cover pages)

(Price: Rs. 25/-)

The Standard on Internal Audit (SIA) 5, *Sampling* provides the guidance regarding the design and selection of an audit sample and also on the use of the audit sampling in the internal audit engagements. This SIA also deals with the evaluation of the sample results. This Standard also provide guidance on the use of sampling in risk assessment procedures and tests of controls performed by the internal auditor to obtain an understanding of the entity, business and its environment, including mechanism of its internal control. The areas covered by the SIA include design of sample, tolerable and expected error, selection of sample, evaluation of sample results, analysis of errors in the sample, projection of errors, reassessing sampling risk. This also describes the internal audi-

tor's documentation requirements in the context of the sampling.

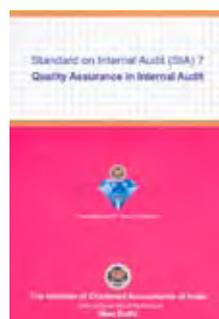


#### **Standard on Internal Audit (SIA) 6, Analytical Procedures**

(Pages: 10 + 2 Initial pages+ 2 Cover pages)

(Price: Rs. 25/-)

The Standard on Internal Audit (SIA) 6, *Analytical Procedures* provides the guidance regarding the application of analytical procedures during internal audit. The SIA deals with the aspects such as, the nature and purpose of analytical procedures, analytical procedures as risk assessment procedures and in planning the internal audit, analytical procedures as substantive procedures, analytical procedures in the overall review at the end of the internal audit, extent of reliance on analytical procedures and investigating unusual items or trends.



#### **Standard on Internal Audit (SIA) 7, Quality Assurance in Internal Audit**

(Pages: 10 + 2 Initial pages+ 2 Cover pages)

(Price: Rs. 25/-)

The Standard on Internal Audit (SIA) 7, *Quality Assurance in Internal Audit* establishes standards and provides guidance regarding quality assurance in internal audit. A system for assuring the quality in internal audit should provide reasonable assurance that the internal auditors comply with professional standards, regulatory and legal requirements so that the reports issued by them are appropriate in the circumstances. This Standard provide the guidance to the person entrusted with the responsibility for the quality of the internal audit whether in-house internal audit or a firm carrying out internal audit. This Standard also provide the extensive knowledge about the internal quality reviews, external quality reviews and communicating the results thereof.

#### **Ordering information:**

The publication(s) can be obtained from the sales counter at the regional offices or at the Head office of the Institute. Copies can also be obtained by post. To order by post, send a demand draft for the amount of price of the publication(s)(add the charges indicated below for the desired mode of delivery) in favour of the "The Secretary, The Institute of Chartered Accountants of India, New Delhi", payable at New Delhi, to the Postal Sales Department, the Institute of Chartered accountants of India, A- 94/4, Sector-58, Sector-1, Noida – 201301 – (U.P)

#### **Postal Charges:**

		Single Book	All Books
By Courier:	Within Delhi:	12/-	
	Rest of India:	22/-	
By Registered Parcel:	Within India:	36/-	36/-
By Unregistered Parcel:	Within India:	19/-	19/-

*Drive thy business, or it will drive thee.*



**The Institute of Chartered Accountants of India**  
**I. P. Marg, New Delhi -110002**  
**Application For Empanelment To Function As Invigilator**  
**At Examination Centres Conducting The Chartered**  
**Accountants Examinations**

1.	Name and Address for Communication (In Capital Letters)	<div style="border: 1px solid black; padding: 5px; width: fit-content; margin: auto;">                 Latest photograph of the applicant to be pasted here             </div>				
2.	Age					
3.	<b>Communication Details:</b>					
	E-mail Id					
	Mobile					
	Phone (O) (with STD Code):					
	Phone (R) (with STD Code):					
	FAX No. (with STD Code):					
4.	PAN NO.					
5.	<b>If Chartered Accountant:</b>					
	Membership Number:					
	Whether ACA or FCA:					
	Date of Enrollment:					
6.	<b>If not Chartered Accountant:</b>					
	Educational Qualifications: (To enclose photocopies of certificates in support thereof)	1.				
		2.				
		3.				
		4.				
		5.				
7.	Whether Employed/Retired.					
	If employed, particulars of employment	Name of Organisation	From	To	Designation	Nature of duties
8.	If you have ever served any educational Institution for any examination work like Invigilation and Examinership etc. (Give Details):					
9.	References (Pl. give names of 2 persons)	Name, Address, Phone No. etc.		Name, Address, Phone No.etc.		
		1.			2.	

Date:

Signature: \_\_\_\_\_

Place:

*The great end of life is not knowledge but action.*

## Draft Regulations For The Accounting Technician Course

[ Published In Part III Section 4 of The

Gazette of India Extraordinary dated 01.09.2008 ]

The Institute of Chartered Accountants of India

### Notification

New Delhi, dated 1<sup>st</sup> September, 2008.

**No.1-CA(7)/123/2008** – The following draft of certain regulations further to amend the Chartered Accountants Regulations, 1988, which the Council of the Institute of Chartered Accountants of India (hereafter referred to as the Council) proposes to make, is hereby published, as required under sub-section (3) of section 30 of the Chartered Accountants Act, 1949 (38 of 1949), for the information of all persons likely to be affected thereby, and a notice is hereby given that the said draft will be taken into consideration on or after the expiry of period of forty-five days from the date on which the copies of the Gazette of India in which these draft regulations are published are made available to the public;

Any person desiring to make any objection or suggestion in respect of the said draft regulations may forward the same for consideration by the Council within the said period so specified above to the Secretary, the Institute of Chartered Accountants of India, "ICAI Bhawan", Indraprastha Marg, New Delhi – 110 002;

#### Draft Regulations

1. (1) These regulations may be called the Chartered Accountants (Second Amendment) Regulations, 2008.

(2) They shall come into force on the date of their final publication in the Official Gazette.

2. In the Chartered Accountants Regulations, 1988, –

(i) **after regulation 28C, the following regulation shall be inserted, namely:-**

“28D. Enrolment for Integrated Professional Competence Course and Fees. – (1) The study course for the chartered accountancy candidates shall be named as Integrated Professional Competence Course, which shall be composed of three levels viz. Group I, Accounting Technician (optional) and Group II. A candidate may opt for enrolment to Group I or Group I and Accounting Technician or Accounting Technician and/or Group II or Group I and Group II or for all the levels referred to above in this regulation.

(2) No candidate shall be eligible for enrolment to any of the level(s) of the Integrated Professional Competence Course unless he has passed the Common Proficiency Test held under these regulations and Senior Secondary Examination (10+2 examination) conducted by an examining body constituted by law in India or an examination recognised by the Central Government as equivalent thereto:

PROVIDED that a candidate who has passed En-

trance Examination or Foundation Examination or Professional Education (Examination-I) under these regulations shall be eligible for enrolment to Integrated Professional Competence Course subject to such conditions as may be specified by the Council:

PROVIDED further that a candidate who was already registered for erstwhile Intermediate Examination as per syllabus under paragraph 2A of Schedule B or of Professional Education (Examination-II) under the syllabus as specified by the Council under sub-regulation (5) of regulation 28B or Professional Competence Examination under the syllabus as specified by the Council under sub-regulation (3) of regulation 28C of these regulations shall be eligible for enrolment to Integrated Professional Competence Course subject to such conditions as may be specified by the Council.

(3) A candidate shall pay such fees for enrolment to Integrated Professional Competence Course as may be fixed by the Council which shall not exceed rupees twelve thousand along with his application in the Form as may be approved by the Council.

28E. Admission to Integrated Professional Competence Examination, Fees and Syllabus

*[Applicable to candidates appearing in Integrated Professional Competence Examination under the syllabus as may be specified by the Council under sub-regulation (3) of this regulation.]*

(1) No candidate shall be admitted to Integrated Professional Competence Examination unless:

(a) he is enrolled for the relevant level(s) of the Integrated Professional Competence Course; and

(b) he produces a certificate to the effect that he has undergone a study course, for a period not less than nine months, as may be specified by the Council for the relevant level(s), as on the first day of the month in which the examination is held, in the manner as may be specified by the Council from time to time; and

(c) he has completed a course on Information Technology Training or Computer Training Programme for such period and in such manner and within such time as may be specified by the Council from time to time.

(2) A candidate for the Integrated Professional Competence Examination shall pay such fees, as may be fixed by the Council,

*Think like a man of action, act like a man of thought.*

which shall not exceed rupees ten thousand.

(3) A candidate for the Integrated Professional Competence Examination shall be examined in the syllabus as may be specified by the Council from time to time.

(4) Notwithstanding anything contained in these regulations, the Council may at any time after the commencement of enrolment to Integrated Professional Competence Course discontinue holding of Professional Competence Examination under the syllabus as specified by the Council under sub-regulation (3) of regulation 28C and require the candidates to pass, in such manner as may be specified by the Council from time to time, Integrated Professional Competence Examination as per the syllabus specified by the Council under sub-regulation (3) above.”;

**(ii) after regulation 29B, the following regulation shall be inserted, namely :-**

“29C. Admission to Final Examination

[Applicable to candidates appearing in Final Examination under the syllabus as may be specified by the Council under regulation 31(i), (ii) and (iii)]

(1) No candidate shall be admitted to the Final Examination unless he has passed the Professional Competence Examination in its entirety, held under these regulations and has completed the practical training as is required for admission as a member on or before the last day of the month preceding the month in which the examination is held:

PROVIDED that a candidate who has passed Professional Education (Examination-II) under the syllabus as specified by the Council under sub-regulation (5) of regulation 28B and has completed the practical training as is required for admission as a member on or before the last day of the month preceding the month in which the examination is held or has been serving the last twelve months of practical training including excess leave, if any on the first day of the month in which the examination is held shall be admitted to the Final examination.

(2) Notwithstanding anything in sub-regulation (1) above, a candidate who has passed the Professional Competence Examination from out of the category of candidates covered under second proviso to sub-regulation (1) of regulation 28C or Integrated Professional Competence Examination under the syllabus as may be specified by the Council under sub-regulation (3) of regulation 28E or the Intermediate Examination under these Regulations or Intermediate Examination under the Chartered Accountants Regulations, 1964 or the Intermediate or the first examination under the Chartered Accountants Regulations, 1949, or was exempted from passing the first examination under those regulations shall be admitted to the Final examination provided he has completed the practical training as is required for admission as a member on or before the last day of the month preceding the month in which the examination is held or has been serving the last six months of practical training including excess leave, if any on the first day of the month in which the examination is held.

*Explanation:* In computing the aforesaid period of six or twelve months, leave taken in excess of one-sixth of the actual period

served subject to a maximum of days, as may be determined by the Council, shall be regarded as the period required to be served under article or audit service, as the case may be.”;

**(iii) in regulation 31, after item (ii), the following item shall be inserted, namely:-**

“(iii) as per the syllabus specified by the Council from time to time after commencement of enrolment to Integrated Professional Competence Course.”;

**(iv) after regulation 37B, the following regulation shall be inserted, namely:-**

“37C. Requirements for passing Integrated Professional Competence Examination

[Applicable to candidates appearing in Integrated Professional Competence Examination under the syllabus as may be specified by the Council under sub-regulation (3) of regulation 28E]

(1) A candidate may appear in Group I or Group II level(s), separately or simultaneously.

(2) A candidate, other than a candidate who has opted for Accounting Technician level, shall ordinarily be declared to have passed the Integrated Professional Competence Examination, if he –

- (a) completes the Orientation Course for such period and in such manner and within such time as may be specified by the Council from time to time; and
- (b) passes in both Group I and Group II levels.

(3) A candidate, who has opted for the Accounting Technician level, shall be declared to have passed in that level, if he –

- (a) passes in Group I level;
- (b) completes the Orientation Course for such period and in such manner and within such time as may be specified by the Council from time to time; and
- (c) completes the practical work experience in accounting and related fields for a period not less than twelve months.

(4) A candidate shall ordinarily be declared to have passed in both the groups simultaneously, if he –

- (a) secures at one sitting a minimum of 40 per cent. marks in each paper of each of the groups, viz., Group I and Group II levels, and minimum of 50 per cent. marks in the aggregate of all the papers of each of the groups; or
- (b) secures at one sitting a minimum of 40 per cent. marks in each paper of both the groups, viz., Group I and Group II levels, and a minimum of 50 per cent. marks in the aggregate of all the papers of both the groups taken together.

(5) A candidate shall be declared to have passed in Group-I level or Group II level, as the case may be, if he secures at one sitting a minimum of 40 per cent. marks in each paper of the group and a

*Success seems to be connected to action. Successful people keep moving. They make mistakes, but they don't quit.*

minimum of 50 per cent. marks in the aggregate of all the papers of that group.

(6) A candidate who has passed in any one but not in both the groups either of the Professional Competence Examination under the syllabus as specified by the Council under sub-regulation (3) of the regulation 28C or Professional Education (Examination-II) under the syllabus as specified by the Council under sub-regulation (5) of regulation 28B effective from October, 2001, the examination for which commenced from November, 2002 or of the Intermediate Examination as per syllabus under paragraph 2A of Schedule 'B' to the Chartered Accountants Regulations, 1988 shall be eligible for exemption in the corresponding paper or papers, if the corresponding paper(s) exists in the new syllabus as may be specified by the Council.

(7) The Council may frame guidelines to continue to award exemption in a paper or papers to a candidate, granted earlier in the Professional Education (Examination-II) under the syllabus as specified by the Council under the syllabus as specified by sub-regulation (5) of regulation 28B or in the Professional Competence Examination under the syllabus as specified by sub-regulation (3) of regulation 28C for the unexpired chance or chances of the exemption in the corresponding paper or papers, as may be specified by the Council, in which he has secured exemption if the corresponding paper or papers exists in the new syllabus as may be specified by the Council. On appearing in the examination of the corresponding paper or papers in which he had failed, he shall be declared to have passed the examination if he secures at one sitting a minimum of 40 per cent. marks in the corresponding paper or papers in which he had failed earlier and a minimum of 50 per cent. marks in the aggregate of all the papers of the group including the marks of the paper or papers in which he had earlier been granted exemption by the Council.

(8) Notwithstanding anything contained in sub-regulations (1) to (5) above, a candidate who fails in one or more papers comprised in a group but secures a minimum of 60 per cent. of the marks in any paper or papers of that group shall be eligible to appear at any one or more of the immediately next three following examinations in the paper or papers in which he secured less than 60 per cent. marks. He shall be declared to have passed in that group if he secures at one sitting a minimum of 40 per cent. marks in each of such papers and a minimum of 50 per cent. of the total marks of all papers of that group including the paper or papers in which he had secured a minimum of 60 per cent. marks in the earlier examination referred to above. He shall not be eligible for any further exemption in the remaining paper(s) of that group until he has exhausted the exemption already granted to him in that group.”;

**(v) after regulation 38B, the following regulation shall be inserted, namely:-**

“38C. Requirements for Passing the Final Examination

[Applicable to candidates appearing in Final Examination under the syllabus as may be specified by the Council under regulation 31(iii)]

(1) A candidate may appear in both the groups simultaneously or in one group in one examination and the remaining group at any

subsequent examination and shall ordinarily be declared to have passed the Final Examination if he passes in both the groups.

(2) A candidate shall ordinarily be declared to have passed in both the groups simultaneously, if he –

- (a) secures at one sitting a minimum of 40 per cent. marks in each paper of each of the groups and minimum of 50 per cent. marks in the aggregate of all the papers of each of the groups; or
- (b) secures at one sitting a minimum of 40 per cent. marks in each paper of both the groups and a minimum of 50 per cent. marks in the aggregate of all the papers of both the groups taken together.

(3) A candidate shall be declared to have passed in a group if he secures at one sitting a minimum of 40 per cent. marks in each paper of the group and a minimum of 50 per cent. marks in the aggregate of all the papers of that group.

(4) A candidate who has passed in any one but not in both the groups of the Final Examination under the syllabus as specified by the Council under clauses (i) and (ii) of regulation 31 or of the Final Examination as per syllabus under paragraph 3 or 3A of Schedule 'B' to the Chartered Accountants Regulations, 1988 or paragraph 3 of Schedule 'BB' to the Chartered Accountants Regulations, 1964 (two groups scheme after January 1, 1985) enforced at the relevant time shall be eligible for exemption in that particular group and shall be required to appear and pass in the remaining group in order to pass the Final Examination.

(5) The Council may frame guidelines to continue to award exemption in a paper or papers to a candidate, granted earlier under the syllabus as specified under clauses (i) and (ii) of regulation 31 for the unexpired chance or chances of the exemption in the corresponding paper or papers for the paper or papers in which he had secured exemption, if the corresponding paper or papers exists in the new syllabus of the Final Examination as may be specified by the Council. On appearing in the examination of the corresponding papers or papers for the paper or papers in which he had failed, he shall be declared to have passed the examination if he secures at one sitting a minimum of 40 per cent. in the corresponding paper or papers for the paper or papers in which he had failed earlier and a minimum of 50 per cent. marks in the aggregate of all the papers of the group including the marks of the paper or papers in which he had earlier been granted exemption by the Council.

(6) Notwithstanding anything contained in sub-regulations (1) to (5) above, a candidate who fails in one or more papers comprised in a group but secures a minimum of 60 per cent. of the marks in any paper or papers of that group shall be eligible to appear at any one or more of the immediately next three following examinations in the paper or papers in which he secured less than 60 per cent. marks. He shall be declared to have passed in that group if he secures at one sitting a minimum of 40 per cent. marks in each of such papers and a minimum of 50 per cent. of the total marks of all papers of that group including the paper or papers in which he had secured a minimum of 60 per cent. marks in the earlier examination referred to above. He shall not be eligible for any further exemption in the remaining paper(s) of that group until he has exhausted the exemption already granted to him in that group;

*Go confidently in the direction of your dreams. Live the life you've imagined.*

**(vi) for regulation 40, the following regulation shall be substituted, namely:-**

“40. Examination Certificates. – A candidate passing the Professional Education (Examination - II), Professional Competence Examination, Integrated Professional Competence Examination, Accounting Technician level, or Final examination shall be granted a certificate to that effect in the Form approved by the Council.”;

**(vii) for regulation 45, the following regulation shall be substituted, namely:-**

“45. Admission to Articleship. – (1) A member engaging articled assistants shall before accepting a person as an articled assistant satisfy himself that –

- (a) he is entitled to train articled assistants under regulation 43, and his professional practice or that of his employer, if he is an employee of chartered accountant in practice or a firm of such chartered accountants, is suitable for the purpose of training articled assistants; and;
- (b) such a person –
  - (i) has passed Professional Education (Examination-II) or has passed Group-I level or Accounting Technician level of Integrated Professional Competence Examination held under these regulations; and
  - (ii) has successfully completed computer training programme or Information Technology Training as may be specified from time to time by the Council and in the manner so specified.

(2) Notwithstanding anything contained in sub-regulation (1) above, a candidate who has passed Common Proficiency Test held under these regulations and also 10+2 examination conducted by an examining body constituted by a law in India or an examination recognised by the Central Government as equivalent thereto; or has passed the Entrance Examination or Foundation Examination or Professional Education (Examination-I) under these regulations shall be eligible for admission to articleship until the commencement of the enrolment to Integrated Professional Competence Course or till such time as the Council may decide:

PROVIDED that a candidate who was registered as an articled assistant before the commencement of the enrolment to Integrated Professional Competence Course shall be eligible to continue and complete the remaining period of practical training as per the deed of articles already executed under these regulations irrespective of any break in the continuity of training;

PROVIDED further that a candidate who has passed Professional Education (Examination-II) at the time of commencement of enrolment to Integrated Professional Competence Course may join three years articleship upto such time as may be specified by the Council.”;

**(viii) In regulation 50, the following proviso shall be inserted at the end, namely:-**

“PROVIDED also that a candidate enrolled for the Integrated Professional Competence Course shall be eligible to three years articleship on his passing the Group I level or Accounting Technician level of the Integrated Professional Competence Examination.”

Sd/-

**T. Karthikeyan**  
Acting Secretary

**Note:** The principal regulations were published in the Gazette of India, Extraordinary, dated the 1<sup>st</sup> June, 1988 vide number 1-CA(7)/134/88 dated 1<sup>st</sup> June, 1988 and subsequently amended by the following numbers:-

- (i) Notification No.1-CA(7)/1/89 published in the Gazette of India dated 7<sup>th</sup> October, 1989
- (ii) Notification No.1-CA(7)/10/90 published in the Gazette of India dated 19<sup>th</sup> January,1991
- (iii) Notification No.1-CA(7)/11/90 published in the Gazette of India dated 19<sup>th</sup> January,1991
- (iv) Notification No.1-CA(7)/12/91 published in the Gazette of India dated 23<sup>rd</sup> February,1991
- (v) Notification No.1-CA(7)/13/90 published in the Gazette of India dated 2<sup>nd</sup> February,1991
- (vi) Notification No.1-CA(7)/19/92 published in the Gazette of India, dated 7<sup>th</sup> March, 1992
- (vii) Notification No.1-CA(7)/28/95 published in the Gazette of India dated 1<sup>st</sup> September,1995
- (viii) Notification No. 1-CA(7)/30/95 published in the Gazette of India, Extraordinary dated 13<sup>th</sup> March, 1996
- (ix) Notification No. 1-CA(7)/31/97 published in the Gazette of India, dated 16<sup>th</sup> August, 1997
- (x) Notification No. 1-CA(7)/44/99 published in the Gazette of India dated 26<sup>th</sup> February, 2000
- (xi) Notification No.1-CA(7)/45/99 published in the Gazette of India, dated 26<sup>th</sup> February, 2000
- (xii) Notification No.1-CA(7)/51/2000 published in the Gazette of India, Extraordinary, dated 17<sup>th</sup> August, 2001
- (xiii) Notification No.1-CA(7)/59/2001 published in the Gazette of India, Extraordinary dated 28<sup>th</sup> September, 2001
- (xiv) Notification No.1-CA(7)/64/2002 published in the Gazette of India, Extraordinary dated 31<sup>st</sup> March, 2003
- (xv) Notification No.1-CA(7)/64A/2003 published in the Gazette of India, Extraordinary dated 4<sup>th</sup> December, 2003
- (xvi) Notification No.1-CA(7)/83/2005 published in the Gazette of India, Extraordinary dated 28<sup>th</sup> July, 2005
- (xvii) Notification No.1-CA(7)/84/2005 published in the Gazette of India, dated 17<sup>th</sup> June, 2006
- (xviii) Notification No. 1-CA(7)/92/2006 published in the Gazette of India, dated 13<sup>th</sup> September, 2006
- (xix) Notification No. 1-CA(7)/102/2007(E) published in the Gazette of India, dated 17<sup>th</sup> August, 2007

*Without dreams, there is no reality!*

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)  
(Set up under The Chartered Accountants Act, 1949)  
Council Guidelines No.1-CA(7)/02/2008, dated 8th August,2008

**GUIDELINES FOR THE MEMBERS OF ICAI**

*(Issued under the provisions of The Chartered Accountants Act, 1949)*

**Chapter I**

**Preliminary**

**1.0 Short title, commencement, etc.**

- (a) These Guidelines have been issued by the Council of the Institute of Chartered Accountants of India under the provisions of The Chartered Accountants Act, 1949, as amended by The Chartered Accountants (Amendment) Act 2006, in supersession of the Notifications issued by the Council under erstwhile Clause (ii) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.
- (b) These Guidelines be called the 'Council General Guidelines, 2008'.

**1.1 Definitions.**

**1.1.1** For the purpose of these Guidelines:

- (a) 'Act' means the Chartered Accountants Act, 1949.
- (b) "Chartered accountant" means a person who is a member of the Institute.
- (c) "Council" means the Council of the Institute constituted under section 9 of the Act.
- (d) "Institute" means the Institute of Chartered Accountants of India constituted under the Act.

1.1.2 All other words and expressions used but not defined herein have the same meaning as assigned to them within the Chartered Accountants Act, 1949 and the Rules, Regulations and Guidelines made there under.

**1.2 Applicability of the Guidelines**

These guidelines shall be applicable to all the Members of the Institute whether in practice or not wherever the context so requires.

**Chapter II**

**Conduct of a Member being an employee**

2.0 A member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.

**Chapter III**

**Appointment of a Member as Cost auditor**

3.0 A member of the Institute shall not accept:-

- (i) The appointment as Cost auditor of a Company under Section 233B of the Companies Act, 1956 while he-
  - (a) is an auditor of the Company appointed under Section 224 of the Companies Act or

- (b) is an officer or employee of the Company; or
- (c) is a partner, of any employee or officer of the Company; or
- (d) is a partner or is in the employment of the Company's auditor appointed under Section 224 of the Companies Act, 1956; or
- (e) is indebted to the Company for an amount exceeding one thousand rupees, or has given any guarantee or provided any security in connection with the indebtedness of any third person to the Company for an amount exceeding one thousand rupees;

OR

- (ii) After his appointment as Cost Auditor, he becomes subject to any of the disabilities stated in items (i) (a) to (e) above and continues to function as a cost auditor thereafter.

3.1 A member of the Institute in practice shall not accept the appointment as auditor of a Company under Section 224 of the Companies Act, 1956, while he is an employee of the cost auditor of the Company appointed under Section 233B of the Companies Act, 1956.

**Chapter IV**

**Opinion on financial statements when there is substantial interest**

4.0 A member of the Institute shall not express his opinion on financial statements of any business or enterprise in which one or more persons who are his "relatives" within the meaning of Section 6 of the Companies Act, 1956 have, either by themselves or in conjunction with such member, a substantial interest in the said business or enterprise.

**Explanation:** For this purpose and for the purpose of compliance of Clause (4) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, the expression "substantial interest" shall have the same meaning as is assigned thereto under Appendix (9) to the Chartered Accountants Regulations, 1988.

**Chapter V**

**Maintenance of books of accounts**

5.0 A member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his / its professional practice, proper books of account including the following:-

- (i) a Cash Book;
- (ii) a Ledger.

*If you can give your son or daughter only one gift, let it be - enthusiasm.*

## Chapter VI

### **Tax Audit assignments under Section 44 AB of the Income-tax Act, 1961**

6.0 A member of the Institute in practice shall not accept, in a financial year, more than the “specified number of tax audit assignments” under Section 44AB of the Income-tax Act, 1961.

**Provided** that in the case of a firm of Chartered Accountants in practice, the “specified number of tax audit assignments” shall be construed as the specified number of tax audit assignments for every partner of the firm.

**Provided** further that where any partner of the firm is also a partner of any other firm or firms of Chartered Accountants in practice, the number of tax audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the “specified number of tax audit assignments” in the aggregate.

**Provided** further that where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total number of such assignments which may be accepted by him shall not exceed the “specified number of tax audit assignments” in the aggregate.

**Provided** also that the audits conducted under Section 44AD, 44AE and 44AF of the Income Tax Act, 1961 shall not be taken into account for the purpose of reckoning the “specified number of tax audit assignments”.

#### **6.1 Explanation:**

For the above purpose, “the specified number of tax audit assignments” means -

- (a) in the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, 45 tax audit assignments, in a financial year, whether in respect of corporate or non-corporate assesses.
- (b) in the case of firm of Chartered Accountants in practice, 45 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

6.1.1 In computing the “specified number of tax audit assignments” each year’s audit would be taken as a separate assignment.

6.1.2 In computing the “specified number of tax audit assignments”, the number such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.

6.1.3 The audit of the head office and branch offices of a concern shall be regarded as one tax audit assignment.

6.1.4 The audit of one or more branches of the same concern by one Chartered Accountant in practice shall be construed as only one tax audit assignment.

6.1.5 A Chartered Accountant being a part time practicing partner of a firm shall not be taken into account for the purpose of reckoning the tax audit assignments of the firm.

6.1.6 A Chartered Accountant in practice shall maintain a record

of the tax audit assignments accepted by him in each financial year in the format as may be prescribed by the Council.

## Chapter VII

### **Appointment of an Auditor in case of non-payment of undisputed fees**

7.0 A member of the Institute in practice shall not accept the appointment as auditor of an entity in case the undisputed audit fee of another Chartered Accountant for carrying out the statutory audit under the Companies Act, 1956 or various other statutes has not been paid:

**Provided** that in the case of sick unit, the above prohibition of acceptance shall not apply.

#### **7.1 Explanation 1:**

For this purpose, the provision for audit fee in accounts signed by both - the auditee and the auditor shall be considered as “undisputed” audit fee.

#### **7.2 Explanation 2:**

For this purpose, “sick unit” shall mean where the net worth is negative.

## Chapter VIII

### **Specified number of audit assignments**

8.0 A member of the Institute in practice shall not hold at any time appointment of more than the “specified number of audit assignments” of Companies under Section 224 and/or Section 228 of the Companies Act, 1956.

**Provided** that in the case of a firm of Chartered Accountants in practice, the “specified number of audit assignments” shall be construed as the specific number of audit assignments for every partner of the firm.

**Provided** further that where any partner of the firm of Chartered Accountants in practice is also a partner of any other firm or firms of Chartered Accountants in practice, the number of audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the “specified number of audit assignments” in the aggregate.

**Provided** further where any partner of a firm or firms of Chartered Accountants in practice accepts one or more audit of Companies in his individual capacity, or in the name of his proprietary firm, the total number of such assignments which may be accepted by all firms in relation to such Chartered Accountant and by him shall not exceed the “specified number of audit assignments” in the aggregate.

#### **8.1 Explanation:**

For the above purpose, the “specified number of audit assignments” means –

- a. in the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, thirty audit assignments whether in respect of private Companies or other Companies.
- b. in the case of Chartered Accountants in practice, thirty audit assignments per partner in the firm, whether in respect of private Companies or other Companies.

**Provided** that out of such “specified number of audit assign

*Throw your heart over the fence and the rest will follow.*

ments, the number of audit assignments of public Companies each of which has a paid-up share capital of rupees twenty-five lakhs or more, shall not exceed ten.

8.2 In computing the “specified number of audit assignments”-

- a. the number of audit of such Companies, which he or any partner of his firm has accepted whether singly or in combination with any other Chartered Accountant in practice or firm of such Chartered Accountants, shall be taken into account.
- b. the audit of the head office and branch offices of a Company by one Chartered Accountant or firm of such Chartered Accountants in practice shall be regarded as one audit assignment.
- c. the audit of one or more branches of the same Company by one Chartered Accountant in practice or by firm of Chartered Accountants in practice in which he is a partner shall be construed as one audit assignment only.
- d. the number of partners of a firm on the date of acceptance of audit assignment shall be taken into account.

8.3 A Chartered Accountant in practice, whether in full-time or part-time employment elsewhere, shall not be counted for the purpose of determination of “specified number of audit of Companies” by firms of Chartered Accountants.

8.4 A Chartered Accountant being a part time practicing partner of a firm shall not be taken into account for the purpose of reckoning the audit assignments of the firm.

8.5 A Chartered Accountant in practice as well as firm of Chartered Accountants in practice shall maintain a record of the audit assignments accepted by him or by the firm of Chartered Accountants, or by any of the partners of the firm in his individual name or as a partner of any other firm, as far as possible, in the following format:

S.No.	Name of the Company	Regis- tration Num- ber	Date of Ap- poin- tment	Date of Accepta- nce	Date on which Form 23-B filed with Registrar of Companies
1	2	3	4	5	6

### Chapter IX

#### **Appointment as Statutory auditor**

9.0 A member of the Institute in practice shall not accept the appointment as statutory auditor of Public Sector Undertaking(s)/Government Company(ies)/Listed Company(ies) and other Public Company(ies) having turnover of Rs.50 crores or more in a year where he accepts any other work(s) or assignment(s) or service(s) in regard to the same Undertaking(s)/Company(ies) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same Undertaking/company.

