

THE CHARTERED ACCOUNTANT

JOURNAL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA



Forecasting
Using Financial
Models

Corporate Governance:
A Long Term Consciousness
Perspective

Managing the Risk – Impact of the
Recent Developments in General
Insurance Industry

Future Trends that will
Shape the World of
Corporate Finance

Celebrating 60th Year of Excellence

Tackling the Global Financial Crisis

All the desperate measures like hefty bail-out packages, acquisition of ownership stakes in banks by US and UK Governments and coordinated rate cuts of several central bankers across the world have failed to contain the shocking global financial crisis, and its ripple effects continue unabated. Having collapsed some largest financial institutions and dried up the liquidity, this tsunami of financial world has hit the world economy hard, triggering fears of serious and longish global recession. India is no exception to the woes of this financial meltdown as it has led to some credit squeeze and erosion of huge amounts of investor wealth.

While there is no reason to panic about the medium-term strength of the Indian economy, including financial sector and credit markets, concerns remain about the problems in the short term. Government measures like three rounds of cuts in Cash Reserve Ratio to release Rs. 1,45,000 crore in financial system and withdrawal of ban on Participatory Notes and cut in the repo rate by 1 percentage point have had only little positive impact on overall situation and gloomy market sentiment, and much more is desired to be done. More worrisome are some ominous signs that suggest that worse may be yet to come. These signs include dismal 1.3% rise in industrial production in August this year over the same period last year giving rise to fears of industrial recession, the continued pressure of rupee which recently hit an all time low of 50.15, a crisis of confidence which recently had turned banks wary of lending to each other just like in West with overnight call rates having touched 24%, and continuing travails of Dow and massive sell-offs by FIIs in Indian stock markets.

The policy makers should seriously take note of the fact that the 1.3% annual growth in the Index of Industrial Production is the lowest the index has registered for any month except October 1998 since the revised IIP came into effect in April 1994. As such, it is high time that RBI firms up softer, easier interest rate agenda to ward off recessionary contagion.

Ensuring liquidity should now continue to be greater concern for RBI than fighting inflation, particularly when the commodity and oil prices have fallen sharply and inflation has eased below 12 per cent mark. Some proposals which are worth considering to make more funds available to credit market, keep up investor confidence and assuage market sentiment include 'directing and nudging' banks not to stop lending, at least to companies with good (AAA)

credit rating, a ban on reverse repo and relaxation of statutory liquidity ratio. The Government can also release the cash to banks for the loan waivers it has already granted to farmers. The RBI has also rightly suggested a sovereign guarantee for money market transactions and mutual funds in a global crisis situation, similar to the cover given to bank deposits to sustain investors' faith in Indian financial institutions. A ban on short short-selling may also be considered to curb the markets' bearish sentiments like in US, Italy and China but only after carefully analyzing some observations and claims that the similar month-long ban in US failed to achieve anything.

Indeed the crashing stocks have turned many dreams into nightmares. But in Indian context, the reason behind sagging market sentiment and massive sell-offs is more a panic, crisis of confidence and anxieties about our prospects of future growth. We are a sort of victims of irrational 'herd behaviour' where difference across economies are getting blurred in a mad rush to safety. As such, these are times when we should continue to have strong faith in our economy whose fundamentals remain sound and which is expected to grow at least at a healthy 7% even in even the worst case scenario. It won't be wrong to share the confidence of International Monetary Fund and Finance Minister P Chidambaram that Indian economy, with its strong internal drivers for growth and strong financial system, can weather the global financial storm and that "there is nothing to fear but the fear itself".

We should feel proud of ourselves for having so far escaped the full trauma of financial crisis experienced by some richest nations. This has been because of our excellent pre-emptive monitoring and supervision of the crisis and sound regularity and compliance mechanism. This has been because our banks are well provided, well regulated, well capitalized, and have little risk of collapse because they do not over-extend themselves in lending against securities or real-estate. The global financial crisis, however, will take time to play out and till such time the RBI and Government need to be in extra-watchful mode.



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CONTENTS

763 EDITORIAL

768 FROM THE PRESIDENT

772 READERS WRITE

788 EAC OPINION

802 E-LEARNING INITIATIVE OF ICAI

805 PHOTOGRAPHS

806 NOSTALGIA

■ Glimpses of the Past

817 LEGAL UPDATE

■ Circulars

■ Legal Decisions

■ Disciplinary Case

886 ICAI NEWS

■ Amendments in the Chartered Accountants Regulations, 1988

■ Branch Notification

■ Issuance of Exposure Draft of Accounting Standard (AS) 3 (revised), *Statement of Cash Flows*

■ Issuance of Exposure Draft of the Guidance Note on Accounting for Service Concession Arrangements

■ Announcements from Committee on Information Technology

■ New Publications

■ Outstanding Exposure Drafts (Issued by AASB)

■ Appeal to Articled Assistants to Contribute towards Chartered Accountants Students Benevolent Fund

■ Certificate Course on Arbitration

■ Reference Books on GST/VAT

898 EVENTS

903 CLASSIFIED

906 ECONOMIC UPDATE

907 NATIONAL UPDATE

908 INTERNATIONAL UPDATE

910 PRACTICE UPDATE

911 ACCOUNTANT'S BROWSER



776 ACCOUNTING
Forecasting Using Financial Models
 — CA. Gurudutt N. Joishy

792 AUDITING
Efficient Auditing
 — Dr. L. Kailasam

807 TAXATION
Section 14A: Special References
 — CA. Rakesh Jhunjunwala

812 Case Study and Suggestions about Allowability of Dividend
 — CA. Dev Kumar Kothari

832 CORPORATE & ALLIED LAWS
Abuse of Dominance: An Offence under Competition Act, 2002
 — CA. Umesh H. Dixit

837 CORPORATE GOVERNANCE
Corporate Governance: A Long Term Consciousness Perspective
 — CA. Om Prakash Dani & M.S. Srinivasan



843 BANKING & FINANCE
Financial Sustainability of Urban Local Bodies: Need of the Hour
 — CA. Pankaj Goel & CA. Aseem Bhargava



855 Compliance Management in Banks
 — Dr. Sanjiv Agarwal



859 Share Buyback Regulations in India: A Critical Analysis
 — Mr. Chanchal Chatterjee & Dr. Debdas Rakshit



866 INFORMATION TECHNOLOGY
Working with MS - Excel
 — CA. B.M. Zinzuvadia



876 INDUSTRY SPECIFIC
Managing the Risk – Impact of the Recent Developments in General Insurance Industry
 — CA. V. Ramasaamy



882 Future Trends that will Shape the World of Corporate Finance
 — CA. Prem S. Khamesra



912 EXPOSURE DRAFTS
Revised Standard on Auditing (SA) 210 Agreeing the Terms of Audit Engagements

925 Standard on Auditing (SA) 720 The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements

931 GENERAL
Be An Effective Communicator
 — CA. Harsh Ramniwas Rathi



937 BACK PAGE
 ■ Crossword 029
 ■ Smile Please
 ■ Cartoon

Dear Esteemed Colleagues,

As I pen down this communication, the financial world and the global economy are in the throes of the worst crisis of our times. The financial bubble— global in scale — has now burst, resulting in the collapse of some of the largest financial institutions, drying up of liquidity, wiping out investor confidence and mind-boggling amounts of wealth, and leaving the world economy teetering on the brink of a serious recession. Despite baffling bail-out packages and other desperate measures by some of the richest nations, the contagious crisis continues to shake the world, India included— raising fears that the worst is yet to come. Only a few could have imagined such a culmination of the last year's US sub-prime crisis. But why did it happen in the first place, when everything looked so rosy, so hunky dory till recently? Our professional wisdom calls for unravelling this question so that we can become wary of the causes of the crisis for future.

The global financial meltdown has indeed had a knock-on effect on India too as witnessed in the bleeding stock markets, but there is no reason to panic as there is no financial crisis *per se* in India. With its strong internal drivers for growth, robust financial system, excellent regulatory mechanism, and pro-active and pre-emptive monitoring of the situation, India will certainly weather this global storm. We can take pride in saying that India's regulations, regulators and compliance systems are better than those in more advanced countries.

However, there is need for the Indian accounting fraternity to be extra-vigilant while performing their duties and be forthcoming with their pre-emptive advices and actions in the best interests of their clients, employers and the national economy. As the backbone of the Indian financial system, the nation today expects from us much more than ever before. I am sure that given our excellent track record as an 'inbuilt check and balance' and 'monitor & ensurer of compliance' in the financial system, we professionals will be able to see India through these turbulent times. Every crisis carries an opportunity with it, and we should accept this opportunity to yet again prove and promote our worth.

Moving on to issues relating to the profession and the Institute, I wish to share the following with you.

New Certificate Courses for Members

In tune with the emerging requirements of the globalised economy and the need for specialised professionals and also as a futuristic move, I am glad to inform you that we have started two new certificate courses on *Forex & Treasury Management*, and *Derivatives*. I am sure these courses will help our members improve their professional visibility and core competence. The course on *Forex & Treasury Management* will cover the areas of foreign exchange market, money market, bond market operations and related financial products. It will also analyse international finance environment within which banks and other intermediaries and companies operate. The course aims to examine alternative strategies and techniques that can be employed to manage the risks associated with international business transactions and other treasury operations. The emphasis is on developing such skill sets which would be required for making sound financial decisions in an international context. The course on *Derivatives* will cover financial derivatives such as forward contracts, futures contracts, options, swaps and other new derivatives. The emphasis of the course will be on successful execution of financial strategies using derivatives as product.

The details of both these courses and the other certificate courses introduced recently i.e., Certificate Course on IFRS, Certificate Course on Valuation and Certificate Course on Arbitration are available on our website with facility of online registration.

Portal for Members in Practice and Members in Industry

Let me also inform you that soon a portal is being launched wherein Members in Practice could post their profiles and areas of expertise so that the same could be utilised by service users and other professionals. Similarly, for Members in Industry, another portal is being launched for putting their profiles for possible use by corporates and prospective employers.

E-Learning Initiative

I am happy to inform you that a mission has been embarked upon to make e-learning one of the most powerful resources of ICAI. As part of this initiative, the ICAI's first e-learning course on Service Tax has now been made available for members on the new e-learning platform <http://elearn.icai.org>. I am sure members will find this course advantageous and helpful in obtaining the CPE credits. Members can now register for the e-learning course and after suc-

successful completion of it, the ICAI's CPE Directorate would automatically update the CPE credits on the CPE portal.

Tie-Ups with Universities for BBA and MBA

I am glad to inform you that Bharatiyar University, Coimbatore has agreed to allow CA students/members to pursue the BBA and MBA courses. A student pursuing PCC/PE-II course can join the BBA course and be eligible for exemption in 10 out of a total of 15 papers and on passing remaining 5 papers, will be entitled to the BBA degree. Similarly, a member or a student having passed the final examination of CA course shall be eligible for exemption in 10 papers out of 15 papers of the MBA examination and will be awarded the MBA degree on passing the remaining 5 papers. Both the BBA and MBA courses will be available across the country. Further details will be hosted on the website immediately after a formal signing of MoU with the Bharatiyar University, which is likely to be in mid-November, 2008.

Similar discussions are on with various other universities and I am quite hopeful that after formalising the MoU with one university, it will be much easier to have similar arrangement with other universities.

Imparting Quality Article Training - Need of the Hour

We must realise that quality training is the key to a strong accountancy profession, which in turn is the key to a strong financial infrastructure in the country. In these times of globalisation, high expectations and fast-increasing number of articulated assistants, the practical training of articles has to be taken much more seriously than ever before to preserve and promote our 60-year-long tradition of high standards. There has been more than a three-fold increase in the number of students enrolling for articleship as compared to the average during the period 2001-2005, which has cast a great responsibility on the principals of the day. It's high time that members/principals rose to the occasion and paid extra attention to groom the CA students into complete professionals. Members need to act like mentors, as 'friend, philosopher and guide' to the CA students and make them feel at home during the period of training. The practical training is required to be meticulously planned and implemented in such a manner that the trainees get exposed to the maximum number of professional activities, circumstances and business environments. Besides, students need to be encouraged to make presentations and participate in group discussions as a regular feature of their training. Weekly meetings of the students could



be arranged where students be asked to share their experiences.

I have asked Board of Studies to work on a comprehensive mentorship guide. I will request all of you to share your experiences and forward your suggestions so that uniform, quality training could be ensured. We, at the Institute level, are constantly improving the Practical Training Programme, but its efficient execution depends largely on the principals. Let's take the task of article training as an obligation to the profession and seriously fulfill the same.

Growing Strength of CA Fraternity

You will be enthused to know that the strength of Chartered Accountant fraternity has grown significantly in recent times. The total number of our members has increased from 1,45,481 to 1,50,265 as on 30.9.2008.

What is even more remarkable is the overwhelming interest of students in the profession and their enthusiasm to join the CA fraternity. The number of students on an average per year joining CA course during the years 2001 to 2005 was between 35,000 to 40,000. However, in the year 2006, this number rose to 99,113 and in the year 2007 to 1,61,952.

I am sure that the increasing interest in the accountancy profession will grow still further in times to come, in line with the all-round expansion of economic activities and the consequent ever-increasing demand of highly qualified accounting professionals in the country. These trends are a matter of pride for all of us.

The fact that needs special mention is that there has been a substantial increase in the number of women members of our fraternity. As on date, women constitute about 15 per cent of the total membership. Out of the 60,929 members who have been added since April 2001, a substantial number of 14,625

(24%) are women. Not only that, the percentage of female students among the new registrants for CA course is above 32 per cent.

Activities Abroad

It is really heartening to inform you that 21 overseas chapters of the Institute are acting as ICAI ambassadors and facilitators of globalisation of the Indian accounting profession with distinction. The chapters are growing from strength to strength and are serving as nerve centres for our members. The multifarious activities of these chapters demonstrate the growing competence and confidence of the Indian professional community abroad.

On our part, we are ensuring that these chapters pursue much more because in this era of globalisation and harmonisation of accounting and auditing standards, the opportunities for our CAs are bound to grow. We are prompting the chapters to increasingly help, support, promote and foster a sense of community, loyalty, fellowship, partnership and professionalism among the members of the Institute. We have taken initiatives to make sure that these chapters establish and maintain close relationship with CAs from India, and also liaise with the foreign professional bodies to enhance their awareness about ICAI and its members.

I recently had the privilege of visiting Sydney, Melbourne and Toronto chapters and attending the programmes organised by each of them during my visit to Australia and Canada as a follow-up of the mutual recognition exercise being carried on with accounting institutes of these countries. I was highly impressed by the role being played and the time being spent by the office bearers of these chapters. The chairpersons of these chapters and the entire executive teams deserve sincere compliments from the whole of the profession for the role being played by them in enhancing the awareness about the Institute and its members. The details of all these chapters with link to their respective websites are available on the ICAI website. In case you need any more information or assistance, please visit their websites and communicate with the office bearers of the chapters concerned.

A Street Named After ICAI

Friends, there has been ever-increasing recognition of the ICAI as a partner in nation building. I am glad to inform you that as part of this process, a street within the limits of Salem Municipal Corporation has been named after the name of the Institute. It is for the first time that this has happened. The street in

which the Salem branch building is situated has been named as "Auditors Street" in commemoration of the Diamond Jubilee Celebrations of the Institute. Similarly, the Municipal Corporation of Delhi has agreed to hand over two roads viz. Jawaharlal Nehru Marg [from Delhi Gate traffic junction to Samata Sthal (Babu Jag Jeevan Ram Samadhi)] and Deen Dayal Upadhyay Marg [From ITO to Minto Road T-point], to the Institute for its upkeep and maintenance. Discussions are on for taking over some of the Delhi Municipal Libraries for upkeep and maintenance and opening of computer centres at such libraries. This is a welcome move, which will help promote the identity and status of the Institute in the society. May I request you to use your good offices and see that the profession and the ICAI get more and more recognition.

Measures to Serve Members

You will be happy to know that a *Members' Help Desk* has been created and hosted on the website of the Institute to respond to day-to-day queries of our members. Our members can now write and post their queries anytime visiting the site www.icaai.org, and a response will be sent to them through e-mail within three working days. I am sure that this will put an end to our members' long-felt requirement for a platform where they could resolve their queries. I will really wait for your feedback in this regard, as this will help us in managing, updating and strengthening this system. This step is actually an addition to the initiative of *Foreign Desk* that is already in operation under the link '*ICAI Internationally*' on the Institute's website. Under this facility our members abroad can reach the Institute by writing to foreigndesk@icaai.org about various matters of professional concern.

Also, in order that ICAI members abroad are able to receive various important periodical communications from the Institute in time, they need to update their e-mail addresses with the institute. A facility has been created for members, *inter alia*, to update their e-mail profile, addresses and other important particulars through the link, '*Update ICAI Members Abroad Profile*' on the Institute's website. I request all our members abroad to use this facility to update their addresses so as to facilitate smooth communication.



CA. Ved Jain

New Delhi, October 24, 2008

New and Welcome Initiatives

I am very glad to know that the ICAI is starting to hold convocations for the award of its various certificates. It will promote stronger bonds among the ICAI fraternity. I am really happy to find out that the ICAI has decided to set up a museum in the interest of its student and members.

- CA. Yogesh Dhiman, Member, Roorkee

I am a regular reader of the Institute's journal for many years. I have been immensely enlightened by reading its articles. The initiatives like providing members with their own e-mail ID and the proposed launch of certificate courses on IFRS and Valuation are splendid. I am eagerly waiting to enrol in those courses. I sincerely extend my heartiest congratulations to the Editorial Board for endlessly bringing out enriching articles covering wide subjects to us. I feel extremely proud to be a member of the esteemed Institute.

- CA. R Satish, Member, Muscat

Advantage to Members in Industry

I am very happy to note that as part of unstructured learning, our Institute has started giving CPE credit for reading the articles of the Journal. It will be very convenient for the members in industry, like me, to avail themselves of CPE credits. I have observed that over the years, our Journal has become an indispensable tool for the members for updating their knowledge, containing detailed inputs on various topics including emerging issues. I feel proud to be a part of our CA fraternity.

- CA. Amit Khurana, Member, Pune

Sustainable Solutions

Oh what a fall was there my countrymen! (William Shakespeare, Julius Caesar). The impact of the fall of some of largest financial institutions has sent shock waves in global markets including our own sensex. Other consequences include tremendous loss of market capitalisation, spiralling speculation, shaking out of investor confidence, and the frightened campus placement cells of B-schools. However, the backdrop of this unfortunate debacle

has been, to a great extent, an utter neglect of basic due diligence of borrowers prior to sanctioning of a loan/line of credit. Either the lenders faltered in executing a 'Know Your Customer (KYC)' review, or they wilfully advanced credit to unscrupulous borrowers with full knowledge that majority of such loans would default in repayment and thus become bad debts or as we call them in banking parlance - Non-Performing Assets (NPA). The fall of Enron and WorldCom in 2002 had cast similar gloom on markets, with Sarbanes Oxley being enacted as a preventive measure. But really how successful are these pieces of legislations? Do they warranty that such cases of corporate failure, frauds and wilful neglect of basic control measures will never occur again? The real sustainable effort towards minimising such instances should come suo motu from the market operators, players, intermediaries, corporate honchos, auditors and related agencies themselves in letter and spirit. Unless we adopt such a mindset, it is difficult to prevent such an unfortunate turn of events which leave behind indelible scars on global financial markets for years to come.

- Arijit Chakraborty, HariBhakti, Kolkata

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The Institute sends the Journal to the subscribers in a polythene bag that is non-destroyable and hazardous in nature. Earlier the Journal was sent in environment-friendly recycled paper bags, but the practice was discontinued. It would be good if that environment friendly practice is revised.

- CA. Ramesh Chaudhari, Member, Akola

Educating Article

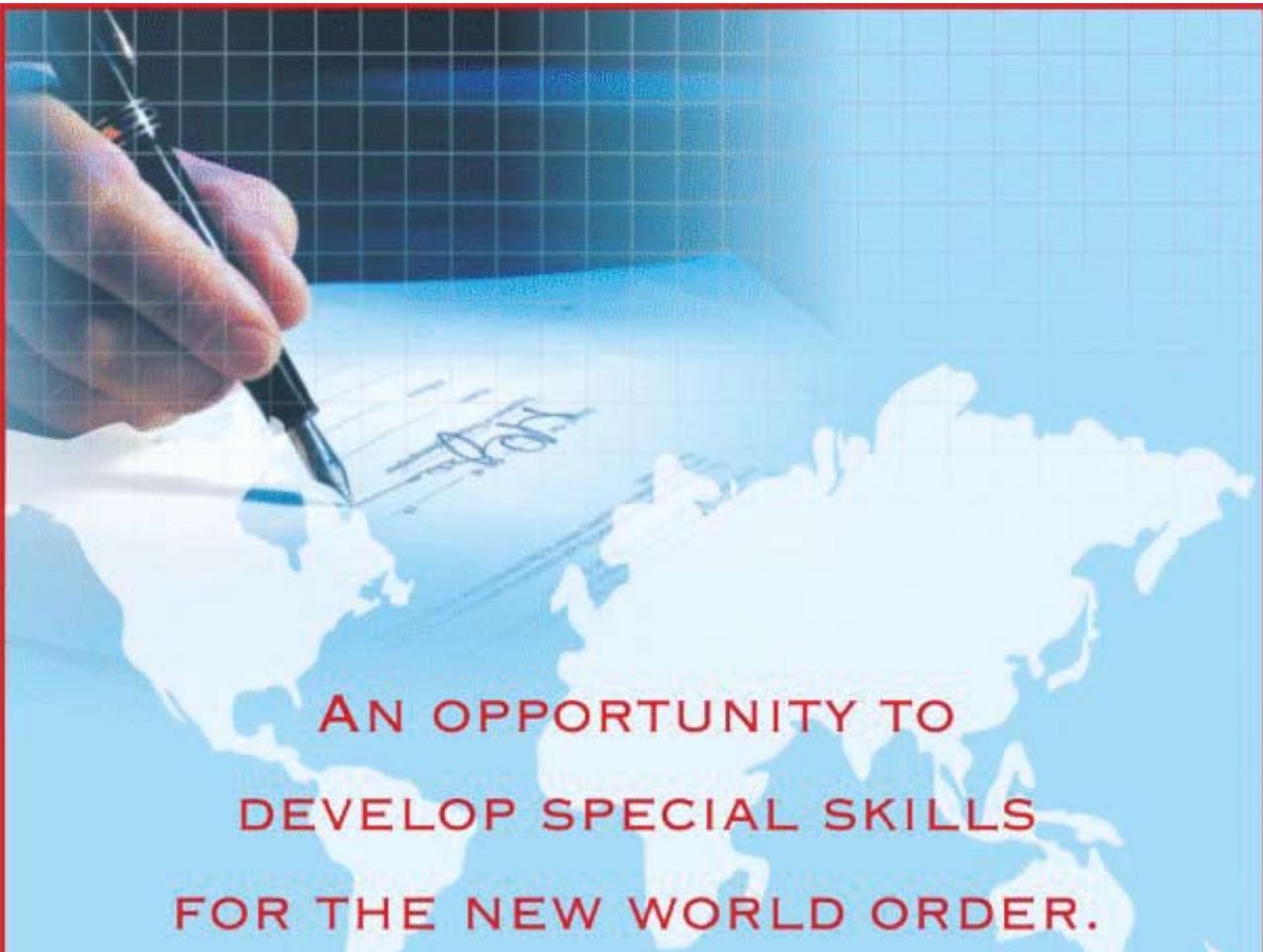
Article on clean development mechanism and carbon credit by Ms. Debrupa Chakrabortyji was very educative. The author has done justice with the topic in all respects. We should explore the field and concept of Clean Development Mechanism to widen the professional opportunities.

- CA. P. K. Agrawal, Member, Maihar

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 / nadeem@icai.org or write to: The Editor, The Journal Section, ICAI Bhawan, C-1, Sector 1, Noida (U.P.) 201 301.

- Editor



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FORECASTING USING FINANCIAL MODELS



Human beings have attempted to foresee the future since times immemorial. Over the years, the methods of foreseeing the future have varied and continued to evolve. Contemporary methods are quite prosaic and models are among the tools used to understand and forecast the future. Central Banks and economists employ models to understand macro economic variables. Financial models are used in businesses to understand and manage risks. This article deals with a few issues encountered in a practical context.

Human beings have attempted to foresee the future since times immemorial. The methods have been varied and continue to evolve. 'Haruspicy' - the art of divining the future by observing the entrails of sacrificed animals, was the method favoured by the ancient Etruscans of Italy from whom the Romans learnt much of their culture and art. Banks use financial models to understand the future cash flow backing/ debt service coverage while extending credit.

Contemporary methods

are quite prosaic and models are among the tools used to understand and forecast the future. Central Banks and economists employ models to understand macro economic variables. Financial models are used in businesses to understand and manage risks.

Banks have used financial models to understand the future cash flow backing/ debt service coverage while extending credit. Possibly frenzied merger and acquisition activity has stretched in-house capability prompting the buyers to outsource the financial modelling related activity. Late-ly potential acquirers, including strategic acquirers with a good



— CA. Gurudutt N. Joishy
 (The author is a member of the ICAI.
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Forecasts using financial models based on scientific methods and logic are not predictions. Financial modellers are not clairvoyant and may not command the importance of 'Haruspices'- practitioners of 'Haruspicy', who were supposedly consulted privately by the Roman Emperors. However, financial models are generally used in valuations by acquiring company management for justifying the price to the Board and thus a critical component in an acquisition process.

understanding of the target business, are engaging independent consultants for reviewing financial models or some times developing financial models. At times financial model review is an extension of a financial due-diligence. In competitive bidding for Government infrastructure projects, the bid-price is sometimes based on the financial model and reliability of the financial model both in terms of its logic and arithmetic accuracy assumes critical importance.

Forecasts using financial models based on scientific methods and logic are not predictions. Financial modellers are not clairvoyant and may not command the importance of 'Haruspices'- practitioners of 'Haruspicy', who were supposedly consulted privately by the Roman Emperors. However, financial models are generally used in valuations by acquiring company management for justifying the price to the Board and thus a critical component in an acquisition process.

Unlike in physical sciences, it is not possible to observe economic phenomenon under laboratory conditions as we are observers and participants simultaneously and prophecies could become self fulfilling and self defeating. The fundamental issue, of relevance of deterministic and static models in an economic setting which can be considered as an evolving system, has not been examined. I have attempted to deal with a few issues encountered in a practical context.

Contents of a Financial Model

Businessdictionary.com has defined financial models as - "mathematical representation of key financial and operational relationships. Comprising of one or several sets of equations, it is used in analysing how a business will react to different economic situations or events, and in estimating the outcome of financial decisions before committing any funds".

Financial models we encounter in practice typically include projected profitability statements, balance sheet and the cash flows accompanied by schedules providing supporting details. The assumptions underlying the projections are also set out. Since financial models are a tool to understand the impact of external

economic variables on the business, assumptions on fundamental economic parameters such as exchange rates, inflation would also need to be spelt out for a meaningful analysis. Since financial models serve as a tool for understanding risk, a good model would need to facilitate sensitivity analysis for changes in key parameters. Financial model supports management's business plan which set out the broader goals and objectives.

Time horizon of 1 to 3 years is reasonably expected to be covered in most of the financial models. More ambitious financial models cover a time span upto even 2 decades. To be meaningful financial models may need to be stretched to the point wherein the stable state cash flows are expected to be achieved.

Financial models are usually excel based. The extent of detailing and granularity in the financial models could vary considerably. It is possible to develop a simple and credible financial model based on a key parameter that is driving the business while there are models that would get into the minutest detail of the business stretching over several spread sheets.

1. Approach

Apart from understanding macro-economic parameters that impact all economic agents, the approach to financial modelling would among others include:

- through understanding of the target business and the industry,
 - understanding historic financial performance of the business,
 - benchmarking with peer-set as may be relevant,
- each of which we shall examine briefly by turns in the succeeding paras.

Overall parameters

Inflation and currency movements are among the key variables that directly impact the numbers. The assumption as to whether the numbers in the financial model are in *real* or *nominal* terms has to be explicit. Central Bank forecasts may for projecting inflation. Prevailing interest rates also factor *expected* inflation in the

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economy. Inflation, the scourge of many economies including that of India, was thought to have been tamed in the last decade, has reared its head again.

Currency movements are of critical importance for companies which are dependent on exports or imports. Prevailing forward premium may be used as a guide-post in verifying the assumptions regarding currency movements. The markets in long dated maturities may not be very deep and liquid and thus of limited relevance. Not all the currencies are freely exchanged. Changes in exchange controls would impact the currency movements.

In case of companies with a track record, projections review is a relatively simple as the past performance may be used as the basis to project the future. Inputs from due diligence, which is usually part of an acquisition process, are of great relevance and necessarily to be used in the projections. Historical parameters need to be adjusted for expected developments. While patterns could be discerned from the past it is not necessary that the future would be a replica of the past. “History doesn't repeat itself - at best it sometimes rhymes” said Mark Twain.

Mature industries usually have considerable data of past performance. Great deal of research on the revenue and cost structure is available and it not difficult to benchmark the revenue, capital costs and recurring costs. Steel, cement, telecom etc. are examples.

It is essential to focus on the behaviour of the key driver for the industry / business. In services - it is the utilisation rate, effective charge out rate that determine the success of such businesses, in telecom - average revenue per user, and customer numbers are among the key parameters, in power industry it would be the tariff and the plant load factor.

Modelling businesses in nascent industries is considerably more challenging. In most cases these are businesses where the capital investment is upfront and the revenue costs are comparatively less significant and ‘network’ effect has an important role in success of such businesses. A financial model would be not of much help in assessing the uncertainty associated with the survival of such businesses.

Formally, **risk** is defined as a consequence of an action in the individuals choice set is a set of possible outcomes each occurring with a **known** probability while

uncertainty is if one or more of the actions open to the individual may cause more than one outcome, the probabilities of which are **unknown**, exists. Refer: *Risk, Uncertainty and Profit* (1921) by Frank Knight.

Financial models are based on finance and economic theories and rely on conventional statistical tools such as regression analysis, standard deviation, mean- variance, and covariance to understand risk, volatility, sensitivity to changes in internal and external environment.

The level of detailing in a financial model is not necessarily an indicator of its efficacy or otherwise. A model should focus on key business driver and a simple model that does this may be more useful than a complex model that neglects this or devotes limited attention to this aspect.