**Provided** that in case appointing authority(ies)/regulatory

body(ies) specify(ies) more stringent condition(s)/restriction(s), the same shall apply instead of the conditions/restrictions specified under these Guidelines.

9.1 The above restrictions shall apply in respect of fees for other work(s) or service(s) or assignment(s) payable to the statutory auditors and their associate concern(s) put together.

9.2 For the above purpose,

- (i) the term “other work(s)” or “service(s)” or “assignment(s)” shall include Management Consultancy and all other professional services permitted by the Council pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 but shall not include: -
  - (a) audit under any other statute;
  - (b) certification work required to be done by the statutory auditors; and
  - (c) any representation before an authority;
- (ii) the term “associate concern” means any corporate body or partnership firm which renders the Management Consultancy and all other professional services permitted by the Council wherein the proprietor and/or partner(s) of the statutory auditor firm and/or their “relative(s)” is/are Director/s or partner/s and/or jointly or severally hold “substantial interest” in the said corporate body or partnership;
- (iii) the terms “relative” and “substantial interest” shall have the same meaning as are assigned thereto under Appendix (9) to the Chartered Accountants Regulations, 1988.

9.3 In regard to taking up other work(s) or service(s) or assignment(s) of the undertaking/company referred to above, it shall be open to such associate concern or corporate body to render such work(s) or service(s) or assignment(s) so long as aggregate remuneration for such other work(s) or service(s) or assignment(s) payable to the statutory auditor/s together with fees payable to its associate concern(s) or corporate body(ies) do/does not exceed the aggregate of fee payable for carrying out the statutory audit.

### Chapter X

#### **Appointment of an auditor when he is indebted to a concern**

10.0 A member of the Institute in practice or a partner of a firm in practice or a firm shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding Rs. 10,000/-

### Chapter XI

#### **Directions in case of unjustified removal of auditors**

11.0 A member of the Institute in practice shall follow the direction given, by the Council or an appropriate Committee or on behalf of any of them, to him being the incoming auditor(s) not

*You must have long term goals to keep you from being frustrated by short term failures.*

to accept the appointment as auditor(s), in the case of unjustified removal of the earlier auditor(s).

### Chapter XII

#### Minimum Audit Fee in respect of Audit

12.0 A member of the Institute in practice shall not, on behalf of the firm of chartered accountants in which he is a partner, accept or carry out any audit work involving receipt of audit fees (excluding reimbursement of expenses, if any) for such work of an amount less than what is specified hereunder:-

- (a) consisting of 5 or more partners but less than 10 partners with at least one partner holding a certificate of practice for five years or more; or
- (b) consisting of 10 or more partners with at least one partner holding a certificate of practice for five years or more.

	Practising firm having 5 or more partners but less than 10 partners	Practising firm having 10 or more partners
(i) In cities with population of 3 million and above. (as per the last census)	Rs. 6000/- p.a.	Rs.12,000/- p.a.
(ii) In cities/towns having population of less than 3 million. (as per the last census)	Rs. 3500/- p.a.	Rs 8000/- p.a.

Provided that such restriction shall not apply in respect of the following: -

- (i) audit of accounts of charitable institutions clubs, provident funds, etc. where the appointment is honorary i.e. without any fees;
- (ii) statutory audit of branches of banks including regional rural banks;
- (iii) audit of newly formed concerns relating to two accounting years from the date of commencement of their operations;
- (iv) certification or audit under Income-tax Act or other attestation work carried out by the Statutory Auditor; and
- (v) Sales Tax Audit and VAT Audit.

#### 12.1 Explanation:

For the purpose of these Guidelines, the expression statutory auditor means and includes a chartered accountant appointed as an auditor under a Central/State or Provincial Act as well as an auditor appointed under any agreement.

The Council has clarified that for the above purpose the audit of Provident Fund Trust; Gratuity Fund etc. carried out by the statutory auditor are to be considered as separate and distinct audit so that the above restrictions are applicable to it.

### Chapter XIII

#### Repeal and Saving

13.0 The Notifications as specified in the **Schedule** hereto, is-

sued under erstwhile Clause (ii) of Part II of the Second Schedule to the Chartered Accountants Act, 1949 by the Council from time to time shall stand repealed from the date herein.

13.1 Notwithstanding such repeal:-

- (a) Anything done or any action taken or purported to have been done or taken, any enquiry or investigation commenced or show cause notice issued in respect of the said notifications shall be deemed to have been done or taken under the corresponding provisions of these guidelines.
- (b) Any application made to the Council or Director (Discipline) under the said Notifications and pending before the Director (Discipline), Board of Discipline, Disciplinary Committee and the Council shall be deemed to have been made under the corresponding provisions of these Guidelines.

### SCHEDULE

#### NOTIFICATIONS ISSUED BY THE COUNCIL UNDER ERSTWHILE CLAUSE (ii) OF PART II OF THE SECOND SCHEDULE TO THE CHARTERED ACCOUNTANTS ACT, 1949.

1. No.1-CA(7)/65, dated 6<sup>th</sup> November, 1965.
2. No.1-CA (37)/70, Published in Part III Section 4 of the Gazette of India dated 30<sup>th</sup> May, 1970.
3. No.1-CA (39)/70, Published in Part III Section 4 of the Gazette of India dated 24<sup>th</sup> October, 1970.
4. No.1-CA (44)/71, Published in Part III Section 4 of the Gazette of India dated 20<sup>th</sup> March, 1971.
5. No. 1-CA (153)/86, Published in Part III Section 4 of the Gazette of India dated 30<sup>th</sup> August, 1986.
6. No.1-CA (7)/3/88, Published in Part III Section 4 of the Gazette of India dated 4<sup>th</sup> February, 1989.
7. No.1-CA (7)/9/89, Published in Part III Section 4 of the Gazette of India dated 19<sup>th</sup> August, 1989 (Since quashed by the Supreme Court vide Order dated 16<sup>th</sup> May, 2007).
8. No. 1-CA (7)/43/99, Published in Part III Section 4 of the Gazette of India dated 31<sup>st</sup> July, 1999.
9. No. 1-CA (7)/46/99, Published in Part III Section 4 of the Gazette of India dated 13<sup>th</sup> November, 1999.
10. No. 1-CA (7)/53/2001, Published in Part III Section 4 of the Gazette of India dated 12<sup>th</sup> May, 2001.
11. No.1-CA (7)/60/2002, Published in Part III Section 4 of the Gazette of India dated 23<sup>rd</sup> March, 2002.
12. No.1-CA (7)/63/2002, Published in Part III Section 4 of the Gazette of India dated 7<sup>th</sup> September, 2002.
13. No.1-CA (7)/67/2002, Published in Part III Section 4 of the Gazette of India dated 19<sup>th</sup> October, 2002.
14. No. 1 - CA (7)/75/2004, Published in Part III Section 4 of the Gazette of India dated 22<sup>nd</sup> May, 2004. □

*Progress has little to do with speed, but much to do with direction.*

## Accounting Standard (AS) 32 Financial Instruments: Disclosures

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the Preface to the Statements of Accounting Standards<sup>1</sup>.)*

Accounting Standard (AS) 32, *Financial Instruments: Disclosures*, issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2009 and will be recommendatory in nature for an initial period of two years. This Accounting Standard will become mandatory<sup>2</sup> in respect of accounting periods commencing on or after 1-4-2011 for all commercial, industrial and business entities except to a Small and Medium-sized Entity, as defined below:

- (i) Whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- (ii) which is not a bank (including a co-operative bank), financial institution or any entity carrying on insurance business;
- (iii) whose turnover (excluding other income) does not exceed rupees fifty crore in the immediately preceding accounting year;
- (iv) which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and
- (v) which is not a holding or subsidiary entity of an entity which is not a small and medium-sized entity.

For the above purpose an entity would qualify as a Small and Medium-sized Entity, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

Where in respect of an entity there is a statutory requirement for disclosing any financial instrument in a particular manner as asset, liability or equity and/or for disclosing income, expenses, gains or losses relating to a financial instrument in a particular manner as income/expense or as distribution of profits, the entity should disclose that instrument and/or income, expenses, gains or losses relating to the instrument in accordance with the requirements of the statute governing the entity. Until the relevant statute is amended, the entity disclosing that instrument and/or income, expenses, gains or losses relating to the instrument in accordance with the requirements thereof will be considered to be complying with this Accounting Standard, in view of paragraph 4.1 of the *Preface to the Statements of Accounting Standards* which recognises that where a requirement of an Accounting Standard is different from the applicable law, the law prevails.

The following is the text of the Accounting Standard.

### Objective

1. The objective of this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

- (a) the significance of financial instruments for the entity's financial position and performance; and
- (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting

date, and how the entity manages those risks.

2. The principles in this Accounting Standard complement the principles for recognising, measuring and presenting financial assets and financial liabilities in Accounting Standard (AS) 30, *Financial Instruments: Recognition and Measurement* and Accounting Standard (AS) 31, *Financial Instruments: Presentation*.

### Scope

3. This Accounting Standard should be applied by all entities to all types of financial instruments, except:

- (a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with AS 21, *Consolidated Financial Statements and Accounting for Investment in Subsidiaries in Separate Financial Statements*, AS 23, *Accounting for Investments in Associates*<sup>3</sup>, or AS 27, *Financial Reporting of Interests in Joint Ventures*. However, in some cases, AS 21, AS 23 or AS 27 permits or requires an entity to account for an interest in a subsidiary, associate or joint venture using Accounting Standard (AS) 30, *Financial Instruments: Recognition and Measurement*; in those cases, entities should apply the disclosure requirements in AS 21, AS 23 or AS 27 in addition to those in this Accounting Standard. Entities should also apply this Accounting Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in AS 31.
- (b) employers' rights and obligations arising from employee benefit plans, to which AS 15, *Employee*

<sup>1</sup>Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

<sup>2</sup>This implies that, while discharging their attest function, it will be the duty of the members of the Institute to examine whether this Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from this Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

<sup>3</sup>The titles of AS 21 and AS 23 have been changed by making Limited Revisions thereto pursuant to the issuance of AS 30, *Financial Instruments: Recognition and Measurement*.

*Benefits*, applies.

- (c) contracts for contingent consideration in a business combination<sup>4</sup>. This exemption applies only to the acquirer.
- (d) insurance contracts as defined in Accounting Standard on Insurance Contracts<sup>5</sup>. However, this Accounting Standard applies to derivatives that are embedded in insurance contracts if Accounting Standard (AS) 30, *Financial Instruments: Recognition and Measurement*, requires the entity to account for them separately. Moreover, an issuer should apply this Accounting Standard to *financial guarantee contracts* if the issuer applies AS 30 in recognising and measuring the contracts, but should apply the Accounting Standard on Insurance Contracts if the issuer elects, in accordance with the Accounting Standard on *Insurance Contracts*, to apply that Accounting Standard in recognising and measuring them.
- (e) financial instruments, contracts and obligations under share-based payment transactions<sup>6</sup> except that this Accounting Standard applies to contracts within the scope of paragraphs 4 to 6 of AS 30.

4. This Accounting Standard applies to recognised and unrecognised financial instruments. Recognised financial instruments include financial assets and financial liabilities that are within the scope of AS 30. Unrecognised financial instruments include some financial instruments that, although outside the scope of AS 30, are within the scope of this Accounting Standard (such as some loan commitments).

5. This Accounting Standard applies to contracts to buy or sell a non-financial item that are within the scope of AS 30 (see paragraphs 4-6 of AS 30).

### Classes of financial instruments and level of disclosure

6. When this Accounting Standard requires

disclosures by class of financial instrument, an entity should group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity should provide sufficient information to permit reconciliation to the line items presented in the balance sheet.

### Significance of financial instruments for financial position and performance

**7. An entity should disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.**

#### Balance sheet

##### Categories of financial assets and financial liabilities

8. The carrying amounts of each of the following categories, as defined in AS 30, should be disclosed either on the face of the balance sheet or in the notes:

- (a) financial assets at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with AS 30;
- (b) held-to-maturity investments;
- (c) loans and receivables;
- (d) available-for-sale financial assets;
- (e) financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with AS 30; and
- (f) financial liabilities measured at amortised cost.

##### Financial assets or financial liabilities at fair value through profit or loss

9. If the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through profit or loss, it

should disclose:

- (a) the maximum exposure to credit risk (see paragraph 36(a)) of the loan or receivable (or group of loans or receivables) at the reporting date.
  - (b) the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.
  - (c) the amount of change, during the period and cumulatively, in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in the credit risk of the financial asset determined either:
    - (i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or
    - (ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.
- Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.
- (d) the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the loan or receivable was designated.

10. If the entity has designated a financial liability as at fair value through profit or loss in accordance with paragraph 8.2 of AS 30, it should disclose:

- (a) the amount of change, during the period and cumulatively, in the fair value of the financial liability

<sup>4</sup>Business combination' is the bringing together of separate entities or businesses into one reporting entity.

At present, Accounting Standard (AS) 14, *Accounting for Amalgamations*, deals with accounting for contingent consideration in an amalgamation, which is a form of business combination.

<sup>5</sup>A separate Accounting Standard on *Insurance Contracts*, which is being formulated, will specify the requirements relating to insurance contracts.

<sup>6</sup>Employee share based payment, which is one of the share-based payment transactions, is accounted for as per the Guidance Note on Accounting for Employee Share-based Payments, issued by the ICAI. Further, some other pronouncements of the ICAI deal with other share-based payments, e.g., AS 10, *Accounting for Fixed Assets*.

that is attributable to changes in the credit risk of that liability determined either:

- (i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (See Appendix B, paragraph B4); or
- (ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.

Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates. For contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.

- (b) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

11. The entity should disclose:

- (a) the methods used to comply with the requirements in paragraphs 9(c) and 10(a).
- (b) if the entity believes that the disclosure it has given to comply with the requirements in paragraph 9(c) or 10(a) does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

#### Reclassification

12. If the entity has reclassified a financial asset as one measured:

- (a) at cost or amortised cost, rather than at fair value; or
- (b) at fair value, rather than at cost or amortised cost,

it should disclose the amount reclassified into and out of each category and the reason for that reclassification (see paragraphs 57-60 of AS 30).

#### Derecognition

13. An entity may have transferred financial assets in such a way that part or all of the financial assets do not qualify for derecognition (see paragraphs 15-37 of AS 30). The entity should disclose for each class of such financial assets:

- (a) the nature of the assets;
- (b) the nature of the risks and rewards of ownership to which the entity remains exposed;
- (c) when the entity continues to recognise all of the assets, the carrying amounts of the assets and of the associated liabilities; and
- (d) when the entity continues to recognise the assets to the extent of its continuing involvement, the total carrying amount of the original assets, the amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities.

#### Collateral

14. An entity should disclose:

- (a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraphs 37(a) of AS 30; and
- (b) the terms and conditions relating to its pledge.

15. When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it should disclose:

- (a) the fair value of the collateral held;
- (b) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
- (c) the terms and conditions associated with its use of the collateral.

#### Allowance account for credit losses

16. When financial assets are impaired by credit losses and the entity records the impairment in a separate account (eg an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets) rather than directly reducing the carrying amount of the asset, it should disclose a reconciliation of changes in that account during the period for each class of financial assets.

#### Compound financial instruments with multiple embedded derivatives

17. If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 58 of AS 31) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it should disclose the existence of those features.

#### Defaults and breaches

18. For *loans payable* recognised at the reporting date, an entity should disclose:

- (a) details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;
- (b) the carrying amount of the loans payable in default at the reporting date; and
- (c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

19. If, during the period, there were breaches of loan agreement terms other than those described in paragraph 18, an entity should disclose the same information as required by paragraph 18 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the reporting date).

#### Statement of profit and loss and equity

#### Items of income, expense, gains or losses

20. An entity should disclose the following items of income, expense, gains or losses

either on the face of the financial statements or in the notes:

- (a) net gains or net losses on:
  - (i) financial assets or financial liabilities at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading in accordance with AS 30;
  - (ii) available-for-sale financial assets, showing separately the amount of gain or loss recognised directly in equity during the period and the amount removed from equity and recognised in the statement of profit and loss for the period;
  - (iii) held-to-maturity investments;
  - (iv) loans and receivables; and
  - (v) financial liabilities measured at amortised cost.
- (b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss;
- (c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:
  - (i) financial assets or financial liabilities that are not at fair value through profit or loss; and
  - (ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;
- (d) interest income on impaired financial assets accrued in accordance with paragraph A113 of AS 30; and
- (e) the amount of any impairment loss for each class of financial asset.

## Other disclosures

### Accounting policies

21. In accordance with AS 1, *Presentation of Financial Statements*<sup>7</sup>, an entity discloses, in the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

### Hedge accounting

22. An entity should disclose the following separately for each type of hedge described in AS 30 (i.e. fair value hedges, cash flow hedges, and hedges of net investments in foreign operations):

- (a) a description of each type of hedge;
- (b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date; and
- (c) the nature of the risks being hedged.

23. For cash flow hedges, an entity should disclose:

- (a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss;
- (b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;
- (c) the amount that was recognised in the appropriate equity account (Hedging Reserve Account) during the period;
- (d) the amount that was removed from the appropriate equity account (Hedging Reserve Account) and included in the statement of profit and loss for the period, showing the amount included in each line item in the statement; and
- (e) the amount that was removed from appropriate equity account (Hedging Reserve Account) during the period and included in the initial cost or other carrying

amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.

24. An entity should disclose separately:

- (a) in fair value hedges, gains or losses:
  - (i) on the hedging instrument; and
  - (ii) on the hedged item attributable to the hedged risk.
- (b) the ineffectiveness recognised in the statement of profit and loss that arises from cash flow hedges; and
- (c) the ineffectiveness recognised in the statement of profit and loss that arises from hedges of net investments in foreign operations.

### Fair value

25. Except as set out in paragraph 29, for each class of financial assets and financial liabilities (see paragraph 6), an entity should disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.

26. In disclosing fair values, an entity should group financial assets and financial liabilities into classes, but should offset them only to the extent that their carrying amounts are offset in the balance sheet.

27. An entity should disclose:

- (a) the methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates.
- (b) whether fair values are determined, in whole or in part, directly by reference to published price quotations in an active market or are estimated using a valuation technique (see paragraphs A90-A99 of AS 30).

<sup>7</sup>Revised AS 1 is under preparation.

- (c) whether the fair values recognised or disclosed in the financial statements are determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable current market transactions in the same instrument (i.e. without modification or repackaging) and not based on available observable market data. For fair values that are recognised in the financial statements, if changing one or more of those assumptions to reasonably possible alternative assumptions would change fair value significantly, the entity should state this fact and disclose the effect of those changes. For this purpose, significance should be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in equity, total equity.
- (d) if (c) applies, the total amount of the change in fair value estimated using such a valuation technique that was recognised in the statement of profit and loss during the period.

28. If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs A93–A99 of AS 30). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (i.e. the fair value of the consideration given or received), unless conditions described in paragraph A95 of AS 30 are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity should disclose, by class of financial instrument:

- (a) its accounting policy for recognising that difference in the statement of profit and loss to reflect a change in factors (including time) that market participants would consider in setting a price (see paragraph A96 of AS 30); and
- (b) the aggregate difference yet to be

recognised in the statement of profit and loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.

29. Disclosures of fair value are not required:

- (a) when the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;
- (b) for an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with AS 30 because its fair value cannot be measured reliably; or
- (c) for a contract containing a discretionary participation feature (as described in the Accounting Standard on *Insurance Contracts*<sup>8</sup>) if the fair value of that feature cannot be measured reliably.

30. In the cases described in paragraph 29(b) and (c), an entity should disclose information to help users of the financial statements make their own judgments about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value, including:

- (a) the fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;
- (b) a description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;
- (c) information about the market for the instruments;
- (d) information about whether and how the entity intends to dispose of the financial instruments; and
- (e) if financial instruments whose fair value previously could not be reliably measured are derecognised,

that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognised.

## Nature and extent of risks arising from financial instruments

**31. An entity should disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date.**

32. The disclosures required by paragraphs 33–42 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk and market risk.

### Qualitative disclosures

33. For each type of risk arising from financial instruments, an entity should disclose:

- (a) the exposures to risk and how they arise;
- (b) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and
- (c) any changes in (a) or (b) from the previous period.

### Quantitative disclosures

34. For each type of risk arising from financial instruments, an entity should disclose:

- (a) summary quantitative data about its exposure to that risk at the reporting date. This disclosure should be based on the information provided internally to key management personnel of the entity (as defined in AS 18 *Related Party Disclosures*), for example the entity's board of directors or chief executive officer.
- (b) the disclosures required by paragraphs 36–42, to the extent not provided in (a), unless the risk is not material (see AS 1 (Revised)<sup>9</sup> for a discussion of materiality).
- (c) Concentrations of risk if not apparent from (a) and (b).

<sup>8</sup>See footnote 5.

<sup>9</sup>See footnote 7.

35. If the quantitative data disclosed as at the reporting date are unrepresentative of an entity's exposure to risk during the period, an entity should provide further information that is representative.

#### **Credit risk**

36. An entity should disclose by class of financial instrument:

- (a) the amount that best represents its maximum exposure to credit risk at the reporting date without taking account of any collateral held or other credit enhancements (eg netting agreements that do not qualify for offset in accordance with AS 31);
- (b) in respect of the amount disclosed in (a), a description of collateral held as security and other credit enhancement;
- (c) information about the credit quality of financial assets that are neither past due nor impaired; and
- (d) the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

*Financial assets that are either past due or impaired*

37. An entity should disclose by class of financial asset:

- (a) an analysis of the age of financial assets that are past due as at the reporting date but not impaired;
- (b) an analysis of financial assets that are individually determined to be impaired as at the reporting date, including the factors the entity considered in determining that they are impaired; and
- (c) for the amounts disclosed in (a) and (b), a description of collateral held by the entity as security and other credit enhancements and, unless impracticable, an estimate of their fair value.

*Collateral and other credit enhancements obtained*

38. When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (eg guarantees), and such as-

sets meet the recognition criteria in other Standards, an entity should disclose:

- (a) the nature and carrying amount of the assets obtained; and
- (b) when the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

#### **Liquidity risk**

39. An entity should disclose:

- (a) a maturity analysis for financial liabilities that shows the remaining contractual maturities; and
- (b) a description of how it manages the liquidity risk inherent in (a).

#### **Market risk**

*Sensitivity analysis*

40. Unless an entity complies with paragraph 41, it should disclose:

- (a) a sensitivity analysis for each type of market risk to which the entity is exposed at the reporting date, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
- (b) the methods and assumptions used in preparing the sensitivity analysis; and
- (c) changes from the previous period in the methods and assumptions used, and the reasons for such changes.

41. If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (eg interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in paragraph 40. The entity should also disclose:

- (a) an explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and
- (b) an explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities

involved.

*Other market risk disclosures*

42. When the sensitivity analyses disclosed in accordance with paragraph 40 or 41 are unrepresentative of a risk inherent in a financial instrument (for example because the year-end exposure does not reflect the exposure during the year), the entity should disclose that fact and the reason it believes the sensitivity analyses are unrepresentative.

## **Appendix A**

### **Defined terms**

*This appendix is an integral part of AS 32, Financial Instruments: Disclosures.*

#### **credit risk**

The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

#### **currency risk**

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

#### **interest rate risk**

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

#### **liquidity risk**

The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

#### **loans payable**

Loans payable are financial liabilities, other than short-term trade payables on normal credit terms.

#### **market risk**

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: **currency risk, interest rate risk and other price risk.**

#### **other price risk**

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those aris-

ing from **interest rate risk or currency risk**), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

#### past due

A financial asset is past due when a counterparty has failed to make a payment when contractually due.

The following terms are defined in paragraph 8 of AS 30, *Financial Instruments: Recognition and Measurement*, or paragraph 7 of AS 31, *Financial Instruments: Presentation*, and are used in this Standard with the meaning specified in AS 30 and AS 31.

- amortised cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognition
- derivative
- effective interest method
- equity instrument
- fair value
- financial asset
- financial instrument
- financial liability
- financial asset or financial liability at fair value through profit or loss
- financial guarantee contract
- financial asset or financial liability held for trading
- forecast transaction
- hedging instrument
- held-to-maturity investments
- loans and receivables
- regular way purchase or sale

## Appendix B

### Application guidance

*This appendix is an integral part of AS 32, Financial Instruments: Disclosures*

### Classes of financial instruments and level of disclosure (paragraph 6)

B1 Paragraph 6 requires an entity to

group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 6 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in AS 30 (which determine how financial instruments are measured and where changes in fair value are recognised).

B2 In determining classes of financial instrument, an entity should, at a minimum:

- (a) distinguish instruments measured at amortised cost from those measured at fair value.
- (b) treat as a separate class or classes those financial instruments outside the scope of this AS.

B3 An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this AS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity should not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity should not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

### Significance of financial instruments for financial position and performance

#### Financial liabilities at fair value through profit or loss (paragraphs 10 and 11)

B4 If an entity designates a financial liability as at fair value through profit or loss, paragraph 10(a) requires it to disclose the amount of change in the fair value of the financial liability that is attributable to changes in the liability's credit risk. Paragraph 10(a)(i) permits an entity to determine this amount as the amount of change in the liability's fair value that is

not attributable to changes in market conditions that give rise to market risk. If the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, this amount can be estimated as follows:

- (a) First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.
- (b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).
- (c) The difference between the observed market price of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.

This example assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in interest rates are not significant. If the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be disclosed in accordance with paragraph 10(a).

#### Other disclosure – accounting policies (paragraph 21)

B5 Paragraph 21 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such

disclosure may include:

- (a) for financial assets or financial liabilities designated as at fair value through profit or loss:
  - (i) the nature of the financial assets or financial liabilities the entity has designated as at fair value through profit or loss;
  - (ii) the criteria for so designating such financial assets or financial liabilities on initial recognition; and
  - (iii) how the entity has satisfied the conditions in paragraphs 8, 11 or 12 of AS 30 for such designation. For instruments designated in accordance with paragraph 8.2 (b)(i) of the definition of a financial asset or financial liability at fair value through profit or loss in AS 30, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph 8.2 (b)(ii) of the definition of a financial asset or financial liability at fair value through profit or loss in AS 30, that disclosure includes a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.
- (b) the criteria for designating financial assets as available for sale.
- (c) whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph 38 of AS 30).
- (d) when an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:
  - (i) the criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case

of a reversal of a write-down, increased directly) and when the allowance account is used; and

- (ii) the criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see paragraph 16).
- (e) how net gains or net losses on each category of financial instrument are determined (see paragraph 20(a)), for example, whether the net gains or net losses on items at fair value through profit or loss include interest or dividend income.
- (f) the criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see paragraph 20(e)).
- (g) when the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms (see paragraph 36(d)).

AS 1 (Revised)<sup>10</sup>, also requires entities to disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

### Nature and extent of risks arising from financial instruments (paragraphs 31–42)

B6 The disclosures required by paragraphs 31–42 should be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

### Quantitative disclosures (paragraph 34)

B7 Paragraph 34(a) requires disclosures of summary quantitative data about an entity's exposure to risks based on the information provided internally to key management personnel of the entity. When an entity uses several methods to manage a risk exposure, the entity should disclose information using the method or methods that provide the most relevant and reliable information. AS 5, *Accounting Policies, Changes in Accounting Estimates and Errors*,<sup>11</sup> discusses relevance and reliability.

B8 Paragraph 34(c) requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgement taking into account the circumstances of the entity. Disclosure of concentrations of risk should include:

- (a) a description of how management determines concentrations;
- (b) a description of the shared characteristic that identifies each concentration (eg counterparty, geographical area, currency or market); and
- (c) the amount of the risk exposure associated with all financial instruments sharing that characteristic.

### Maximum credit risk exposure (paragraph 36(a))

B9 Paragraph 36(a) requires disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:

- (a) any amounts offset in accordance with AS 31; and
- (b) any impairment losses recognised in accordance with AS 30.

B10 Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

- (a) granting loans and receivables to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the

<sup>10</sup>See footnote 7.

<sup>11</sup>The revised Standard is under preparation.

related financial assets.

- (b) entering into derivative contracts, eg foreign exchange contracts, interest rate swaps and credit derivatives. When the resulting asset is measured at fair value, the maximum exposure to credit risk at the reporting date will equal the carrying amount.
- (c) granting financial guarantees. In this case, the maximum exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognised as a liability.
- (d) making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change. If the issuer cannot settle the loan commitment net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment. This is because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount recognised as a liability.

### Contractual maturity analysis (paragraph 39(a))

B11 In preparing the contractual maturity analysis for financial liabilities required by paragraph 39(a), an entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

- (a) not later than one month;
- (b) later than one month and not later than three months;
- (c) later than three months and not later than one year; and
- (d) later than one year and not later than five years.

B12 When a counterparty has a choice of when an amount is paid, the liability is included on the basis of the earliest date on which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand

(eg demand deposits) are included in the earliest time band.

B13 When an entity is committed to make amounts available in instalments, each instalment is allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.

B14 The amounts disclosed in the maturity analysis are the contractual undiscounted cash flows, for example:

- (a) gross finance lease obligations (before deducting finance charges);
- (b) prices specified in forward agreements to purchase financial assets for cash;
- (c) net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;
- (d) contractual amounts to be exchanged in a derivative financial instrument (eg a currency swap) for which gross cash flows are exchanged; and
- (e) gross loan commitments.

Such undiscounted cash flows differ from the amount included in the balance sheet because the balance sheet amount is based on discounted cash flows.

B15 If appropriate, an entity should disclose the analysis of derivative financial instruments separately from that of non-derivative financial instruments in the contractual maturity analysis for financial liabilities required by paragraph 39(a). For example, it would be appropriate to distinguish cash flows from derivative financial instruments and non-derivative financial instruments if the cash flows arising from the derivative financial instruments are settled gross. This is because the gross cash outflow may be accompanied by a related inflow.

B16 When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the reporting date. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the reporting date.

### Market risk – sensitivity analysis (paragraphs 40 and 41)

B17 Paragraph 40(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. In accordance with paragraph B3, an entity decides how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments. For example:

- (a) an entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading.
- (b) an entity would not aggregate its exposure to market risks from areas of hyperinflation with its exposure to the same market risks from areas of very low inflation.

If an entity has exposure to only one type of market risk in only one economic environment, it would not show disaggregated information.

B18 Paragraph 40(a) requires the sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable (eg prevailing market interest rates, currency rates, equity prices or commodity prices). For this purpose:

- (a) entities are not required to determine what the profit or loss for the period would have been if relevant risk variables had been different. Instead, entities disclose the effect on profit or loss and equity at the balance sheet date assuming that a reasonably possible change in the relevant risk variable had occurred at the balance sheet date and had been applied to the risk exposures in existence at that date. For example, if an entity has a floating rate liability at the end of the year, the entity would disclose the effect on profit or loss (i.e. interest expense) for the current year if interest rates had varied by reasonably possible amounts.
- (b) entities are not required to dis-

close the effect on profit or loss and equity for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient.

B19 In determining what a reasonably possible change in the relevant risk variable is, an entity should consider:

- (a) the economic environments in which it operates. A reasonably possible change should not include remote or 'worst case' scenarios or 'stress tests'. Moreover, if the rate of change in the underlying risk variable is stable, the entity need not alter the chosen reasonably possible change in the risk variable. For example, assume that interest rates are 5 per cent and an entity determines that a fluctuation in interest rates of  $\pm 50$  basis points is reasonably possible. It would disclose the effect on profit or loss and equity if interest rates were to change to 4.5 per cent or 5.5 per cent. In the next period, interest rates have increased to 5.5 per cent. The entity continues to believe that interest rates may fluctuate by  $\pm 50$  basis points (i.e. that the rate of change in interest rates is stable). The entity would disclose the effect on profit or loss and equity if interest rates were to change to 5 per cent or 6 per cent. The entity would not be required to revise its assessment that interest rates might reasonably fluctuate by  $\pm 50$  basis points, unless there is evidence that interest rates have become significantly more volatile.
- (b) the time frame over which it is making the assessment. The sensitivity analysis should show the effects of changes that are considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.

B20 Paragraph 41 permits an entity to use

a sensitivity analysis that reflects interdependencies between risk variables, such as a value-at-risk methodology, if it uses this analysis to manage its exposure to financial risks. This applies even if such a methodology measures only the potential for loss and does not measure the potential for gain. Such an entity might comply with paragraph 41(a) by disclosing the type of value-at-risk model used (eg whether the model relies on Monte Carlo simulations), an explanation about how the model works and the main assumptions (eg the holding period and confidence level). Entities might also disclose the historical observation period and weightings applied to observations within that period, an explanation of how options are dealt with in the calculations, and which volatilities and correlations (or, alternatively, Monte Carlo probability distribution simulations) are used.

B21 An entity should provide sensitivity analyses for the whole of its business, but may provide different types of sensitivity analysis for different classes of financial instruments.

#### Interest rate risk

B22 *Interest rate risk* arises on interest-bearing financial instruments recognised in the balance sheet (eg loans and receivables and debt instruments issued) and on some financial instruments not recognised in the balance sheet (eg some loan commitments).

#### Currency risk

B23 *Currency risk* (or foreign exchange risk) arises on financial instruments that are denominated in a foreign currency, i.e. in a currency other than the functional currency<sup>12</sup> in which they are measured. For the purpose of this Standard, currency risk does not arise from financial instruments that are non-monetary items or from financial instruments denominated in the functional currency.

B24 A sensitivity analysis is disclosed for each currency to which an entity has significant exposure.

#### Other price risk

B25 *Other price risk* arises on financial instruments because of changes in, for example, commodity prices or equity prices. To comply with paragraph 40, an entity might disclose the effect of a decrease in a

specified stock market index, commodity price, or other risk variable. For example, if an entity gives residual value guarantees that are financial instruments, the entity discloses an increase or decrease in the value of the assets to which the guarantee applies.

B26 Two examples of financial instruments that give rise to equity price risk are a holding of equities in another entity, and an investment in a trust, which in turn holds investments in equity instruments. Other examples include forward contracts and options to buy or sell specified quantities of an equity instrument and swaps that are indexed to equity prices. The fair values of such financial instruments are affected by changes in the market price of the underlying equity instruments.

B27 In accordance with paragraph 40(a), the sensitivity of profit or loss (that arises, for example, from instruments classified as at fair value through profit or loss and impairments of available-for-sale financial assets) is disclosed separately from the sensitivity of equity (that arises, for example, from instruments classified as available for sale).

B28 Financial instruments that an entity classifies as equity instruments are not re-measured. Neither profit or loss nor equity will be affected by the equity price risk of those instruments. Accordingly, no sensitivity analysis is required.

## Appendix C

### Comparison with IFRS 7, Financial Instruments: Disclosure

Note: This Appendix is not a part of the Accounting Standard (AS) 32. The purpose of this appendix is only to bring out the differences between Accounting Standard (AS) 32 and the corresponding International Financial Reporting Standard (IFRS) 7.

### Comparison with IFRS 7, Financial Instruments: Disclosures

This Accounting Standard is based on International Financial Reporting Standard (IFRS) 7, *Financial Instruments: Disclosures* issued by the International Accounting Standards Board (IASB). There is no material difference between AS 32 and IFRS 7.

<sup>12</sup>See paragraph 8.16 of AS 30 for definition of 'Functional Currency'.

## Appendix D

### Guidance on implementing AS 32, Financial Instruments: Disclosures

This Appendix is not part of AS 32.

#### Introduction

- IG1 This guidance suggests possible ways to apply some of the disclosure requirements in AS 32. The guidance does not create additional requirements.
- IG2 For convenience, each disclosure requirement in the AS is discussed separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures might satisfy more than one requirement. For example, information about concentrations of risk might also convey information about exposure to credit or other risk.

#### Materiality

- IG3 Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.
- IG4 Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The Framework for the Preparation and Presentation of Financial Statements states in paragraph 26 that 'It is assumed that users have a reasonable knowledge of business and economic activities and accounting and study the information with

reasonable diligence.' Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

#### Classes of financial instruments and level of disclosure (paragraphs 6 and B1–B3)

- IG5 Paragraph B3 states that 'an entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of AS 32, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics.' To satisfy the requirements, an entity may not need to disclose all the information suggested in this guidance.
- IG6 AS 1 (Revised)<sup>13</sup> requires an entity to 'provide additional disclosures when compliance with the specific requirements in ASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.'

#### Significance of financial instruments for financial position and performance (paragraphs 7–30, B4 and B5)

##### Financial liabilities at fair value

[paragraph B4(a)]

First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.

##### through profit or loss (paragraphs 10(a)(i) and B4)

- IG7 The following example illustrates the calculation that an entity might perform in accordance with paragraph B4 of Appendix B of this AS.
- IG8 On 1 January 20X1, an entity issues a 10-year bond with a par value of Rs. 150,000 and an annual fixed coupon rate of 8 per cent, which is consistent with market rates for bonds with similar characteristics.
- IG9 The entity uses MIBOR as its observable (benchmark) interest rate. At the date of inception of the bond, MIBOR is 5 per cent. At the end of the first year:
- MIBOR has decreased to 4.75 per cent.
  - the fair value for the bond is Rs. 153,811, consistent with an interest rate of 7.6 per cent.<sup>14</sup>
- IG10 The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in MIBOR are the only relevant changes in market conditions.
- IG11 The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

<p>[paragraph B4(a)]</p> <p>First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.</p>	<p>At the start of the period of a 10-year bond with a coupon of 8 per cent, the bond's internal rate of return is 8 per cent.</p> <p>Because the observed (benchmark) interest rate (MIBOR) is 5 per cent, the instrument-specific component of the internal rate of return is 3 per cent.</p>
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<sup>13</sup>See footnote 7.

<sup>14</sup>This reflects a shift in MIBOR from 5 per cent to 4.75 per cent and a movement of 0.15 per cent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

<p>[paragraph B4(b)]</p> <p>Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph B4(a).</p>	<p>The contractual cash flows of the instrument at the end of the period are:</p> <ul style="list-style-type: none"> <li>• interest: Rs. 12,000<sup>(a)</sup> per year for each of years 2–10.</li> <li>• principal: Rs. 150,000 in year 10.</li> </ul> <p>The discount rate to be used to calculate the present value of the bond is thus 7.75 per cent, which is 4.75 per cent end of period MIBOR rate, plus the 3 per cent instrument-specific component.</p> <p>This gives a present value of Rs. 152,3679<sup>(b)</sup></p>
<p>[paragraph B4(c)]</p> <p>The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph B4(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.</p>	<p>The market price of the liability at the end of the period is Rs. 153,811<sup>(c)</sup></p> <p>Thus, the entity discloses Rs. 1,444, which is Rs. 153,811 – Rs. 152,367 as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.</p>
<p>(a) <math>\text{Rs. } 150,000 \times 8\% = \text{Rs. } 12,000</math></p> <p>(b) <math>\text{PV} = [\text{Rs. } 12,000 \times (1 - (1 + 0.0775)^{-9})/0.0775] + \text{Rs. } 150,000 \times (1 + 0.0775)^{-9}</math></p> <p>(c) <math>\text{market price} = [\text{Rs. } 12,000 \times (1 - (1 + 0.076)^{-9})/0.076] + \text{Rs. } 150,000 \times (1 + 0.076)^{-9}</math></p>	

## Defaults and breaches (paragraphs 18 and 19)

IG12 Paragraphs 18 and 19 require disclosures when there are any defaults or breaches of loans payable. Any defaults or breaches may affect the classification of the liability as current or non-current in accordance with AS 1 (Revised)<sup>15</sup>.

## Total interest expense (paragraph 20(b))

IG13 Total interest expense disclosed in accordance with paragraph 20(b) is a component of the finance costs, which AS 1 (Revised)<sup>16</sup> requires to be presented separately on the face of the statement of profit and loss. The line item for

finance costs may also include amounts associated with non-financial liabilities.

## Fair value (paragraph 28)

IG14 The fair value at initial recognition of financial instruments that are not traded in active markets is determined in accordance with paragraph A95 of AS 30. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the dif-

ference will be recognised in the statement of profit and loss in subsequent periods in accordance with AS 30 and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would consider in setting a price (see paragraph A96 of AS 30). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 28:

### Background

On 1 January 20X1 an entity purchases for Rs. 15 crore financial assets that are not traded in an active market. The entity has only one class of such financial assets.

The transaction price of Rs. 15 crore is the fair value at initial recognition.

After initial recognition, the entity will apply a valuation technique to establish the financial assets' fair value. This valuation technique includes variables other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of Rs. 14 crore, which differs from fair value by Rs. 1 crore.

The entity has existing differences of Rs. 5 crore at 1 January 20X1.

### Application of requirements

The entity's 20X2 disclosure would include the following:

#### Accounting policies

The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with AS 30, is generally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

*In the notes to the financial statements*

<sup>15</sup>See footnote 7.

<sup>16</sup>ibid

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with AS 30, the fair value of an instrument at inception is generally the transaction price. If the transaction

price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy].

The differences yet to be recognised in the statement of profit and loss are as follows:

	31 Dec X2	31 Dec X1
	Rs.	Rs.
	crore	crore
Balance at beginning of year	5.3	5.0
New transactions	–	1.0
Amounts recognised in the statement of profit and loss during the year	(0.7)	(0.8)
Other increases	–	0.2
Other decreases	(0.1)	(0.1)
	<u>4.5</u>	<u>5.3</u>
Balance at end of year	<u>4.5</u>	<u>5.3</u>

### Nature and extent of risks arising from financial instruments (paragraphs 31–42 and B6–B28)

#### Qualitative disclosures (paragraph 33)

IG15 The type of qualitative information an entity might disclose to meet the requirements in paragraph 33 includes, but is not limited to, a narrative description of:

- (a) the entity's exposures to risk and how they arose. Information about risk exposures might describe exposures both gross and net of risk transfer and other risk-mitigating transactions.
- (b) the entity's policies and processes for accepting, measuring, monitoring and controlling risk, which might include:
  - (i) the structure and organisation of the entity's risk management function(s), including a discussion of independence and accountability;
  - (ii) the scope and nature of the entity's

risk reporting or measurement systems;

(iii) the entity's policies for hedging or mitigating risk, including its policies and procedures for taking collateral; and

(iv) the entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.

(c) the entity's policies and procedures for avoiding excessive concentrations of risk.

IG16 Information about the nature and extent of risks arising from financial instruments is more useful if it highlights any relationship between financial instruments that can affect the amount, timing or uncertainty of an entity's future cash flows. The extent to which a risk exposure is altered by such relationships might be apparent to users from the disclosures required by this Standard, but in some cases further disclosures might be useful.

IG17 In accordance with paragraph

33(c), entities disclose any change in the qualitative information from the previous period and explain the reasons for the change. Such changes may result from changes in exposure to risk or from changes in the way those exposures are managed.

#### Quantitative disclosures (paragraphs 34–42 and B7–B28)

IG18 Paragraph 34 requires disclosure of quantitative data about concentrations of risk. For example, concentrations of credit risk may arise from:

- (a) industry sectors. Thus, if an entity's counterparties are concentrated in one or more industry sectors (such as retail or wholesale), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (b) credit rating or other measure of credit quality. Thus, if an entity's counterparties are concentrated in one or more credit qualities (such as secured loans or unsecured loans) or in one or more credit ratings (such as investment grade or speculative grade), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (c) geographical distribution. Thus, if an entity's counterparties are concentrated in one or more geographical markets (such as Asia or Europe), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (d) a limited number of individual counterparties or groups of closely related counterparties.

Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk may arise from the repayment terms

of financial liabilities, sources of borrowing facilities or reliance on a particular market in which to realise liquid assets. Concentrations of foreign exchange risk may arise if an entity has a significant net open position in a single foreign currency, or aggregate net open positions in several currencies that tend to move together.

IG19 In accordance with paragraph B8, disclosure of concentrations of risk includes a description of the shared characteristic that identifies each concentration. For example, the shared characteristic may refer to geographical distribution of counterparties by groups of countries, individual countries or regions within countries.

IG20 When quantitative information at the reporting date is unrepresentative of the entity's exposure to risk during the period, paragraph 35 requires further disclosure. To meet this requirement, an entity might disclose the highest, lowest and average amount of risk to which it was exposed during the period. For example, if an entity typically has a large exposure to a particular currency, but at year-end unwinds the position, the entity might disclose a graph that shows the exposure at various times during the period, or disclose the highest, lowest and average exposures.

### Credit risk (paragraphs 36–38, B9 and B10)

IG21 Paragraph 36 requires an entity to disclose information about its exposure to credit risk by class of financial instrument. Financial instruments in the same class share economic characteristics with respect to the risk being disclosed (in this case, credit risk). For example, an entity might determine that residential mortgages, unsecured consumer loans, and commercial loans each have different economic characteristics.

#### *Collateral and other credit enhancements pledged (paragraph 36(b))*

IG22 Paragraph 36(b) requires an entity to describe collateral available as security for assets it holds and

other credit enhancements obtained. An entity might meet this requirement by disclosing:

- (a) the policies and processes for valuing and managing collateral and other credit enhancements obtained;
- (b) a description of the main types of collateral and other credit enhancements (examples of the latter being guarantees, credit derivatives, and netting agreements that do not qualify for offset in accordance with AS 31);
- (c) the main types of counterparties to collateral and other credit enhancements and their creditworthiness; and
- (d) information about risk concentrations within the collateral or other credit enhancements.

#### *Credit quality (paragraph 36(c))*

IG23 Paragraph 36(c) requires an entity to disclose information about the credit quality of financial assets with credit risk that are neither past due nor impaired. In doing so, an entity might disclose the following information:

- (a) an analysis of credit exposures using an external or internal credit grading system;
- (b) the nature of the counterparty;
- (c) historical information about counterparty default rates; and
- (d) any other information used to assess credit quality.

IG24 When the entity considers external ratings when managing and monitoring credit quality, the entity might disclose information about:

- (a) the amounts of credit exposures for each external credit grade;
- (b) the rating agencies used;
- (c) the amount of an entity's rated and unrated credit exposures; and
- (d) the relationship between in-

ternal and external ratings.

IG25 When the entity considers internal credit ratings when managing and monitoring credit quality, the entity might disclose information about:

- (a) the internal credit ratings process;
- (b) the amounts of credit exposures for each internal credit grade; and
- (c) the relationship between internal and external ratings.

#### *Financial assets that are either past due or impaired (paragraph 37)*

IG26 A financial asset is past due when the counterparty has failed to make a payment when contractually due. As an example, an entity enters into a lending agreement that requires interest to be paid every month. On the first day of the next month, if interest has not been paid, the loan is past due. Past due does not mean that a counterparty will never pay, but it can trigger various actions such as renegotiation, enforcement of covenants, or legal proceedings.

IG27 When the terms and conditions of financial assets that have been classified as past due are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether the financial asset remains past due.

IG28 Paragraph 37(a) requires an analysis by class of the age of financial assets that are past due but not impaired. An entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

- (a) not more than three months;
- (b) more than three months and not more than six months;
- (c) more than six months and not more than one year; and
- (d) more than one year.

IG29 Paragraph 37(b) requires an analysis of impaired financial assets by class. This analysis might include:

- (a) the carrying amount, before deducting any impairment loss;
- (b) the amount of any related impairment loss; and
- (c) the nature and fair value of collateral available and other credit enhancements obtained.

**Liquidity risk (paragraphs 39 and B11)**

*Liquidity management (paragraph 39(b))*

IG30 If an entity manages liquidity risk on the basis of expected maturity dates, it might disclose a maturity analysis of the expected maturity dates of both financial liabilities and financial assets. If an entity discloses such an expected maturity analysis, it might clarify that expected dates are based on estimates made by management, and explain how the estimates are determined and the principal reasons for differences from the contractual maturity analysis that is required by paragraph 39(a).

IG31 Paragraph 39(b) requires the entity to describe how it manages the liquidity risk inherent in the maturity analysis of financial liabilities required in paragraph 39(a). The factors that the entity might consider in providing this disclosure include, but are not limited to, whether the entity:

- (a) expects some of its liabilities to be paid later than the earliest date on which the entity can be required to pay (as may be the case for customer deposits placed with a bank);
- (b) expects some of its undrawn loan commitments not to be drawn;
- (c) holds financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs;
- (d) has committed borrowing facilities (eg commercial paper facilities) or other lines of credit (eg stand-by credit facilities) that it can access to meet liquidity needs;
- (e) holds financial assets for

which there is not a liquid market, but which are expected to generate cash inflows (principal or interest) that will be available to meet cash outflows on liabilities;

- (f) holds deposits at central banks to meet liquidity needs;
- (g) has very diverse funding sources; or
- (h) has significant concentrations of liquidity risk in either its assets or its funding sources.

**Market risk (paragraphs 40–42 and B17–B28)**

IG32 Paragraph 40(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. There are three types of market risk: interest rate risk, currency risk and other price risk. Other price risk may include risks such as equity price risk, commodity price risk, prepayment risk (ie the risk that one party to a financial asset will incur a financial loss because the other party repays earlier or later than expected), and residual value risk (eg a lessor of motor cars that writes residual value guarantees is exposed to residual value risk). Risk variables that are relevant to disclosing market risk include, but are not limited to:

- (a) the yield curve of market interest rates. It may be necessary to consider both parallel and non-parallel shifts in the yield curve.
- (b) foreign exchange rates.
- (c) prices of equity instruments.
- (d) market prices of commodities.

IG33 Paragraph 40(a) requires the sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable. For example, relevant risk variables might include:

- (a) prevailing market interest rates, for interest-sensitive financial instruments such as a variable-rate loan; or

- (b) currency rates and interest rates, for foreign currency financial instruments such as foreign currency bonds.

IG34 For interest rate risk, the sensitivity analysis might show separately the effect of a change in market interest rates on:

- (a) interest income and expense;
- (b) other line items of the statement of profit and loss (such as trading gains and losses); and
- (c) when applicable, equity.

An entity might disclose a sensitivity analysis for interest rate risk for each currency in which the entity has material exposures to interest rate risk.

IG35 Because the factors affecting market risk vary depending on the specific circumstances of each entity, the appropriate range to be considered in providing a sensitivity analysis of market risk varies for each entity and for each type of market risk.

IG36 The following example illustrates the application of the disclosure requirement in paragraph 40(a):

**Interest rate risk**

At 31 December 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, post-tax profit for the year would have been Rs. 1.7 crore (20X1—Rs. 2.4 crore) higher, arising mainly as a result of lower interest expense on variable borrowings, and other components of equity would have been Rs. 2.8 crore (20X1—Rs. 3.2 crore) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale. If interest rates had been 10 basis points higher, with all other variables held constant, post-tax profit would have been Rs. 1.5 crore (20X1—Rs. 2.1 crore) lower, arising mainly as a result of higher interest expense on variable borrowings, and other components of equity would have been Rs. 3.0 crore (20X1—Rs. 3.4 crore) lower, arising mainly as a result of a de-

crease in the fair value of fixed rate financial assets classified as available for sale. Profit is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X)(a)

#### Foreign currency exchange rate risk

At 31 December 20X2, if the Rupee had weakened 10 per cent against the US dollar with all other variables held constant, post-tax profit for the year would have been Rs. 2.8 crore (20X1—Rs. 6.4 crore) lower, and other components of equity would have been Rs. 1.2 crore (20X1—Rs. 1.1 crore) higher. Conversely, if the Rupee had strengthened 10 per cent against the US dollar with all other variables held constant, post-tax profit would have been Rs. 2.8 crore (20X1—Rs. 6.4 crore) higher, and other components of equity would have been Rs. 1.2 crore (20X1—Rs. 1.1 crore) lower. The lower foreign currency exchange rate sensitivity in profit in 20X2 compared with 20X1 is attributable to a reduction in foreign currency denominated debt. Equity is more sensitive in 20X2 than in 20X1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.

(a) Paragraph 39(a) requires disclosure of a maturity analysis of liabilities.

#### Other market risk disclosures (paragraph 42)

IG37 Paragraph 42 requires the disclosure of additional information when the sensitivity analysis disclosed is unrepresentative of a risk inherent in a financial instrument. For example, this can occur when:

- (a) a financial instrument contains terms and conditions whose effects are not apparent from the sensitivity analysis, eg options that remain out of (or in) the money for the chosen change in the risk variable;
- (b) financial assets are illiquid, eg when there is a low volume of transactions in similar assets and an entity finds it difficult to find a counterparty; or
- (c) an entity has a large holding of a financial asset that, if sold in its entirety, would be sold at a discount or premium to the quoted market price for a smaller holding.

IG38 In the situation in paragraph IG37(a), additional disclosure might include:

- (a) the terms and conditions of the financial instrument (eg the options);
- (b) the effect on profit or loss if the term or condition were met (i.e. if the options were exercised); and

- (c) a description of how the risk is hedged.

For example, an entity may acquire a zero-cost interest rate collar that includes an out-of-the-money leveraged written option (eg the entity pays ten times the amount of the difference between a specified interest rate floor and the current market interest rate). The entity may regard the collar as an inexpensive economic hedge against a reasonably possible increase in interest rates. However, an unexpectedly large decrease in interest rates might trigger payments under the written option that, because of the leverage, might be significantly larger than the benefit of lower interest rates. Neither the fair value of the collar nor a sensitivity analysis based on reasonably possible changes in market variables would indicate this exposure. In this case, the entity might provide the additional information described above.

IG39 In the situation described in paragraph IG37(b), additional disclosure might include the reasons for the lack of liquidity and how the entity hedges the risk.

IG40 In the situation described in paragraph IG37(c), additional disclosure might include:

- (a) the nature of the security (eg entity name);
- (b) the extent of holding (eg 15 per cent of the issued shares);
- (c) the effect on profit or loss; and
- (d) how the entity hedges the risk.

## Limited Revision to Accounting Standard (AS) 19 Leases

The following is the text of the limited revision to AS 19, Leases, issued by the Institute of Chartered Accountants of India.

In view of Accounting Standard (AS) 32, Financial Instruments: Disclosures, AS 19 is modified as under (modifications are shown as underline/ strike-through):

1. Paragraph 22 is modified as below:
 

**“22. The lessee should, in addition to**

**the requirements of AS 10, Accounting for Fixed Assets, AS 6, Depreciation Accounting, AS 32, Financial Instruments: Disclosures, and the governing statute, make the following disclosures for finance leases: .....**”

2. Paragraph 46 is modified as below:

**“46. The lessor should, in addition to the requirements of AS 6, Depreciation Accounting and AS 10, Accounting for**

**Fixed Assets, AS 32, Financial Instruments: Disclosures, and the governing statute, make the following disclosures for operating leases: .....**”

The limited revision comes into effect in respect of accounting periods commencing on or after the date on which Accounting Standard (AS) 32, Financial Instruments: Disclosures, comes into effect.

## Revised Standard on Auditing (SA) 580 Written Representations\*

Standard on Auditing (SA) 580 (Revised), "Written Representations" 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.

### Introduction

#### Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance.

#### Written Representations as Audit Evidence

2. Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based.<sup>2</sup> Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. (Ref: Para. A1)

3. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

#### Effective Date

4. This SA is effective for audits of financial statements for periods beginning on or after 1st April, 2009.

### Objectives

5. The objectives of the auditor are:

- (a) To obtain written representations from management that management believes that it has fulfilled the fundamental responsibilities that constitute the premise on which an audit is conducted; (Ref: Para. A2-A3)
- (b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and

- (c) To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

### Definition

6. For purposes of the SAs, the following term has the meaning attributed below:

**Written Representations** – A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

7. For purposes of this SA, references to "management" should be read as "management and, where appropriate, those charged with governance". Furthermore, in the case of a fair presentation framework, management is responsible for the preparation and *fair* presentation of the financial statements in accordance with the financial reporting framework; or the preparation of financial statements *that give a true and fair view* in accordance with the financial reporting framework.

### Requirements

#### Management from Whom Written Representations Requested

8. The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned. (Ref: Para. A4-A8)

#### Written Representations about Management's Responsibilities

##### Preparation and Presentation of the Financial Statements

9. The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation and presentation of the financial statements as set out in the terms of the audit engagement<sup>3</sup> and, in particular, whether the financial statements are prepared and presented in accordance with

the applicable financial reporting framework. (Ref: Para. A9-A11, A16, A24)

#### Information Provided to the Auditor

10. The auditor shall request management to provide a written representation that it has provided the auditor with all relevant information agreed in the terms of the audit engagement,<sup>4</sup> and that all transactions have been recorded and are reflected in the financial statements. (Ref: Para. A9-A11, A16, A24)

#### Description of Management's Responsibilities in the Written Representations

11. Management's responsibilities shall be described in the written representations required by paragraphs 9 and 10 in the manner in which these responsibilities are described in the terms of the audit engagement. (Ref: Para. A3)

#### Other Written Representations

12. Other SAs require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations. (Ref: Para. A12-A15, A16, A24)

#### Date of and Period(s) Covered by Written Representations

13. The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. The written representations shall be for all financial statements and period(s) referred to in the auditor's report. (Ref: Para. A17-A20)

#### Form of Written Representations

14. The written representations shall be in the form of a representation letter addressed to the auditor. If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required by paragraphs 9 or 10, the relevant matters covered by such statements

<sup>1</sup> Earlier known as the Auditing and Assurance Standard (AAS) 11, "Representations by Management".

<sup>2</sup> Published in the July, 2007 issue of the Journal.

<sup>3</sup> SA 500, "Audit Evidence", (earlier known as AAS 5), refer paragraphs 2 and 3. The Standard is being revised in the light of the corresponding International Standard.

<sup>4</sup> SA 210, "Terms of Audit Engagement", (earlier known as AAS 26), refer paragraph 6. The Standard is being revised in the light of the corresponding International Standard.

<sup>5</sup> Refer footnote 3.

need not be included in the representation letter. (Ref: Para. A21-A23)

### **Doubt as to the Reliability of Written Representations and Requested Written Representations Not Provided**

#### **Doubt as to the Reliability of Written Representations**

15. If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: Para. A26-A27)

16. In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: Para. A25)

17. If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with (Proposed) SA 705<sup>5</sup>, having regard to the requirement in paragraph 19 of this SA.

#### **Requested Written Representations Not Provided**

18. If management does not provide one or more of the requested written representations, the auditor shall:

- (a) Discuss the matter with management;
- (b) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- (c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with [Proposed] SA 705, having regard to the requirement in paragraph 19 of this SA.

#### **Written Representations about Management's Responsibilities**

19. The auditor shall disclaim an opinion on the financial statements in accordance with [Proposed] SA 705 if: (Ref: Para. A28-A29)

- (a) The auditor concludes that there is sufficient doubt about the integrity of management such that the written representations required by paragraphs 9 and 10 are not reliable; or
- (b) Management does not provide the written representations required by paragraphs 9 and 10.

#### **Application and Other Explanatory Material**

##### **Written Representations as Audit Evidence** (Ref: Para. 2)

A1. Written representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

##### **Premise, relating to Management's Responsibilities, on which an Audit is Conducted** (Ref: Para. 5(a), 11)

A2. Law or regulation may establish management's responsibilities in relation to financial reporting. However, the extent of these responsibilities, or the way in which they are described, may differ under each law or regulation. Despite these differences, an audit in accordance with the SAs is conducted on the premise that management has responsibility:

- (a) for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and

(b) To provide the auditor with:

- (i) All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;
- (ii) Any additional information that the auditor may request from management; and
- (iii) Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.<sup>6</sup>

A3. SA 210 (Revised) requires the auditor to obtain the agreement of management that it acknowledges and understands those responsibilities as a precondition for accepting the audit engagement<sup>7</sup> by him. If management's responsibilities prescribed by law or regulation are equivalent in effect to those described in paragraph A2, the auditor may use the wording of the law or regulation to describe them in the terms of the audit engagement.<sup>8</sup>

##### **Management from Whom Written Representations Requested** (Ref: Para. 8)

A4. Written representations are requested from those responsible for the preparation and presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation; however, management (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer, or other equivalent persons in entities that do not use such titles. In some circumstances, however, other parties, such as those charged with governance, are also responsible for the preparation and presentation of the financial statements.

A5. Due to its responsibility for the preparation and presentation of the financial statements, and its responsibilities for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing and presenting the financial statements and the assertions therein on which to base the written representations.

A6. In some cases, however, management may

<sup>5</sup> SA 705, "Modifications to the Opinion in the Independent Auditor's Report". The Auditing and Assurance Standards Board will issue an Exposure Draft of the proposed new Standard based on the corresponding International Standard on Auditing in the near future. Presently, the concept of modified opinion in the auditor's report is dealt in SA 700, "The Auditor's Report on Financial Statements", hitherto AAS 28.

<sup>6</sup> SA 200, "Basic Principles Governing an Audit" (earlier known as AAS1), refer paragraphs 18 and 19. The Standard is being revised in the light of the corresponding International Standard.

<sup>7</sup>Refer footnote 3.

<sup>8</sup>Refer footnote 3.

decide to make inquiries of others who participate in preparing and presenting the financial statements and assertions therein, including individuals who have specialised knowledge relating to the matters about which written representations are requested. Such individuals may include:

- An actuary responsible for actuarially determined accounting measurements.
- Staff engineers who may have responsibility for and specialised knowledge about environmental liability measurements.
- Internal counsel who may provide information essential to provisions for legal claims.

A7. In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.

A8. To reinforce the need for management to make informed representations, the auditor may request that management include in the written representations, confirmation that it has made such inquiries as it considered appropriate to place it in the position to be able to make the requested written representations. It is not expected that such inquiries would usually require a formal internal process beyond those already established by the entity.

**Written Representations about Management's Responsibilities** (Ref: Para. 9-10)

A9. Audit evidence obtained during the audit that management is fulfilling the responsibilities that it agreed to in the terms of the audit engagement is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities. For example, the auditor could not conclude that management has provided the auditor with the information described in paragraph A2(b) without asking it whether, and receiving confirmation that, such information has been provided.

A10. The written representations required by paragraphs 9 and 10 draw on the agreed ac-

knowledge and understanding of management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them. The auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is particularly appropriate when:

- Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- The terms of the audit engagement were prepared in a previous year;
- There is any indication that management misunderstands those responsibilities; or
- Changes in circumstances make it appropriate to do so.

Consistent with the requirement of [proposed] SA 210 (Revised),<sup>9</sup> such reconfirmation of management's acknowledgement and understanding of its responsibilities is not made subject to the best of management's knowledge and belief (as discussed in paragraph A7 of this SA).

A11. The mandates for audits of the financial statements of certain entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of such an entity is conducted may give rise to additional written representations. These may include written representations confirming that transactions and events have been carried out in accordance with legislation or proper authority.

**Other Written Representations** (Ref: Para. 12)

**Additional Written Representations about the Financial Statements**

A12. In addition to the written representation required by paragraph 9, the auditor may consider it necessary to request other written representations about the financial statements. Such written representations may supplement, but do not form part of, the written representation required by paragraph 9. They may include representations about the following:

- Whether the selection and application of accounting policies are appropriate; and
- Whether matters such as the following, where relevant under the applicable financial reporting framework, have been recognised, measured, presented or disclosed

in accordance with that framework:

- Plans or intentions that may affect the carrying value or classification of assets and liabilities;
- Liabilities, both actual and contingent;
- Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral; and
- Aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.