Specific Factors

Revenue assumptions are in most cases the key parameter in a financial model. The market in which the entity is expected to operate is to be carefully examined. Defining the market size in a globalised economy is in itself a challenge as a business is impacted by factors outside national boundaries. In case of perfectly competitive markets, where a single buyer or seller may not be in a position to influence the price, the prevailing price may be used to build the revenue assumptions. Commodities such as steel, oil may be closer to this type of a situation. In case a new entrant is trying to break into a market which is virtually monopolised, assuming the existing price charged by the dominant player may not be realistic. The incumbent may drop the price to protect the market share. Perfect competition or a perfect monopoly are ideals seldom observed in reality and the markets are actually quite complex with possibility of product substitution, companies influenced by competitors, co-operation amongst companies and many other interesting variants. Game theoretic models, considering how other

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participants would react to one another's actions, are more relevant in such cases.

The revenues of companies dependent on ‘network’ effect could grow exponentially once the critical mass is achieved. Conventional method whereby revenue is projected as a percentage growth over the previous year may not be relevant as the revenue growth may be exponential following power laws equations which we may be hesitant in accepting easily given our conservative inclinations. Stock exchanges, telecoms on-line auction sites are good examples illustrating the network effect.

Though tariff barriers are being lowered and its importance is diminishing, the current level of duty protection has to be understood particularly in industries where pricing is dictated by import parity principles. Reduction in tariff barriers, have direct revenue impact on such businesses. Exchange rate movements could also influence trade in a manner similar to tariff barriers and its impact is to be considered. Keeping the home currency low can provide impetus to exports and discourage imports. If news reports are to be relied, China is an example.

Capital expenditure could be verified based on the project reports, orders placed, quotations received. Interest during construction is also an important capital cost element depending on the time period for commissioning and gearing assumed for funding the project.

Fundamentally, revenue expenditure is to be analysed in terms of *variable* or *fixed* in nature. In case of oil refineries it is the conversion margin earned that is the key variable and the material cost of crude would move broadly in line with that of the revenue. The linkage between variable costs and revenue tends to be weaker for businesses relying on intangibles such as brands, technology and also where positive network externality is at play.

Businesses are gradually becoming more intangible asset intensive and human resources usually play a key role in such businesses. Stock options are becoming common and accounting for a larger part of the remuneration. Estimating the economic cost of employee stock options that would be granted and vested

in future years is not quite easy. Apart from stock options other employee related costs such as pensions, gratuity need to be emphasised on.

Regulations impacts businesses. Apart from licensing to operate businesses in some cases, Governments could be participants in other ways. In case of infrastructure projects/ telecom a part of the revenues may have to shared as per the terms of the concession agreement/ licence and has to be factored accordingly. A significant part of the surplus generated has to be shared with the Government in the forms of taxes. Among others, timing differences between book depreciation and tax depreciation need to be modelled correctly from a cash flow perspective. Tax breaks for backward area, location in export processing zone are to be considered to arrive at the tax outflows.

Working capital requirements account for a large part of the cash flows in retail business, services etc. and influence valuations. Inventories, receivables and payables levels need to considered realistically. Tax deducted at source by clients may on certain occasions are involuntarily funded in case the profit margin is much lower than the rate of deduction of taxes.

Many clients are interested in ascertaining cash payouts. Dividends/ share buy-backs rules governing such distributions and forming part of the company law need to be applied to ascertain the amount. There could be industry specific regulatory requirements. *E.g.* Banks need to transfer part of the profits to a special reserve.

Though not relevant from cash flow/ valuation standpoint, presentation as per Generally Accepted Accounting Principles (“GAAP”) cannot be ignored. The profitability disclosure as per accounting rules has a persuasive impact on market prices of the shares of the entity. GAAP rules applied are to be disclosed since the outcomes of asset/ liability measurement and profitability vary under different rules.

Sanity checks

A financial model has to viewed as an integrated whole since each of the parameters are linked to one another and are not isolated elements. Overall checks for testing reasonableness assume great importance

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in this context.

Return on capital employed is an important cross check. It is important to remind ourselves that businesses, on an average, cannot earn super normal profits. The sustainability of the competitive advantage in the longer has to be assessed very carefully. Profits erode with the entry of competitors attracted by returns higher than the cost of capital.

Model review is an integral part of a valuation process. Efficient markets are the cornerstones of a free market economy and price signals emanating from the market prices may also to be used as a sanity check. In free markets, market prices perform the important role of disseminating information including the growth prospects of the industry. Market prices are the most objective indicators of value. In case market participants are rational the prices must be the discounted value of future cash flows. It might be useful to ascertain the indicative net present value outcome based on the financial model and compare the same with the market prices of peer set companies after suitable adjustments to give a broad indication of deviation of the model from the market perception.

In real estate projects, the market price of land is expected to capture the development potential. However this proposition may not hold good for townships which transform the surrounding and thus alter the prevailing market dynamics.

2. Issues

A financial model would fructify only if they are the expression of management/ promoter intentions. The sponsors of the financial model need to have the ability to mobilise the resources required for implementation of the business plan. Even taking for granted the abilities and commitment of the management, there are unanticipated events in the external environment such as changes in the regulatory environment, competition acting irrationally, disruptive innovations that could render the financial model completely obsolete. The IMF's *World Economic Outlook* of May 2001 in the article *How well do Forecasters Predict Turning Points* quoted “the failure to predict major slowdowns has been a notable feature of forecasts

of US economy for many years”. Needless to add, these unforeseen macroeconomic changes impact the financial models.

Friedrich August von Hayek had advocated free markets as opposed to a controlled economy since the necessary knowledge is dispersed among the participants. In his Nobel Prize Lecture, FA Hayek had observed that “in economics and other disciplines that deal with essentially complex phenomena, the aspect of the events to be accounted for which we can get quantitative data are necessarily limited and may not include the important ones”. Leave alone other parameters, it may not be possible to recall a single financial model in the past decade wherein the rupee/dollar movement was captured correctly.

Typically we benchmark the parameters in the financial model to those of companies in existence and this results in a bias as such companies are among the few survivors out of a large universe that had ventured into the business and the models thus could have an optimistic bias. Have we ever come across a model that would anticipate a business failure? The way an organisation has grown would determine its unique characteristics and be part of its DNA which cannot be copied easily. Accidental events could have far reaching impact with irreversible consequences and these are not reflected in the financial model.

Nassim Nicholas Taleb has straddled both academia and the business world and is the author of *Black Swan* and *Foiled by Randomness* apart from numerous articles on uncertainty. He has defined ‘black swan’ as a large-impact, hard-to-predict, and rare event outside the boundaries of normal expectations. He has claimed that almost all consequential events in history come from the unexpected and that the assumption that the unexpected can be predicted by extrapolating from variations in statistics based on past observations, especially when these statistics are assumed to represent samples from a bell curve could be erroneous. Many events defy known models and reasoning altogether. World Wars, September 11, market crash of 1929, collapse of communist regimes are examples of such events.

Many of the scientific inventions have been serendipitous with the successful outcome not necessarily the

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inventor’s original goal. Penicillin, Vaccine for small pox, Viagra is among the notable examples. We are aware of instances in business history where the entrepreneur took instinctive decisions not necessarily explained or justified through a financial model. Sergey Brin and Larry Page are said to have approached Andy Bechtolsheim, a founder of Sun Microsystems who in a hurry to get to another meeting, immediately recognised Google’s potential, cut the meeting short, and wrote a check for \$100,000 on the spot (Refer *The Google Story(2005)* by David Vise). The rest, as the cliché goes, is history.

Neither does the urge to forecast the future cease nor do the endeavours to improve on the forecasting methods. James Surowieki in his book *The Wisdom of the Crowds* as the title suggests has argued that in many situations a group’s judgment may be superior to that of an individual. Class room experiments have shown that the average estimate of a gathering has been quite close to the actual. Prediction markets (such as Intrade) are betting exchanges that attempt to combine the benefits of a free market with the wisdom of people at large. Assets are created whose final cash value is linked to the probability of the event’s occurrence and the ruling price may be interpreted as predictions of or the expected value of the parameter. Hewlett-Packard pioneered applications in sales forecasting and uses prediction markets in several business units.(Refer: *Information Aggregation Mechanisms: Concept, Design and Implementation for a Sales Forecasting Problem – March 2002* by Charles R Plott and Kay-Yut Chen of HP Laboratories). Currently Intrade data is used as a price discovery tool by various agencies including US Navy, Federal Reserve banks, European Central Bank (Refer: *Fortune Telling in The Economist* dated 19-25 July, 2008).

‘Winners curse’ is said to be attached to the highest bid in an auction as it is likely that he has overpaid; the returns from the asset may not justify the price paid. This should be particularly true if the winner has bid against the other knowledgeable strategic bidders with private values incorporating synergies. In India’s privatisation programme, there are winners with aggressive bids way above that of the next highest bidder who have actually made the acquisition work in the

face of the winners curse.

3. Conclusion

In the absence of an alternative, it would not be possible to discard financial models whatever may be the limitation they are subject to. At the bare minimum a well thought out model would surely fulfill the function of understanding the risks associated in a business and ways of mitigating them in the prevailing environment. The models need to be considered only as among the many tools that aid in decision making and not expected to be the last word on how a business is likely to shape in the future.

An entrepreneur thrives by betting against the odds. Seemingly irrational and foolhardy decisions, if financial models were the touchstones, have in reality proven inspired in retrospect. However, professionals may not be able to ignore the prevailing consensus opinion and market signals in reviewing/ building financial models. John Maynard Keynes remark in *General Theory of Employment, Interest and Money* (1936) that “Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally” is unfortunately relevant in an environment where the threat of lawsuit is quite real for the consultant and the report is for meeting internal corporate governance requirements of the client.

Client expectations are to be managed carefully in such engagements and ensured are anchored at realistic levels. A consultant should communicate candidly to the client on the shortcomings inherent the endeavours of financial modelling. As professionals while we would certainly apply reasonable judgment based on knowledge/ information available at a point in time, we are not in possession of any faculties that would make us seers. Caveats and small print in mandate letters/ report/ deliverables are not effective tools in mitigating client dissatisfaction.

It might be pertinent to recall Niels Bohr, a physics Nobel laureate, had said “It is very difficult to make an accurate prediction especially if it’s about the future” which incidentally was in the context of explaining Heisenberg’s uncertainty principle (setting the limits on the accuracy of measurement in physical sciences). □

Valuation of Investment in Shares of a Subsidiary for Non-cash Consideration

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 State Government company (hereinafter referred to as 'the company') in which the State Government is holding 99.99% shares, is engaged in mining and selling of Rock Phosphate, Gypsum, Limestone and Lignite. Its mines are located at different places in the State of Rajasthan. The State Government company is also having Wind Power Mills installed in one of the districts of the State.

2. The Government of India (GOI), vide its letter dated 13.11.2006, has allocated coal blocks in certain Lignite mines in favour of the company for mining of Lignite in the State. As per the condition mentioned in the allotment letter, 'in principle approval' for the mining rights was given to the company for carrying out the Lignite mining either by that company or a separate company to be created with participation of the company provided that the separate company created is a Government company eligible to do mining as per the provisions of Coal Mines (Nationalisation) Act, 1983.

3. In view of the above, the company has entered into a Joint Venture (JV) Agreement on 27.12.2006 with a private company to form a JV company (JVC) in which the company shall be holding 51% equity shares. As per the JV Agreement, the private company should make all the investments and the company shall have no financial liability with respect to the JVC. (Copy of the JV Agreement has been furnished by the querist for the perusal of the Committee.)

4. As per the terms and conditions of JV agreement, the company should obtain mining lease of the Lignite mines in reference from the Government of Rajasthan and transfer the same to the JVC. The company should also obtain all necessary licenses/consents/approvals from the Government and regulatory approvals/consents from the Central as well as the State Government for use, operation, development and management of the mines. As per the terms of

the agreement all the expenses incurred /to be incurred by the company shall be borne by the JVC/private company. After transfer of mining leases in favour of JVC, the Lignite mines would be developed and operated by JVC/private company and the Lignite to be mined from the mines is to be consumed by the private company for power generation by lignite based power plant to be established by the private company.

5. In compliance with the terms of JV Agreement, a JVC was incorporated on 19.01.2007 with initial paid up capital of Rs. 5,00,000 and as per the terms of JV Agreement, 51% of the share capital of Rs. 5,00,000, i.e., shares having face value of Rs. 10 each, valuing Rs. 2,55,000 of JVC were allotted to the company. In future also, as and when subscribed and paid-up capital of the JVC is increased by the private company, 51% shares would be allotted in favour of the company and the value of such shares may be few crores of rupees depending upon the investment to be made in the JVC by the private company.

6. Since the company has not invested/paid any money for obtaining the shares in the JVC, the company treated the face value of shares (Rs. 2,55,000) as 'Investment' and credited the Capital Reserve in its Balance Sheet for the year ended on 31.3.2007. Besides, the company has also made disclosure in the 'Notes to Accounts' by giving a note as reproduced below:

"The company has formed a joint venture company with ... (name of the private company) namely ... (name of the JVC). The JVC will undertake the work of Lignite mining in... areas of ... District and supply the same to... (name of the private company) which is going to install Lignite based pit head power plant. As per terms of agreement between the company and ... (name of the private company), the company shall have 51% shares in the JVC and ...(name of the private company) will hold the remaining 49% of the

equity of the JVC. The shares will be issued to the company in lieu of fulfillment of various obligations and for transfer of mining lease rights by the company to the JVC. The company will not take any financial liability for its holding in the JVC. The JVC has allotted shares worth Rs. 5.00 lakh till 31.03.2007, out of which shares worth Rs. 2.55 lakh being 51% of the shares so allotted have been issued to the company."

7. As per the querist, the Statutory Auditors of the company were of the view that the accounting treatment given by the company was not correct and have qualified the balance sheet of the company by stating that the company had shown under the head investment in a subsidiary company, the equity shares issued by the JVC of Rs. 2,55,000 being 25,500 equity shares, 51% of the paid up share capital. In their opinion, the same should be shown at zero value as the company had not paid any consideration for the same and therefore, the investment in subsidiary company and capital reserve had been overstated by Rs. 2,55,000.

B. Query

8. The querist has sought the opinion of the Expert Advisory Committee on the correct accounting treatment for the value of shares of the JVC issued/to be issued in future in favour of the company for which it will not pay any consideration in cash as per the terms of JV Agreement.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist relates to valuation of investments in the shares of the JVC with 51% equity held by the company for presentation in the separate financial statements of the company. Therefore, the Committee has examined only this issue and has not examined any other issue that may be contained in the Facts of the Case, such as, accounting for the mining license

received by the company, accounting in the books of the JVC, whether the JVC should be considered as a subsidiary or a jointly controlled entity, etc.

10. The Committee notes that the Institute of Chartered Accountants of India has issued Accounting Standard (AS) 13, 'Accounting for Investments'. Paragraphs 28 and 29 of AS 13 read as below:

“28. The cost of an investment should include acquisition charges such as brokerage, fees and duties.

29. If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost should be the fair value of the securities issued (which in appropriate cases may be indicated by the issue price as determined by statutory authorities). The fair value may not necessarily be equal to the nominal or par value of the securities issued. If an investment is acquired in exchange for another asset, the acquisition cost of the investment should be determined by reference to the fair value of the asset given up. Alternatively, the acquisition cost of the investment may be determined with reference to the fair value of the investment acquired if it is more clearly evident.”

11. From the above, the Committee notes that AS 13, inter alia, deals with the determination of the cost of acquisition of an investment by way of either issue of securities or in exchange of another asset. The other asset may be either monetary or non-monetary. Though AS 13 does not deal with acquisition of shares in exchange of services, the Committee is of the view that the above principles are equally applicable for investments acquired in exchange for services also. Further, the Committee is of the view that the above principles are

equally applicable for securities to be issued/ assets to be transferred/ services to be rendered as consideration for the investment already acquired.