**Additional Written Representations about Information Provided to the Auditor**

A13. In addition to the written representation required by paragraph 10, the auditor may consider it necessary to request management to provide a

**Written Representations about Specific Assertions**

A14. When obtaining evidence about, or evaluating, judgments and intentions, the auditor may consider one or more of the following:

- The entity's past history in carrying out its stated intentions.
- The entity's reasons for choosing a particular course of action.
- The entity's ability to pursue a specific course of action.
- The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.

A15. In addition, the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. For example, if the intent of management is important to the valuation basis for investments, it may not be possible to obtain sufficient appropriate audit evidence without a written representation from management about its intentions. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

**Communicating a Threshold Amount** (Ref: Para. 9-10, 12)

A16. (Proposed) SA 450 (Revised)<sup>10</sup> requires the auditor to accumulate misstatements identified

<sup>9</sup>Refer footnote 3.

<sup>10</sup>SA 450, "Evaluation of Misstatements Identified During the Audit". The Auditing and Assurance Standards Board will issue an Exposure Draft of the proposed new Standard based on the corresponding International Standard on Auditing in the near future. Presently, the concept of audit materiality is dealt with in AAS 13 "Audit Materiality".

during the audit, other than those that are clearly trivial. The auditor may determine a threshold above which misstatements cannot be regarded as clearly trivial. In the same way, the auditor may consider communicating to management a threshold for purposes of the requested written representations.

### **Date of and Period(s) Covered by Written Representations** (Ref: Para. 13)

A17. Because written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

A18. In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.

A19. The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

A20. Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

### **Form of Written Representations** (Ref: Para. 14)

A21. Written representations are required to be included in a representation letter addressed to the auditor. Some laws or regulations may, however, require management to make a written public statement about its responsibilities. Although such statement is a representation to the users of the financial statements, or to relevant

authorities, the auditor may determine that it is an appropriate form of written representation in respect of some or all of the representations required by paragraph 9 or 10. Consequently, the relevant matters covered by such statement need not be included in the representation letter. Factors that may affect the auditor's determination include:

- Whether the statement includes confirmation of the fulfillment of responsibilities that are equivalent to some or all of those set out in the terms of the audit engagement.
- Whether the statement has been given or approved by those from whom the auditor requests the relevant written representations.
- Whether a copy of the statement is provided to the auditor as near as practicable to, but not after, the date of the auditor's report on the financial statements (see paragraph 13).

A22. A formal statement of compliance with law or regulation, or of approval of the financial statements, would not contain sufficient information for the auditor to be satisfied that all necessary representations have been consciously made. The expression of management's responsibilities in law or regulation is also not a substitute for the requested written representations.

A23. The Appendix to this Standard provides an illustrative example of a representation letter.

### **Communication with Those Charged with Governance** (Ref: Para. 9-10, 12)

A24. SA 260 (Revised)<sup>11</sup> requires the auditor to communicate with those charged with governance the written representations which the auditor has requested from management.

### **Doubt as to the Reliability of Written Representations and Requested Written Representations Not Provided**

#### **Doubt as to the Reliability of Written Representations** (Ref: Para. 15-16)

A25. In the case of identified inconsistencies between one or more written representations and audit evidence obtained from another source, the auditor may consider whether the risk assessment remains appropriate and, if not, revise the risk assessment and determine the nature, timing and extent of further audit procedures to respond to the assessed risks.

A26. Concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of

these, may cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted. In such a case, the auditor may consider, where possible, withdrawing from the engagement, unless those charged with governance put in place appropriate corrective measures. Such measures, however, may not be sufficient to enable the auditor to issue an unmodified audit opinion.

A27. SA 230 (Revised)<sup>12</sup> requires the auditor to document significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. The auditor may have identified significant issues relating to the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, but concluded that the written representations are nevertheless reliable. In such a case, this significant matter is documented in accordance with SA 230 (Revised).

### **Written Representations about Management's Responsibilities** (Ref: Para. 19)

A28. As explained in paragraph A9, the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities. Therefore, if, as described in paragraph 19(a), the auditor concludes that the written representations about these matters are unreliable, or if management does not provide those written representations, the auditor is unable to obtain sufficient appropriate audit evidence. The possible effects on the financial statements of such inability are not confined to specific elements, accounts or items of the financial statements and are hence pervasive. [Proposed] SA 705 requires the auditor to disclaim an opinion on the financial statements in such circumstances.

A29. A written representation that has been modified from that requested by the auditor does not necessarily mean that management did not provide the written representation. However, the underlying reason for such modification may affect the opinion in the auditor's report. For example:

- The written representation about management's fulfillment of its responsibility for the preparation and presentation of the financial statements may state that management believes that, except for material non-compliance with a particular requirement of the applicable financial reporting framework, the financial statements are prepared and presented in accordance with that framework. The requirement in paragraph 19 does not apply because the

<sup>11</sup>The Exposure Draft of Revised SA 260, "Communication with Those Charged with Governance", (hitherto known as AAS 27) has been published in May, 2008 issue of the Journal. Refer paragraph 12(c)(iii) of the said Exposure Draft.

<sup>12</sup>SA 230 (Revised), "Audit Documentation" (hitherto known as AAS 3), refer paragraph 8. The Standard is being revised in the light of the corresponding International Standard.

auditor concluded that management has provided reliable written representations. However, the auditor is required to consider the effect of the non-compliance on the opinion in the auditor's report in accordance with [Proposed] SA 705.

- The written representation about the responsibility of management to provide the auditor with all relevant information agreed in the terms of the audit engagement may state that management believes that, except for information destroyed in a fire, it has provided the auditor with such information. The requirement in paragraph 19 does not apply because the auditor concluded that management has provided reliable written representations. However, the auditor is required to consider the effects of the pervasiveness of the information destroyed in the fire on the financial statements and the effect thereof on the opinion in the auditor's report in accordance with [Proposed] SA 705.

## Material Modifications to ISA 580, "Written Representations"

### Deletions

1. Paragraph A11 of the Application Section of ISA 580 deals with the application of the requirements of ISA 580 to the audits of public sector entities regarding the premise, relating to management's responsibilities which may give rise to additional written representations. Since as mentioned in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

Since it is also possible that even in case of non public sector entities, management responsibilities may give rise to additional representations, accordingly, the spirit of erstwhile A11, highlighting the fact that in case of certain entities, the need of additional representations may arise, has been retained.

## Appendix

(Ref. Para. A23)

### Illustrative Representation Letter

The following illustrative letter includes written representations that are required by this and other SAs in effect as at [date]. It is assumed in this illustration that the applicable financial reporting

framework is applicable accounting standards in India; the requirement of SA 570 (Revised)<sup>13</sup> to obtain a written representation is not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor)

(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended December 31, 20XX<sup>14</sup> for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, (or give a true and fair view) in accordance with the applicable accounting standards in India.

We confirm that *(to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves)*:

#### Financial Statements

- We have fulfilled our responsibilities for the preparation and presentation of the financial statements as set out in the terms of the audit engagement dated [insert date] and, in particular, the financial statements are fairly presented (or *give a true and fair view*) in accordance with the applicable accounting standards in India.
- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. (SA 540 (Revised))
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of applicable accounting standards in India. (SA 550 (Revised))<sup>15</sup>
- All events subsequent to the date of the financial statements and for which applicable accounting standards in India require adjustment or disclosure have been adjusted or disclosed. (SA 560 (Revised))
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. ([Proposed] SA 450 (Revised))
- [Any other matters that the auditor may consider appropriate (see paragraph A12 of this SA).]

#### Information Provided

- We have provided you with:
  - All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;
  - Additional information that you have requested from us; and
  - Unrestricted access to those within the entity.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (SA 240 (Revised)).
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
  - Management;
  - Employees who have significant roles in internal control; or
  - Others where the fraud could have a material effect on the financial statements. (SA 240 (Revised))
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (SA 240 (Revised))
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (SA 250 (Revised))<sup>16</sup>
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (SA 550 (Revised))<sup>17</sup>
- [Any other matters that the auditor may consider necessary (see paragraph A13 of this SA).]

Management Management

<sup>13</sup>The Exposure Draft of Revised SA 570, "Going Concern" (hitherto known as AAS 16) has been published in the October, 2007 issue of the Journal.

<sup>14</sup>Where the auditor reports on more than one period, the auditor adjusts the date so that the letter pertains to all periods covered by the auditor's report.

<sup>15</sup>SA 550, "Related Parties" (hitherto known as AAS 23). The Standard is being revised in the light of the corresponding International Standard.

<sup>16</sup>The Exposure Draft of Revised SA 250, "The Auditor's Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements" has been published in the February, 2008 issue of the Journal.

<sup>17</sup>SA 550, "Related Parties" (hitherto known as AAS 23). The Standard is being revised in the light of the corresponding International Standard.

## Framework for Standards on Internal Audit

The following is the text of the Framework for Standards on Internal Audit, issued by the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the “Preface to the Standards on Internal Audit”, issued by the Institute of Chartered Accountants of India.

In terms of the decision taken by the Council of the Institute, the following Framework shall be recommendatory in nature in the initial period. The Framework shall become mandatory from such date as notified by the Council.

### Introduction and Scope

1. In February 2004, the Institute of Chartered Accountants of India, set-up the Committee on Internal Audit. The main function of the Committee on Internal Audit, as set out in its Terms of Reference and the Preface to the Standards on Internal Audit, is to review the existing internal audit practices in India and to develop Standards on Internal Audit (SIAs).

2. Paragraph 3.1 of the Preface to the Standards on Internal Audit, issued by the Council of the Institute of Chartered Accountants of India in 2004, describes internal audit as follows:

*“Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity’s strategic risk management and internal control system.”*

3. Every standard setting process requires a framework, hence the need for this Framework for Standards on Internal Audit. The overall objective of the Framework for Standards on Internal Audit is to promote professionalism in the internal audit activity.

4. Internal audit is conducted in variant economic, legal, cultural and business environments. The organisations in which internal audit is performed differ widely in

size, structure, nature of business, scale, purpose, objectives and geographical spread. Further, the internal audit activity may be performed by an entity’s employees or by some external agency. Thus, the Framework for Standards on Internal Audit applies to all the persons performing internal audit activity, irrespective of whether the function is performed in-house or by an external agency.

5. The Framework for Standards on Internal Audit would cover all aspects of an internal audit activity, including, planning, gathering evidence, documentation, using the work of other experts, evaluating controls and risk management systems and reporting.

### Components of the Framework

6. The Framework for Standards on Internal Audit comprises four components viz., the Code of Conduct, the Competence Framework, the Body of Standards and the Technical Guidance. Each of these components has been discussed in the following paragraphs.

#### The Code of Conduct

7. The Code of Conduct establishes the essential principles of conduct and prescribes ethical behaviour for the professionals in internal audit activity. Every professional must make a commitment to ethical conduct, including integrity, confidentiality, etc.

8. A member of the Institute of Chartered Accountants of India, carrying out an internal audit activity, would additionally be governed by:

- (i) the requirements of the Chartered Accountants Act, 1949;
- (ii) the Code of Ethics issued by the Institute of Chartered Accountants of India; and
- (iii) other relevant pronouncements of the Institute of Chartered Accountants of India.

#### The Competence Framework

9. The Competence Framework address-

es the key characteristics that are required of persons performing internal audit. This includes aspects, such as, objectivity, technical competence, interpersonal skills, operational efficiency and due professional care. The Competence Framework is a minimum expectation.

#### The Body of Standards

10. The Body of Standards ensures commitment to providing quality services and details the expectations required of the individuals engaged in internal audit in discharging their responsibilities. The Standards will specify basic principles and processes, such as defining the scope, planning, communicating, etc. They will further establish the basis for quality and performance evaluation of internal audit. The Body of Standards are mandatory minimum requirements that all the internal auditors must meet.

#### The Technical Guidance

11. Technical Guidance can take two forms. It will include explanatory material on the Standards or it may detail the application of Standards in specific industries or situations in the form of Technical Guides. These Technical Guides would, therefore, provide guidance to internal auditors in resolving professional issues arising during the course of an internal audit while discharging their duties as internal auditors.

#### Authority

12. The first three components of the Framework for Standards on Internal Audit viz., the Code of Conduct, the Competence Framework and the Body of Standards shall be mandatory. Compliance with the mandatory elements of the Framework for Standards on Internal Audit is necessary to meet the responsibilities placed upon the internal auditors in execution of their work since the internal audit activity is carried out at the behest of the governing body and/or the management of an entity and renders service by assessing and reporting upon the effectiveness of issues related to governance, risk and controls and making recommendations for improvements in these areas.

## Standard on Internal Audit (SIA) 4 Reporting

The following is the text of the Standard on Internal Audit (SIA) 4, Reporting, issued by the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the “Preface to the Standards on Internal Audit”, issued by the Institute of Chartered Accountants of India.

In terms of the decision taken by the Council of the Institute, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standard shall become mandatory from such date as notified by the Council.

### Introduction

1. The purpose of this Standard on Internal Audit (SIA) is to establish standards on the form and content of the internal auditor’s report issued as a result of an internal audit performed by an internal auditor of the systems, processes, controls including items of financial statements of an entity.

**2. The internal auditor should review and assess the analysis drawn from the internal audit evidence obtained as the basis for his conclusion on the efficiency and effectiveness of systems, processes and controls including items of financial statements.**

3. This review and assessment involves considering whether the systems, procedures and controls are in existence and are operating effectively.

**4. The internal auditor’s report should contain a clear written expression of significant observations, suggestions/ recommendations based on the policies, processes, risks, controls and transaction processing taken as a whole and managements’ responses.**

### Basic Elements of the Internal Audit Report

5. The internal auditor’s report includes the following basic elements, ordinarily, in the following layout:

- (a) Title;
- (b) Addressee;
- (c) Report Distribution List;
- (d) Period of coverage of the Report;

(e) Opening or introductory paragraph:

- (i) identification of the processes/functions and items of financial statements audited; and
- (ii) a statement of the responsibility of the entity’s management and the responsibility of the internal auditor.

(f) Objectives paragraph - statement of the objectives and scope of the internal audit engagement;

(g) Scope paragraph (describing the nature of an internal audit):

- (i) a reference to the generally accepted audit procedures in India, as applicable;
- (ii) a description of the engagement background and the methodology of the internal audit together with procedures performed by the internal auditor; and
- (iii) a description of the population and the sampling technique used.

(h) Executive Summary, highlighting the key material issues, observations, control weaknesses and exceptions;

(i) Observations, findings and recommendations made by the internal auditor;

(j) Comments from the local management;

(k) Action Taken Report – Action taken/ not taken pursuant to the observations made in the previous internal audit reports;

(l) Date of the report;

(m) Place of signature; and

(n) Internal auditor’s signature with Membership Number.

A measure of uniformity in the form and content of the internal auditor’s report is desirable because it helps to promote the reader’s understanding of the internal auditor’s

report and to identify unusual circumstances when they occur.

**6. The internal auditor should exercise due professional care to ensure that the internal audit report, *inter alia*, is:**

- (i) clear
- (ii) **factual – presents all significant matters with disclosure of material facts**
- (iii) **specific**
- (iv) **concise**
- (v) **unambiguous**
- (vi) **timely**
- (vii) **complies with generally accepted audit procedures in India, as applicable.**

### Title

**7. The internal auditor’s report should have an appropriate title expressing the nature of the Report.**

### Addressee

**8. The internal auditor’s report should be appropriately addressed as required by the circumstances of the engagement.** Ordinarily, the internal auditor’s report is addressed to the appointing authority or such other person as directed.

### Report Distribution List, Coverage and Opening or Introductory Paragraph

**9. There should be a mention of the recipients of the report in the section on Report Distribution List.**

**10. The internal auditor’s report should identify the systems, processes, functional lines or other items of the entity that have been audited, including the date of and period covered.**

**11. The report should include a statement that the operation of systems, procedures and controls are the responsibility of the entity’s management and a statement that the responsibility of the internal auditor is to express an opinion on the weaknesses in internal controls, risk management and governance (entity level controls) framework, highlighting any excep-**

tions and cases of non-compliance and suggest or recommend improvements in the design and operations of controls based on the internal audit.

### Scope Paragraph

12. The internal auditor's report should describe the scope of the internal audit by stating that the internal audit was conducted in accordance with generally accepted audit procedures as applicable. The management needs this as an assurance that the audit has been carried out in accordance with established Standards.

13. "Scope" refers to the internal auditor's ability to perform internal audit procedures deemed necessary in the circumstances.

14. The report should include a statement that the internal audit was planned and performed to obtain reasonable assurance whether the systems, processes and controls operate efficiently and effectively and financial information is free of material misstatement.

15. The internal auditor's report, in line with the terms of the engagement, should describe the internal audit as including:

- (a) examining, on a test basis, evidence to support the amounts and disclosures in financial statements;
- (b) assessing the strength, design and operating effectiveness of internal controls at process level and identifying areas of control weakness, business risks and vulnerability in the system and procedures adopted by the entity;
- (c) assessing the accounting principles and estimates used in the preparation of the financial statements; and
- (d) evaluating the overall entity-wide risk management and governance framework.

16. The Report should include a description of the engagement background, internal audit methodology used and procedures performed by the internal auditor mentioning further that the internal audit provides a rea-

sonable basis for his comments.

### Executive Summary Paragraph

17. The Executive Summary paragraph of the internal auditor's report should clearly indicate the highlights of the internal audit findings, key issues and observations of concern, significant controls lapses, failures or weaknesses in the systems or processes.

### Observations (Main Report) Paragraph

18. The Observations paragraph should clearly mention the process name, significant observations, findings, analysis and comments of the internal auditor.

### Comments from Local Management

19. The Comments from Local Management Paragraph should contain the observations and comments from the local management of the entity provided after giving due cognizance to the internal auditor's comments. This should also include local management's action plan for resolution of the issues and compliance to the internal auditor's recommendations and suggestions on the areas of process and control weakness/ deficiency. The management action plan, should contain, *inter alia* :

- (a) the timeframe for taking appropriate corrective action;
- (b) the person responsible; and
- (c) resource requirements, if any, for ensuring such compliance.

20. Further comments from the internal auditor, in response to the auditee feedback, are to be clearly mentioned. This paragraph should also contain the internal auditor's suggestions and recommendations to mitigate risks, strengthen controls and streamline processes with respect to each of the observations and comments made.

### Action Taken Report Paragraph

21. The Action Taken Report paragraph should be appended after the observations and findings and should include:

- (a) Status of compliance / corrective action already taken / being taken by the auditee with respect to previous internal audit

observations;

- (b) Status of compliance / corrective action not taken by the auditee with respect to previous internal audit observations and the reasons for non-compliance thereof; and
- (c) Revised timelines for compliance of all open items in (b) above and fixation of the responsibility of the concerned process owner.

### Date

22. The date of an internal auditor's report is the date on which the internal auditor signs the report expressing his comments and observations.

### Place of Signature

23. The report should name the specific location, which is ordinarily the city where the internal audit report is signed.

### Internal Auditor's Signature

24. The report should be signed by the internal auditor in his personal name. The internal auditor should also mention the membership number assigned by the Institute of Chartered Accountants of India in the report so issued by him.

### Communication to Management

25. The internal audit report contains the observations and comments of the internal auditor, presents the audit findings, and discusses recommendations for improvements. To facilitate communication and ensure that the recommendations presented in the final report are practical from the point of view of implementation, the internal auditor should discuss the draft with the entity's management prior to issuing the final report. The different stages of communication and discussion should be as under:

- (a) **Discussion Draft** - At the conclusion of fieldwork, the internal auditor should draft the report after thoroughly reviewing his working papers and the discussion draft before it is presented to the entity's management for auditee's comments. This discussion draft should be submitted to the entity management

for their review before the exit meeting.

- (b) **Exit Meeting** - The internal auditor should discuss with the management of the entity regarding the findings, observations, recommendations, and text of the discussion draft. At this meeting, the entity's management should comment on the draft and the internal audit team should work to achieve consensus and reach an agreement on the internal audit findings.
- (c) **Formal Draft** - The internal auditor should then prepare a formal draft, taking into account any revision or modification resulting from the exit meeting

and other discussions. When the changes have been reviewed by the internal auditor and the entity management, the final report should be issued.

- (d) **Final Report** - The internal auditor should submit the final report to the appointing authority or such members of management, as directed. The periodicity of the Report should be as agreed in the scope of the internal audit engagement. The internal auditor should mention in the Report, the dates of discussion draft, exit meeting, Formal Draft and Final Report.

### Limitation on Scope

26. When there is a limitation on the

scope of the internal auditor's work, the internal auditor's report should describe the limitation.

### Restriction on Usage and Report Circulation Otherwise Than to the List of Intended Recipients

27. The internal auditor should state in the Report that the same is to be used for the intended purpose only as agreed upon and the circulation of the Report should be limited to the recipients mentioned in the Report Distribution List.

### Effective Date

28. This Standard on Internal Audit is applicable to all internal audits commencing on or after \_\_\_\_\_. Earlier application of the SIA is encouraged.

## Standard on Internal Audit (SIA) 5 Sampling

*The following is the text of the Standard on Internal Audit (SIA) 5, Sampling, issued by the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the "Preface to the Standards on Internal Audit", issued by the Institute of Chartered Accountants of India.*

*In terms of the decision taken by the Council of the Institute, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standard shall become mandatory from such date as notified by the Council.*

### Introduction

1. The purpose of this Standard on Internal Audit (SIA) is to establish standards on the design and selection of an audit sample and provide guidance on the use of audit sampling in internal audit engagements. The SIA also deals with the evaluation of the sample results. This SIA applies equally to both statistical and non-statistical sampling methods. Either method, when properly applied, can provide sufficient appropriate audit evidence.

**2. When using either statistical or non-statistical sampling methods, the internal auditor should design and select an audit sample, perform audit procedures thereon, and evaluate sample results so as to provide sufficient appropriate audit evidence to meet**

**the objectives of the internal audit engagement unless otherwise specified by the client.**

### Definitions

3. "Audit sampling" means the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the internal auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form a conclusion concerning the population. Certain testing procedures, however, do not come within the definition of sampling. Tests performed on 100% of the items within a population do not involve sampling. Likewise, applying internal audit procedures to all items within a population which have a particular characteristic (for example, all items over a certain amount) does not qualify as audit sampling with respect to the portion of the population examined, nor with regard to the population as a whole, since the items were not selected from the total population on a basis that was expected to be representative. Such items might imply some characteristic of the remaining portion of the population but would not necessarily be the basis for a valid conclusion about the remaining portion of the population.

4. "Error" means either control deviations when performing tests of controls,

or misstatements, when performing tests of details.

5. "Population" means the entire set of data from which the sample is selected and about which the internal auditor wishes to draw conclusions. A population may be divided into various strata, or sub-populations, with each stratum being examined separately.

6. "Sampling risk" means the risk that from the possibility that the internal auditor's conclusions, based on examination of a sample may be different from the conclusion reached if the entire population was subjected to the same types of internal audit procedure. The two types of sampling risk are –

- (a) The risk that the internal auditor concludes, in the case of tests of controls (TOC), that controls are more effective than they actually are, or in the case of tests of details (TOD), that a material error or misstatement does not exist when in fact it does.
- (b) The risk that the internal auditor concludes, in the case of tests of controls (TOC), that controls are less effective than they actually are, or in the case of tests of details (TOD), that a material error or misstatement exists when in fact it does not.

The mathematical complements of these risks are termed confidence levels.

7. “Sampling unit” means the individual items or units constituting a population, for example, credit entries in bank statements, sales invoices or debtors’ balances.

8. “Statistical sampling” means any approach to sampling procedure which has the following characteristics –

- (a) Random selection of a sample; and
- (b) Use of theory of probability to evaluate sample results, including measurement of sampling risk.

9. “Tolerable error” means the maximum error in a population that the internal auditor is willing to accept.

### Use of Sampling in Risk Assessment Procedures and Tests of Controls

10. The internal auditor performs risk assessment procedures to obtain an understanding of the entity, business and its environment, including the mechanism of its internal control. Ordinarily, risk assessment procedures do not involve the use of sampling. However, there are cases, where the internal auditor often plans and performs tests of controls concurrently with obtaining an understanding of the design of controls and examining whether they have been implemented.

11. Tests of controls are performed when the internal auditor’s risk assessment includes an expectation of the operating effectiveness of controls. Sampling of tests of controls is appropriate when application of the control leaves audit evidence of performance (for example, initials of the credit manager on a sales invoice indicating formal credit approval).

**12. Sampling risk can be reduced by increasing sample size for both tests of controls and tests of details. Non-sampling risk can be reduced by proper engagement planning, supervision, monitoring and review.**

### Design of the Sample

**13. When designing an audit sample, the internal auditor should consider the specific audit objectives, the population from which the internal auditor wishes to sample, and the sample size.**

#### Internal Audit Objectives

14. The internal auditor would first consider the specific audit objectives to be

achieved and the internal audit procedures which are likely to best achieve those objectives. In addition, when internal audit sampling is appropriate, consideration of the nature of the audit evidence sought and possible error conditions or other characteristics relating to that audit evidence will assist the internal auditor in defining what constitutes an error and what population to use for sampling. For example, when performing tests of controls over an entity’s purchasing procedures, the internal auditor will be concerned with matters such as whether an invoice was clerically checked and properly approved. On the other hand, when performing substantive procedures on invoices processed during the period, the internal auditor will be concerned with matters such as the proper reflection of the monetary amounts of such invoices in the periodic financial statements. When performing tests of controls, the internal auditor makes an assessment of the rate of error the internal auditor expects to find in the population to be tested. This assessment is on the basis of the internal auditor’s understanding of the design of the relevant controls, and whether they have actually been implemented or the examination of a small number of items from the population.

#### Population

15. The population is the entire set of data from which the internal auditor wishes to sample in order to reach a conclusion. The internal auditor will need to determine that the population from which the sample is drawn is appropriate for the specific audit objective. For example, if the internal auditor’s objective were to test for overstatement of accounts receivable, the population could be defined as the accounts receivable listing. On the other hand, when testing for understatement of accounts payable, the population would not be the accounts payable listing, but rather subsequent disbursements, unpaid invoices, suppliers’ statements, unmatched receiving reports, or other populations that would provide audit evidence of understatement of accounts payable.

16. The individual items that make up the population are known as sampling units. The population can be divided into sampling units in a variety of ways. For example, if the internal auditor’s objective were to test the validity of accounts receivables, the sampling unit could be defined as customer balances or individual customer invoices. The internal auditor defines the sampling unit in order to obtain an effi-

cient and effective sample to achieve the particular audit objectives.

17. It is important for the internal auditor to ensure that the population is appropriate to the objective of the internal audit procedure, which will include consideration of the direction of testing. The population also needs to be complete, which means that if the internal auditor intends to use the sample to draw conclusions about whether a control activity operated effectively during the financial reporting period, the population needs to include all relevant items from throughout the entire period.

**18. When performing the audit sampling, the internal auditor performs internal audit procedures to ensure that the information upon which the audit sampling is performed is sufficiently complete and accurate.**

#### Stratification

19. To assist in the efficient and effective design of the sample, stratification may be appropriate. Stratification is the process of dividing a population into sub-populations, each of which is a group of sampling units, which have similar characteristics (often monetary value). The strata need to be explicitly defined so that each sampling unit can belong to only one stratum. This process reduces the variability of the items within each stratum. Stratification, therefore, enables the internal auditor to direct audit efforts towards the items which, for example, contain the greatest potential monetary error. For example, the internal auditor may direct attention to larger value items for accounts receivable to detect overstated material misstatements. In addition, stratification may result in a smaller sample size.

#### Sample Size

**20. When determining the sample size, the internal auditor should consider sampling risk, the tolerable error, and the expected error.** The lower the risk that the internal auditor is willing to accept, the greater the sample size needs to be. Examples of some factors affecting sample size are contained in Appendix 1 and Appendix 2 to the Standard.

21. The sample size can be determined by the application of a statistically based formula or through exercise of professional judgment applied objectively to the circumstances of the particular internal audit engagement.

## Statistical and Non-Statistical Approaches

22. The decision of using either statistical or non-statistical sampling approach is a matter for the internal auditor's professional judgment. In the case of tests of controls, the internal auditor's analysis of the nature and cause of errors will often be of more importance than the statistical analysis of the mere presence or absence of errors. In such case, non-statistical sampling approach may be preferred.

23. When applying statistical sampling, sample size may be ascertained using either probability theory or professional judgment. Sample size is a function of several factors. Appendices 1 and 2 discuss some of these factors.

### Tolerable Error

24. Tolerable error is the maximum error in the population that the internal auditor would be willing to accept and still conclude that the result from the sample has achieved the objective(s) of the internal audit. Tolerable error is considered during the planning stage and, for substantive procedures, is related to the internal auditor's judgement about materiality. The smaller the tolerable error, the greater the sample size will need to be.

25. In tests of controls, the tolerable error is the maximum rate of deviation from a prescribed control procedure that the internal auditor would be willing to accept, based on the preliminary assessment of control risk. In substantive procedures, the tolerable error is the maximum monetary error in an account balance or class of transactions that the internal auditor would be willing to accept so that when the results of all audit procedures are considered, the internal auditor is able to conclude, with reasonable assurance, that the financial statements are not materially misstated.

### Expected Error

26. If the internal auditor expects error to be present in the population, a larger sample than when no error is expected ordinarily needs to be examined to conclude that the actual error in the population is not greater than the planned tolerable error. Smaller sample sizes are justified when the population is expected to be error free. In determining the expected error in a population, the internal auditor would consider such matters as error levels identified in previous internal audits, changes in the entity's procedures, and evidence available from other procedures.

## Selection of the Sample

**27. The internal auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items or sampling units in the population have an opportunity of being selected.**

28. While there are a number of selection methods, three methods commonly used are:

- Random selection and use of CAATs
- Systematic selection
- Haphazard selection

Appendix 3 to the Standard discusses these methods.

## Evaluation of Sample Results

**29. Having carried out, on each sample item, those audit procedures that are appropriate to the particular audit objective, the internal auditor should:**

- (a) analyse the nature and cause of any errors detected in the sample;
- (b) project the errors found in the sample to the population;
- (c) reassess the sampling risk; and
- (d) consider their possible effect on the particular internal audit objective and on other areas of the internal audit engagement.

**30. The internal auditor should evaluate the sample results to determine whether the assessment of the relevant characteristics of the population is confirmed or whether it needs to be revised.**

### Analysis of Errors in the Sample

31. In analysing the errors detected in the sample, the internal auditor will first need to determine that an item in question is in fact an error. In designing the sample, the internal auditor will have defined those conditions that constitute an error by reference to the audit objectives. For example, in a substantive procedure relating to the recording of accounts receivable, a mis-posting between customer accounts does not affect the total accounts receiv-

able. Therefore, it may be inappropriate to consider this an error in evaluating the sample results of this particular procedure, even though it may have an effect on other areas of the audit such as the assessment of doubtful accounts.

32. When the expected audit evidence regarding a specific sample item cannot be obtained, the internal auditor may be able to obtain sufficient appropriate audit evidence through performing alternative procedures. For example, if a positive account receivable confirmation has been requested and no reply was received, the internal auditor may be able to obtain sufficient appropriate audit evidence that the receivable is valid by reviewing subsequent payments from the customer. If the internal auditor does not, or is unable to, perform satisfactory alternative procedures, or if the procedures performed do not enable the internal auditor to obtain sufficient appropriate audit evidence, the item would be treated as an error.

33. The internal auditor would also consider the qualitative aspects of the errors. These include the nature and cause of the error and the possible effect of the error on other phases of the audit.

34. In analysing the errors discovered, the internal auditor may observe that many have a common feature, for example, type of transaction, location, product line, or period of time. In such circumstances, the internal auditor may decide to identify all items in the population which possess the common feature, thereby producing a sub-population, and extend audit procedures in this area. The internal auditor would then perform a separate analysis based on the items examined for each sub-population.

### Projection of Errors

35. The internal auditor projects the error results of the sample to the population from which the sample was selected. There are several acceptable methods of projecting error results. However, in all the cases, the method of projection will need to be consistent with the method used to select the sampling unit. When projecting error results, the internal auditor needs to keep in mind the qualitative aspects of the errors found. When the population has been divided into sub-population, the projection of errors is done separately for each sub-population and the results are combined.

36. For tests of controls, no explicit projection of errors is necessary since the sample error rate is also the projected rate of error for the population as a whole.

### Reassessing Sampling Risk

37. The internal auditor needs to consider whether errors in the population might exceed the tolerable error. To accomplish this, the internal auditor compares the projected population error to the tolerable error taking into account the results of other audit procedures relevant to the specific control or financial statement assertion. The projected population error used for this comparison in the case of substantive procedures is net of adjustments made by the entity. When the projected error exceeds tolerable error, the internal auditor reassesses the sampling risk and if that risk is unacceptable, would consider extending the audit procedure or performing alternative internal audit procedures.

38. If the evaluation of sample results indicate that the assessment of the relevant characteristic of the population needs to be revised, the internal auditor, may:

- (a) Request management to investigate the identified errors and the potential for any further errors, and to make necessary adjustments, in cases where management prescribes the sample size; and / or
- (b) Modify the nature, timing and extent of internal audit procedures. In case of tests of controls, the internal auditor might extend the sample size, test an alternative control or modify related substantive procedures; and / or
- (c) Consider the effect on the Internal Audit Report.

### Documentation

39. Documentation provides the essential support to the opinion and/ or findings of the internal auditor. In the context of sampling, the internal auditor's documentation may include aspects such as:

- i. Relationship between the design of the sample *vis a vis* specific audit objectives, population from which sample is drawn and the sample size.
- ii. Assessment of the expected rate of error in the population to be tested *vis a vis* auditor's understanding of

the design of the relevant controls.

- iii. Assessment of the sampling risk and the tolerable error.
- iv. Assessment of the nature and cause of errors.
- v. Rationale for using a particular sampling technique and results thereof.
- vi. Analysis of the nature and cause of any errors detected in the sample.
- vii. Projection of the errors found in the sample to the population.
- viii. Reassessment of sampling risk, where appropriate.
- ix. Effect of the sample results on the internal audit's objective(s).
- x. Projection of sample results to the characteristics of the population.

### Effective Date

40. This Standard on Internal Audit is applicable to all internal audits commencing on or after \_\_\_\_\_. Earlier application of the SIA is encouraged.

## Appendix 1

### Examples of Factors Influencing Sample Size for Tests of Controls

The following are some factors which the internal auditor considers when determining the sample size required for tests of controls (TOC). These factors need to be considered together assuming the internal auditor does not modify the nature or timing of TOC or otherwise modify the approach to substantive procedures in response to assessed risks.

Factor to be considered by Internal Auditor	Effect on sample size
An increase in the extent to which the risk of material misstatement is reduced by the operating effectiveness of controls	Increase
An increase in the rate of deviation from the prescribed control activity that the internal auditor is willing to accept	Decrease

An increase in the rate of deviation from the prescribed control activity that the internal auditor expects to find in the population	Increase
An increase in the internal auditor's required confidence level	Increase
An increase in the number of sampling units in the population	Negligible effect

### Notes –

1. Other things being equal, the more the internal auditor relies on the operating effectiveness of controls in risk assessment, the greater is the extent of the internal auditor's tests of controls, and hence the sample size is increased.
2. The lower the rate of deviation that the internal auditor is willing to accept, the larger the sample size needs to be.
3. The higher the rate of deviation that the internal auditor expects, the larger the sample size needs to be so as to make a reasonable estimate of the actual rate of deviation.
4. The higher the degree of confidence that the internal auditor requires that the results of the sample are indicative of the actual incidence of errors in the population, the larger the sample size needs to be.
5. For large populations, the actual population size has little effect on sample size. For small populations, sampling is often not as efficient as alternative means of obtaining sufficient appropriate audit evidence.

## Appendix 2

### Examples of Factors Influencing Sample Size for Tests of Details (TOD)

The following are some factors which the internal auditor considers when determining the sample size required for tests of details (TOD). These factors need to be considered together assuming the internal auditor does not modify the nature or

timing of TOD or otherwise modify the approach to substantive procedures in response to assessed risks.

Factor to be considered by Internal Auditor	Effect on sample size
An increase in the internal auditor's assessment of the risk of material misstatement	Increase
An increase in the use of other substantive procedures by the internal auditor, directed at the same assertion	Decrease
An increase in the total error that the internal auditor is willing to accept (Tolerable Error)	Decrease
Stratification of the population when appropriate	Decrease
An increase in the amount of error which the internal auditor expects to find in the population	Increase
An increase in the internal auditor's required confidence level	Increase
The number of sampling units in the population	Negligible effect

## Appendix 3

### Methods of Sample Selection

The principal methods of sample selection are as –

1. **Using a computerised random number generator** or through random number tables.

2. **Systematic selection** – In this method, the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 20, and having thus determined a starting point within the first 20, each 20<sup>th</sup> sampling unit thereafter is selected. Although the starting point may be haphazardly determined, the sample is likely to be truly random if the same is determined by using a computerised random number generator or random number tables. In this method, the internal auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with any particular pattern within the population.

3. **Haphazard selection** – In this method, the internal auditor selects the sample without following any structured technique. **The internal auditor should attempt to ensure that all items within the population have a chance of selection, without having any conscious bias or predictability.** This method is not appropriate when using statistical sampling technique.

4. **Block selection** – This method involves selection of a block(s) of adjacent or contiguous items from within the population. Block selection normally cannot be used in internal audit sampling because most populations are structured in such a manner that items forming a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. This method would not be an appropriate sample selection technique when the in-

ternal auditor intends to draw valid inferences about the entire population, based on the sample.

## Appendix 4

### Frequency of Control Activity and Sample Size

The following guidance related to the frequency of the performance of control may be considered when planning the extent of tests of operating effectiveness of manual controls for which control deviations are not expected to be found. The internal auditor may determine the appropriate number of control occurrences to test based on the following minimum sample size for the frequency of the control activity dependant on whether assessment has been made on a lower or higher risk of failure of the control.

Frequency of control activity	Minimum sample size	
	Risk of failure	
	Lower	Higher
Annual	1	1
Quarterly (including period-end, i.e., +1)	1+1	1+1
Monthly	2	3
Weekly	5	8
Daily	15	25
Recurring manual control (multiple times per day)	25	40

#### Note

Although +1 is used to indicate that the period-end control is tested, this does not mean that for more frequent control operations the year-end operation cannot be tested.

## Standard on Internal Audit (SIA) 6 Analytical Procedures

The following is the text of the Standard on Internal Audit (SIA) 6, Analytical Procedures, issued by the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the "Preface to the Standards on Internal

Audit", issued by the Institute of Chartered Accountants of India.

In terms of the decision taken by the Council of the Institute, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The

Standard shall become mandatory from such date as notified by the Council.

### Introduction

1. The purpose of this Standard on Internal Audit (SIA) is to establish standards

on the application of analytical procedures during an internal audit.

**2. The internal auditor should apply analytical procedures as the risk assessment procedures at the planning and overall review stages of the internal audit.** Risk assessment procedures refer to the internal audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, in the information subjected to internal audit. Analytical procedures may also be applied at other stages.

3. "Analytical procedures" means the analysis of significant ratios and trends, including the resulting investigation of fluctuations and relationships in both financial and non-financial data that are inconsistent with other relevant information or which deviate significantly from predicted amounts. Analytical procedures provide the internal auditor with an efficient and effective means of making an assessment of information collected in an audit. The assessment results from comparing such information with expectations identified or developed by the internal auditor.

### Nature and Purpose of Analytical Procedures

4. Analytical procedures include the consideration of comparisons of the entity's financial and non-financial information with, for example:

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts or expectations of the internal auditor.
- Predictive estimates prepared by the internal auditor, such as an estimation of depreciation charge for the year.
- Similar industry information, such as a comparison of the entity's ratio of sales to trade debtors with industry averages, or with other entities of comparable size in the same industry.

5. Analytical procedures also include consideration of relationships:

- Among elements of financial information that would be expected to conform to a predictable pattern

based on the entity's experience, such as gross margin percentages.

- Between financial information and relevant non-financial information, such as payroll costs to number of employees or total production costs to quantity produced.

6. Various methods may be used in performing the above procedures. These range from simple comparisons to complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, financial statements of components (such as subsidiaries, divisions or segments) and individual elements of financial information and relevant non-financial information. The internal auditor's choice of procedures, methods and level of application is a matter of professional judgement. Specific analytical procedures include, but are not limited to ratio, trend, and regression analysis, reasonableness tests, period-to-period comparisons, comparisons with budgets, forecasts, and external economic information.

**7. In determining the extent to which the analytical procedures should be used, the internal auditor should consider the following factors, including:**

- The significance of the area being examined.
- The adequacy of the system of internal control.
- The availability and reliability of financial and non-financial information.
- The precision with which the results of analytical procedures can be predicted.
- The availability and comparability of information regarding the industry in which the organisation operates.
- The extent to which other auditing procedures provide support for audit results.

**After evaluating the aforementioned factors, the internal auditor should consider and use additional auditing procedures, as necessary, to achieve the audit objective.**

8. Analytical procedures are used for the following purposes:

- to assist the internal auditor as risk assessment procedures to obtain initial understanding of the entity and its environment and thereafter in planning the nature, timing and extent of other internal audit procedures;
- as substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions;
- as an overall review of the systems and processes in the final review stage of the internal audit; and
- to evaluate the efficiency of various business/ management systems.

9. Analytical procedures may identify, among other things, differences that are not expected or absence of differences when they are expected, which may have arisen on account of factors such as errors, frauds, unusual or non recurring transaction or events, etc.

### Analytical Procedures as Risk Assessment Procedures and in Planning the Internal Audit

**10. The internal auditor should apply analytical procedures as risk assessment procedures to obtain an understanding of the business, the entity and its environment and in identifying areas of potential risk.** Application of analytical procedures may indicate aspects of the business of which the internal auditor was unaware and will assist in determining the nature, timing and extent of other internal audit procedures.

11. Analytical procedures in planning the internal audit use both financial and non-financial information, for example, in retail business, the relationship between sales and square footage of selling space or volume of goods sold.

### Analytical Procedures as Substantive Procedures

12. The internal auditor's reliance on substantive procedures to reduce detection risk relating to specific financial statement assertions and assertions relating to process, systems and controls may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedures to use to achieve a particular internal audit objective

is based on the internal auditor's judgement about the expected effectiveness and efficiency of the available procedures in reducing detection risk for specific financial statement assertions or assertions relating to process, systems and controls.

13. The internal auditor will ordinarily inquire of management as to the availability and reliability of information needed to apply analytical procedures and the results of any such procedures performed by the entity. It may be efficient to use analytical data prepared by the entity, provided the internal auditor is satisfied that such data is properly prepared.

14. When intending to perform analytical procedures as substantive procedures, the internal auditor will need to consider a number of factors such as the:

- Objectives of the analytical procedures and the extent to which their results can be relied upon.
- Nature of the business, entity and the degree to which information can be disaggregated.
- Availability of information, both financial, such as budgets or forecasts, and non-financial, such as the number of units produced or sold.
- Reliability of the information available, for example, whether budgets is prepared with sufficient professional care.
- Relevance of the information available, for example, whether budgets have been established as results to be expected rather than as goals to be achieved.
- Source of the information available, for example, sources independent of the entity are ordinarily more reliable than internal sources.
- Comparability of the information available, for example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products.
- Knowledge gained during previous internal audits, together with the internal auditor's understanding of the effectiveness of the accounting and internal control systems and the types of problems that in prior periods have given rise to account-

ing adjustments.

- Controls over the preparation of the information, for example, controls over the preparation, review and maintenance of MIS reports, budgets, etc.

### Analytical Procedures in the Overall Review at the End of the Internal Audit

**15. The internal auditor should apply analytical procedures at or near the end of the internal audit when forming an overall conclusion as to whether the systems, processes and controls as a whole are robust, operating effectively and are consistent with the internal auditor's knowledge of the business.** The conclusions drawn from the results of such procedures are intended to corroborate conclusions formed during the internal audit of individual components or elements of the financial statements, e.g., purchases, and assist in arriving at the overall conclusion. However, in some cases, as a result of application of analytical procedures, the internal auditor may identify areas where further procedures need to be applied before the internal auditor can form an overall conclusion about the systems, processes and associated controls.

### Extent of Reliance on Analytical Procedures

16. The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides the internal auditor evidence as to the completeness, efficiency and effectiveness of systems, processes and controls. However, reliance on the results of analytical procedures will depend on the internal auditor's assessment of the risk that the analytical procedures may identify relationships as expected when, in fact, a material misstatement exists.

17. The extent of reliance that the internal auditor places on the results of analytical procedures depends on the following factors:

- materiality of the items involved, for example, when inventory balances are material, the internal auditor does not rely only on analytical procedures in forming conclusions. However, the internal auditor may

rely solely on analytical procedures for certain income and expense items when they are not individually material;

- other internal audit procedures directed toward the same internal audit objectives, for example, other procedures performed by the internal auditor while reviewing the credit management process, in the collectibility of accounts receivable, such as the review of subsequent cash receipts, might confirm or dispel questions raised from the application of analytical procedures to an ageing schedule of customers' accounts;
- accuracy with which the expected results of analytical procedures can be predicted. For example, the internal auditor will ordinarily expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising; and
- assessments of inherent and control risks, for example, if internal control over sales order processing is weak and, therefore, control risk is high, more reliance on tests of details of transactions and balances than on analytical procedures in drawing conclusions on receivables may be required.

18. The internal auditor will need to consider testing the controls, if any, over the preparation of information used in applying analytical procedures. When such controls are effective, the internal auditor will have greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The controls over non-financial information can often be tested in conjunction with tests of accounting-related controls. For example, an entity in establishing controls over the processing of sales invoices may include controls over the recording of unit sales. In these circumstances, the internal auditor could test the controls over the recording of unit sales in conjunction with tests of the controls over the processing of sales invoices.

### Investigating Unusual Items or Trends

**19. When analytical procedures identify significant fluctuations or relationships that are inconsistent with other**

relevant information or that deviate from predicted amounts, the internal auditor should investigate and obtain adequate explanations and appropriate corroborative evidence. The examination and evaluation should include inquiries of management and the application of other auditing procedures until the internal auditor is satisfied that the results or relationships are sufficiently explained. Unexplained results or relationships may be indicative of a significant condition such as a potential error, irregularity, or illegal act. Results

or relationships that are not sufficiently explained should be communicated to the appropriate levels of management. The internal auditor may recommend appropriate courses of action, depending on the circumstances.

20. The investigation of unusual fluctuations and relationships ordinarily begins with inquiries of management, followed by:

- corroboration of management's responses, for example, by comparing them with the internal auditor's knowledge of the business and

other evidence obtained during the course of the internal audit; and

- consideration of the need to apply other internal audit procedures based on the results of such inquiries, if management is unable to provide an explanation or if the explanation is not considered adequate.

### Effective Date

21. This Standard on Internal Audit is applicable to all internal audits commencing on or after \_\_\_\_\_. Earlier application of the SIA is encouraged.

## Standard on Internal Audit (SIA) 7 Quality Assurance in Internal Audit

The following is the text of the Standard on Internal Audit (SIA) 7, *Quality Assurance in Internal Audit*, issued by the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the "Preface to the Standards on Internal Audit", issued by the Institute of Chartered Accountants of India.

In terms of the decision taken by the Council of the Institute, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standard shall become mandatory from such date as notified by the Council.

### Introduction

1. Paragraph 3.1 of the Preface to the Standards on Internal Audit, describes the internal audit as follows:

*"Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system. Internal audit, therefore, provides assurance that there is transparency in reporting, as a part of good governance."*

2. Paragraphs 7 and 8 of the Standard on Internal Audit (SIA) 2, Basic Principles Governing Internal Audit, state as follows:

**"7. The internal auditor should either have or obtain such skills and competence, acquired through general education, technical knowledge obtained through study and formal courses, as are necessary for the purpose of discharging his responsibilities.**

**8. The internal auditor also has a continuing responsibility to maintain professional knowledge and skills at a level required to ensure that the client or the employer receives the advantage of competent professional service based on the latest developments in the profession, the economy, the relevant industry and legislation."**

### Scope

3. This Standard on Internal Audit shall apply whenever an internal audit is carried out, whether carried out by an in house internal audit department or by an external firm of professional accountants. For the purpose of this Standard, the term "firm" means a sole practitioner/proprietor, partnership or any such entity of professional accountants as may be permitted by law<sup>1</sup>.

### Objective

4. The purpose of this Standard on Internal Audit (SIA) is to establish standards and provide guidance regarding quality assurance in internal audit.

**5. A system for assuring quality in internal audit should provide reasonable assurance that the internal auditors**

comply with professional Standards, regulatory and legal requirements, so that the reports issued by them are appropriate in the circumstances.

6. In order to ensure compliance with the professional Standards, regulatory and legal requirements, and to achieve the desired objective of the internal audit, a person within the organisation should be entrusted with the responsibility for the quality in the internal audit, whether done in – house or by an external agency.

7. In the case of the in – house internal audit or a firm carrying out internal audit, the person entrusted with the responsibility for the quality in internal audit should ensure that the system of quality assurance include policies and procedures addressing each of the following elements:

- Leadership responsibilities for quality in internal audit* - The person entrusted with the responsibility for the quality in internal audit should take responsibility for the overall quality in internal audit.
- Ethical requirements* - The person entrusted with the responsibility for the quality in internal audit should establish policies and procedures designed to provide it with reasonable assurance that the personnel comply with

<sup>1</sup>The Standard on Quality Control (SQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements* issued by the Council of the Institute of Chartered Accountants of India applies to the firms carrying out internal audit to the extent such internal audit activities fall under the scope of audits and reviews of the historical financial information and other assurance and other related services.

relevant ethical requirements. If matters come to his attention that indicate that the members of the internal audit engagement team have not complied with relevant ethical requirements, he should, in consultation with the appropriate authority in the entity, determine the appropriate course of action.

- c) *Acceptance and continuance of client relationship and specific engagement, as may be applicable* – The person entrusted with the responsibility for the quality in internal audit should establish policies and procedures for the acceptances and continuance of client relationships and specific engagements, designed to provide reasonable assurance that it will undertake or continue relationships and engagements.
- d) *Human resources* - The person entrusted with the responsibility for the quality in internal audit should establish policies and procedures regarding assessment of the staff's capabilities and competence designed to provide it with reasonable assurance that there are sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to:
- Perform engagements in accordance with professional standards and regulatory and legal requirements; and
  - Enable the firm or engagement partner to issue reports that are appropriate in the circumstances.
- e) *Engagement performance*- The person entrusted with the responsibility for the quality in internal audit should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with the applicable professional Standards and regulatory and legal requirements and that the reports issued by the internal auditors

are appropriate in the circumstances.

- f) *Monitoring* - The person entrusted with the responsibility for the quality in internal audit should establish policies and procedures designed to provide reasonable assurance that the policies and procedures relating to the system of quality assurance are relevant, adequate, operating effectively and complied with in practice.

8. In order to improve the functionalities of the organisation, transparency in reporting and good governance, the person entrusted with responsibility for the quality in internal audit, while establishing the quality assurance framework, should consider the following parameters of the internal audit activity:

- Terms of engagement and their adequacy.
- Professional standards and compliance therewith.
- Internal audit goals and the extent to which they are being achieved.
- Recommendations for improving the quality of internal audit and the extent to which they are being implemented and their effectiveness.
- Skills and technology used in carrying out internal audit.

9. The person entrusted with the responsibility for the quality in internal audit needs to ensure that the quality assurance framework is embedded in the internal audit. This can, for example, be achieved in the following manner:

- Developing an internal audit manual clearly defining the specific role and responsibilities, policies and procedures, documentation requirements, reporting lines and protocols, targets and training requirements for the staff, internal audit performance measures and the indicators.
- Ensuring that the internal audit staff at all levels is appropriately trained and adequately supervised and directed on all assignments.

- Identifying the customers of the internal audit activity.
- Establishing a formal process of feedback from the users of the internal audit services, such as the senior management executives, etc. Some of the attributes on which the feedback may be sought include quality, timeliness, value addition, efficiency, innovation, effective communication, audit team, time management. **The responses received from the users of the internal audit services should also be shared with the appropriate levels of management and those charged with governance.**
- Establishing appropriate performance criteria for measuring the performance of the internal audit function. In case the internal audit activity is performed by an external agency, the contract of the engagement should contain a clause for establishment of performance measurement criteria and periodic performance review. These performance measurement criteria should be approved by the management.
- Identify and benchmark with industry/ peer group performance.

10. The quality assurance framework established by the person entrusted with the responsibility for the quality in internal audit should, therefore, cover all the elements of the internal audit activity. For example,

- Development and implementation of the internal audit policies and procedures.
- Maintenance and monitoring of the budget for the internal audit activity.
- Maintenance and updations of the overall internal audit plan.
- Identification of the risk areas and the internal audit plan to address these risks.
- Acquisition and deployment of audit tools and use of technology to enhance the efficiency and effectiveness of the internal audit activity.
- Co-ordination with the external auditors.

- Staffing related aspects of internal audit – recruitment, training, etc.
- Planning and implementation of the training and professional development of the internal audit staff.
- Implementation of the performance metrics for the internal audit activity and periodic monitoring of the same.
- Review of the follow up actions taken on the findings of the internal audit activity.

### Internal Quality Reviews

11. The internal quality review framework should be designed with a view to provide reasonable assurance to that the internal audit is able to efficiently and effectively achieve its objectives of adding value and strengthening the overall governance mechanism of the entity, including the entity’s strategic risk management and internal control system.

#### Internal Quality Reviewer

12. The internal quality review should be done by the person entrusted with the responsibility for the quality in internal audit and/ or other experienced member(s) of the internal audit function.

13. The internal quality reviews should be undertaken on an ongoing basis. The person entrusted with the responsibility for the quality in internal audit should ensure that recommendations resulting from the quality reviews for the improvements in the internal audit activity are promptly implemented.

#### Communicating the Results of the Internal Quality Review

14. The person entrusted with the responsibility for the quality in internal audit should also ensure that the results of the internal quality reviews are also communicated to the appropriate levels of management and those charged with governance on a timely basis along with the proposed plan of action to address issues and concerns raised in the review report.

### External Quality Review

15. External quality review is a critical factor in ensuring and enhancing the quality of internal audit. **The frequency of the external quality review should be**

**based on a consideration of the factors such as the maturity level of the internal audit activity in the entity, results of the earlier internal audit quality reviews, feedbacks as to the usefulness of the internal audit activity from the customers of the internal audit, costs *vis a vis* perceived benefits of the frequent external reviews. The frequency should not in any case be less than once in three years.**

#### External Quality Reviewer

16. The external quality review should be done by a professionally qualified person having an in depth knowledge and experience of, *inter alia*, the professional Standards applicable to the internal auditors, the processes and procedures involved in the internal audit generally and those peculiar to the industry in which the entity is operating, etc. The external quality reviewer should be appointed in consultation with the person entrusted with the responsibility for the quality in internal audit, senior management and those charged with governance.

#### Communicating Results of the External Quality Review

17. The external quality reviewer should discuss his findings with the person entrusted with the responsibility for the quality in internal audit. His final report should contain his opinion on all the parameters of the internal audit activity, as discussed in paragraph 10, and should be submitted to the person entrusted with the responsibility for the quality in internal audit and copies thereof be also sent to those charged with governance. The person entrusted with the responsibility for the quality in internal audit should, also submit to those charged with governance, a plan of action to address the issues and concerns raised by the external quality reviewers in his report.

#### Effective Date

18. This SIA is effective for all quality assessments/reviews of internal audit undertaken on or after ..... Earlier application of the SIA is encouraged. □

## Accounting Standard (AS) 2 (Revised)

### Inventories

The following is the Exposure Draft of the Accounting Standard (AS) 2 (revised), Inventories, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, for comments. The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to be received not later than **November 15, 2008**. Comments can also be sent by e-mail at [edcommentsasb@icai.org](mailto:edcommentsasb@icai.org) or [tdte@icai.org](mailto:tdte@icai.org).

(This Exposure Draft of the revised Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Exposure Draft of the revised Accounting Standard should be read in the context of its objective and the Preface to the Statements of Accounting Standards<sup>1</sup>).

Accounting Standard (AS) 2, *Inventories* (revised), issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after \_\_\_\_\_ and is mandatory in nature<sup>2</sup> from that date. The revised Standard supersedes Accounting Standard (AS) 2 (revised 1999) 'Valuation of Inventories'.

The following is the text of the revised Accounting Standard.

### Objective

1. The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised. This Standard deals with the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also deals with the cost formulas that are used to assign costs to inventories.

### Scope

2. **This Standard applies to all inventories, except:**

- (a) **work in progress arising under construction contracts, including directly related service contracts (see Accounting Standard (AS) 7, Construction Contracts (revised 2002));**
- (b) **financial instruments (see Accounting Standard (AS) 30, Financial Instruments: Recognition and Measurement and Accounting Standard (AS) 31, Financial Instruments: Presentation); and**
- (c) **biological assets (i.e., living animals or plants) related to agricultural activity and agricultural produce at the point of harvest.**

3. **This Standard does not apply to the measurement of inventories held by:**

- (a) **producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in the statement of profit and loss in the period of the change.**
- (b) **commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in the statement of profit and loss in the period of the change.**

4. The inventories referred to in paragraph 3(a) are measured at net realisable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or minerals have been extracted and sale is assured under a forward contract or a government guarantee, or when an active market exists and there is a negligible risk of failure to sell. These inventories are excluded from only the measurement requirements of this Standard.

5. Broker-traders are those who buy or sell commodities for others or on their own account. The inventories referred to in paragraph 3(b) are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin. When these inventories are measured at fair value less costs to sell, they are excluded from only the measurement requirements of this Standard.

### Definitions

6. **The following terms are used in this Standard with the meanings specified:**

***Inventories* are assets:**

- (a) **held for sale in the ordinary course of business;**
- (b) **in the process of production for such sale; or**
- (c) **in the form of materials or supplies to be consumed in the production process or in the rendering of services.**

***Net realisable value* is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.**

***Fair value* is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.**

7. Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. Fair value reflects the amount for which the same inventory could be exchanged between knowledgeable and willing buyers and sellers in the marketplace. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

8. Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by a retailer and held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the entity and include materials and supplies awaiting use in the production process.

<sup>1</sup>Attention is specifically drawn to paragraph 4.3 of the Preface, according to which accounting standards are intended to apply only to items which are material.

<sup>2</sup>This implies that, while discharging their attest function, it will be the duty of the members of the Institute to examine whether this Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from this Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

In the case of a service provider, inventories include the costs of the service, as described in paragraph 19, for which the entity has not yet recognised the related revenue (see *Accounting Standard (AS) 9, (Revised) Revenue*<sup>3</sup>).

## Measurement of inventories

**9. Inventories shall be measured at the lower of cost and net realisable value.**

### Cost of inventories

**10. The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.**

#### Costs of purchase

11. The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

#### Costs of conversion

12. The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

13. The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production

or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

14. A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

#### Other costs

15. Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.

16. Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

- (a) abnormal amounts of wasted materials, labour or other production costs;
- (b) storage costs, unless those costs are necessary in the production process before a further production stage;
- (c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and
- (d) selling costs.

17. Accounting Standard (AS) 16, *Borrowing Costs*, identifies limited circumstances where borrowing costs are included in the cost of inventories.

18. An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

### Cost of inventories of a service provider

19. To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-attributable overheads that are often factored into prices charged by service providers.

### Cost of agricultural produce harvested from biological assets

20. Inventories comprising agricultural produce that an entity has harvested from its biological assets are measured on initial recognition at their fair value less estimated costs to sell at the point of harvest. This is the cost of the inventories at that date for application of this Standard.

### Techniques for the measurement of cost

21. Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

22. The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items with similar margins for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory that has been marked down to below its original selling price. An average percentage for each retail department is often used.

<sup>3</sup> Accounting Standard (AS) 9, *Revenue Recognition*, is being revised on the lines of IAS 18, *Revenue*.

## Cost Formulas

**23. The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.**

24. Specific identification of cost means that specific costs are attributed to identified items of inventory. This is the appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced. However, specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on profit or loss.

**25. The cost of inventories, other than those dealt with in paragraph 23, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.**

26. For example, inventories used in one operating segment<sup>4</sup> may have a use to the entity different from the same type of inventories used in another operating segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

27. The FIFO formula assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

## Net realisable value

28. The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of

inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.

29. Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular operating segment<sup>5</sup>. Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.

30. Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

31. Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices. Provisions may arise from firm sales contracts in excess of inventory quantities held or from firm purchase contracts. Such provisions are dealt with under Accounting Standard (AS) 29, *Provisions, Contingent Liabilities and Contingent Assets*.

32. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realisable value, the materials are written down to net realisable value. In such cir-

cumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

33. A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed (ie the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of the cost and the revised net realisable value. This occurs, for example, when an item of inventory that is carried at net realisable value, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

## Recognition as an expense

**34. When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.**

35. Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset.

## Disclosure

**36. The financial statements shall disclose:**

- (a) *the accounting policies adopted in measuring inventories, including the cost formula used;*
- (b) *the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;*
- (c) *the carrying amount of inventories carried at fair value less costs to sell;*
- (d) *the amount of inventories recog-*

<sup>4</sup>Accounting Standard (AS) 17, Segment Reporting, is being revised on the lines of IFRS 8, Operating Segments.

<sup>5</sup> ibid

nised as an expense during the period;

- (e) the amount of any write-down of inventories recognised as an expense in the period in accordance with paragraph 34;
- (f) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period in accordance with paragraph 34;
- (g) the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 34; and
- (h) the carrying amount of inventories pledged as security for liabilities.

37. Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are merchandise, production supplies, materials, work in progress and finished goods. The inventories of a service provider may be described as work in progress.

38. The amount of inventories recognised as an expense during the period, which is often referred to as cost of sales, consists of those costs previously included in the measurement of inventory that has now been sold and unallocated production overheads and abnormal amounts of production costs of inventories. The circumstances of the entity may also warrant the inclusion of other amounts, such as distribution costs.

39. Some entities adopt a format for statement of profit and loss that results in amounts being disclosed other than the cost of inventories recognised as an expense during the period. Under this format, an entity presents an analysis of expenses using a classification based on the nature of expenses. In this case, the entity discloses the costs recognised as an expense for raw materials and consumables, labour costs and other costs together with the amount of the net change in inventories for the period.

### Appendix A

*Note: This Appendix is not a part of the Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard (AS) 2 (revised) and the corresponding International*

*Accounting Standard (IAS) 2, Inventories.*

#### Comparison with IAS 2, Inventories

There is no major difference between the Exposure Draft of AS 2 (revised), *Inventories* and International Accounting Standard (IAS) 2, *Inventories*.