12. The Committee notes that in the present case, under the terms of the JV Agreement, the company in question is obliged to obtain and transfer the mining licenses to the JVC and to fulfill certain obligations. However, all the expenses under the JV Agreement incurred by the company are to be borne by the JVC/private company. In addition, 51% of shares are also allotted to the company. The passing on of expenses to the JVC/private company is an additional benefit given to the company. That does not alter the principle that cost of the investment in shares of the JVC should be equal to fair value of the license and other services rendered by the company. Alternatively, if fair value of the investments is more clearly evident, that may be taken as cost of the investment as permitted in paragraph 29 of AS 13 quoted above.

13. The Committee notes paragraph 88 of the 'Framework for the Preparation and Presentation of Financial Statements', issued by the Institute of Chartered Accountants of India, which reads as below:

“88. An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably.”

14. The Committee notes that the company is entitled not only to 51% of initial share capital but also to 51% of share capital to be issued in future without consideration in cash. The shares so obtained/to be obtained constitute investment by the company in the JVC. Further, it seems that the mining licenses are yet to be obtained and transferred to the JVC, since what is obtained is only 'in principle approval'. From the copy of the JV Agreement furnished by the querist, the Committee notes that apart

from obtaining licenses, approvals, etc., the company should also contribute its local knowledge, technical knowledge and other expertise in relation to mines, while the private company shall provide the management support and the entire investment to the JVC (clause 2 of the JV Agreement).

15. In case, there is a reliable measure of fair value of the license and the service, that fair value should be recorded as the cost of investment. The corresponding credit should be reflected as a liability to the extent of the fair value of obligations (to be fulfilled including license to be obtained) and to profit and loss account to the extent of fair value of obligations already fulfilled. As and when the obligation is fulfilled, the appropriate portion of the liability should be cleared by transfer to the profit and loss account.

16. In case the fair value of investment is more clearly evident and adopted as cost of investment, that should be allocated on a reasonable basis to fair value of obligations fulfilled and fair value of obligations yet to be fulfilled so that corresponding credit aspect of investment account can be accounted. Subsequent accounting will be as explained in paragraph 15 above.

17. The Committee is of the view that if the fair values as stated in the above paragraphs are not reasonably determinable, then, investment should be recorded at a nominal value, say, Re. 1.

D. Opinion

18. On the basis of the above, the Committee is of the opinion that the correct accounting treatment in the books of the company for the shares of the JVC issued/to be issued in future in favour of the company for which it will not pay any consideration in cash as per the terms of JV Agreement would be to recognise the same at fair value of the services and the license to be provided by the company to the JVC. However, in case the fair value of the shares is more clearly evident, the same should be recognised at fair value thereof. □

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.icaai.org/category.html?c_id=146

EFFICIENT AUDITING



In these days of globalisation and international competition, the auditor are bound to develop or resort to new techniques and tools in order to perform his duties more efficiently, effectively and economically. This article explains about a new tool of Audit Confidence Model (ACM) which has been developed after removing the lacuna in the existing Audit Risk Model. The major audit tool of statistical sampling has also been used for developing the new Audit Confidence Model. The model developed could also be extended according to needs of the auditors' professional work. The new model developed will help the auditor to derive more useful and scientific conclusions and get more confidence of his clients.

In these days of globalisation, auditors' responsibility could not be confined only with checking of vouchers or records and their correctness and consistency with the accounts. Today, an auditor is expected to perform additional duties for unearthing deficiencies existing within the organisation and to suggest remedial measures for rectifying the deficiencies to improve the profitability of the organisation. These additional responsibilities necessitates the auditor to adopt many new skills such as statistical analysis, bench marking, focus group, interviews, qualitative analysis, data spread, ratio analysis, survey, programming logic model, flow charts etc. Specifically, statistical techniques such as variance analysis, regression analysis, factor

analysis, correlation analysis, hypothesis testing and sampling could be adopted by the auditor in performing his duties more professionally.

Now-a-days one hundred percent audit check is not practicably possible and feasible due to time and cost constraints. In many circumstances, statistical sampling techniques help the auditor to ease his work with higher audit efficiency and effectiveness and also to perform his work more economically. The application of statistical technique involves selection of transactions by adopting various sampling methods. It follows the detailed checks to be applied in transactions selected and the projecting the deficiency noticed to the entire population of the transactions. Then, finally the auditor has to report and suggest conclusions



-Dr. L. Kailasam

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The Audit Confidence Model developed below helps reduce this risk to the least level. This model uses statistical sampling techniques as well as econometrical modeling for deriving the conclusions with intention to ease auditors' work for deriving scientific audit conclusions. This innovative approach will enlighten how much an auditor is confident and reliable in deriving his conclusions as well as precision of the audit opinion he made.

for rectifying the deficiencies and also recommend the measures for the prevention of deficiencies in future.

'Statement on Auditing Standards' (SAS 39 and SAS 47), on 'Audit Sampling' and 'Materiality and Audit Risk' as well as 'An Auditor's Approach to Statistical Sampling' and 'Behavior of Major statistical Estimators in Sampling Accounting Population', issued by AICPA discussed elaborately how sampling techniques could be applied in auditing.

While expressing audit opinion, it becomes necessary to inform the client the method adopted by him and how much he is confident, and the various account balances derived by him and the interval of account balance in which the account balance falls. This specific information to the client will enable the auditor to secure greater confidence of the clients.

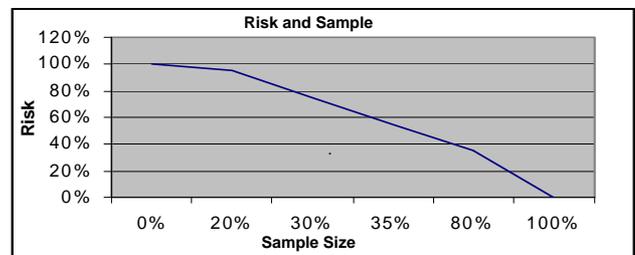
The Audit Confidence Model developed below helps reduce this risk to the least level. This model uses statistical sampling techniques as well as econometrical modeling for deriving the conclusions with intention to ease auditors' work for deriving scientific audit conclusions. This innovative approach will enlighten how much an auditor is confident and reliable in deriving his conclusions as well as precision of the audit opinion he made.

Audit Confidence Model

In adopting the sampling techniques, the auditor has to select the optimum number of transactions for detailed check. If the number of transactions selected is excessive, there is no doubt that the efficiency of audit is not affected but the economy of audit is much affected. The auditor has to spend more time and consequently money, in conducting the detailed check on the transactions selected. On the other hand, if lesser number of transactions is selected for audit, there is always a possibility that some vital transactions fall out of the scope of audit and thus the audit efficiency will be affected. Therefore, the sample size plays a critical role while adopting the sampling technique by the auditor¹.

Audit Risk can be defined as risk of the auditor providing an inappropriate opinion on the financial statements of an entity. It is the risk of the auditor stating that the

financial statements present fairly the financial position of the entity, when in fact they do not. The audit risk also encompasses the risk of the auditor stating that the financial statements do not present fairly the financial position of the entity, when in fact they do. The audit risk depends upon the sample size and the transactions selected for sample for detailed analysis. The following diagram explains the relationship between the audit risk and sample size.



The audit risk occurs when the auditor expressed unqualified opinion on materiality of the financial statement. This depends mainly on the selection of the sample transactions. While selecting the sample transactions, the auditor has to analyse the risk of incorrect acceptance as well as the risk of incorrect rejection. The risk of incorrect acceptance is the risk of the auditor willing to accept that the sample that supports the conclusion that the recorded balance is materially stated when it is. On the other hand, the risk of incorrect rejection is the risk when the sample supports the conclusion that the recorded balance is not materially stated when it is not. The risk of incorrect rejection may be termed as *alpha risk* and it reflects the audit efficiency and the risk of incorrect acceptance are termed as *beta risk* and it relates to audit effectiveness.

The audit risk depends upon the following factors, according to the classical theory of audit risk:

1. Material misstatement occurs in the financial statements (Inherent Risk -IR)
2. Failure of Internal Control Mechanism (Control Risk- CR)
3. Failure to detect the misstatement while Statistical audit procedures adopted (Detection Risk- DR)
4. Failure to detect the misstatement while

Guy M Dan, *Audit Sampling- An Introduction*, Fifth Edition, John Wiley & Sons Inc, USA

non-statistical Audit Procedures adopted (AP)

There are many methodologies for measuring audit risk. The probability theory could be adopted for measuring the audit risk. 'Belief-function' theory can also measure audit risk, if the risk components are considered as evidence. In this case, audit risk becomes a combination of mass of evidence. Fuzzy logic could also be adopted in measuring audit risk.

The 'Classical Audit Risk' model was developed by using the probability theory, by considering the inherent risk, control risk and detection risks as a set of events. In such cases the audit risk becomes the product of the probability of the occurrence of these risks.

The audit risk could be termed as function of the above factors

$$\text{Audit Risk} = f(\text{CR}, \text{IR}, \text{AP}, \text{DR})$$

The 'Classical theory of Audit Risk' states that the audit risk is the product of inherent risk, control risk and detection risk and risk of incorrect adoption of the audit procedure i.e.

$$\text{Audit risk} = \text{Inherent Risk} * \text{Control Risk} * \text{Detection Risk} * \text{Audit Procedure Risk}$$

The above classical theory consists of the following deficiencies.

1. If any of the risk is zero then the entire audit risk becomes Zero, which is not correct.
2. If any of the two risks are of decimal values, the product will be a lesser quantity.

(As an example the control risk = 0.30, detection risk = 0.40, inherent risk = 0.5 and audit procedure risk = 0.1 the over all audit risk becomes 0.006. In this example, the audit risk is much lesser than the inherent risk, control risk and detection risk, and risk of adoption of incorrect audit procedure which is also incorrect).

3. Various other risks which have impact on audit risk are not defined and considered in the model.

Therefore, it became essential to make certain changes in the classical theory of audit risk. In this article a preliminary attempt is made to rectify the above deficiencies as detailed below.

The first and second deficiencies in the basic audit risk model will be removed if we consider Audit Confidence instead of audit risk. The audit confidence will be one minus audit risk. Similarly the internal control confidence, inherent confidence, detection confidence and confidence of incorrect adoption of the audit procedure could be found. Then the audit

confidence will be the product of internal control confidence, inherent confidence, detection confidence and confidence of incorrect adoption of the audit procedure

$$\text{Audit Confidence} = \text{Internal Control Confidence} * \text{Inherent Confidence} * \text{Detection Confidence} * \text{Confidence of incorrect adoption of the Audit Procedure}$$

After identifying the audit confidence, the audit risk could be found by deducting the same from one

It is true that the audit risk does not wholly depend upon the risks mentioned above. There may be some other risks such as inter-personnel relationship between the employees of auditor and the auditee institution or any other risks which affects the audit risk. As the auditor could not confine with the inherent risk, control risk and detection risks alone and there may be some more risks which could not be easily identified and quantified-- which can be called disturbance factors. Econometric Model could be adopted in measuring the audit risk as such model always considers residual or disturbance factors. Since, the econometric model takes into consideration of the unexplained risks i.e. disturbances also; it is most suitable while applying in practice. In this article, K-Linear model has been adopted for calculating the detection risk for deriving the conclusions. This could be found by using the following equations.

$$\text{Log (Audit Confidence)} = \text{Log (Internal Control Confidence)} + \text{Log (Inherent Confidence)} + \text{Log (Detection Confidence)} + \text{Log (Confidence of incorrect adoption of the Audit Procedure)} + \text{Log (Other Risks / disturbances)}$$

The audit sampling model consist four stages.

- Assessing various risks and confidence (Stage I)
- Determination of Sample Size (Stage II)
- Calculation of achieved and corrected precision (Stage III)
- Determination of Estimated Audited Value (Stage IV)

In first stage, apart from calculating Tolerable Misstatement (Step 1) and C_R Coefficient (Step 2) various risks are to be ascertained by developing a detailed internal control questionnaire, flow chart and relative narrative memoranda etc. After making the assessment of various risks, the auditor has to ascertain 'Inherent Confidence', 'Control Confidence', and 'Procedural Confidence'. This could be obtained by using the formula. i.e. Risk + Confidence = 1 (Step 3). By adopting K-Linear Model, detection confidence and beta risk coefficient are to be evaluated (Step 4 & 5).

In the second stage, the precision must be calculated

based on the desired or calculated detection risk (Step 6). The auditor has to select the appropriate sampling plan and determine sample size. The appropriate sampling plan has to be selected based on audit objectives and population characteristics (Step 7) and the selected items are to be audited in-depth (Step 8).

In third stage, evaluation of difference between the book value and admissible value are to be calculated (Step 9). It is possible to calculate achieved precision (Step 10) after auditing the sample, which may differ from the precision earlier calculated. The auditor has to calculate the corrected precision (Step 11). In the last stage the auditor estimated value (Step 12), constructs a decision interval (Step 13).

The following example will explain the steps involved in the ACM Model discussed above.

Example

An auditor was given an assignment of auditing the transactions of an entity. While analysing the Balance sheet of the entity, the auditor found that there are about 100 items in the Fixed Assets and the value mentioned in the Balance Sheet under the fixed asset is Rs 53,22,819.58. He found that it is practically not feasible to verify all the 100 items. Therefore, he prefers to adopt the sampling technique in deriving his conclusions. The list of items of fixed assets and its monetary value are given below.

Fixed Assets and its Monetary Value (Table No 1)

Item No	Value of Fixed Assets	Item No	Value of Fixed Assets	Item No	Value of Fixed Assets	Item No	Value of Fixed Assets
1	31375.75	26	8257.96	51	66580.64	76	94011.57
2	19699.80	27	6990.04	52	30060.37	77	36356.82
3	59991.73	28	95498.10	53	38355.81	78	78573.86
4	18442.63	29	93933.87	54	26989.46	79	64879.87
5	61474.35	30	56884.36	55	56884.35	80	56676.51
6	81986.52	31	55626.62	56	78592.92	81	56520.04
7	57157.19	32	47.93	57	77568.93	82	34282.18
8	21043.12	33	39433.40	58	98641.37	83	49914.28
9	98120.89	34	59686.63	59	98395.56	84	61832.06
10	98433.42	35	13854.13	60	35396.91	85	32012.50
11	59686.64	36	75985.22	61	66690.36	86	38737.12
12	59074.37	37	42076.66	62	55482.61	87	60582.03
13	16864.98	38	54327.62	63	83357.39	88	68683.54
14	90504.86	39	90616.39	64	11659.26	89	34288.76
15	42076.67	40	48928.07	65	32785.87	90	45138.38
16	49914.27	41	56520.03	66	3746.62	91	43844.60
17	31683.38	42	98325.92	67	61461.62	92	54327.63
18	97657.96	43	75075.16	68	95552.65	93	14152.66
19	59991.72	44	86122.86	69	66236.66	94	52586.96
20	83390.11	45	10151.12	70	8206.69	95	21865.97
21	20390.62	46	4197.14	71	57020.12	96	48928.06
22	86732.80	47	62064.08	72	57157.18	97	43844.59
23	92807.97	48	90169.05	73	64399.05	98	13763.62
24	78233.98	49	6788.27	74	22169.29	99	65444.81
25	57020.11	50	40168.90	75	97450.48	100	15387.54
Total Value of Fixed Assets							5322963.50

Stage I – Assessing Various Risks

Step 1- Calculating Tolerable Misstatement

The first step is to fix the Tolerable Misstatement (TM) by the Auditor. If the value which is below or above the one per cent value of the inventory mentioned in the balance sheet is acceptable by the auditor, then the tolerable misstatement will be $5322963.50 * 1\% = 53229.64$. The determination of this level wholly depends upon the judgment of the auditor and his willingness to accept the value mentioned in the Balance sheet.