### Appendix B

#### Major Differences between the Exposure Draft of AS 2 (revised), *Inventories* and existing AS 2, *Valuation of Inventories*

*Note: This Appendix is provided to bring out the major differences between the Exposure Draft of Accounting Standard (AS) 2 (revised), 'Inventories', and existing AS 2, 'Valuation of Inventories', with a view to facilitate commentators in sending their comments on the Exposure Draft of revised AS 2.*

The Exposure Draft of AS 2 (revised) differs from the existing AS 2 in the following major respects:

- (i) On the lines of IAS 2, the Exposure Draft of revised AS 2 deals with the subsequent recognition of cost/carrying amount of inventories as an expense, whereas the existing AS 2 does not provide the same (refer paragraphs 1 and 34 of the Exposure Draft of revised AS 2).
- (ii) The Exposure Draft of revised AS 2 provides explanation with regard to inventories of service providers whereas the existing AS 2 does not contain such an explanation (refer paragraphs 8, 19 and 29 of the Exposure Draft of revised AS 2).
- (iii) The existing AS 2 explains that inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are accounted for in accordance with Accounting Standard (AS) 10, *Accounting for Fixed Assets*. The Exposure Draft of revised AS 2 does not contain specific explanation in respect of such spares as this aspect is covered under revised AS 10.
- (iv) The Exposure Draft of revised AS 2 does not apply to measurement of inventories held by commodity broker-traders, who measure their inventories at fair value less costs to sell. However, this aspect is not there in the existing AS 2. Accordingly, revised AS 2 defines

fair value and provides an explanation in respect of distinction between 'net realisable value' and 'fair value'. The existing AS 2 does not contain the definition of fair value and such explanation.

- (v) The Exposure Draft of revised AS 2 provides detailed guidance in case of subsequent assessment of net realisable value (refer paragraph 33 of the Exposure Draft of revised AS 2). It also deals with the reversal of the write-down of inventories to net realisable value to the extent of the amount of original write-down, and the recognition and disclosure thereof in the financial statements. The existing AS 2 does not deal with such reversal.
- (vi) The Exposure Draft of revised AS 2 excludes from its scope only the measurement of inventories held by producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products though it provides guidance on measurement of such inventories (refer paragraphs 4 and 20 of the Exposure Draft of revised AS 2). However, the existing AS 2 excludes from its scope such types of inventories.
- (vii) The existing AS 2 specifically provides that the formula used in determining the cost of an item of inventory should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition whereas the Exposure Draft of revised AS 2 does not specifically state so and requires the use of consistent cost formulas for all inventories having a similar nature and use to the entity. The Exposure Draft of revised AS 2 also explains this aspect (refer paragraphs 25 and 26).
- (viii) The Exposure Draft of revised AS 2 uses the term 'operating segment' in paragraph 29 thereof in expectation of issuance of Accounting Standard corresponding to IFRS 8, *Operating Segments*, whereas the existing AS 2 uses 'business segment' in its corresponding paragraph 21 in view of the term used in the existing Accounting Standard (AS) 17, *Segment Reporting*.
- (ix) The Exposure Draft of revised AS 2 requires more disclosures as compared to the existing AS 2 (refer paragraph 36 of the Exposure Draft of revised AS 2). □

## **Explanatory Memorandum to the Exposure Draft (Revised) Standard on Auditing (SA) 402<sup>1</sup> Audit Considerations Relating to an Entity Using a Third Party Service Organisation**

### **Background**

The Institute of Chartered Accountants of India had in August 2002 issued the Auditing and Assurance Standard (AAS) 24, *Audit Considerations Relating to Entities Using Service Organisations*. The AAS 24 was effective for all audits relating to accounting periods beginning on or after 1<sup>st</sup> April, 2003. The Institute being a member of the International Federation of Accountants (IFAC), as a part of its membership obligations, the Institute, while formulating any Auditing and Assurance Standard is required to harmonise with the corresponding International Standards on Auditing, if any, issued by the International Auditing and Assurance Standards Board (IAASB) of the IFAC. The AAS 24 was, therefore, based on the corresponding Revised International Standard (ISA) 402 of the same name issued by the International Auditing and Assurance Standards Board (IAASB).

### **IAASB's Clarity Project**

The IAASB, in December 2007, pursuant to its Clarity Project issued the Exposure Draft of the Revised and Redrafted ISA 402, **"Audit Considerations Relating to An Entity Using A Third Party Service Organisation"**. As a part of its Clarity Project, an International Standard on Auditing is now presented in a new format. As per the new format, the Standard is divided into two sections, one the Requirements part containing the fundamental principles of the Standard and second, the application guidance and appendices, detailing the implementation aspects of the principles. The IAASB is also revising and/or redrafting all its existing International Standards on Auditing in line with the said presentation.

Attention of the readers is also drawn to, **"A Guide for National Standard Setters that Adopt IAASB's International Standards but**

**Find it Necessary to Make Limited Modifications**<sup>2</sup>, issued by IAASB in July, 2006.

### **ICAI's Response**

The Council of the Institute, at its 267<sup>th</sup> meeting held in April, 2007 has also decided to adopt this approach for writing Standards. The Council, at the said meeting, also decided to rename, re-categorise and re-number the existing Auditing and Assurance Standards on the lines that followed by the IAASB. The details of this exercise are published elsewhere in the Journal. The readers are also requested to refer to the **Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services**<sup>3</sup> published elsewhere in the Journal.

### **Highlights of the New Preface**

#### **I. Engagement Standards**

The new Preface introduces the concept of Engagement Standards. The term "Engagement Standards" comprises the following Standards:

- (a) **Standards on Auditing (SAs)**, to be applied in the audit of historical financial information.
- (b) **Standards on Review Engagements (SREs)**, to be applied in the review of historical financial information.
- (c) **Standards on Assurance Engagements (SAEs)**, to be applied in assurance engagements, dealing with subject matters other than historical financial information.
- (d) **Standards on Related Services (SRSs)**, to be applied to engagements involving application of agreed upon procedures to information, compilation engagements, and other related services engagements, as may be speci-

fied by the ICAI.

The new Preface therefore, does away with the terminology **"Auditing and Assurance Standards"** in use till date.

The **Standards on Quality Control (SQC)** are to be applied to all services covered by the Engagement Standards.

#### **II. Standards on Auditing**

The Standards on Auditing (SAs) referred to in I. above are formulated in the context of an audit of financial statements by an independent auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

#### **III. New Format of Presenting the Standards on Auditing**

In line with the format adopted by the IAASB under its Clarity Project, the Standards on Auditing would now contain two distinct sections, one, the Requirements section and, two, the Application Guidance section.

#### **Requirements**

The fundamental principles of the Standard are contained in the Requirements and represented by use of "shall". Hitherto, the word, "should" was used in the Standards, for this purpose. Further, this format also does away with the need to present the principles laid down by the Standard in bold text.

#### **Application & Other Explanatory Material**

The application and other explanatory material contained in an SA is an integral part of the SA as it provides further explanation of, and guidance for carrying out, the requirements of an SA, along with the background information on the matters addressed in the SA. It may include examples of procedures, some of which

<sup>1</sup>Hitherto known as Auditing and Assurance Standard (AAS) 24, "Audit Considerations Relating to Entities Using Service Organisations."

<sup>2</sup>The full text of the Policy Position can be downloaded free of charge at [http://www.ifac.org/IAASB/downloads/Modification\\_Policy\\_Position.pdf](http://www.ifac.org/IAASB/downloads/Modification_Policy_Position.pdf)

<sup>3</sup>The full text of the Preface can be downloaded free of charge at <http://www.icai.org/icairoot/announcements/announ1050.pdf>

the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement.

In view of this format of writing, the standard portion or principles enunciated in a Standard are no longer given in **bold face**.

**The new presentation format has, however, not as yet been followed in drafting the Standards on Quality Control and other Standards.**

The Preface also contains the principles as to when a Standard on Auditing would be inapplicable as also the reporting responsibilities of the members in case of non-compliance with any of the Standards.

**There is no change in the authority attached to the Standards, i.e., they are mandatory in nature, notwithstanding the new format of writing the Standards.**

### This Exposure Draft

This Exposure Draft of the Revised Standard on Auditing (SA) 402, “**Audit Considerations Relating to An Entity Using A Third Party Service Organisation**” is based on the corresponding above mentioned Exposure Draft of ISA 402, issued by the IAASB in December, 2007, and follows the same writing style.

The first, i.e. the Introduction and Requirements Section Contains the principles. The second, i.e. the Application and Other Explanatory Material section contains implementation guidance on the topics discussed in the Requirements section. Cross-reference to the relevant paragraphs of the Application Material is built within the Requirements section. The paragraphs in the Requirements section have been numbered as 1 to 19 and the paragraphs in the Application and other Explanatory Material are numbered as AI to A36.

### Topics Covered by Revised SA 402

The Standard covers the following main aspects:

- Scope of the Standard
- Objectives
- Definitions
- Requirements
  - Obtaining an understanding of the services provided by a service organisation
  - Assessing the risk of material misstatement
  - Using an assurance report from service auditor
  - Other audit evidence considerations regarding service organisations
  - Fraud, non-compliance with laws and regulations and uncorrected misstatement in relation to activities at the service organisation
- Application & other explanatory material
- Appendix

### Highlights of Revised SA 402

1. The Exposure Draft of SA 402 adopts a risk-based approach to the auditor’s consideration of the nature and significance of the services rendered by the service organisation, their effect on entity’s internal controls relevant to audit for identification, assessment and responding to risks of material misstatement. The Standard, therefore, links the process of obtaining and using an understanding of the service organisation to the principle laid down in SA 315 in this regard.

2. The proposed Standard introduces certain new terminology such as complementary user entity controls, service auditor, service organisation, sub-service organisation, user auditor. All these terms have been defined comprehensively in the Standard.

3. Unlike the existing Standard, which requires the auditor of the service organisation to give an opinion that the description of the controls as given in the Report is **accurate**, the Exposure Draft requires that auditor to express only a **reasonable assurance** on the description of those controls.

4. The Exposure Draft also explicitly prohibits reference to the work of the service auditor in the report of the auditor of the client (user auditor) except where required by any law/regulation or such reference would provide better understanding of the auditor’s opinion. In such cases, however, the user auditor should make a clear statement that this does not diminish his responsibility in any way.

5. The Exposure Draft also contains guidance for the user auditor in respect of situations where there are non-compliance with laws and regulations and uncorrected misstatements in relation to activities of the service organisation.

6. The Exposure Draft contains comprehensive and detailed guidance on application of the principles laid down in the Standard such as considerations in use of Type A/Type B reports, understanding controls at service organisation, sufficiency of auditor’s understanding, assessing the risk of material misstatement, using the assurance report from service organisation’s auditor, communication of deficiencies in internal controls identified during the audit, service auditor’s professional reputation, competence and independence, other audit evidence, etc. □

*Your comments on the Exposure Draft should reach us by **DECEMBER 1, 2008**. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:*

**Secretary, Auditing and Assurance Standards Board**

**The Institute of Chartered Accountants of India**

ICAI Bhawan,

C-1, Sector-1,

NOIDA,

Uttar Pradesh – 201 301.

*Comments can also be emailed at: [aash@icai.org](mailto:aash@icai.org)*

## EXPOSURE DRAFT REVISED STANDARD ON AUDITING (SA) 402 Audit Considerations Relating To An Entity Using A Third Party Service Organisation<sup>4</sup>

Proposed Standard on Auditing (SA) 402 (Revised), "Audit Considerations Relating to an Entity Using a Third Party Service Organisation" should be read in context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"<sup>5</sup>, which sets out the authority of SAs.

### Introduction

#### Scope of this SA

1. This Standard on Auditing (SA) deals with the user auditor's responsibilities to obtain sufficient appropriate audit evidence when an entity uses one or more third party service organisations. Specifically, it expands on how the auditor applies SA 315<sup>6</sup> and SA 330<sup>7</sup> in identifying and assessing the risks of material misstatement and in designing and performing further audit procedures.

2. Many entities outsource aspects of their business to organisations that provide services ranging from performing a specific task under the direction of an entity to replacing an entity's entire business units or functions. Many of the services provided by such organisations are integral to the entity's business operations; however, not all those services are directly linked to an entity's information system relevant to financial reporting.

3. A service organisation's services are part of an entity's information system, including related business processes, relevant to financial reporting if they affect any of the following:

- (a) The classes of transactions in the entity's operations that are significant to the entity's financial statements;
- (b) The procedures, within both information technology (IT) and manual systems, by which the entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- (c) The related accounting records, either in electronic or manual form, supporting information and specific accounts in the entity's financial statements that

are used to initiate, record, process and report the entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;

- (d) How the entity's information system captures events and conditions, other than transactions, that are significant to the financial statements;
- (e) The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures; and
- (f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

4. The focus of this SA is on an entity's use of a third party service organisation, but it may also be applicable, adapted as necessary in the circumstances, to situations where an entity uses a shared service center which provides services to a group of related entities.

5. This SA does not apply to services provided by an organisation, such as a financial institution, that are limited to processing an entity's transactions that are specifically authorised by the entity, such as the processing of bank transactions by a bank or the processing of securities transactions by a broker. In addition, this SA does not apply to the audit of transactions arising from proprietary financial interests in other entities, such as partnerships, corporations and joint ventures, when proprietary interests are accounted for and reported to interest holders.

#### Effective Date

6. This SA is effective for audits of financial statements for periods beginning on or after \_\_\_\_\_[date]

### Objective

7. The objective of the auditor, when the user entity uses a service organisation, is to obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's internal control relevant to the audit sufficient to identify, assess and respond to the risks of material misstatement.

### Definitions

8. For purposes of this SA, the following terms have the meanings attributed below:

- (a) **Complementary user entity controls** – Controls that the service organisation assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives, are identified in the description of the system.
- (b) **Service auditor** – An auditor who provides an assurance report on the controls of a service organisation.
- (c) **Service organisation** – A third party organisation (or segment of a third party organisation) that provides services to user entities that are part of those entities' information system relevant to financial reporting.
- (d) **Sub-service organisation** – A service organisation used by another service organisation to perform some of the services provided to user entities that are part of those user entities' information system relevant to financial reporting.
- (e) **User auditor** – An auditor who audits and reports on the financial statements of a user entity.
- (f) **User entity** – An entity that uses a ser-

<sup>4</sup>Hitherto known as AAS 24, "Audit Considerations Relating to Entities Using Service Organisations".

<sup>5</sup>Published in the July 2007, issue of the Journal.

<sup>6</sup>SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment".

<sup>7</sup>SA 330, "The Auditor's Responses to Assessed Risks".

vice organisation and whose financial statements are being audited.

(g) **Report on the description and design of controls at a service organisation (referred to in this SA as a Type A report)** – A report that comprises:

- (i) A description, prepared by management of the service organisation, of the system, control objectives and related controls that have been designed and implemented as at a specified date; and
- (ii) A report conveying reasonable assurance that includes the service auditor's opinion on the description of the system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.

(h) **Report on the description, design, and operating effectiveness of controls at a service organisation (referred to in this SA as a Type B report)** – A report that comprises:

- (i) A description, prepared by management of the service organisation, of the system, control objectives and related controls, their design and implementation, and their operating effectiveness throughout a specified period; and
- (ii) A report conveying reasonable assurance that includes:
  - a. The service auditor's opinion on the description of the system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and
  - b. A description of the service auditor's tests of the controls and the results thereof.

(a) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the user entity's internal control; (Ref: Para. A1-A2)

(b) The nature and materiality of the transactions processed or accounts affected by the service organisation and the degree of interaction between the activities of the service organisation and those of the user entity; and (Ref: Para. A3-A4)

(c) The nature of the relationship between the user entity and the service organisation, including the contractual terms for the relevant activities undertaken by the service organisation. (Ref: Para. A5-A8)

10. When obtaining an understanding of internal control relevant to the audit in accordance with SA 315,<sup>9</sup> the user auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services performed by the service organisation, including those that are applied to the transactions processed by the service organisation, and relevant monitoring controls. (Ref: Para. A9-A11)

11. The user auditor shall determine whether a sufficient understanding of the user entity's internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement. If the user auditor is unable to obtain that understanding from information on the service organisation available at the user entity, the user auditor shall obtain audit evidence from one or more of the following procedures: (Ref: Para. A12-A16)

- (a) Obtaining a Type A or Type B report;
- (b) Contacting the service organisation, through the user entity, to obtain specific information;
- (c) Requesting that a service auditor be engaged to perform procedures that will provide the necessary information; or
- (d) Visiting the service organisation and performing such procedures.

**Assessing the Risks of Material Misstatement**

12. When the user auditor's risk assessment includes an expectation that controls at the service organisation are operating effectively for certain assertions for which controls are applied only at the service organisation, the user auditor shall obtain audit evidence about the operating effectiveness of those controls from one or more of

the following procedures: (Ref: Para. A17)

- (a) Obtaining a Type B report;
- (b) Requesting the service auditor to perform tests of controls at the service organisation on behalf of the user auditor; or
- (c) Performing appropriate tests of controls at the service organisation.

**Using an Assurance Report from a Service Auditor**

13. If the user auditor plans to use a Type A or Type B report as audit evidence about the design and implementation of controls at the service organisation, the user auditor shall: (Ref: Para. A18-A19)

- (a) Evaluate whether the description of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes;
- (b) Evaluate the sufficiency and appropriateness of the evidence provided for the understanding of internal control relevant to the audit; and
- (c) Determine whether complementary user entity controls identified by the service organisation are relevant to the user entity and if so, obtain an understanding of whether the user entity has designed and implemented such controls.

14. If the user auditor plans to use a Type B report as audit evidence that controls at the service organisation are operating effectively, the user auditor shall: (Ref: Para. A20-A28)

- (a) Evaluate whether the description of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes;
- (b) Evaluate the sufficiency and appropriateness of the evidence provided about the effectiveness of controls for the relevant assertions;
- (c) Determine whether complementary user entity controls identified by the service organisation are relevant to the user entity, and if so, obtain an understanding of whether the user entity has designed and implemented such controls and, if so, test their operating effectiveness;
- (d) Evaluate the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and

**Requirements**

**Obtaining an Understanding of the Services Provided by a Service Organisation**

9. When obtaining an understanding of the entity in accordance with SA 315 (Redrafted)<sup>8</sup>, the user auditor shall obtain an understanding of how a user entity uses a service organisation in its operations, including:

<sup>8</sup>SA 315, paragraph 11.  
<sup>9</sup>SA 315, paragraph 12.

- (e) Evaluate the specific tests of controls performed by the service auditor and the results thereof relevant to those assertions to determine if sufficient appropriate audit evidence has been obtained about the operating effectiveness of the controls to support the user auditor's risk assessment.

15. In determining the sufficiency and appropriateness of the audit evidence provided by a Type A or Type B report in support of the user auditor's opinion, the user auditor shall be satisfied as to the service auditor's professional reputation, competence and independence where such service auditor is not a member of the Institute of Chartered Accountants of India. (Ref: Para. A29)

16. The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion. (Ref: Para. A30)

17. If reference to the work of a service auditor is relevant to an understanding of a modification to the user auditor's opinion, the user auditor's report shall indicate that such reference does not diminish the user auditor's responsibility for that opinion. (Ref: Para. A31)

#### **Other Audit Evidence Considerations Regarding Service Organisations**

18. In responding to assessed risks in accordance with SA 330, the user auditor shall: (Ref: Para. A32-A35)

- (a) Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held at the user entity; and, if not,
- (b) Perform further audit procedures to obtain sufficient appropriate audit evidence or request the service auditor to perform those procedures on the user auditor's behalf.

#### **Fraud, Non-Compliance with Laws and Regulations and Uncorrected Misstatements in Relation to Activities at the Service Organisation**

19. The user auditor shall inquire of management of the user entity whether the service organisation has reported to the user entity any fraud, non-compliance with laws and regulations or uncorrected misstatements and if so, the user auditor shall evaluate how they affect the nature, timing and extent of the user auditor's further audit procedures. (Ref: Para. A36)

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## **Application and Other Explanatory Material**

### **Obtaining an Understanding of the Services Provided by a Service Organisation**

#### **Nature of the Services Provided by the Service Organisation** (Ref: Para. 9(a))

A1. A user entity may use a service organisation such as one that processes transactions and maintains related accountability, or records transactions and processes related data. Service organisations that provide such services include, for example, bank trust departments that invest and service assets for employee benefit plans or for others, mortgage bankers that service mortgages for others, and application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions. The Appendix to this SA provides examples of some types of service organisations.

A2. Examples of service organisation services that are relevant to the audit include:

- Maintenance of the user entity's accounting records.
- Management of assets.
- Initiating, recording or processing transactions as agent of the user entity.

#### **Nature and Materiality of Transactions Processed by the Service Organisation and the Degree of Interaction** (Ref: Para. 9(b))

A3. A service organisation may establish policies and controls that affect the user entity's internal control. These policies and controls are at least in part physically and operationally separate from the user entity. The significance of the controls of the service organisation to those of the user entity depends on the nature of the services provided by the service organisation, including the nature and materiality of the transactions it processes for the user entity. In certain situations, the transactions processed and the accounts affected by the service organisation may not appear to be material to the user entity's financial statements, but the nature of the transactions processed may be significant and the user auditor may determine that an understanding of those controls is necessary in the circumstances.

A4. The significance of the controls of the service organisation to those of the user entity also depends on the degree of interaction between its activities and those of the user entity. The degree of interaction refers to the extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organisation. For example, a high degree of interaction exists be-

tween the activities of the user entity and those at the service organisation when the user entity authorises transactions and the service organisation processes and does the accounting of those transactions. In these circumstances, it may be practicable for the user entity to implement effective controls over those transactions. On the other hand, when the service organisation initiates or initially records, processes, and does the accounting of the user entity's transactions, there is a lower degree of interaction between the two organisations. In these circumstances, the user entity may be unable to, or may elect not to, implement effective controls over these transactions.

#### **Nature of the Relationship between the User Entity and the Service Organisation** (Ref: Para. 9(c))

A5. The contract or service level agreement between the user entity and the service organisation may provide for matters such as:

- The information to be provided to the user entity and responsibilities for initiating transactions relating to the activities undertaken by the service organisation;
- The application of requirements of regulatory bodies concerning the form of records to be maintained, or access to them;
- The indemnification, if any, to be provided to the user entity in the event of a performance failure;
- Whether the service organisation will provide a Type A or Type B report; and
- Whether the user auditor has rights of access to the accounting records of the service organisation and other information necessary for the conduct of the audit.

A6. There is a direct relationship between the service organisation and the user entity and between the service organisation and the service auditor. These relationships do not necessarily create a direct relationship between the user auditor and the service auditor. When there is no direct relationship between the user auditor and the service auditor, communications between the user auditor and the service auditor are usually conducted through the user entity and the service organisation. A direct relationship may also be created between a user auditor and a service auditor, taking into account the relevant ethical and confidentiality considerations. A user auditor, for example, may request a service auditor to perform procedures on the user auditor's behalf, such as:

- (a) Tests of controls at the service organisation; or

- (b) Substantive procedures on the user entity's financial statement transactions and balances maintained by a service organisation.

A7. In case of certain entities, such as national, local or regional governments, auditors may have broad rights of access established by legislation. However, there may be situations where such rights of access are not available, for example when the service organisation is located in a different jurisdiction. In such cases, the auditor may need to obtain an understanding of the legislation applicable in the different jurisdiction to determine whether appropriate access rights can be obtained, or ask the user entity to incorporate rights of access in any contractual arrangements between the user entity and the service organisation.

A8. The user auditors, in case of entities covered by paragraph A7 above, may also request a service auditor to perform tests of controls or substantive procedures in relation to compliance with legislation or proper authority.

**Understanding the Controls Relating to Services Provided by the Service Organisation** (Ref: Para.10)

A9. The user entity may establish controls over the service organisation's services that may be tested by the user auditor and that may enable the user auditor to conclude that the user entity's controls are operating effectively for some or all of the related assertions. If a user entity, for example, uses a service organisation to process its payroll transactions, the user entity may establish controls over the submission and receipt of payroll information that could prevent or detect material misstatements. In this situation, the user auditor may perform tests of the user entity's controls over payroll processing that would provide a basis for the user auditor to conclude that the user entity's controls are operating effectively for the assertions related to payroll transactions.

A10. A user entity may use a service organisation that in turn uses a sub-service organisation to perform some of the services provided to a user entity that are part of the user entity's information system as it relates to an audit of the financial statements. The sub-service organisation may be a separate entity from the service organisation or may be related to the service organisation. A user auditor may need to consider controls at the sub-service organisation. In situations where one or more sub-service organisations are used, the interaction between the user entity and the service organisation is expanded to include the interaction between the user entity, the service organisation and the sub-service

organisations. The degree of this interaction, as well as the nature and materiality of the transactions processed by the service organisation and the sub-service organisations are the most important factors for the user auditor to consider in determining the significance of the service organisation's and sub-service organisation's controls to the user entity's controls.

A11. As noted in SA 315,<sup>10</sup> in respect of some risks, the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions and account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. Such automated processing characteristics may be particularly present when the user entity uses service organisations. In such cases, the entity's controls over such risks are relevant to the audit and the user auditor is required to obtain an understanding of such controls in accordance with paragraph 10 of this SA.

**Sufficiency of the User Auditor's Understanding** (Ref: Para. 11)

A12. Information on the nature of the services provided by a service organisation may be available from a wide variety of sources, such as:

- User manuals;
- System overviews;
- Technical manuals;
- The contract between the user entity and the service organisation;
- Reports by service organisations, internal auditors or regulatory authorities on controls at the service organisation; and
- Reports by the service auditor, including management letters, if available.

A13. Knowledge obtained through the user auditor's experience with the service organisation may also be helpful in obtaining an understanding of the nature of the services provided by the service organisation. This may be particularly helpful if the services and controls at the service organisation over those services are highly standardised.

A14. A service organisation may engage a service auditor to report on the description and design of its controls (Type A report) or on the description and design of its controls and their operating effectiveness (Type B report). Type A and Type B reports are typically reports issued under [proposed] Standard for Assurance Engagements (SAE) 3402<sup>11</sup>.

A15. In some circumstances, a user entity may outsource one or more significant business units or functions, such as its entire tax planning and compliance functions, or finance and accounting or the controllership function to one or more service organisations. The user auditor's ability to gain an understanding of controls at the service organisations may be dependent on the direct interaction with management at the service organisations, as a report on controls at the service organisations may not be available.

A16. If the user auditor is unable to obtain an understanding of the user entity's internal control relevant to the audit by performing the procedures required by paragraphs 9-11 of this SA, the auditor is required to modify the opinion in the auditor's report.<sup>12</sup>

**Assessing the Risks of Material Misstatement** (Ref: Para. 12)

A17. If a Type B report is not available, a user auditor may contact the service organisation, through the user entity, to request that a service auditor be engaged to provide a Type B report that includes tests of the operating effectiveness of the relevant controls or to perform procedures that test the operating effectiveness of those controls. A user auditor may also visit the service organisation and perform tests of relevant controls if the service organisation agrees to it. In all cases, the user auditor's risk assessments are based on the combined evidence provided by service auditor's report and the user auditor's own procedures.

**Using an Assurance Report from a Service Auditor**

**Using a Type A Report** (Ref: Para. 13)

A18. A Type A report, along with information about the user entity, may be helpful in providing an understanding of:

- (a) The aspects of controls at the service organisation that may affect the processing of the user entity's transactions, including the use of sub-service organisations;
- (b) The flow of significant transactions through the service organisation to determine the points in the transaction flow where material misstatements in the user entity's financial statements could occur;
- (c) The control objectives at the service organisation that are relevant to the user entity's financial statement assertions; and
- (d) Whether controls at the service organisation are suitably designed to prevent or detect processing errors that could

<sup>10</sup>SA 315, paragraph 29.

<sup>11</sup>[Proposed] SAE 3402, "Assurance Reports on Controls at a Third Party Service Organization".

<sup>12</sup>[Proposed] SA 705, "Modifications to the Opinion in the Independent Auditor's Report", paragraph [9].

result in material misstatements in the user entity's financial statements. A Type A report may be helpful in providing a sufficient understanding to identify and assess the risks of material misstatement of the user entity. Such a report, however, does not provide any evidence of the operating effectiveness of the relevant controls.

A19. A Type A report that is as of a date outside of the reporting period of a user entity may be helpful in providing a user auditor with a preliminary understanding of the controls implemented at the service organisation if the report is supplemented by additional current information from other sources. If the service organisation's description of controls is as of a date that precedes the beginning of the period under audit, the user auditor may perform procedures to update the information in a Type A report, such as:

- Discussing the changes at the service organisation with user entity personnel who would be in a position to know of such changes;
- Reviewing current documentation and correspondence issued by the service organisation; or
- Discussing the changes with service organisation personnel.

#### **Using a Type B Report (Ref: Para. 14)**

A20. A Type B report may be intended to satisfy the needs of several different user auditors; therefore specific tests of controls and results in the service auditor's report may not be relevant to assertions that are significant in the user entity's financial statements. For those tests of controls and results that are relevant, the nature, timing and extent of such tests of controls are evaluated to determine that the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment. In doing so, the user auditor may consider the following factors:

- (a) The time period covered by the tests of controls and the time elapsed since the performance of the tests of controls;
- (b) The scope of the audit and applications covered, the controls tested and tests that were performed, and the way in which tested controls relate to the user entity's controls; and
- (c) The results of those tests of controls and the service auditor's opinion on the operating effectiveness of the controls.

A21. For certain assertions, the shorter the period covered by a specific test and the longer the time elapsed since the performance of the test, the less audit evidence the test may provide. In comparing

the period covered by the Type B report to the user entity's financial reporting period, the auditor may conclude that the Type B report offers less audit evidence if there is little overlap between the period covered by the Type B report and the period for which the user auditor intends to rely on the report. When this is the case, a Type B report covering a preceding or subsequent period may provide additional audit evidence.

A22. It may also be necessary for the user auditor to obtain additional evidence about significant changes to the relevant controls at the service organisation outside of the period covered by the Type B report or determine additional audit procedures to be performed. Relevant factors in determining what additional audit evidence to obtain about controls at the service organisation that were operating outside of the period covered by the service auditor's report may include:

- The significance of the assessed risks of material misstatement at the assertion level;
- The specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information system, processes, and personnel;
- The degree to which audit evidence about the operating effectiveness of those controls was obtained;
- The length of the remaining period;
- The extent to which the user auditor intends to reduce further substantive procedures based on the reliance of controls;
- The control environment; and
- The effectiveness of the control environment and monitoring controls at the user organisation.

A23. Additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the user entity's monitoring controls.

A24. If the service auditor's testing period is completely outside the user entity's financial reporting period, the user auditor will be unable to rely on such tests for the user auditor to conclude that the user entity's controls are operating effectively because they do not provide current audit period evidence of the effectiveness of the controls, unless other procedures are performed.

A25. In certain circumstances, a service provided by the service organisation may be designed with the assumption that certain controls will be implemented by the user entity. For example, the service may be designed with the assumption that the user entity will have controls in place for authorising

transactions before they are sent to the service organisation for processing. In such a situation, the service organisation's description of controls may include a description of those complementary user entity controls. The user auditor considers whether those complementary user entity controls are required and whether they are relevant to the service provided to the user entity.

A26. If the user auditor believes that the service auditor's assurance report may not provide sufficient audit evidence, for example, if a service auditor's report does not contain a description of the service auditor's tests of controls and results thereon, the user auditor may supplement the understanding of the service auditor's procedures and conclusions by contacting the service organisation, through the user entity, to request discussing with the service auditor the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, the user auditor may contact the service organisation, through the user entity, to request that the service auditor perform procedures at the service organisation, or the user auditor may perform such procedures.

A27. The service auditor's assurance report identifies results of tests, including exceptions and other information that could affect the user auditor's conclusions. Exceptions noted by the service auditor or a modified opinion in the service auditor's assurance report do not automatically mean that the service auditor's assurance report will not be useful for the audit of the user entity's financial statements in assessing the risks of material misstatement. Rather, the exceptions and the matter giving rise to a modified opinion in the service auditor's assurance report are considered in the user auditor's assessment of the testing of controls performed by the service auditor. In considering the exceptions and matters giving rise to a modified opinion, the user auditor may wish to discuss such matters with the service auditor. Such communication is dependent upon the user entity contacting the service organisation, and obtaining the service organisation's approval for the communication to take place.

#### *Communication of Deficiencies in Internal Control Identified during the Audit*

A28. The user auditor is required to communicate all deficiencies in internal control identified during the audit on a timely basis to management at an appropriate level of<sup>13</sup> responsibility and is required to communicate all significant deficiencies with those charged with governance (unless all of those charged with governance are involved in managing the entity).<sup>14</sup> Matters that the user auditor may identify during the audit and may wish to communicate to management and those charged with governance of the user entity include:

<sup>13</sup>The Exposure Draft of SA 265, "Communicating Deficiencies in Internal Control", has been published in the August, 2008 issue of the Journal. Refer paragraph [9].

- Any monitoring controls that could be implemented by the user entity, including those identified as a result of obtaining a Type A or Type B report;
- Instances where complementary user controls are noted in the Type A or Type B report and are not implemented at the user entity; and
- Controls that may be needed at the service organisation that do not appear to have been implemented or that are not specifically covered by a Type B report.

**The Service Auditor's Professional Reputation, Competence and Independence** (Ref: Para. 15)

A29. In case the service auditor is not a member of the Institute of Chartered Accountants of India, the user auditor may inquire as to the professional reputation and standing of the service auditor from the auditor's professional organisation or other practitioners and inquire whether the service auditor is subject to regulatory oversight. The service auditor may be practicing in a jurisdiction where different standards are followed in respect of reports on controls at a service organisation. In such a situation, the user auditor may inquire about the adequacy of those standards.

**Reference to the Work of a Service Auditor** (Ref: Para. 16-17)

A30. In some cases, law or regulation may require a reference to the work of a service auditor in the user auditor's report, for example, for the purposes of transparency in the public sector. In such circumstances, the user auditor may need the consent of the service auditor before making such a reference.

A31. The fact that a user entity uses a service organisation does not alter the user auditor's responsibility under SAs to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Therefore, the user auditor does not make reference to the service auditor's assurance report as a basis, in part, for the user auditor's opinion on the user entity's financial statements. However, when the user auditor expresses a modified opinion because of a modified opinion in a service auditor's assurance report, the user auditor is not precluded from referring to the service auditor's assurance report if such reference assists in explaining the reason for the user auditor's modified opinion. In such circumstances, the user auditor may need the consent of the service auditor before making such a reference.

**Other Audit Evidence Considerations Regarding Service Organisations** (Ref: Para. 18)

A32. When the service organisation maintains material elements of the accounting records of the user entity, direct access to those records may be necessary in order for the user auditor to obtain sufficient appropriate audit evidence relating

to the operations of controls over those records or to substantiate transactions and balances recorded in them, or both. Such access may involve either physical inspection of records at the service organisation's premises or interrogation of records maintained electronically from the user entity or another location, or both. Where direct access is achieved electronically, the user auditor may obtain evidence as to the adequacy of controls operated by the service organisation over the completeness and integrity of the user entity's data for which the service organisation is responsible. The user auditor may also request the service auditor, on the user auditor's behalf, to gain access to the user entity's records maintained by the service organisation.

A33. In determining the nature and extent of audit evidence to be obtained in relation to balances representing assets held or transactions undertaken by a service organisation, the following procedures may be considered by the user auditor:

- Inspecting records and documents held by the user entity: the reliability of this source of evidence is determined by the nature and extent of the accounting records and supporting documentation retained by the user entity. In some cases the user entity may not maintain independent detailed records or documentation of specific transactions undertaken on its behalf.
- Inspecting records and documents held by the service organisation: the user auditor's access to the records of the service organisation is likely to be established as part of the contractual arrangements between the user entity and the service organisation.
- Obtaining confirmations of balances and transactions from the service organisation: where the user entity maintains independent records of balances and transactions and a service organisation processes transactions only at the specific authorisation of the user entity or acts only as a simple custodian of assets, confirmation from the service organisation corroborating those records usually constitutes reliable audit evidence concerning the existence of the transactions and assets concerned. If the user entity does not maintain independent records, information obtained in confirmations from the service organisation is merely a statement of what is reflected in the records maintained by the service organisation. Hence such confirmations do not, taken alone, constitute reliable audit evidence. In these circumstances the user auditor considers whether there is a separation

of functions for the services provided such that an alternative source of independent evidence can be identified.

- Performing analytical procedures on the records maintained by the user entity or on the reports received from the service organisation: the effectiveness of analytical procedures is likely to vary by assertion and will be affected by the extent and detail of information available.
- Requesting the service auditor to perform further audit procedures on the user auditor's behalf at the service organisation.

A34. A service auditor may perform procedures that are substantive in nature for the benefit of user auditors. Such an engagement may involve the performance, by the service auditor, of procedures agreed upon by the user entity and its user auditor and by the service organisation and its service auditor. The findings resulting from the procedures performed by the service auditor are reviewed by the user auditor to determine whether they constitute sufficient appropriate audit evidence. In addition, there may be requirements imposed by governmental authorities or through contractual arrangements whereby a service auditor performs designated procedures that are substantive in nature. The results of the application of the required procedures to balances and transactions processed by the service organisation may be used by user auditors as part of the evidence necessary to support their audit opinions. In these circumstances, it may be useful for the user auditor and the service auditor to agree, prior to the performance of the procedures, to the audit documentation or access to audit documentation that will be provided to the user auditor.

A35. In certain circumstances, in particular when a user entity outsources some or all of its finance function to a service organisation, the user auditor may face a situation where a significant portion of the audit evidence resides at the service organisation. Substantive procedures may need to be performed at the service organisation by the user auditor or the service auditor on behalf of the user auditor. A service auditor may provide a Type B report and, in addition, may perform substantive procedures on behalf of the user auditor. As noted in paragraph A31, the involvement of a service auditor does not alter the user auditor's responsibility to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Accordingly, the user auditor's consideration of whether sufficient appropriate audit evidence has been obtained and whether the user auditor needs to perform further substantive procedures includes the user auditor's involvement with, or evidence of, the direction, supervision and performance of the substantive

<sup>14</sup>SA 265, paragraphs [9-10]. Refer footnote 13

procedures performed by the service auditor.

**Fraud, Non-Compliance with Laws and Regulations and Un-corrected Misstatements in Relation to Activities at the Service Organisation** (Ref: Para. 19)

A36. A service organisation may be required under the terms of the contract with user entities to disclose to affected user entities any fraud, non-compliance with laws and regulations or uncorrected misstatements attributable to the service organisation's management or employees. As required by paragraph 19, the user auditor makes inquiries of the user entity management regarding whether the service organisation has reported any such matters and evaluates whether any matters reported by the service organisation affect the nature, timing and extent of the user auditor's further audit procedures. In certain circumstances, the user auditor may require additional information to perform this evaluation, and may consider contacting the service organisation or the service auditor to obtain the necessary information.

**Material Modifications to ISA 402, "Audit Considerations Relating to an Entity Using a Third Party Service Organisation"**

**Deletions**

1. Paragraph A7 of the Application Section of ISA 402 deals with the application of the requirements of ISA 402 to the audits of public sector entities regarding broad rights of access available to the public sector auditor. Since as mentioned in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

Further, it is also possible that even in case of non public sector entities, the auditor may have broad rights of access established by legislation. Accordingly, the spirit of erstwhile A7, highlighting the fact that in case of certain entities, the auditors may have broad rights of access, has been retained.

**Additions**

1. Paragraph 15 of the Requirements Section of ISA 402 dealing with determining the sufficiency and appropriateness of the audit evidence provided by a Type A or Type B report in support of the user auditor's opinion, mentions that "the user auditor shall be satisfied as to the service auditor's professional reputation, competence and indepen-

dence". The SA 402 has retained this concept subject to the condition that it applies "where such service auditor is not a member of the Institute of Chartered Accountants of India".

2. Paragraph A29 of the Application Section of ISA 402 dealing with The Service Auditor's Professional Reputation, Competence and Independence mentions that the user auditor may inquire as to the professional reputation and standing of the service auditor from the auditor's professional organisation or other practitioners and inquire whether the service auditor is subject to regulatory oversight. The SA 402 has retained this concept subject to the condition that it applies "In case the service auditor is not a member of the Institute of Chartered Accountants of India".

**Appendix**

(Ref: Para. A1)

**Types of Service Organisations**

The following are examples of service organisations, which perform services that are part of the user entity's information system relevant to financial reporting:

- *Trust departments of banks and insurance companies.* The trust department of a bank or an insurance company may provide a wide range of services to user entities such as employee benefit plans. This type of service organisation could be given authority to make decisions about how a plan's assets are invested. It also may serve as custodian of the plan's assets, maintain records of each participant's account, allocate investment income to the participants based on a formula in the trust agreement, make distributions to the participants, and prepare filings for the plan.
- *Transfer agents, custodians, and record keepers for investment companies.* Transfer agents process purchases, sales and other shareholder activity for investment companies. Custodians may be responsible for the receipt, delivery and safekeeping of the company's portfolio securities; the receipt and disbursement of cash resulting from transactions in these securities; and the maintenance of records of the securities held for the investment company. The custodian also may perform other services for the investment company, such as collecting dividend and interest income and distributing that income to the investment company. Record keepers maintain the financial accounting records of the investment company based on information provided by the transfer agent and the custodian of the investment company's investments.
- *Insurers that maintain the accounting for ceded re-insurance.* Re-insurance is the assump-

tion by one insurer (the assuming company) of all or part of the risk originally undertaken by another insurer (the ceding company). Generally, the ceding company retains responsibility for claims processing and is reimbursed by the assuming company for claims paid.

- *Mortgage services or depository institutions that service loans for others.* Investor organisations may purchase mortgage loans or participation interests in such loans from thrifts, banks or mortgage companies. These loans become assets of the investor organisations, and the sellers continue to service the loans. Mortgage servicing activities generally include collecting mortgage payments from borrowers, conducting collection and foreclosure activities, maintaining escrow accounts for the payment of property taxes and insurance, paying taxing authorities and insurance companies as payments become due, remitting monies to investors (user entities), and reporting data concerning the mortgage to user entities.
- *Application service providers.* Application service providers generally provide packaged software applications and a technology environment that enable customers to process financial and operational transactions. An application service provider may specialise in providing a particular software package solution to its users, may provide services similar to traditional mainframe data center service bureaus, may perform business processes for user entities that they traditionally had performed themselves, or some combination of these services.
- *Internet service providers and Web hosting service providers.* Internet service providers enable user entities to connect to the Internet. Web hosting service providers generally develop, maintain and operate Web sites for user entities. If the user entity is using the Internet or Web site to process transactions, the user entity's information system may be affected by certain controls maintained by the Internet service provider or Web hosting service provider, such as controls over the completeness and accuracy of the recording of transactions and controls over access to the system.
- *Third party financial shared service center.* A third party financial shared service center enables an entity to centralise finance and administrative operations and handling of financial processing activities to eliminate redundancies and create economies of scale. A third party financial shared service center operates as a stand alone business, treating individual units as customers. □

## Explanatory Memorandum to the Exposure Draft Revised Standard on Auditing (SA) 510 Initial Audit Engagements – Opening Balances

### Background

The Institute of Chartered Accountants of India had in July, 2001 issued the Standard on Auditing (SA) 510<sup>1</sup>, “Initial Engagements—Opening Balances”, operative for all audits commencing on or after July 1, 2001. The Institute is a member of the International Federation of Accountants (IFAC). Therefore, as a part of its membership obligations, while formulating any Auditing and Assurance Standard, it is required to harmonise with the corresponding International Standards on Auditing (ISAs), if any, issued by the International Auditing and Assurance Standards Board (IAASB) of the IFAC.

### IAASB’s Clarity Project

The IAASB had, in July, 2008, issued the final **Redrafted** ISA 510 meaning thereby that the IAASB proposed a redrafted version of ISA 510, written pursuant to the style adopted under the Clarity Project. As a part of its Clarity Project, an International Standard on Auditing is divided into two sections, one, the Requirements part containing the fundamental principles of the Standard and second, the Application and Other Explanatory Materials section and Appendices, detailing the implementation aspects of the principles. Attention of the readers is also drawn to, “A Guide for National Standard Setters that Adopt IAASB’s International Standards but Find it Necessary to Make Limited Modifications”<sup>2</sup>, issued by the IAASB in July, 2006.

### ICAI’s Response

The Council of the Institute, at its 267<sup>th</sup> meeting held in April, 2007 has also decided to adopt this approach for writing Standards. The Council, at the said meeting, also decided to rename, re-categorise and re-number the existing Auditing and Assurance Standards on the lines followed by the IAASB. The readers are also requested to refer to the **Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services**<sup>3</sup> published in the July, 2007 issue of the Journal. This revised Preface is effective from April 1, 2008.

### This Exposure Draft

This Exposure Draft of the Revised Standard on Auditing (SA) 510, “Initial Audit Engagements—Opening Balances”, is based on the corresponding Redrafted ISA 510 issued by the IAASB in July, 2008 and follows the same writing style. The first, i.e., the Introduction and Requirements

section contains the principles. The second, i.e., the Application and Explanatory Material section contains implementation guidance on the topics discussed in the Requirements section. Cross reference to the relevant paragraphs of the Application Material is built within the Requirements section. The paragraphs in the Requirements section have been numbered as 1 to 13 and the paragraphs in the Application and Other Explanatory Material are numbered as A1 to A8.

### Highlights of Revised SA 510

1. This SA focuses on the auditor’s responsibilities relating to opening balances when conducting an initial audit engagement.
2. Apart from obtaining the sufficient appropriate audit evidence on consistency of the appropriate accounting policies, SA 510 also requires the auditor to obtain the sufficient appropriate audit evidence about whether such changes are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework. SA further requires that if the auditor concludes that the accounting policies have not been consistently applied or properly accounted for, the auditor has to express either a qualified or adverse opinion, as may be appropriate.
3. The SA 510 elaborates the definition of opening balances and initial audit engagements; and introduces the definition of predecessor auditor.

4. The SA 510 requires the auditor to read the most recent financial statements, if any, and the predecessor auditor’s report thereon to obtain the information relevant to the opening balances.
5. The SA 510 requires the auditor to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements, if yes, auditor has to perform additional audit procedures to determine the effect of the misstatements on the current year’s financial statements. Further, if the auditor concludes that such a misstatement exist in the current period’s financial statements, the auditor requires communicating the same to the appropriate level of management and those charged with governance.
6. The SA 510 requires the auditor to evaluate the matters giving rise to modifications in the prior period’s financial statements for assessing the risk of material misstatements.
7. The SA 510 requires the current year’s auditor to modify its report if there was a modification in a prior period auditor’s report and it is still relevant in the current financial year.
8. The SA 510 provides that the auditor may be able to obtain sufficient appropriate audit evidence by reviewing predecessor auditor’s working papers, which is influenced by the professional competence and independence of the predecessor auditor.

*Your comments on the Exposure Draft should reach us by **October 31, 2008**. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:*

**Secretary, Auditing and Assurance Standards Board**

**The Institute of Chartered Accountants of India**

**ICAI Bhawan, C-1, Sector-1,**

**NOIDA,**

**Uttar Pradesh – 201 301.**

*Comments can also be emailed at: [aasb@icai.in](mailto:aasb@icai.in) or [aasb@icai.org.in](mailto:aasb@icai.org.in)*

<sup>1</sup>Hitherto known as Auditing and Assurance Standard (AAS) 22.

<sup>2</sup>The full text of the Policy Position can be downloaded free of charge at [http://www.wifac.org/IAASB/downloads/Modification\\_Policy\\_Position.pdf](http://www.wifac.org/IAASB/downloads/Modification_Policy_Position.pdf).

<sup>3</sup>The full text of the Preface can be downloaded free of charge at <http://www.icai.org/icairoot/announcements/announ1050.pdf>.

## Exposure Draft

# Revised Standard on Auditing (SA) 510

## Initial Audit Engagements – Opening Balances

Standard on Auditing (SA) 510 (Revised), “Initial Engagements—Opening Balances” should be read in conjunction with 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 relating to opening balances when conducting an initial audit engagement. In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments. When the financial statements include comparative financial information, the requirements and guidance in [proposed] SA 710 (Revised)<sup>4</sup> also apply. SA 300 (Revised)<sup>5</sup> includes additional requirements and guidance regarding activities prior to starting an initial audit.

#### Effective Date

2. This SA is effective for audits of financial statements for periods beginning on or after \_\_\_\_\_.

### Objective

3. In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- (a) Opening balances contain misstatements that materially affect the current period’s financial statements; and
- (b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period’s financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

### Definitions

4. For the purposes of the SAs, the following terms have the meanings attributed below:

- (a) Initial audit engagement – An engagement in which either:
  - (i) The financial statements for the

- (ii) The financial statements for the prior period were audited by a predecessor auditor.
  - (b) Opening balances – Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.
  - (c) Predecessor auditor – The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.

### Requirements

#### Audit Procedures

##### Opening Balances

5. The auditor shall read the most recent financial statements, if any, and the predecessor auditor’s report thereon, if any, for information relevant to opening balances, including disclosures.
6. The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period’s financial statements by: (Ref: Para. A1)
  - (a) Determining whether the prior period’s closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year’s Statement of Profit and Loss<sup>6</sup>;
  - (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and
  - (c) Performing one or more of the follow-

ing: (Ref: Para. A2–A6)

- (i) Where the prior year financial statements were audited, reviewing the predecessor auditor’s working papers to obtain evidence regarding the opening balances;
- (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

7. If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period’s financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period’s financial statements. If the auditor concludes that such misstatements exist in the current period’s financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with SA 450<sup>7</sup>.

#### Consistency of Accounting Policies

8. The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period’s financial statements, and whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

#### Relevant Information in the Predecessor Auditor’s Report

9. If the prior period’s financial statements were audited by a predecessor auditor and there was a modification to the opinion, the auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period’s financial statements in accordance with SA 315.<sup>8</sup>

<sup>♦</sup>Presently, SA 200 (AAS 1), “Basic Principles Governing an Audit” and SA 200A (AAS 2), “Objective and Scope of an Audit of Financial Statements” correspond to Proposed International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the Proposed ISA 200 (Revised and Redrafted). Post this revision, the principles covered by SA 200 and SA 200A will be merged into one Standard, i.e., SA 200.

<sup>4</sup>Currently, SA 710 (AAS 25), “Comparatives” is in force. The Standard is being revised in the light of the corresponding International Standard.

<sup>5</sup>Published in December, 2007 issue of the Journal.

<sup>6</sup>Accounting Standard (AS) 5, “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies” requires that prior period items should be separately disclosed in the Statement of Profit and Loss in a manner that their impact on the current profit or loss can be perceived.

<sup>7</sup>At present, there is no separate Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 450, “Evaluation of Misstatements Identified during the Audit”. However, the concept of evaluation of misstatements identified during the audit has been discussed in SA 320 (AAS 13), “Audit Materiality”.

<sup>8</sup>Published in February, 2008 issue of the Journal.

## Audit Conclusions and Reporting

### Opening Balances

10. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.<sup>9</sup> (Ref: Para. A7)

11. If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.

### Consistency of Accounting Policies

12. If the auditor concludes that:

- (a) the current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or
- (b) a change in accounting policies is not properly accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework,

the auditor shall express a qualified opinion or an adverse opinion as appropriate in accordance with SA 705.

### Modification to the Opinion in the Predecessor Auditor's Report

13. If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's opinion on the current period's financial statements in accordance with SA 705 and [proposed] SA 710 (Revised). (Ref: Para. A8)

## Application and Other Explanatory Material

### Audit Procedures (Ref: Para.A6)

A1. In the certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), there may be legal or regulatory limitations on the information that the current auditor can obtain from the predecessor auditor. For example, if the entity has previously been audited by an auditor appointed by for example, the Comptroller and Auditor General of India (CAG), or other suitably qualified person appointed on behalf of the CAG, is privatised, the amount of access to working papers or other information that the such auditor can provide to an incoming auditor, who is a practicing Chartered Accountant within a meaning of Chartered Accountants Act, 1949, may be constrained by privacy or

secrecy laws or regulation. In situations where such communications are constrained, audit evidence may need to be obtained through other means and, if sufficient appropriate audit evidence cannot be obtained, consideration given to the effect on the auditor's opinion.

### Opening Balances (Ref: Para. 6(c))

A2. The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on such matters as:

- The accounting policies followed by the entity.
- The nature of the account balances, classes of transactions and disclosures and the risks of material misstatement in the current period's financial statements.
- The significance of the opening balances relative to the current period's financial statements.
- Whether the prior period's financial statements were audited and, if so, whether the predecessor auditor's opinion was modified.

A3. If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by reviewing the predecessor auditor's working papers. Whether such a review provides sufficient appropriate audit evidence is influenced by the professional competence and independence of the predecessor auditor.

A4. Relevant ethical and professional requirements guide the current auditor's communications with the predecessor auditor.

A5. For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period. In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

- Observing a current physical inventory count and reconciling it to the opening inventory quantities.
- Performing audit procedures on the valuation of the opening inventory items.
- Performing audit procedures on gross profit and cut-off.

A6. For non-current assets and liabilities, such as property plant and equipment, investments and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances. In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties, for example, for long-term debt and investments. In other cases, the auditor may need to carry out additional audit procedures.

### Audit Conclusions and Reporting

#### Opening Balances (Ref: Para. 10)

A7. SA 705 establishes requirements and provides guidance on circumstances that may result in a modification to the auditor's opinion on the financial statements, the type of opinion appropriate in the circumstances, and the content of the auditor's report when the auditor's opinion is modified. The inability of the auditor to obtain sufficient appropriate audit evidence regarding opening balances may result in one of the following modifications to the opinion in the auditor's report:

- (a) A qualified opinion or a disclaimer of opinion, as is appropriate in the circumstances; or
- (b) Unless prohibited by law or regulation, an opinion which is qualified or disclaimed, as appropriate, regarding the results of operations, and cash flows, where relevant, and unmodified regarding State of Affairs.

The **Appendix** includes illustrative auditors' reports.

#### Modification to the Opinion in the Predecessor Auditor's Report (Ref: Para. 13)

A8. In some situations, a modification to the predecessor auditor's opinion may not be relevant and material to the opinion on the current period's financial statements. This may be the case where, for example, there was a scope limitation in the prior period, but the matter giving rise to the scope limitation has been resolved in the current period.

### Material Modifications to ISA 510, "Initial Audit Engagements-Opening Balances"

#### Deletion

1. Paragraph 6 (a) of the Requirement Part of ISA 510 dealt with the procedure for obtaining sufficient appropriate audit evidence about the opening balances which contain misstatements that materially affect the current period's financial statements by determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated. Since in India Accounting Standard (AS) 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that

<sup>9</sup>At present, there is no separate Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 705, "Modifications to the Opinion in the Independent Auditor's Report". However, the concept of modified audit report has been discussed in SA 700, "The Auditor's Report on Financial Statements".

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 have been replaced with the requirement to disclose the prior period items in the current year's Statement of Profit & Loss.

2. Paragraph A1 of the Application Section of ISA 510 dealt with the legal and limitations on the information to be gathered by the current auditor from the predecessor auditor in obtaining the sufficient appropriate audit evidence about misstatements that could materially affect the current period's financial statements while doing the audits of public sector entities. Since as mentioned in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

Further, it is also possible that such a specific legal and limitations on the information to be gathered by the current auditor from the predecessor auditor in obtaining the sufficient appropriate audit evidence may also exist in case of non public sector entities pursuant to a requirement under the statute or regulation under which they operate. Accordingly, the spirit of erstwhile A1, highlighting the fact that in some cases, there may be legal or regulatory limitations on the information that the current auditor can obtain from the predecessor auditor.

3. Paragraph A2 of the Application Section of ISA 510 dealt with the outsourcing of an audit of a public sector entity by the statutorily appointed auditor to a private sector audit firm. Since in the Indian context such situation does not exist, the paragraph A2 of the application part has been deleted completely.

## Appendix

(Ref: Para. A8)

### Illustrations of Auditors' Reports with Modified Opinions\*

#### Illustration 1:

#### Circumstances described in paragraph A8(a)

#### include the following:

- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material but not pervasive to the entity's results of operations and cash flows.<sup>10</sup>
- The State of Affairs at year end gives a true and fair view.
- In this particular jurisdiction, law and regulation prohibit the auditor from giving an opinion which is qualified regarding the results of operations and cash flows and unmodified regarding State of Affairs.

### INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

#### Report on the Financial Statements<sup>11</sup>

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at March 31, 20X1, and the Statement of Profit and Loss, and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with applicable Accounting Standards.<sup>12</sup> This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### *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. Those standards require that we comply with ethical requirements and plan

and perform the audit to obtain reasonable assurance 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<sup>13</sup> of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>14</sup> 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*

We were appointed as auditors of the company on June 30, 20X0 and thus did not observe the counting of the physical inventories at the beginning of the year. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at March 31, 20X0. Since opening inventories enter into the determination of the results of operations and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the profit for the year reported in the Statement of Profit and Loss and the net cash flows from operating activities reported in the cash flow statement.

#### *Qualified Opinion*

In our opinion, except for the possible 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 ABC Company as of March 31, 20X1, and of its Results of Operations and its cash flows for the year then ended in accordance with applicable Accounting Standards.

#### *Other Matters*

The financial statements of the Company for the year ended March 31, 20X0, were audited by

\* The Reporting Standards may give risk to conforming amendments to the illustrations of auditors' reports.

<sup>10</sup> If the possible effects, in the auditor's judgment, are considered to be material and pervasive to the entity's results of operations and cash flows, the auditor would disclaim an opinion on the results of operations and cash flows.

<sup>11</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>12</sup> Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and fair presentation of these financial statements in accordance with applicable accounting standards."

<sup>13</sup> Depending on the circumstances, this sentence may read: "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, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control."

<sup>14</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "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." In the case of footnote 13, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

another auditor whose report dated July 1, 20X0 expressed an unmodified opinion on those statements.

**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 ABC and Co.  
Chartered Accountants  
Signature  
(Name of the Member Signing the Audit Report)  
(Designation<sup>15</sup>)  
Membership Number

Place of Signature

Date

**Illustration 2:**

**Circumstances described in paragraph A8(b) include the following:**

- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material but not pervasive to the entity's results of operations and cash flows.<sup>16</sup>
- The State of Affairs at year end gives a true and fair view.
- An opinion that is qualified regarding the results of operations and cash flows and unmodified regarding State of Affairs is considered appropriate in the circumstances.

**INDEPENDENT AUDITOR'S REPORT**

[Appropriate Addressee]

**Report on the Financial Statements<sup>17</sup>**

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at March 31, 20X1, and the Statement of Profit and Loss, and the cash flow statement for the year then ended, and a sum-

mary of significant accounting policies and other explanatory notes.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and presentation<sup>18</sup> of financial statements that give a true and fair view in accordance with applicable Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*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. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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<sup>19</sup> of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>20</sup> 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 unmodified opinion on the State of Affairs and our qualified audit opinion on the results of operations and cash flows.

*Basis for Qualified Opinion on the Results of*

*Operations and Cash Flows*

We were appointed as auditors of the company on June 30, 20X0 and thus did not observe the counting of the physical inventories at the beginning of the year. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at March 31, 20X0. Since opening inventories enter into the determination of the results of operations and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the profit for the year reported in the Statement of Profit and Loss and the net cash flows from operating activities reported in the cash flow statement.

*Qualified Opinion on the Results of Operations and Cash Flows*

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the Statement of Profit and Loss and Cash Flow Statement give a true and fair view of the results of operations and cash flows of ABC Company for the year ended March 31, 20X1 in accordance with applicable Accounting Standards.

*Opinion on the State of Affairs*

In our opinion, the balance sheet gives a true and fair view of the State of Affairs of ABC Company as of March 31, 20X1 in accordance with applicable Accounting Standards.

*Other Matters*

The financial statements of the Company for the year ended March 31, 20X0, were audited by another auditor whose report dated July 1, 20X0 expressed an unmodified opinion on those statements.

**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 ABC and Co.  
Chartered Accountants  
Signature  
(Name of the Member Signing the Audit Report)  
(Designation)<sup>21</sup>  
Membership Number

Place of Signature

Date

<sup>15</sup> Partner or Proprietor, as the case may be.

<sup>16</sup> If the possible effects, in the auditor's judgment, are considered to be material and pervasive to the entity's results of operations and cash flows, the auditor would disclaim the opinion on the results of operations and cash flows.

<sup>17</sup> The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

<sup>18</sup> Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and fair presentation of these financial statements in accordance with applicable Accounting Standards."

<sup>19</sup> Depending on the circumstances, this sentence may read: "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, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control."

<sup>20</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "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." In the case of footnote 19, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

<sup>21</sup> Partner or Proprietor, as the case may be.

## Exposure Draft

# Standard on Internal Audit (SIA), Terms of Internal Audit Engagement

The Committee on Internal Audit of the Institute of Chartered Accountants of India invites comments on the Exposure Draft of the Standard on Internal Audit (SIA), Terms of Internal Audit Engagement. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Committee on Internal Audit, The Institute of Chartered Accountants of India, C-1, Sector-1, NOIDA-201 301 so as to be received on or before **November 3, 2008**. Comments can also be sent by e-mail at [cia@icai.in](mailto:cia@icai.in).

### Introduction

1. The purpose of this Standard on Internal Audit is to establish standards and provide guidance in respect of terms of engagement of the internal audit activity whether carried out in house or by an external agency. A clarity on the terms of the internal audit in the agreement between the internal auditors and the users of their services (hitherto known as “auditee”) is essential for inculcating professionalism and avoiding any misunderstanding as to any aspect of the internal audit engagement.

2. **The internal auditor and the auditee should agree on the terms of the engagement before the commencement of the internal audit engagement.** The agreed terms would need to be recorded in an engagement letter or other suitable form of contract. Normally, it is the responsibility of the internal auditor to prepare the engagement letter and it is to be signed by both the auditors as well as the auditee.

### Terms of Engagement

3. The terms of engagement of the internal audit define the scope, authority, responsibilities confidentiality, limitation and compensation of the internal auditors. **The terms of engagement should be approved by the Board of Directors<sup>1</sup> or a relevant Committee thereof such as the Audit Committee.** The terms should be reviewed by the Internal Auditor and the audit committee periodically and be modified suitably, if required, to meet the changed circumstances.

### Elements of Terms of Engagement

4. The following are the key elements of the terms of the internal audit engagement:

- i. Scope
- ii. Responsibility
- iii. Authority
- iv. Confidentiality

- v. Limitations
- vi. Reporting
- vii. Compensation
- viii. Compliance with Standards

Each of these elements has been discussed in the following paragraphs.

#### Scope

5. Paragraph 3.1 of the Preface to the Standards on Internal Audit describes internal audit as “an independent function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity’s strategic risk management and internal control system.”

6. **The terms of the engagement should contain a statement in respect of the scope of the internal audit engagement. It should clearly delineate the broad areas of function of internal audit like evaluating internal controls, review of business process cycle controls, risk management and governance.**

7. **It should indicate cover areas where internal auditors are expected to make their recommendations and value added comments.**

8. **The terms of engagement should clearly mention that the internal audit should not result in the expression of an opinion, or any other form of assurance on the financial statements or any part thereof of the auditee, nor an opinion or any other form of assurance on the auditee’s internal control systems or its compliance with laws, regulations or other matters.**

9. **The scope of the terms of the engagement, after delineating the broad areas of function of internal audit should clarify that any additional services that are not encompassed by this engagement letter shall be performed only on mutual agreement and with separate engagement letter.**

#### Responsibility

10. **The terms of the engagement should clearly mention the responsibility of the auditee vis a vis internal auditor.** The auditee is responsible for establishing, maintaining and ensuring operating effectiveness of a system of internal control. The auditee would also be responsible for timely communication of material weaknesses or other significant issues relating to internal controls, misstatements in the financial information or similar matters to its external auditors, the Audit Committee, the Board of Directors, regulators and to those to whom the auditee is required to so communicate.