Step 2- Calculating CR Coefficient

The next step is to prescribe the confidence level. In this case let us assume that the auditor accepts the fixed assets inventory valuation of Rs 5322963.50 will be acceptable if he can be 99% confident that the actual inventory is within ± 53229.64 . Therefore, the reliability will be 99% and the corresponding CR coefficient derived from the normal curve area table will be 2.58.

Step 3- Evaluation of Various Risks and Confidence

The auditor has to ascertain the strength of internal control of mechanism. Based on proper following of the observations relating to the instructions and evaluation of competence and carefulness of client personnel taking inventory, the auditor may derive the control risk. Afterwards he has to calculate the other audit procedure risk. It consists of inventory turnover calculations and cut-off tests to ensure that purchases and sales are properly reflected in inventory in the proper accounting period etc. By the previous experience of the auditor, the various risks were identified by the auditor and they are given below.

Audit Risk and other Risks (Table No 2)

Detection Risk	Inherent Risk	Control Risk	Procedure Risk	Audit Risk
92%	99%	80%	90%	80%
93%	96%	90%	65%	70%
88%	93%	90%	60%	60%
70%	91%	90%	60%	50%
61%	90%	90%	40%	30%

From the above 'Audit Confidence' and other Confidence could be found

Audit Confidence and other Confidence (Table No 3)

Detection Confidence	Inherent Confidence	Control Confidence	Procedure Confidence	Audit Confidence
8%	1%	20%	10%	20%
7%	4%	10%	35%	30%
12%	7%	10%	40%	40%
30%	9%	10%	40%	50%
39%	10%	10%	60%	70%

Step 4 – Evaluation of detection confidence

The Audit Confidence is the product of Internal Control Confidence, Inherent Confidence, Detection Confidence, and Confidence of incorrect adoption of the Audit Procedure and Other Confidences. i.e.

$$\text{Audit Confidence} = \text{Internal Control Confidence} * \text{Inherent Confidence} * \text{Detection Confidence} * \text{Confidence of incorrect adoption of the Audit Procedure} * \text{Other Confidences} / \text{disturbances}$$

Taking logarithm on both sides

$$\text{Log of Audit Confidence} = \text{Log of Internal Control Confidence} + \text{Log of Inherent Confidence} + \text{Log of Detection Confidence} + \text{Log of Confidence of incorrect adoption of the Audit Procedure} + \text{Log of Other Confidences/Disturbances}$$

Log of detection confidence could be found from the above equation

$$\text{Log of Detection Confidence} = \text{Log of Audit Confidence} -$$

Log of Internal Control Confidence - Log of Inherent Confidence - Log of Confidence of incorrect adoption of the Audit Procedure - Log of Other Confidences

By using the values given above the Detection Confidence could be evaluated by the following equation.

$$\begin{aligned} \text{Log of Detection Confidence} = & 0.435714 - \\ & 3.57143 \text{ Log of inherent Confidence} - 3.17143 \\ & \text{Log of control Confidence} - 1.88571 \text{ Log} \\ & \text{of procedural Confidence} + \\ & 2.514286 \text{ Log of audit Confidence} \end{aligned} \quad (3.4)$$

The detection risk has to be calculated after evaluating the present inherent risk, control risk, procedural risk and audit risk from the present environment of the entity.

Evaluation of Risks (Table No 4)

Sl. No	Type of Risk	Risk factors Evaluated by Auditor
1	Inherent Risk	15%
2	Control Risk	40%
3	Procedure Risk	70%
4	Audit Risk	04%

From the above table, present level of the various confidences could be calculated as detailed below.

Evaluation of Confidences (Table No 5)

Sl. No	Type of Confidence	Confidence factors evaluated by Auditor
1	Inherent onfidence	85%

2	Control onfidence	60%
3	Procedure Confidence	30%
4	Audit Confidence	96%

By substituting the values in the equation the log of detection risk is calculated as follows:

$$\begin{aligned} \text{Log of Detection Confidence} = & 0.435714 - \\ & 3.57143 \text{ Log of inherent Confidence} - 3.17143 \\ & \text{Log of control Confidence} - 1.88571 \text{ Log} \\ & \text{of procedural Confidence} + \\ & 2.514286 \text{ Log of audit Confidence.} \end{aligned}$$

By substituting the values the detection Confidence could be found as follows.

$$\begin{aligned} \text{Log of Detection Confidence} = & 0.435714 - \\ & (3.57143) * (-0.07) - \\ & (3.17143) * (-0.22) - (1.88571) * \\ & (-0.52) + 2.514286 * \\ & (-0.70) \\ = & -0.05248 \\ \text{Detection Confidence} = & \text{Anti Log of} \\ & (-0.05248) = 89\% \end{aligned}$$

Step 5 – Evaluation of beta risk coefficient

Since the detection confidence is 89%, the detection risk will be 11%. The normal curve can be used for the determination of beta risk coefficient. The beta risk coefficient in the said case is calculated by finding the corresponding standard deviation to 0.5-0.11 = 0.39.

In this case the beta risk coefficient is found to be 1.23

Stage II- Determination of Sample Size

Step 6 – Determination of acceptable precision level

The acceptable precision level can be calculated by using the following equation.

$$P = TM \cdot C^R / (CR + Z^{\text{beta}})$$

Where P = Precision, TM= Tolerable Misstatement = 53228.20,

C^R = reliability factor = 2.58, Z^{beta} = beta risk coefficient = 1.23

By substituting the values, in the following equation the acceptable and planned precision will be evaluated as follows

$$P = 53229.64 \cdot 2.58 / (2.58 + 1.23) = 36045.27$$

Step 7 - Determination of Sample Size

The next step is to calculate the sample size, which is determined as follows. It is done by conducting pilot study. In the pilot study the auditor has to take a sample and find standard deviation as detailed below. In this case the auditor takes the following five items.

Initial Sample and Value of Assets (Table No 6)

Sl No	Item No	Value (Rs)	Sl No	Item No	Value (Rs)
1	31	55626.62	4	30	56884.36
2	81	56520.04	5	71	57020.12
3	80	56676.51			
	Mean	56545.53		Standard Deviation	548.23

The standard deviation of the items audited is found to be 548.23. By using the following formula the sample necessarily to be selected, 'n' could be calculated by the following formula.

$$n' = ((C^R \cdot SD \cdot N) / P)^2 \text{ and } n = n' / (1 + n' / N)$$

By substituting the values U^R , SD, N, P, then n' and

n could be found.

$$n' = (2.58 \cdot 548.23 \cdot 100 / 36045.27)^2 = 15.40 \text{ and}$$

$$n = 15.40 / (1 + 15.40 / 100) = 13.34$$

The sample size will be fourteen items.

Step 8 - Detailed Audit on samples selected

Since the sample size determined is more than the sample selected for pilot study, the additional samples of nine items are to be selected by using appropriate sample method. The sample mean of book values and the population mean of book values should not be substantially different. If it is substantially different, discard the sample and select another sample. Already the auditor selected five items. The remaining nine items are to be selected from the 100 items. The auditor may adopt any type of sampling method as situation warrants. A detailed audit test to be applied in the transactions has to be selected. Each sample item is recounted and re-priced. All the misstatements identified are to be analysed in order to determine the cause.

Stage III- Calculation of Achieved and Corrected Precision

Step 9 - Detailed Audit and Evaluation of difference between the book value and admissible value

After this random sample of 14 items are to be selected from 100 items. The auditor shall adopt any type of sampling method as situation warrants. A detailed audit test to be applied in the transactions has to be selected. Each sample items are recounted and re-priced. The book value and admissible audited values of the fourteen items are given below:

Book Value and Admissible value of sample items of Fixed Assets (Table No 7)

S. No	Item No	Book Value(Rs)	Admissible Vale(Rs)	Differ-ence (Rs)	Sl No	Item No	Book Value (Rs)	Admissible Vale(Rs)	Differ-ence (Rs)
1	31	55626.62	57126.62	1500.00	8	39	54327.62	54122.62	-205.00
2	81	56520.04	57520.04	1000.00	9	72	57157.18	55162.18	-1995.00
3	80	56676.51	58676.51	2000.00	10	91	43844.60	44289.60	445.00
4	30	56884.36	57134.36	250.00	11	90	45138.38	45746.38	608.00
5	71	57020.12	57220.12	200.00	12	12	59074.37	59676.37	602.00

S. No	Item No	Book Value(Rs)	Admissible Vale(Rs)	Differ-ence (Rs)	Sl No	Item No	Book Value (Rs)	Admissible Vale(Rs)	Differ-ence (Rs)	
6	83	49914.28	49414.28	-500.00	13	07	57157.19	57682.19	525.00	
7	94	52586.96	47586.96	-5000.00	14	97	43844.59	44339.59	495.00	
Mean of the Differences				-5.357	Standard Deviation of the Differences				1711.385	

The auditor found the standard deviation of difference between the book value and admissible of the 14 items found to be 1711.385 and the mean will be -5.357

Therefore the standard error will be $1711.385 / \sqrt{14} = 457.3868155$

Step 10 - Calculation of achieved precision value

The achieved precisions level will be calculated by using the following formula

$$P' = C^R * SE * N \sqrt{1-n/N} \quad (3.10)$$

P' = Achieved precision level

SE= Standard Error = 457.3868155

N= Total Population = 100

n = Sample size =14

CR = Reliability factor = 2.58

By substituting the values the achieved precision level could be found.

$$P' = 2.58 * 457.3868155 * 100 \sqrt{1-14/100} \quad (3.11)$$

$$= 109434.075$$

Step 11- Calculation of corrected precision value

The corrected precision is to be calculated by using the following formula

$$P'' = P' + TM (1-P'/P)$$

Where

TM = Tolerable misstatement = 53229.64

P' = Achieved precision = 109434.075, and

P = Acceptable precision = 36045.27

By substituting the values, the corrected precision level could be found.

$$P'' = 109434.075 + 53229.64$$

$$(1- 109434.075 /36045.27) \quad (3.12)$$

$$= 1057.589596$$

Stage IV- Determination of Estimated Audited Value

Step 12 – Evaluation of Estimated Audited Value

The next step is to evaluate the estimated audited value. This can be found by multiplying the mean of the differences of the sample to the total number of population and add to the book value.

From the above calculation the estimated audited value will be

$$5322964 + 100 * (-5.357) = 5322428.29$$

Step 13 - Determination of Decision Interval

The next step is to construct decision interval. The decision interval will be $5322963.50 \pm 1057.589596$. i.e. (5321905.91, 5324021.09)

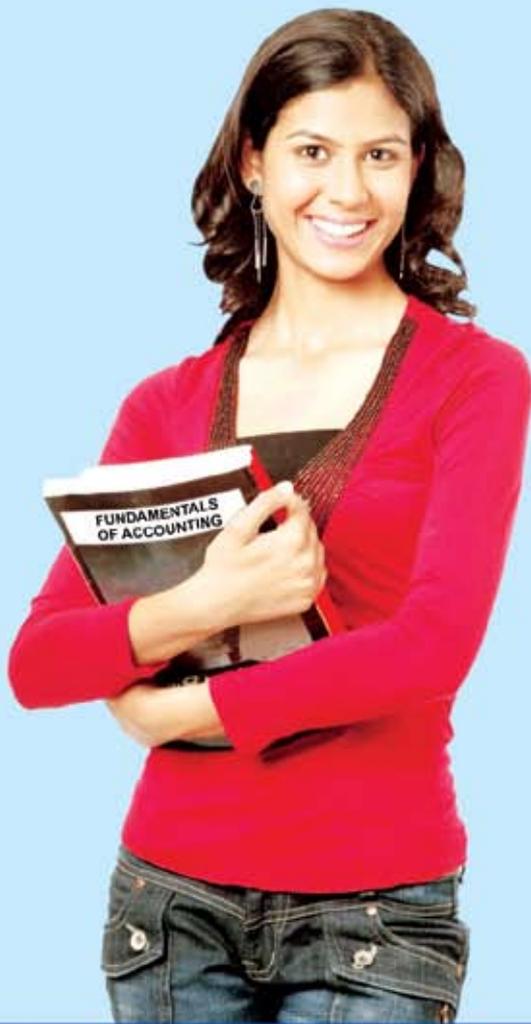
Since the 'estimated audited value' falls within the decision interval the auditor can conclude that the statistical evidence supports material correctness.

Therefore, the auditor has 99 per cent confidentially says that the value of fixed assets falls in the interval (5321905.91, 5324021.09) and the estimated value of the fixed assets will be Rs 53,22,428.29

Conclusion

The audit confidence model developed above removes the deficiencies subsist in the classical audit risk model. This model also takes into consideration of the unidentified risks apart from the explained risks by adopting econometric techniques, which will help to calculate the detection risk more accurately. The basic model explained could be expanded according to the needs of the auditor. As an example, in the basic audit confidence model discussed above, the un-stratified data was taken into consideration. This model could be expanded, and applied after stratification of data too. Similarly this basic model could be expanded for the point assessment of the population total by Ratio estimation.