11. The management of the auditee is responsible for providing timely and accurate data, information, records, personnel etc., and for extending cooperation to the audit team.

12. **Similarly, where the internal auditor has a specific responsibility, say that arising out of a law or a regulation or a professional standard applicable to the internal auditor, to communicate directly, the above mentioned issues to an appropriate authority or someone within the entity or a regulator, the terms of the engagement should contain a clear mention of such responsibility.**

13. **The internal auditor has the responsibility to inform the management before commencement of the assignment about the engagement team and the audit plan.**

#### Authority

14. **The terms of engagement should provide the internal auditor with requisite authority, including unrestricted access to all departments, records, property and personnel and authority to call for information from concerned personnel in the organisation.**

15. **The internal auditor should have full authority to the technologies and other properties like hardware and audit tools they may use in course of performing their internal audit.**

<sup>1</sup> Or an equivalent authority where the entity is not in a corporate form. For example, the Board of Trustees in a Cooperative Society.

### Confidentiality

#### Confidentiality of Working Papers

16. The terms of engagement should be clear that the ownership of the working papers rests with the internal auditor and not the auditee. It should also be made clear that the internal auditor may, upon a request received in this regard from the auditee, provide copies of non proprietary working papers available to the auditee. The terms should lay down the policy and the procedures to be followed regarding requests received for internal auditor's working papers from third parties including external auditors.

17. The internal audit engagement may also be subject to a peer review by a regulator, requiring the internal auditor to disclose his working papers to the peer reviewer without the permission of the auditee. The engagement letter should bring out this fact clearly.

#### Confidentiality of the Report

18. The engagement letter should contain a condition that the report of the internal

auditor not to be distributed or circulated by the auditee or the internal auditor to any party other than that mutually agreed between the internal auditor and the auditee unless there is a statutory or a regulatory requirement to do so.

#### Limitations

19. The terms of engagement should specify clearly the limitations on scope, coverage and reporting requirement, if any. It may also mention that the internal auditor or any of its employees shall not be liable to the auditee for any claims, damages, liabilities or expenses relating to the engagement exceeding the aggregate amount of compensation agreed upon by both the parties.

#### Reporting

20. The terms of the engagement should clearly lay down the requirements as to the manner frequency of reporting and the list of intended recipients of the internal audit report.

#### Compensation

21. There should be a clear understanding among the internal auditor and the client as

to the basis on which the internal auditor would be compensated, including any out of pocket expense, taxes etc. for the services performed by him.

#### Compliance with Standards

22. The terms of the internal audit engagement should contain a statement that the internal audit engagement would be carried out in accordance with the professional Standards applicable to such engagement as on the date of audit.

#### Withdrawal from the Engagement

23. In case the internal auditor is unable to agree in the terms of the engagement contract and is not permitted to continue as per the original terms, he should withdraw from the engagement and should consider whether there is an obligation, contractual or otherwise, to report the circumstances necessitating the withdrawal to other parties.

#### Effective Date

24. This Standard on Internal Audit is effective for all internal audits beginning on or after..... Earlier application of the Standard is encouraged.

## Exposure Draft Standard on Internal Audit (SIA) Internal Audit Evidence

*The Committee on Internal Audit of the Institute of Chartered Accountants of India invites comments on the Exposure Draft of the Standard on Internal Audit (SIA), Internal Audit Evidence. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.*

*Comments should be submitted in writing to the Secretary, Committee on Internal Audit, The Institute of Chartered Accountants of India, C-1, Sector-1, NOIDA-201 301 so as to be received on or before **November 17, 2008**. Comments can also be sent by e-mail at [cia@icai.org](mailto:cia@icai.org)*

### Introduction

1. Paragraph 14 of the SIA 2, "Basic Principles Governing an Internal Audit", states:

***"14. The internal auditor should, based on his professional judgment, obtain sufficient appropriate evidence to enable him to draw reasonable conclusions therefrom on which to base his opinion or findings. Factors affecting the professional judgment include the activity under audit, possible errors and their materiality and the risk of occurrence of such errors."***

The purpose of this Standard on Internal Audit is to amplify the basic principle outlined above and to provide guidance in respect of applicability of this standard during an internal audit.

### Objective

The scope of an internal audit is much broader is comparison to that of statutory audit. The depth of coverage of internal audit, being a management function, would also be much wider. An internal audit func-

tion normally is spread beyond checking of financial transactions and is expected to cover comments on internal control systems, risk management, propriety aspect of transactions. Accordingly, an internal auditor is required to collect appropriate evidence out of his audit process to substantiate his checking and findings. This standard deals with the qualitative and quantitative aspects of evidence in internal audit.

### Internal Audit Evidence

3. Internal audit evidence is all the information used by the internal auditor to support the facts and opinion contained in his report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the internal audit.

Various types of audit evidence which the internal auditor should consider includes :

- **Observed processes and existence of physical items can include observation of activates, property and information systems.**

- **Documentary audit evidence, recorder on paper or other media can include:**
  - Results of data extraction;
  - Records of transaction;
  - Program listing;
  - Invoices;
  - Activity and Control Logs;
  - System Development Documentations.
- **Representations of the auditee can be internal audit evidence, such as :**
  - Written Policies and Procedures;
  - System Flowchart;
  - Written or Oral Statement.
- **Analysis: The internal auditor can also use comparisons, simulations, calculations, and reasoning to analysis the internal audit evidence so gathered, For Example :**
  - Benchmarking internal con-

ontrol performance as against the best practises;

- Comparison of error rates between applications, transactions, and users.

### Sufficient and Appropriate Internal Audit Evidence

5. Sufficiency and appropriateness are interrelated and apply to evidence obtained from analytical procedures. Sufficiency refers to the quantum of internal audit evidence obtained; Appropriateness relates to its relevance and reliability. Normally, internal audit evidence is persuasive rather than conclusive in nature. The internal auditor may often seek evidence from different sources or of different nature to support the same finding.

**6. The internal auditor should evaluate whether he has obtained sufficient appropriate audit evidence before he draws his conclusions therefrom. The internal audit evidence should enable the internal auditor to form an opinion on the scope of the terms of the engagement.** In forming such an opinion, the internal auditor may obtain audit evidence on a selective basis by way of judgmental or statistical sampling procedures.

7. The internal auditor's judgement as to what is sufficient and appropriate internal audit evidence is influenced by :

- The materiality of the item;
- The type of information available;
- Degree of risk of misstatement which may be affected by factors such as :
  - i. The nature of the item,
  - ii. The nature or size of the business carried on by the entity,
  - iii. Situation which may exert an unusual influence on management.

8. The reliability of the internal audit evidence depends on its source – internal or

external and on its type.

### Inconsistency in, or Doubts Over Reliability of, Internal Audit Evidence

9. When internal audit evidence obtained from one source is inconsistent with that obtained from another, or the internal auditor has doubts over the reliability of information to be used as internal audit evidence, the internal auditor shall determine what modifications to or additional audit procedures are necessary to resolve the matter.

### Obtaining Internal Audit Evidence

10. The internal auditor obtains evidence in performing compliance and substantive procedures by one or more of the following methods:

- Inspection
- Observation
- Inquiry and confirmation
- Computation
- Analytical review

The timing of such procedures will be dependent, in part, upon the periods of time during which the internal audit evidence sought is available.

### Inspection

11. Inspection consists of examining records, documents, or tangible assets. Inspection of records and documents provides evidence of varying degrees of reliability, depending on their nature and source and the effectiveness of internal controls over their processing. Four major categories of documentary evidence, which provide different degrees of reliability to the internal auditor, are:

- documentary evidence originating from and held by third parties;
- documentary evidence originating from third parties and held by the entity;
- documentary evidence originating from the entity and held by third parties; and

- documentary evidence originating from and held by the entity.

Inspection of tangible assets is one of the methods to obtain reliable evidence with respect to their existence but not necessarily as to their ownership or value.

### Observation

12. Observation consists of witnessing a process or procedure being performed by others. For example, the auditor may observe the counting of inventories by client personnel or the performance of internal control procedures that leave no audit trail.

### Inquiry and Confirmation

13. Inquiry consists of seeking appropriate information from knowledgeable persons inside or outside the entity. Inquiries may range from formal written inquiries addressed to third parties to informal oral inquiries addressed to persons inside the entity. Responses to inquiries may provide the internal auditor with information which he did not previously possess or may provide him with corroborative evidence.

14. Confirmation consists of the response to an inquiry to corroborate information contained in the accounting records. For example, the auditor requests confirmation of receivables by direct communication with debtors.

### Computation

15. Computation consists of checking the arithmetical accuracy of source documents and accounting records or performing independent calculations.

### Analytical Review

16. Analytical review consists of studying significant ratios and trends and investigating unusual fluctuations and items.

### Effective Date

17. This Standard on Internal Audit is applicable to all internal audits commencing on or after \_\_\_\_\_. Earlier application of the SIA is encouraged.

## Exposure Draft Standard on Internal Audit (SIA) Communication with Management

The Committee on Internal Audit of the Institute of Chartered Accountants of India invites comments on the Exposure Draft of the Standard on Internal Audit (SIA), Communication with Management. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Committee on Internal Audit, The Institute of Chartered Accountants of India, C-1, Sector-1, NOIDA-201 301 so as to be received on or before **November 17, 2008**. Comments can also be sent by e-mail at [cia@icai.org](mailto:cia@icai.org).

### Introduction

1. This Standard on Internal Audit provides an overarching framework for the internal auditor's communication with management and identifies

some specific matters to be communicated with the management as described in the terms of engagement.

2. In performing such an activity, the inter-

nal auditor should :

- a. Communicate clearly the responsibilities of the internal auditor, and an overview of the planned scope and

timing of the audit with the management;

- b. Obtain information relevant to the internal audit from the management;
- c. Provide timely observations arising from the internal audit that are significant and relevant to their responsibility as described in the scope of the engagement to the management; and
- d. Promote effective two-way communication between the internal auditor and the management.

### Matters to be Communicated

#### *The Internal Auditor's Responsibilities in Relation to the Terms of Engagement*

3. The internal auditor's responsibility for performing the internal audit, in accordance with the terms of engagement.

#### *Planned Scope and Timing of the Internal Audit*

4. Communication regarding the planned scope and timing of the internal audit may:

- Assist the management to understand better the consequences of the internal auditor's work, to discuss issues of risk and materiality with the internal auditor, and to identify any areas in which they may request the internal auditor to undertake additional procedures; and
- b. Assist the internal auditor to understand better the entity and its environment.

5. Care is required when communicating to management about the planned scope and timing of the internal audit so as not to compromise with the effectiveness of the internal audit. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable.

6. Matters communicated may include:

- How the internal auditor proposes to address the significant risks of material misstatement, whether due to fraud or error.
- The internal auditor's approach to internal control relevant to the internal audit.
- The application of materiality in the context of an audit.

7. Communication with management, may assist the internal auditor to plan the scope and timing of the internal audit. It does not change the internal auditor's sole responsibility to establish the overall internal audit strategy and the internal audit plan, including the nature, timing and extent of procedures necessary to obtain sufficient appropriate audit evidence.

#### *Significant Findings from the Internal Audit*

8. Paragraph 25 of the SIA 4, "Reporting", states:

*"25. The internal audit report contains the observations and comments of the internal auditor, presents the audit findings, and discusses recommendations for improvements. To facilitate communication and ensure that the recommendations presented in the final report are practical from the point of view of implementation, the internal auditor should discuss the draft with the entity's management prior to issuing the final report. The different stages of communication and discussion should be as under:*

*Discussion Draft - At the conclusion of fieldwork, the internal auditor should draft the report after thoroughly reviewing his working papers and the discussion draft before it is presented to the entity's management for auditee's comments. This discussion draft should be submitted to the entity management for their review before the exit meeting.*

*Exit Meeting - The internal auditor should discuss with the management of the entity regarding the findings, observations, recommendations, and text of the discussion draft. At this meeting, the entity's management should comment on the draft and the internal audit team should work to achieve consensus and reach an agreement on the internal audit findings.*

*Formal Draft - The internal auditor should then prepare a formal draft, taking into account any revision or modification resulting from the exit meeting and other discussions. When the changes have been reviewed by the internal auditor and the entity management, the final report should be issued.*

*Final Report - The internal auditor should submit the final report to the appointing authority or such members of management, as directed. The periodicity of the Report should be as agreed in the scope of the internal audit engagement. The internal auditor should mention in the Report, the dates of discussion draft, exit meeting, Formal Draft and Final Report."*

### The Communication Process

#### *Establishing the Communication Process*

9. Clear communication of the internal auditor's responsibilities, the planned scope and timing of the internal audit, and the expected general content of communications helps establishing the basis for effective two-way communication.

10. Matters that contribute to effective two-way communication include:

- The purpose of communications should be clear, which make the internal auditor and the management better placed to have a mutual understanding of relevant issues and the expected actions arising from the

communication process.

- The form in which communications will be made.
- The person(s) in the internal audit team and the representative of the management, will communicate regarding particular matters.
- The internal auditor's expectation that communication will be two-way, and that the management will communicate with the internal auditor, matters they consider relevant to the internal audit, for example, strategic decisions that may significantly affect the nature, timing and extent of internal audit procedures, the suspicion or the detection of fraud, and concerns with the integrity or competence of senior management.
- The process for taking action and reporting back on matters communicated by the internal auditor and the management.

#### *Forms of Communication*

11. Effective communication may involve structured presentations and written reports as well as less structured communications, including discussions. The internal auditor may communicate matters other than those described in the terms of engagement, either orally or in writing.

12. In addition to the significance of a particular matter, the form of communication (e.g., whether to communicate orally or in writing, the extent of detail or summarization in the communication, and whether to communicate in a structured or unstructured manner) may be affected by such factors as:

- a. Whether the matter has been satisfactorily resolved;
- b. Whether management has previously communicated the matter;
- c. The size, operating structure, control environment, and legal structure of the entity;
- d. In the case of an internal audit of a specific aspect of an operation, whether the internal auditor also audits the entire operation or the entity;
- e. The expectations of the management including arrangements made for periodic meetings or communications with the auditor;
- f. The amount of ongoing contact and dialogue the internal auditor has with the management;
- g. Whether there have been significant changes in the membership of a governing body.

#### *Timing of Communications*

13. The appropriate timing for communications will vary with the circumstances of the

engagement. Relevant circumstances include the significance and nature of the matter, and the action expected to be taken by the management. For example:

- Communications regarding planning matters may often be made early in the audit engagement
- It may be appropriate to communicate a significant difficulty encountered during the internal audit as soon as practicable.
- Similarly, it may be appropriate to communicate material weaknesses in the design, implementation or operating effectiveness of internal control that have come to the internal auditor's attention as soon as practicable.
- Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards.
- The exist meeting may also be an appropriate time to communicate findings from the internal audit.

#### **Adequacy of the Communication Process**

14. The internal auditor need not design spe-

cific procedures to support the evaluation of the two-way communication with the management, rather, that evaluation may be based on observations resulting from audit procedures performed for other purposes. Such observations may include:

- The appropriateness and timeliness of actions taken by the management in response to matters raised by the internal auditor. Where significant matters raised in previous communications have not been dealt with effectively, it may be appropriate for the internal auditor to inquire as to why appropriate action has not been taken, and to consider raising the point again. This avoids the risk of giving an impression that the internal auditor is satisfied that the matter has been adequately addressed or is no longer significant.
- The apparent openness of the management in their communications with the internal auditor.
- The apparent ability of the management to fully comprehend matters raised by the internal auditor, for example, the extent to which the management probes issues and questions recommendations made to them.

- Difficulty in establishing the management a mutual understanding of the form, timing and expected general content of communications.
- Whether the two-way communication between the internal auditor and the management meets applicable legal and regulatory requirements.

15. Inadequate two-way communication may indicate an unsatisfactory control environment and influence the internal auditor's assessment of the risks of material misstatements. There is also a risk that the internal auditor may not have obtained sufficient appropriate internal audit evidence to support his findings or opinion.

#### **Documentation**

16. Where matters required by this SIA to be communicated are communicated orally, the internal auditor shall document them, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the internal audit documentation.

#### **Effective Date**

17. This Standard on Internal Audit is effective for all internal audits beginning on or after \_\_\_\_\_. Earlier application of the Standard is encouraged. □

## **Exposure Draft Standard on Internal Audit (SIA) Coordination with External Auditors**

*The Committee on Internal Audit of the Institute of Chartered Accountants of India invites comments on the Exposure Draft of the Standard on Internal Audit (SIA), Coordination with External Auditors. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.*

*Comments should be submitted in writing to the Secretary, Committee on Internal Audit, The Institute of Chartered Accountants of India, C-1, Sector-1, NOIDA-201 301 so as to be received on or before **November 17, 2008**. Comments can also be sent by e-mail at [cia@icai.org](mailto:cia@icai.org).*

### **Introduction**

1. This Standard on Internal Audit provide a framework for the internal auditor's coordination with external auditor and identifies some specific matters which should be communicated to the external auditor with the prior approval of the management.

### **Need for Coordination of the External and Internal Auditors**

2. Although internal and external audit function has different responsibilities, there are many common objectives which can be a basis for coordination between them. The coordination between the auditors is also necessary to avoid the overlapping or gaps.

3. While the external auditor has sole responsibility for his report and for the determination of the nature, timing and extent of the auditing procedures, much of the work of the internal audit function may be useful to him in his examination of the financial information.

**4. There should be sufficient liaison between the internal and the external auditor. Both should share information regarding scope, audit programme and audit findings.**

#### **Matters to be Coordinated**

5. **The internal Auditor should communicate matters relevant to the external audit.** Such communication shall include:

- (a) Whether the internal auditor has complied with the ethical requirements that are relevant to the external audit, including independence;
- (b) Information on instances of non – compliance with laws or regulations that could give rise to material misstatement of the financial statements;
- (c) Description of any identified material weaknesses in internal control over financial reporting;
- (d) Any other matters that may be relevant to

the external audit, or to which internal auditor wishes to draw to the attention of the external auditors, including exceptions noticed in the written representations that the internal auditor requested from management; and

- (e) The Internal Auditor's overall findings, conclusions or opinion.

### **The Coordination Process**

#### **Establishing the Coordination Process**

6. Clear communication of the internal auditor's responsibilities, the planned scope and timing of the internal audit, and the expected general content of communications helps establishing the basis for effective two-way communication.

7. Matters that contribute to effective two-way communication include the following:

- (a) Clarity on the purpose of communications make the internal auditor and the external auditor better placed to have a mutual understanding of relevant issues and the ex-

pected actions arising from the communication process;

- (b) The form in which communications will be made;
- (c) The internal auditor's expectation that communication will be two-way, and in order to perform such an activity the internal auditor communicate matters they consider relevant to the audit.

#### Means of Coordination

8. The coordination between the internal and the external auditor also depends on the size and complexity of the entity. Main activities which might be considered as means of coordination are as follows:

- (a) *Exchange of Audit Documentation* - The exchange of audit documentation is a very basic type of coordination. Such audit documentation is of two types - working papers and reports. The exchange of working papers and reports might be considered as good means of coordination;
- (b) *Sharing of Information* - Exchange of information such as organisation changes, introduction of new technology acquired during the course of internal audit etc;
- (c) *Use of Common Methodologies*- Use of common technical and documentation procedures especially for aspects such as audit sampling can ease the co-ordination process;
- (d) *Joint Planning* - The internal and external auditors plan the internal audit in such a way that overlapping or gaps are minimised;
- (e) *Work Assistance* - internal auditor may at a specific request received in this regard from the external auditor, perform work for the latter.

#### Timing of Coordination

9. Coordination with the external auditor is usually more effective when meetings are held at appropriate intervals during the year.

#### Effective Date

10. This Standard on Internal Audit is applicable to all internal audits commencing on or after \_\_\_\_\_. Earlier application of the SIA is encouraged. □

## Exposure Draft Standard on Internal Audit Consideration of Fraud in Internal Audit

*The Committee on Internal Audit of the Institute of Chartered Accountants of India invites comments on the Exposure Draft of the Standard on Internal Audit (SIA), Consideration of Fraud in Internal Audit. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.*

*Comments should be submitted in writing to the Secretary, Committee on Internal Audit, The Institute of Chartered Accountants of India, C-1, Sector-1, NOIDA-201 301 so as to be received on or before **November 17, 2008**. Comments can also be sent by e-mail at [cia@icai.org](mailto:cia@icai.org).*

#### Introduction

1. Fraud is defined as an intentional act by one or more individuals among management, those charged with governance, or third parties, involving the use of deception to obtain unjust or illegal advantage. A fraud could take form of misstatement of an information (financial or otherwise) or misappropriation of the assets of the entity.
2. The primary responsibility for prevention and detection of frauds rests with management and those charged with governance. They achieve this by designing, establishing and ensuring continuous operation of an effective system of internal controls.
3. Paragraph 6 of the Standard on Internal Audit (SIA) 2, Basic Principles Governing Internal Audit, states as follows:

***The internal auditor should exercise due professional care, competence and diligence expected of him while carrying out the internal audit.*** *Due professional care signifies that the internal auditor exercises due professional care in carrying out the work entrusted to him in terms of deciding on aspects such as the extent of work required to achieve the objectives of the engagement, relative complexity and materiality of the matters subjected to internal audit, assessment of risk management, control and governance processes and cost benefit analysis. Due professional care, however, neither implies nor guarantees infallibility, nor does it require the internal auditor to travel beyond the scope of his engagement.*

**An internal auditor should, therefore, use his knowledge and skills to reasonably enable**

him to identify indicators of frauds. However, the internal auditor cannot be expected to possess the expertise of a person with specialized knowledge and skills in detecting and investigating frauds.

### Common Fraud Situations

4. A fraud normally occurs in situations where there is an incentive or a pressure to commit fraud, an opportunity to commit fraud or a rationalisation for committing fraud. **Although, normally, an internal auditor is not expected to possess skills and knowledge of a person expert in detecting and investigating frauds, he should, however, have reasonable knowledge of factors that might increase the risk of opportunities for frauds in an entity and exercise reasonable care and professional skepticism while carrying out internal audit.** In addition, the understanding of the design and implementation of the internal controls in an entity would also help the internal auditor to assess the risk of frauds.

### Internal Control System

5. Internal control refers to the process designed, implemented and maintained by the management of the entity to ensure accomplishment of its following objectives:

- Reliability of financial reporting;
- Efficiency and effectiveness in operations;
- Compliance with applicable laws and regulations; and
- Safeguarding of assets.

The design and the manner of implementation and maintenance of internal controls varies with the size and complexity of the entity.

6. Internal controls can, however, provide only reasonable assurance to the entity with regard to accomplishments of its objectives stated in paragraph 5 above since any system of internal control is subject to inherent limitations such as faulty human judgment, ineffective use of the information generated for the purpose of internal controls, collusion among two or more persons, management override of controls, faulty design of controls, management judgments as to nature and extent of risks it wants to assume, etc.

### Elements of Internal Control System

7. A system of internal control comprise of following five elements:

- the control environment;
- entity's risk assessment process;
- information system and communication;
- control activities; and
- monitoring of controls.

It is essential for the internal auditor to gain an understanding of the components of the system of internal control. These components have been discussed in the following paragraphs.

8. The *control environment* sets the tone at the top in an entity and greatly impacts the effectiveness of internal controls. It includes the following:

- the policies and procedures established by the management to communicate and enforce the culture of integrity and ethical values in the entity.
- management's commitment to competence.
- management's philosophy and operating style.
- organizational structure.
- assignment of authority and responsibility.
- human resources policies and practices.

9. The *entity's risk assessment process* includes the policies and procedures adopted by the management to identify risks that can affect the achievement of the objectives of the entity and to distinguish risks from opportunities. In the context of prevention of frauds, the entity's risk assessment process would include the policies and procedures of the management to identify and assess the risk of frauds, including the possibility of fraudulent financial reporting and misappropriation of assets.

10. The *information system and communication* refers to the policies and procedures established by the management to identify, capture and communicate relevant information to the concerned persons in the entity to enable them to make timely and effective decisions and discharge their responsibilities efficiently. In the context of frauds, such policies and procedures could take form of whistleblower policies and mechanisms, ethics helplines and counseling, training of employees, etc.

11. The *control activities* refer to the policies and procedures established by the management to ensure that the risks identified are responded to as per the policy or the specific decision of the management, as the case may be. In the context of frauds, the control activities include actions taken by management to prevent or detect and correct the frauds or breach of internal controls.

12. *Monitoring* refers to continuous supervision and assessment of the internal controls to identify instances of any actual or possible breaches therein and to take corrective action on a timely basis.

### Responsibilities of the Internal Auditor

13. As discussed in paragraph 2, the primary responsibility for prevention and detection of frauds is that of the management of the entity. **The internal auditor should, however, help the management fulfill its responsibilities relating to fraud prevention and detection.** The following paragraphs discuss the approach of the internal auditor regarding this.

### Control environment

14. The internal auditor should obtain an understanding of the various aspects of the control environment and evaluate the same as to the operating effectiveness.

### Risk Assessment

15. The internal auditor should obtain an understanding of the policies and procedures adopted by the management to identify risks that can affect the achievement of the objectives of the entity and to distinguish risks from opportunities and evaluate the effectiveness of these policies and procedures. In the context of prevention of frauds, the internal auditor should specifically evaluate the policies and procedures established by the management to identify and assess the risk of frauds, including the possibility of fraudulent financial reporting and misappropriation of assets.

### Information system and communication

16. The internal auditor should assess the operating effectiveness of the policies and procedures established by the management to identify, capture and communicate relevant information to the concerned persons in the entity to enable them to make timely and effective decisions and discharge their responsibilities efficiently.

### Control Activities

17. The internal auditor should assess whether the controls implemented by the management to ensure that the risks identified are responded to as per the policy or the specific decision of the management, as the case may be are in fact working effectively and whether they are effective in prevention or timely detection and correction of the frauds or breach of internal controls.

### Monitoring

18. The internal auditor should evaluate the mechanism in place for supervision and assessment of the internal controls to identify instances of any actual or possible breaches therein and to take corrective action on a timely basis.

### Communication of Fraud

19. The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action. However, in case the internal auditor comes across any actual or suspected fraud or any other misappropriation of assets, he should immediately bring the same to the attention of the management.

### Effective Date

20. This Standard on Internal Audit is effective for all internal audits beginning on or after \_\_\_\_\_. Earlier application of the Standard is encouraged. □

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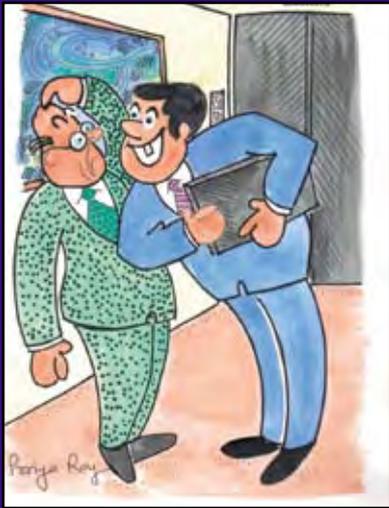
**Smile Please**

"I have to have a raise," the man said to his boss. "There are three other companies after me."

"Is that so?" asked the manager. "Which other companies are after you?"

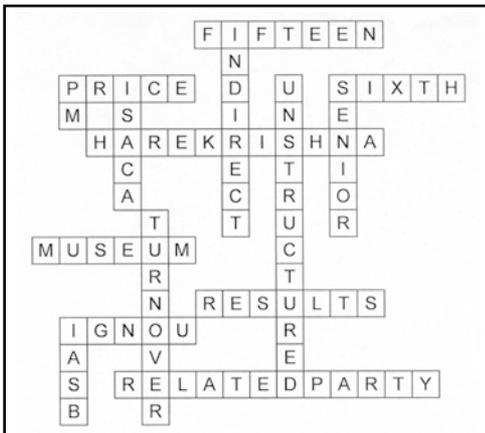
"The electric company, the telephone company, and the gas company. I haven't paid the bills you know."

**OUT OF THE BOX**

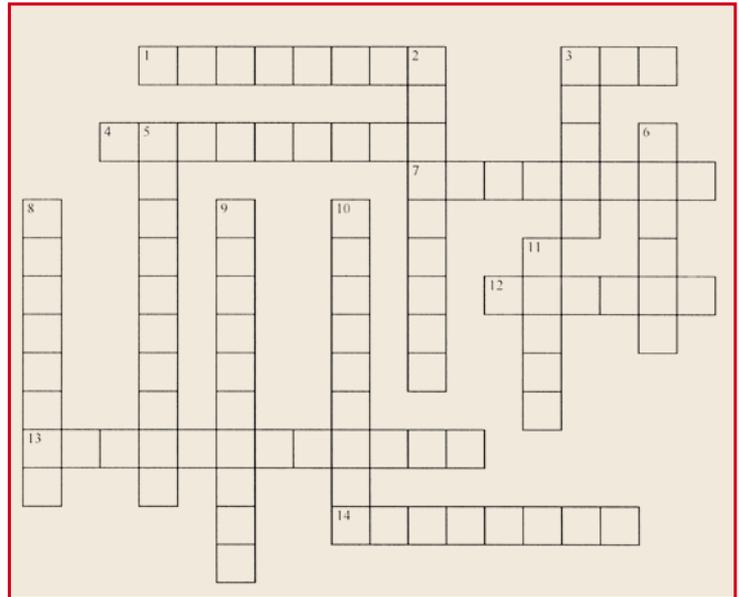


*I Think the big boss here is a visionary. He kept saying ' I see... I see...' Throughout the presentation even when i had nothing to show!*

**Crossword 027 - Solution**



**CROSSWORD 028**



**ACROSS**

1. An asset is known to be \_\_\_\_\_ when the carrying amount of the assets exceeds its recoverable amount.
3. A tax which is proposed to be implemented from April 1, 2010.
4. ICAI lunched its Certificate Course on \_\_\_\_\_. (9)
7. \_\_\_\_\_ goodwill should be capitalized and amortized in accordance with AS 14.
12. An assessee cannot be denied the benefit extended under a scheme due to dislocation caused by the \_\_\_\_\_ Department. (6)
13. An \_\_\_\_\_ firm commitment is the element of financial statements that is designated as being hedged. (12)
14. One of the stages of the Money Laundering. (8)

**DOWN**

2. An item about which disclosure is required to be made under Income Tax Return for companies but not mentioned in Scheduled VI of the Companies Act, 1956.
3. Corporate services from \_\_\_\_\_ have been hired by the ICAI to provide organisational email ids. (5)
5. As per Accounting Standard 18, \_\_\_\_\_ are also a Related Party. (10)
6. One of the investment banks collapsed recently. (6)
8. One of the methods prescribed under Transfer Pricing Rules to determine the profits. (4,4)
9. An assessee can make \_\_\_\_\_ payment of taxes from the account of other person also. (10)
10. A \_\_\_\_\_ equity share is a financial instruments or other contract that entitles or may entitle, its holder to equity shares. (9)
11. Short name of the foreign company involved in mineral oil business in India in whose favor Supreme Court gave its decision recently.(5)

**Note:** The first ten correct entries from the members will be awarded one hour CPE Credit. The entries, along with name, membership no. and contact details shall be sent by post to: The Editor, The Chartered Accountant, ICAI Bhawan, C-1, Sector 1, Noida - 201 301.