Though the audit confidence model involves lot of mathematical and statistical calculations, it is highly useful for the auditors to derive his conclusions systematically and scientifically. The auditor may inform the methodology adopted for deriving his conclusions to the client. This will enable him to gain more confidence of the clients and also avoid any disputes with the clients in future. □



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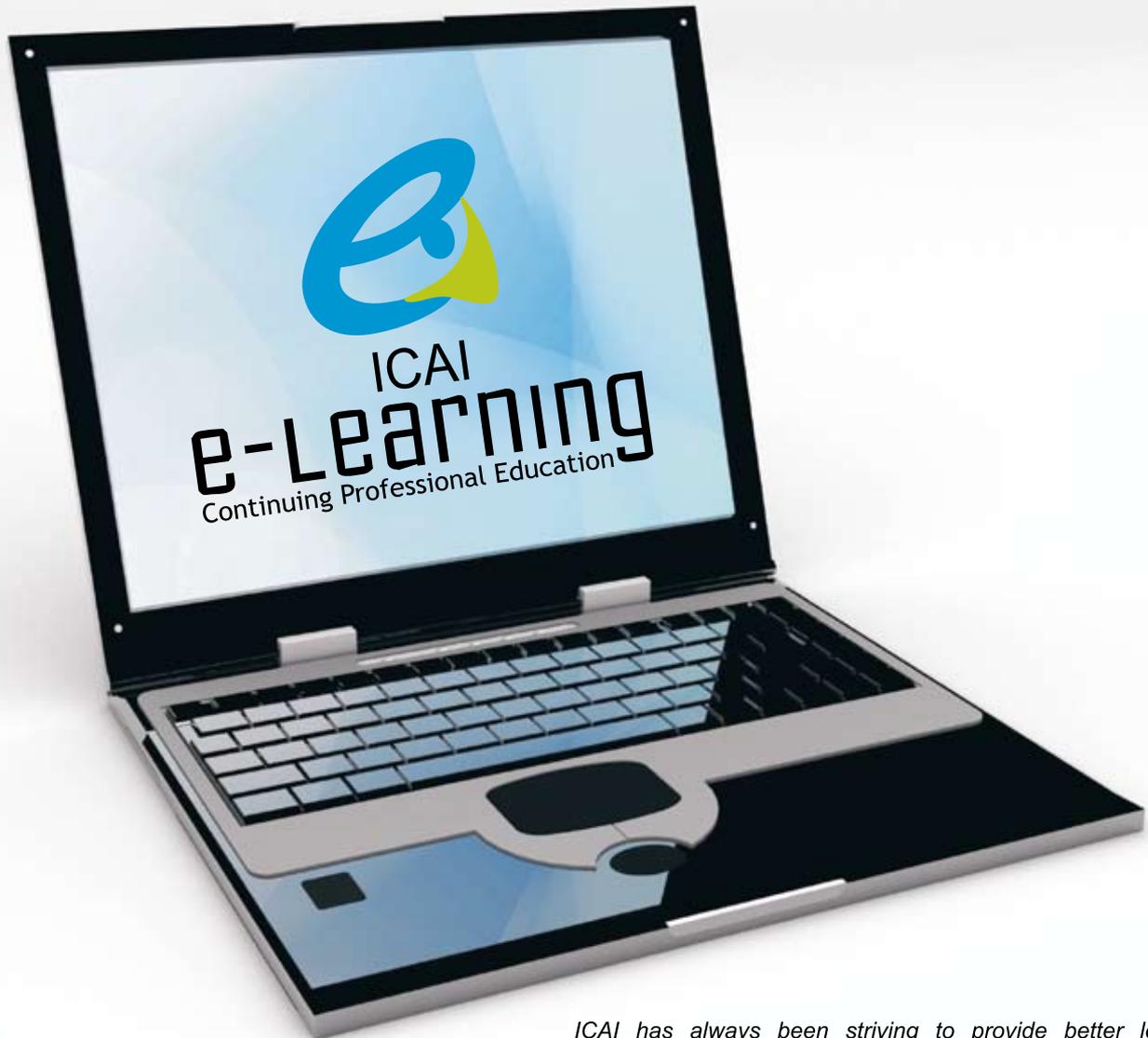
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The Institute of Chartered Accountants of India

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ICAI launches its e-Learning Portal for you to experience anytime learning



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- Transfer Pricing
- Investment Banking
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- Due Diligence

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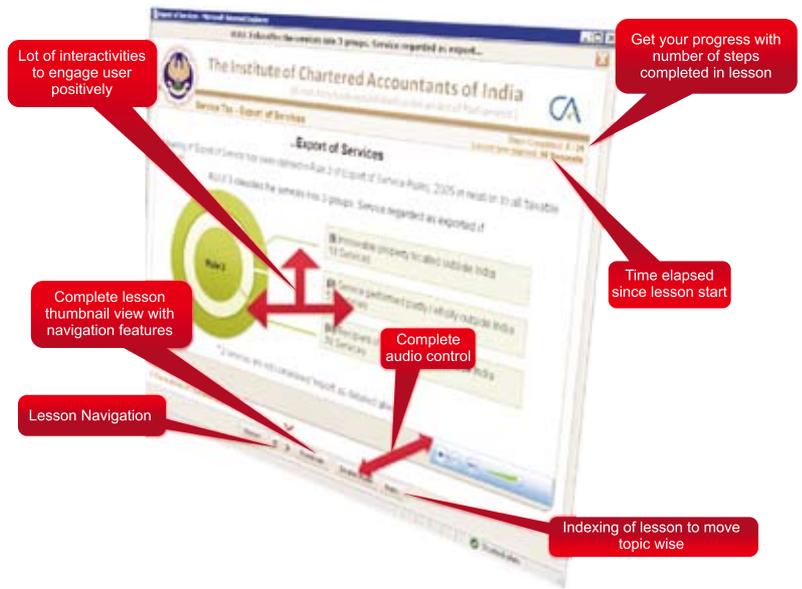
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The Continuing Professional Education Committee
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Tune in to easy learning

The Continuing Professional Education Committee of the Institute has been organizing continuing professional education programmes in the teleconferencing mode through the Gyan Darshan Channel of Doordarshan.

The objective is to provide quality programmes to the maximum members and students in general and to those in mofussil areas and remote places, in particular.

These interactive, participative teaching & learning programmes are structured to provide contemporary knowledge and are addressed by well-known experts in the concerned subject area.

These teleconferencing programmes are being organized on Second Saturday of every month from 10 am to 12 noon (except during the examination dates). Any particular change in the schedule of any month is intimated well in advance.

These programmes can be viewed through direct reception facilities located throughout India in Regional Councils or Branches.

The members can also view these programmes in the comfort of their homes as they are now also available on GD-1 & GD-2 on Direct to Home (DTH) platform of DD, Dish TV and Sky T.V.



*Prospective participants may kindly send their queries in advance, by email at **cpetele@icai.org** or **cpeadmin@icai.org**, which could be considered for response during the teleconference.*

The queries can be asked by the members during live telecast of the programme on telephone No.s 011-29532844, 011-29532845 or can be faxed at 011-29536134.

Members of ICAI please note that participation in the Teleconference Programme through Regional Council / Branch / CPE Chapter / CPE Study Circle / CPE Study Group is necessary to avail CPE Credit for Structured Learning Activities. Viewing these programmes without the supervision of any POU would be covered under Unstructured Learning Activities.

For further details, kindly refer the Advisory on Unstructured Learning Activities on Institute website www.icai.org or www.cpeicai.org





Seen from Left to Right are Chairman of Sydney Chapter of ICAI CA. Yateender Gupta, ICAI President CA. Ved Jain, former Prime Minister of Australia Mr. John Howard and ICAI Vice President CA. Uttam Prakash Agarwal during a meeting in Sydney on 9th October 2008.

ICAI President CA. Ved Jain and ICAI Vice President CA. Uttam Prakash Agarwal with other dignitaries during a visit to Melbourne Chapter of ICAI on 12th October 2008. The Melbourne Chapter Chairman CA. Suresh Kumar Vallath and Vice Chairman of the Chapter CA. Noble Thomas were also present on the occasion.



ICAI President CA. Ved Jain and ICAI Vice President CA. Uttam Prakash Agarwal with Chairman of Toronto Chapter of ICAI CA. Asger Khambati, Vice Chairman of the Chapter CA. Ram Balakrishnan and other dignitaries during a visit to Toronto Chapter of ICAI on 18th October, 2008.

ICAI President CA. Ved Jain speaks during the foundation laying ceremony of Bhilai branch of ICAI in Bhilai on 2nd October, 2008 as other dignitaries look on.



Following are the brief details of some notable events pertaining to the accountancy profession and the Institute of Chartered Accountants of India (ICAI) that unfolded in the first decade (1949-1959) of the existence of the ICAI. These events and some interesting facts, which carry nostalgic value, are being retold as part of the ICAI's diamond jubilee celebrations. Subsequent decades will be covered in forthcoming issues of this journal.

Opening of the ICAI Headquarters

On April 2, 1954, Dr. Rajendra Prasad, President of India, inaugurated the building of ICAI Headquarters and also inaugurated the first Conference of Chartered Accountants of India. The day is truly a memorable date in the annals of the Institute.

In his speech, the President of India observed "Whether we are men in the professions – Chartered Accountants, Engineers, Lawyers and the like or mere horny-handed sons of soil destined to work on the fields or in the factories – all of us must realise that the nation's advance ultimately depends on our character and on the sincerity and devotion with which we carry out the tasks allotted to us. This simple truth is likely to be forgotten in the stress and strain of day-to-day living". He exhorted the profession to follow the foot-steps of the great Architect of India's freedom (Mahatma Gandhi): "His example should be a perpetual reminder to all of us of the potency of the basic qualities of individual character. That men of his stature are rare should not discourage us from making an earnest effort to trail the path blazed by him". Dr. Prasad reminded the profession that "The fast increasing tempo of the industrial and economic development of the country makes it imperative that every Chartered Accountant should realise that he belongs to a profession which provides the first line of defence to the unwary public against money-grabbers and opportunists. Your responsibility in this matter becomes all the greater because of the autonomy which your profession enjoys. The confidence of the public in even reliable and well-managed business undertakings would be gravely undermined, if unscrupulous persons were allowed without let or hindrance, to manipulate company accounts or otherwise indulge in malpractices only to serve 'their own ignoble ends. The Government and the public are therefore alike interested in the maintenance of the independence and integrity of the Accountancy profession, but it is primarily for the profession itself to create conditions favourable to the growth of these qualities in its members".

Postal Tuition for Articled and Audit Clerks

In 1956, the Chartered Accountants Regulations were amended with a view to make it obligatory upon all entrants to the profession to undergo a course of postal-tuition before being permitted to sit for the examinations of the Institute.

The Coaching Scheme for providing postal-tuition came into operation from 1st July, 1956. After this date, before taking up articles or service as audit clerk, everyone were required to enroll himself for receiving postal-tuition with the Coaching Board set up by the Council for this purpose. On their completing the postal-tuition to the satisfaction of the Coaching Board, the persons who underwent the course were to be granted a certificate. Any person who did not obtain this certificate were not allowed to sit for the examinations of the Institute. The period of postal-tuition for the Intermediate Examination was 12 months and that for the Final Examination was 18 months. The fee for the entire course was Rs.300 which was payable in advance. This was only the first phase of the Coaching Scheme, for was proposed afterwards to supplement the postal-tuition by a course of oral tuition, at the Regional centers, for a period of 2 months in the case of Intermediate and 4 months in the case of Final Examinations. This oral tuition, however, was optional, for which a separate fee was charged.

The Coaching Board made all the necessary preliminary arrangements for the operation of the Scheme. A panel of experts prescribed the books for the study on different subjects, prepared study notes, test papers and other literature for the use of candidates preparing for the examinations. It was proposed to engage whole-time tutors for grading the test papers submitted by the students. These tutors were not only to assess the test papers submitted by students but were also to advise the students how to get-over their special difficulties and deficiencies. They were also expected to attend to the individual requirements of students and for the purpose the tutors were, if necessary, required to have regular correspondence with the students who needed special attention.

The Council at that time had been able to arrange for the provision of postal-tuition in the manner described above, the need for which was being felt for the past many years, with the promise of financial assistance from the Central Government, for which the Accountants in the country at that time felt indebted to the Government. □

Interesting Statistics of 1954

The following statistics will, it is believed, be of some interest to the members:

- Number of CPAs (United States): Just crossed 50,000 mark.
- Number of U.K. Accountants (comprising three Chartered Institutes, The Society of Incorporated Accountants, and the other Association): Over 41,000 Members.
- Number of Members of our own Institute (as on 31.03.1954): 2,819 members



Shri N.M. Rajji, the oldest member of the Council of the Institute of Chartered Accountants of India, placing the President's Collar for the first time on Shri G.Basu, the retiring President, for to be used by the ICAI Presidents on important occasion. Also seen in the photograph are Central Council Member Shri C.S. Sastri and Shri S. Venkataraman (Secretary).

SECTION 14A: SPECIAL REFERENCES



CBDT has on March 24, 2008 issued a notification prescribing Rules for computation of expenditure of income. These rules state that expenditure incurred in relation to exempt income shall not be deductible in computing the taxable income. The rules also prescribe that expenditure incurred in relation to exempt income shall not be deductible in computing the taxable income. Assessing Officer will have the authority to make, at his discretion, allocation of expenses for dividend income, long-term capital gains on listed shares, share of income from Partnership Firm & AOP and even to deductions under sections 10A/10B etc. This article deals with the issues related to the abovesaid Notification No. 45/2008.

New Income-tax Rule Notified

CBDT has on March 24, 2008 issued Notification No. 45/2008 prescribing Rules for computation of expenditure in relation to exempt income. Apparently an innocuous provision, when analysed, it virtually results in imposition of Wealth Tax on shares and withdrawal of tax exemption on dividend income and long-term capital gains on listed shares.

Section 14A of the Income-tax Act, 1961 (Act) provides that expenditure incurred in relation to exempt income shall *not be deductible* in computing the taxable income. The incomes which are exempt from tax include:-Agricultural income {Section 10(1)

of the Act}, Dividend Income {Section 10(34)}, Long-term capital gains on listed shares {Section 10(38)}, Share of income from partnership firm or AOP {Section 10(2A)}. This is on the logic that since such income is not taxable, expenses relating to such exempt income cannot be claimed as deductible expense against other taxable income i.e., business income, income from house property, income from other sources etc.



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Section 14A further authorises the Assessing Officer (AO) to determine the amount of such disallowable expenditure incurred in relation to the exempt income *in accordance with the prescribed method*, if the Assessing Officer is not satisfied with the correctness of the assessee's disclosure of

Section 14A of the Income-tax Act, 1961 (Act) provides that expenditure incurred in relation to exempt income shall not be deductible in computing the taxable income. The incomes which are exempt from tax include:- Agricultural income {Section 10(1) of the Act}, Dividend Income {Section 10(34)}, Long-term capital gains on listed shares {Section 10(38)}, Share of income from partnership firm or AOP {Section 10(2A)}.

amount of expenditure incurred in relation to tax exempt income.

The New Rule 8D

By Notification dated, 24.3.2008 a new rule 8D has been introduced, which prescribes the method of determining the expenditure in relation to tax exempt income. The amount of disallowable expenditure in relation to an exempt income shall be the aggregate of the following:-

- (a) Direct expenses, if any, relating to exempt income, {Rule 8D (2) (i)} *plus*,
- (b) Interest expenses, {other than that included in (a) above}, to be notionally allocated on the following basis -

Total interest expenses - interest

$$\frac{\text{directly relatable to exempt income}}{\text{\{Rule 8D (2) (ii)\}}} \times \frac{\text{Average value of investment}}{\text{Average value of total assets}}$$

plus,

- (c) Half per cent of the average value of investment. { Rule 8D (2) (iii) }

“Investment” for purpose of this Rule means all such investment,” income from which ***does not or shall not*** form part of taxable income”. The phrase “does not or shall not” enlarges the scope to include not only those investments which produces exempt income but also even those which *would produce* exempt income in future. Therefore this would include aggregate investment in shares in the Balance Sheet, irrespective of the fact that the tax payer might not have received any dividend on certain shares.

In the rule 8D(2)(i) for allocation of direct expenses the phrase used is: “income which ***does not*** form part of total income”. The scope of allocation for direct expenses has been limited to actual exempt income accruing during the year.

The average of the cost of investments / assets appearing in the balance sheet on the first day and the last day of the financial year will be taken as the average value of the investments / assets.

The Implications of the New Rule 8D

The expenses allocated under the new rule 8D towards exempt income would reduce the quantum of expenses relatable to taxable income or in other words the expenses which are deductible in computing the taxable income. Consequently the taxable income will increase. Rule 8D will not affect assessee's having only salary income apart from exempt income.

Interest expenses:

(i) **Direct interest expenses for earning tax-exempt income:** As per the new rule 8D(2)(i) if shares are purchased out of borrowed funds, then the interest expenses incurred on such direct borrowings will be disallowed in totality. If shares have not been purchased out of borrowings, then the interest incurred is obviously relatable to taxable income and such interest cannot under any stretch of imagination be attributed to exempt income. Till now it was the practice of the Income-tax Deptt. (ITD) to check in the course of assessment whether any borrowings have been made by the assessee specifically for making investments in shares. If the ITD was satisfied that the borrowings were not made for making investments, but wholly and exclusively for purposes of business, no interest was allocated against the exempt dividend income and / or exempt long-term capital gains.

(ii) **Indirect interest expenses for earning tax-exempt income:** Henceforth even if the borrowings are specifically, wholly and exclusively made for the purpose of business and not for investments, the Notification dated, 24.3.2008 has given discretionary powers to the Assessing Officer to notionally allocate a part of the interest incurred for earning taxable income to exempt income and disallow the interest expenses so allocated.

Rule 8D provides that the interest expense to be allocated on basis of investment /asset ratio will be such interest which is not directly attributable to any particular income or receipt. But the Rule does not lay down any norms for determining the interest expense “which is not directly attributable to any particular income or

A manufacturing company and an investment company have been treated on same basis in the new Notification. The quantum of exempt income, interest expenses incurred for own manufacturing purposes, and investment / asset ratio of a manufacturing company are bound to be different than that of an investment company.

receipt” i.e., for determining the indirect interest expenses to be allocated to exempt income under the new Rule. It has been left totally at the Assessing Officer’s discretion. Interest expenses in a year may include amount relating to borrowings made and utilised in business in earlier years. CBDT should lay down norms on basis of which an Assessing Officer is supposed to reach to a conclusion that borrowings are related to particular income/ receipt of the relevant year other than exempt income and thus out of purview of rule 8D.

(iii) Cost of borrowings: Borrowings and operational surplus are pooled and the aggregate funds are utilised for business purposes. Surplus fund, if any, are invested. Investments are generally made out of savings and / or taxed income and not made out of borrowings. This is because in India the cost of borrowing is generally higher than normal returns on investments yielding exempt income. Investments out of borrowings are made in exceptional cases of acquisitions (e.g., Jaguar, Corus), subscribing to mega issues e.g., DLF, Reliance Power. In such situations the interest expenses component is easily identifiable as relating to exempt income, if any. Thereafter there is no justification for giving discretionary powers to the Assessing Officer to notionally allocate the interest expense to the exempt income.

(iv) One formula for all type of assessee: A manufacturing company and an investment company have been treated on same basis in the new Notification. The quantum of exempt income, interest expenses incurred for own manufacturing purposes, and investment / asset ratio of a manufacturing company are bound to be different than that of an investment company. If a manufacturing company has any exempt income and also holds shares of its subsidiary companies, the Assessing Officer will allocate the interest and other expenses under the new Notification, though it may not have acquired the subsidiary shares from the borrowed funds! Suppose X Ltd. has interest expenses of Rs. 10 crore which have been incurred on borrowings used for its manufactur-

ing business. The total assets as per Balance Sheet of X are 180 crore and the book value of investments is Rs. 18 crore. Then interest expenses of Rs. 1.5 crore (10 x 18/180) will be notionally allocated and disallowed as deemed to be for earning tax exempt income under the new Rules. The more the investments held by a manufacturing company in proportion to its total assets, more disallowance of the interest expenses it will have to suffer.

- (v) Litigation galore:** Areas of dispute which may arise in relation to the new Rule are –
- whether the interest expense to be allocated is to be considered on gross basis or on net basis i.e., after adjusting interest income.
 - whether “total assets” will include current assets on gross basis or on “net current” basis i.e., after deduction of current liabilities.

Other Indirect Expenses Relating to Exempt Income

Under rule 8D(2)(iii), half per cent of the average value of shares on overall basis will be deemed to be expenditure in relation to exempt income and will be disallowed under section 14A of the Act, irrespective of the fact that dividend has been received only on certain shares and not on all shares. The amounts that would be allocated and disallowed in case of foreign acquisition out of borrowings are mind boggling.

The dividend on the shares is declared and received based on the face value of the shares, whereas the allocation of expenses under rule 8D is based on a percentage of the cost of shares in the books. Such costs in the books are normally many times more than the face value. Consequently the expenses (for earning exempt income) to be allocated on notional basis on value of investment will have no co-relation or proportion with the exempt income earned

To illustrate: X Ltd. is a manufacturing company. X Ltd. has shares of 10 companies in its portfolio which were purchased at many times of the face value of shares. X Ltd. receives dividend from only 2 companies that also on face value of the shares. But the half per cent of the cost (and not the face value) of all such shares of the 10 companies will be treated as a notional expense for earning dividend on face

Many companies invest the surplus fund in mutual funds for short-term during the year on dividend option basis. The units are purchased and sold during the year. The units are redeemed at book value without any gain / loss. The dividend received on such units is exempt. Since there will be no investments on the opening and closing date of the year, there is no scope of allocation of expenses under the new Rule

value of shares of 2 companies and disallowed in computing the business income of X Ltd.

No Overall Limit

It is thus obvious that the purpose of the new Rule is to surreptitiously withdraw the exemption of dividend income. The total expenses to be notionally deemed to be relatable to the exempt income under the new Rule may exceed even the total exempt income received by a tax payer. No overall limit has been specified in rule 8D in respect of expenditure to be determined and disallowed in relation to exempt income. To illustrate: the total exempt dividend income is say, Rs.1 lac but the disallowance proposed by rule-8D could far exceed Rs.1 lac. It is against the established and accepted principles and norms of natural justice that the notional deemed disallowance may exceed not only the actual expenditure but also exceed the exempt income!

Investments Which Yield Both Taxable and Exempt Income

Shares held as stock-in-trade, unlisted companies shares, listed companies shares held for less than 12 months are examples of a particular investment having both taxable income (on disposal of shares) and exempt income (dividend income). The new Rule has not excluded such investments in laying down the formula for allocation of expenses under section 14A

Investments Made and Sold During the Year

Many companies invest the surplus fund in mutual funds for short-term during the year on dividend option basis. The units are purchased and sold during the year. The units are redeemed at book value without any gain / loss. The dividend received on such units is exempt. Since there will be no investments on the opening and closing date of the year, there is no scope of allocation of expenses under the new Rule.

Cascading Effect

Further rule 8D(2)(ii) and rule 8D(2)(iii) will lead to multiple disallowance. Under rule 8D(2)(ii) first the notional interest expenses will be allocated to exempt income and disallowed even if there is no interest

incurred in relation to exempt income. Such allocation will be based on total investment value. Thereafter under rule 8D(2)(iii) once again indirect expenses will be allocated @ 0.5% of the total investment value on overall basis to tax exempt income and disallowed.

Section 48 and Rule 8D

Section 48 of the Act specifically provides the method of computing capital gains including an exempt capital gain. Section 48 does not provide for notionally allocating any expenses in computing the exempt capital gain. Provisions of the Rule cannot override specific provisions of the Act. On this ground alone rule-8D, as far as it pertains to determining expenditure on notional basis against 'capital gain', is contrary to the provisions of section-48 of the Act (which lays down method of computation of capital gains) and may be held invalid.

Book-Profit

Section 115JB provides that the incomes which are exempt under sections 10, 10A and 10B and expenses which are relatable to such tax exempt income will be excluded from computing the book-profit for purposes of MAT. The Assessing Officer could compute the expenses relatable to exempt income including income under section 10A/10B (which are more of deduction than exemption) under the new rule 8D and make a high pitched MAT assessment.

Discretionary Power of the Assessing Officer

The new rule 8D starts with a preamble –

“Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with-(a) the correctness of the claim of expenditure made by the assessee; or

(b) the claim made by the assessee that no expenditure has been incurred, in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).”

Neither the existing section 14A nor do the new rule 8 D specifically exclude those cases where for

Assessing Officer will have the authority to make, at his discretion, allocation of expenses for dividend income, long-term capital gains on listed shares, share of income from Partnership Firm & AOP and even to deductions under section 10A/10B etc. Such notionally allocated expenses will not be deductible against taxable income, even though they might have been

past several decades the assessee's computation of exempt income has been accepted by the Income-tax Department (ITD). In fact the new section 268A proposed to be introduced by the Finance Bill, 2008 provides that acceptance of an issue in past by the ITD will not be deemed to be a precedence and cannot prevent the ITD from filing of appeals in future on the same issue. It seems the ITD has presumed immunity from the principle of *res-judicata* on comprehensive basis.

Assessing Officer will have the authority to make, at his discretion, allocation of expenses for dividend income, long-term capital gains on listed shares, share of income from Partnership Firm & AOP and even to deductions under section 10A/10B etc. Such notionally allocated expenses will not be deductible against taxable income, even though they might have been incurred for earning taxable income.

Suggestions

- (a) The allocation of expenses for earning tax exempt income has been based only on investment and asset value. But one formula cannot be valid both for an investment company and a manufacturing / service company having different asset ratio and income ratio. The allocation of expenses should be made after considering both investments / asset ratio and exempt income/ total income ratio. In the USA, the expenses for earning tax-exempt income is computed by applying the average of investment/ asset ratio + exempt income/total income ratio and not just the investment / asset ratio simpliciter.
- (b) There should be a ceiling that the total amount to be allocated and disallowed under section 14A read with rule 8D shall not exceed the amount of income which is claimed exempt.
- (c) The investments on which no tax-free income has been received in preceding three years should not be considered in the formula for allocation of expenses
- (d) The shares held as stock-in-trade, investments in the shares of unlisted companies, investments in shares held for less than 12 months etc. should not be considered for computing the expenses relating to exempt income.
- (e) The Rule should not be applicable in computing

book-profit under section 115JB for purposes of MAT.

- (f) The Rule should not be applicable to income for which deduction is provided under section 10A/10B.
- (g) The computation of expenses for earning tax-exempt income should be certified by a chartered accountant either as part of Tax Audit Report or otherwise and ITD should accept such certification of both interest expenses and other expenses attributable to exempt income.
- (h) Rule-8D has been made effective from the date of its publication in the Official Gazette. A lot of litigation is going on in the country whether such Rules apply with retrospective effect in respect of pending assessments/appeals. Although Rule is stated to be come into force from date of publication in the Official Gazette, the ITD may apply the Rule even in assessments and/or appeals pending on the date of the Notification. The assessee might be made liable for interest and penalty irrespective of the fact the assessee was not even aware of the new method of computing the expenses relating to tax exempt income when he filed his return or the last date of revising the filed return. It should be clarified that no retrospective effect of the Rule can be given and the Rule will be applicable from assessment year 2008-09 onwards.

Conclusion

The new rule 8D nullifies the exemption of dividend income and in effect levies Wealth-tax on value of shares by back door method. The aforesaid provisions of rule 8D as notified are against the well established and accepted principles of law and justice and will enhance the discretionary powers of Assessing Officer leading to litigation. Nothing can be more illogical, self contradictory and draconian, than the new rule 8D. There is no justification to vest in Assessing Officer such sweeping discretionary powers through delegated legislation. The only consequence will be that the lawyers' "interest" will increase because of ensuing litigation on this issue. The investment climate of the country may be adversely affected by the new amendment. □

CASE STUDY AND SUGGESTIONS ABOUT ALLOWABILITY OF DIVIDEND



Dividend not covered by section 115-O may be allowable as business expenditure in view of the decision of the Tribunal in *Vishnu Sugar Mills Ltd.*'s case (infra) which has attained finality since no appeal was filed by the Revenue against this order. In view of the author in consequence to this section 115-o deserves to be amended by omission of sub-section (5) thereof to allow dividend as business expenditure.

During 1990-92 the author had written an article which was published in several newspapers and its brief was also published in the Newsletter of the Institute. There he had very strongly contended that dividend paid by a company to its shareholders is a payment to service for the share capital already raised and used for the purpose of business of the company. Shareholders and companies are two different persons. Dividend once

declared goes out of pocket of the company and therefore, it is a revenue expenditure incurred wholly for the purpose of business. It was contended that dividend paid by companies is not covered by any provisions of sections 30 to 36, 40 and 40A of the Income-tax Act, 1961 (at the relevant time section 115-o was not in the Income-tax Act). Therefore, dividend can be considered as an allowable expenditure under section 37(1), as it satisfies all conditions for allowability as business expenditure and there is no bar to al-



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Dividend paid to shareholders should be allowed as business expenditure. Allowability of dividend is also desirable to avoid double taxation.

low the same.

It appears that many companies might have claimed dividend at that time and in many cases the same might have been allowed also. For example see *CIT V Aриhant Industries Ltd.* [2002] 255 ITR 458 (P & H) in which assessee claimed dividend paid amounting to Rs.1,27,98,515 and it was not disallowed in intimation under section 143(1) [and perhaps under section 143(3) as well- it is not very clear, from reported judgment]. Then the revenue rectified the order under section 154(1)(b) to disallow dividend, which was not permitted by the CIT(A), ITAT and the High Court. The reason given is that because notice under section 143(2) was issued. The High Court has noted that order under section 154(1)(b) is dated, 9.3.1992 and the order under section 143(3) is dated, 27.3.1992. The Court held that if any action is required, it can only be in relation to order under section 143(3) and not 143(1).

Statutory recognition of commercial expediency

We find that under law also there is recognition of 'commercial expediency' and nature of 'expenditure' involved in payment of dividend by companies to its shareholders.

- a) Dividend is paid only on recommendation of the Board of Directors to the shareholders, while recommending dividend requirement of funds of the company and commercial expediency in paying dividend to maintain reputation and goodwill are also considered besides other factors.
- b) Under the Companies Act, 1956, the payment of dividend is to be made out of profits after providing depreciation. However, in certain circumstances the Central Government may, if it thinks necessary so to do in the public interest, allow any company to declare or pay dividend for any financial year out of the profits of the company for that year or any previous financial year or years without providing depreciation. – Section 205(1)(c) of the Companies Act.
- c) Under section 208 of the Companies Act, in some circumstances, company may pay interest on share capital where share capital is raised to defray long gestation projects or assets which cannot be made profitable before a long time. By nature, and circumstances such interest is in

lieu of dividend. This also shows that interest to shareholders or dividend is a payment out of commercial expediency.

- d) Unpaid dividend has to be kept in separate accounts from where only shareholder can claim and ultimately unclaimed amount will be transferred to investor education and protection fund – sections 205A, 205B, and 205C of the Companies Act.
- e) Penalty -If dividend is not distributed within specified time then penalty can be levied under section 207 of the Companies Act.
- f) In case of non-payment of dividend the shareholder can bring action against company.

The above provisions of the Companies Act clearly show that dividend is paid out of commercial expediency and once dividend is paid the money goes out of pocket of the company for ever. In case of other expenses, in some situations a company or any other person may get some refund or credit against payment made by him or liability incurred by him earlier. However, in case of dividend there is no such chance that company may get a refund or waiver.

Appropriation / below the line or application of income

As per standard forms of profit and loss account dividend declared, amount contributed to any fund or reserves etc. are shown below the line but that should really not make a difference. Many reserves like investment allowance reserve, development allowance reserve, molasses reserve, statutory reserves etc. are shown below the line still deduction in respect of the same is allowed. The company and shareholder are different persons and dividend is paid out of discretion of the Board of Directors (and not by the shareholder). Therefore, dividend is expenditure and not an application of income. Even if dividend is considered as application of income, it is for purpose of business - maintaining and improving goodwill, servicing capital, maintaining and improving share price and price earning ratio, etc. therefore, it will be for the business purpose.

In this write-up a case, argued by the author in which dividend was claimed and was allowed by the Tribunal and that order has attained its finality, is discussed.

Order of the Tribunal

Tax on dividend distributed may continue to be disallowed because even if shareholder pay tax on dividend, it will not be allowable in his hands.

In the case of *Deputy Commissioner of Income-tax vs. M/s Vishnu Sugar Mills Ltd* [ITA Nos. 2131, 2133(Kol.)/2004, 193 & 774/Kol./2005 and 918/Kol./2002 (Assessment years 2001-02,1998-99,1996-97,1997-98,1997-98) decided by ITAT, Kolkata Bench on 17-08-2005] the assessee had submitted detailed written submission before the Commissioner (Appeals) which is summarised below:

“Ground no. 3 - Claim for dividend paid Rs.7, 50,000 as allowable business and revenue expenditure:

- (a) Assessee- company and its shareholders are different persons. Now it is settled by several judgments of the Supreme Court that even when 100% shares are held by GOI, (100% Government Company) the company is not the Government or a Government department but is a separate corporate legal entity.
- (b) A payment of dividend by company is not payment to assessee itself but to shareholders who are different persons. There is no joint venture or joint ownership between the company and its shareholders. The property of company is property of company and not that of shareholders. The company can sue shareholders and shareholders can sue company.
- (c) Dividend is paid to maintain goodwill, and to service capital already raised.
- (d) Capital raised from shareholders have been used for the purpose of business therefore reward made to shareholders by way of dividend is an expenditure wholly and exclusively incurred for the purpose of business.
- (e) Dividend once declared is expenditure. It has to be paid to the shareholders. Even if dividend remains un-claimed it has to be deposited in separate account from which shareholders can claim. Thus, it cannot come back to the company.
- (f) Dividend is paid for capital already raised and used for business, it is not to create any new capital base or capital asset, therefore dividend is revenue expenditure and not a capital expenditure.
- (g) Dividend paid by company to its shareholders is not covered by any of the provisions of sections 30 to 36, it is not prohibited by section 40 and 40A therefore it can be considered under section 37 or 28.

- (h) The source of payment (profit or reserves of company) is not a relevant factor. The purpose of payment is to be considered for allowing the claim of any expenditure. For example salary may be paid out of profit, or reserves, or capital or borrowings it will be allowable in any case.
- (i) Therefore all conditions for allowing the claim are satisfied – it is not a capital expenditure, it is not personal expenditure of assessee it is not covered by sections 30 to 36 it is not also covered by sections 40 and 40A and the expenditure has been wholly and exclusively incurred for the purpose of the business. Disallowances under sections 40 and 40A are exhaustive whereas amount allowable under section 28 or 37 is illustrative.
- (j) There is no provision to authorise disallowance of claim, in other words there is no bar for allowing dividend because the dividend was declared on 18.10.1995 and payment was made during the F.Y. 1995-96. Dividend so paid is not covered by section 115-o.
- (k) Thus, sub-section (5) of section 115-o is not applicable. Therefore, there is no disabling provision for allowability of dividend.
- (l) In recently reported case of *Arihant Industries Ltd* the assessee claimed dividend as expenditure. The High Court held that it cannot be disallowed in proceedings under section 143(1) (a) or (under section 154).
- (m) In case of *Ledo Tea Co. Ltd* the learned CIT (A) VI, in order 20.1.1999 in appeal No. 1871/CIT(A) –VI/ 97-98/ IC-7 (1) allowed dividend after considering similar arguments made before him by the same authorised representative that is Shri D.K.Kothari.
- (n) Kindly direct the Assessing Officer to allow the sum of Rs.7, 50,000/- paid as dividend to our shareholders.”

Relevant portion of the order dated 1.11.2004 passed by the Commissioner (Appeals) in Appeal No. 508/CIT(A)-X/ Circle 10/01-02 on the issue of Dividend as allowable expenditure: (paras 9-11) in the case of *M/s. Vishnu Sugar Mills Ltd* for assessment year 1996-97:

“9. Ground No.3 is related to not allowing dividend paid to the shareholders as business expenses under

section 28 or 37 of the Income-tax Act.

10. It was submitted that assessee (should be shareholders as per author) and company are different persons. A payment of dividend by company is not payment to assessee itself but to shareholders who are different persons. There is no joint venture or joint ownership between the company and its shareholders. The property of the company is the property of the company and not that of shareholders. The company can sue shareholders and shareholders can sue the company. Dividend is paid to maintain goodwill and to service capital already raised. Capitals raised from shareholders have been used for the purpose of business and therefore reward made to shareholders by way of dividend is an expenditure wholly and exclusively incurred for the purpose of business. Dividend once declared is expenditure. It has to be paid to the shareholders and even if dividend remains unclaimed it has to be deposited in separate account from which shareholders can claim. Thus, it cannot come back to the company. The dividend paid is not to create any new capital base or capital asset and therefore dividend is revenue expenditure and not a capital expenditure. The dividend paid by the company is not covered by any of the provisions of sections 30 to 36 and it is also not covered by sections 40 and 40A and by section 115-0. The AR also has cited the decision of P&H High Court in the case of *Arihant Indus. Ltd.*'s case (*supra*). The AR also has contended that in the case of *Ledo Tea Co. Limited* the Ld. C.I.T. (A)-VI in Appeal No.1871/CIT (A) VI/97-98/IC-7(1) allowed dividend after considering the argument made by him before the CIT (A) and furnished copy of the said order.

11. The submission and facts of the case have been duly considered. The then Ld. CIT(A)-VI in order dated 20.1.1999 in the aforesaid appeal after having duly considered the facts in that case has directed the Assessing Officer to allow dividend paid by the appellant company to its shareholders as business expenditure. I find similar issue is involved in this ground. Respectfully following the said order, the Assessing Officer is directed to allow dividend paid to its shareholders as business expenditure.”

Arguments before the Tribunal:

Before the Tribunal the revenue has taken the following ground of appeal:

That on the facts and in the circumstances of the case, the Ld. CIT (A) has erred in directing the Assessing Officer to allow dividend paid to the shareholders by the assessee-company as business expenditure.

And the assessee in its cross objection taken the following ground of appeal:

For that Ld. CIT (A) has rightly allowed dividend paid by assessee-company to its shareholders as business expenditure.

The author as authorised representative of the assessee-company

relied on written submission filed before the CIT (A) and the order of the CIT (A) and emphasised all contentions. After careful consideration of the facts and circumstances of the case and also legal provisions particularly sections 30 to 36, 40, 40A and 115-o of the Income-tax Act, 1961 the grounds of appeal and cross-objection about dividend, Tribunal observed and held as follows *vide* paras 8 to 11 of the order dated 17.8.2005 :

“8. In appeal No.193 (Kol.)/2005 the Department has raised another issue relating to the consideration of dividend paid to the shareholders as business expenses of the assessee. Supporting this finding of the CIT (A) the assessee has raised ground Nos.A (2) in its cross-objection No.49/Kol./05.

9. On careful consideration of the rival submissions it was found that the Ld. CIT(A) has considered this issue in Para 10 of the impugned order and gave his finding in Para 11. It was observed by the CIT (A) that his predecessor *vide* his order dated 20.1.1999 has allowed such claim by considering the same in detail. Basing on that only the CIT (A) has directed the Assessing Officer to allow the said expenditure. Before the Tribunal it was contended by the learned representative of the assessee that there is no restriction imposed under sections 40, 40A and 115-o of the Act. The dividend is paid out of commercial expediency and to maintain goodwill, and is allowable, in view of no specific restriction in allowing such expenditure.

10. On careful consideration of the submissions of both the parties on the issue we find that the Hon'ble Punjab and Haryana High Court in the case reported in 255 ITR 458 held that dividend cannot be disallowed in a summary proceedings under section 143(1)(A) of the Act. In the present case on hand the Department has passed order under section 143(3) against which the CIT (A) has found that the expenditure is allowable. Hence we find that the decision of the CIT (A) is not suffered from any infirmity requiring any interference. Hence, we hereby uphold the same finding; the issue rose by the Department as devoid of merits and is dismissed. The second ground raised by the

Department in appeal No.193 (Kol.)/2005 is dismissed.

11. In view of that finding the issue raised in ground No. A (2) in C.O. No. 49 (Kol.)/ 2005 by the assessee is hereby allowed.”

Therefore, the Tribunal confirmed the order of the CIT (A) by dismissing the ground of appeal of the revenue and allowing ground of objection of the assessee and confirming the order of the CIT (A).

Finality of the order of the ITAT

The order of the Tribunal was passed about 32 months ago (when the author wrote this write up), therefore, the limitation to file appeal has lapsed long ago and the assessee has not received any notice about filing of appeal against the order of Tribunal. Therefore, it is clear that the order of the Tribunal has been accepted by the revenue. Even if revenue impact involved in the instant case was much more than the limit prescribed by the CBDT for not filing an appeal before the High Court, the Department preferred not to file appeal against the order of the Tribunal. Therefore, the case is not hit by newly inserted section 268A in the Income-tax Act. Accordingly, it can be said that the order of the Tribunal is binding all over India as we do not find any contrary order of any High Court.

Desirability of amendment of section 115-o

In view of above discussion it is clear that dividend should be allowed as expenditure. For ease in collection of tax payable on income of shareholders, the system of tax on distributed profits is suitable. Allowability of dividend is also desirable to avoid double taxation - first in hands of company because dividend is generally paid out of taxable income, and then tax on distributed profits it is desirable that the dividend paid to shareholders should be allowed as business expenditure and therefore sub-section (5) of section 115-o should be omitted. If so done, it will avoid double taxation and shall also provide a boost to the capital market.

Conclusion

Tax on dividend distributed may continue to be disallowed because even if shareholder pay tax on dividend, it will not be allowable in his hands. Tax on distributed profit shall then be disallowed under section 40(ii). Though, the same may be amended to specifically cover tax on dividend distributed as levied under section 115-o, for clarity. □

NOTIFICATIONS/CIRCULARS

Significant Circulars/Orders issued during the Month of September, 2008

DIRECT TAXES

I. Circulars

1. Circular No. 8/2008, dated 22-9-2008

The agents of non-residents, within the meaning of section 160(1)(i) of the Income-tax Act, are facing difficulties in electronically furnishing the returns of non-residents. This is because of the reason that there may be more than one agent for a non-resident in India for different transactions or a person in India may be an agent of more than one non-resident. Such situations are not covered by the existing software which functions on the principle of one assessee - one PAN - one return.

Vide this Circular it has been decided by the Central Board of Direct Taxes that it will not be mandatory for agents of non-residents, within the meaning of section 160(1)(i) to electronically furnish the returns of non-residents for assessment year 2008-09.

2. Circular No. 9/2008, dated 29-09-2008

This circular contains instructions given by the Central Board of Direct Taxes with a view to help the employers to understand the various provisions relating to tax deduction at source from "Salaries" for the Financial Year 2008-09.

It contains the rates of deduction of income-tax under section 192 from the payment of income chargeable under the head "Salaries" during the financial year 2008-09 and also explains certain related provisions of the Income-tax Act.

Further, this circular contains clarifications regarding TDS on arrears of salary paid to government servants on account of implementation of recom-

mendations of Sixth Pay Commission.

For details visit: http://www.incometaxindia.gov.in/archive/192Circular_01102008.pdf

II. Orders

1. F. No. 225/138/2008/ITA-II dated 18-09-2008

In exercise of powers conferred under section 119 of the Income-tax Act, 1961, the Central Board of Direct Taxes has, for the income-tax assesseees in the State of Bihar, extended the due date of obtaining tax audit report under section 44AB and filing of return of income required to be furnished by 30th September 2008 to 30th November, 2008.

For details visit: http://www.incometaxindia.gov.in/archive/Bihar_order119_19092008.pdf

2. F. No. 225/138/2008/ITA-II dated 23-09-2008

In exercise of powers conferred under section 119 of the Income-tax Act, 1961, the Central Board of Direct Taxes has, for the income-tax assesseees in the State of Jammu and Kashmir, extended the due date of obtaining tax audit report under section 44AB and filing of return of income required to be furnished by 30th September 2008 to 30th November, 2008.

For details visit: http://www.incometaxindia.gov.in/archive/orderforJK_23092008.pdf

3. F.No.225/138/2008-ITA-II dated 29-09-2008

In exercise of powers conferred under section 119 of the Income-tax Act, 1961, the Central Board of Direct Taxes has, for the income-tax assesseees in the State of Orissa, extended the due date of obtaining tax audit report under section 44AB and filing of return of income required to be furnished by

30th September 2008 to 31st October, 2008.

For details visit: http://www.incometaxindia.gov.in/archive/Orderus119_29092008.pdf

4. F.No.225/138/2008-ITA-II (Pt.) dated 30-09-2008

In exercise of powers conferred under section 119 of the Income-tax Act, 1961, the Central Board of Direct Taxes has, for the non-sikkimese assesseees residing in the State of Sikkim, extended the due date of filing return of income required to be furnished by 31st July 2008 to 31st October, 2008.

For details visit: http://www.incometaxindia.gov.in/archive/Orderus119_30092008.pdf

INDIRECT TAXES

EXCISE

I. Notification

1. Notification No. 35/2008-Central Excise (N.T.) dated 24th September, 2008 has inserted a proviso after rule 3(1)(xi) of the CENVAT Credit Rules, 2004 to provide that the amount equal to central excise duty paid on the capital goods at the time of debonding of the unit in terms of the para 8 of *Notification No. 22/2003 CE dated 31.03.2003 shall be allowed as CENVAT credit. Notification No. 22/2003* exempts certain goods when brought into 100% EOU / STP complex.

For details visit: <http://www.cbec.gov.in/excise/cx-act/notfns-2k8/cent35-2k8.htm>

2. Notification No. 38/2008 CE (NT) dated 29.09.2008 has inserted rule (2A) after rule 2 in the Central Excise Rules, 2002. The new rule (2A) provides that every assessee shall submit to the Superintendent of Central Excise, an Annual Installed Capacity

Statement declaring the annual production capacity of the factory for the financial year to which the statement relates in the prescribed form by the 30th day of April of the succeeding financial year. However, the Central Government may specify assessee or class of assessee who may not require to submit such an Annual Installed Capacity Statement. For the year 2007-08, the said statement shall be furnished by 31st day of October, 2008.

For details visit: <http://www.cbec.gov.in/excise/cx-act/notfns-2k8/cent38-2k8.htm>

3. Notification No. 39/2008 CE (NT) dated 29.09.2008 has specified form ER-7 for the Annual Installed Capacity Statement to be submitted under rule (2A) of the Central Excise Rules, 2002.

For details visit: <http://www.cbec.gov.in/excise/cx-act/notfns-2k8/cent39-2k8.htm>

4. Notification No. 40/2008 CE (NT) dated 29.09.2008 has amended Notification No. 36/2001 CE (NT) dated 26.06.2001 which grants exemption from obtaining central excise registration to certain specific assessee. The said notification has been amended to provide that the assessee manufacturing goods chargeable to nil rate of duty or fully exempt goods should file the revised declaration for the previous year 2007-08 by 31st October, 2008.

For details visit: <http://www.cbec.gov.in/excise/cx-act/notfns-2k8/cent40-2k8.htm>

5. Notification No. 41/2008 CE (NT) dated 29.09.2008 has amended the Notification No. 39/2004 CE (NT) dated 25.11.2004 so as to remove the condition of paying the stipulated amount of duty from account current i.e., in cash. Thus, now the manufacturer manufacturing the prescribed excisable goods and who has paid duty of Rs.100 lakh (by any mode, either in cash or through CENVAT credit) during the financial year shall be exempted from filing the annual information re-

lating to principal inputs and monthly return of receipt and consumption of each of the principal inputs.

For details visit: <http://www.cbec.gov.in/excise/cx-act/notfns-2k8/cent41-2k8.htm>

6. Notification No. 42/2008 CE (NT) dated 29.09.2008 has amended the Notification No. 17/2006 CE (NT) dated 01.08.2006 so as to remove the condition of paying the stipulated amount of duty from account current i.e., in cash. Thus, now the assessee who has paid duty of Rs.100 lakh (by any mode, either in cash or through CENVAT credit) during the financial year shall be exempted from filing the Annual Financial Information Statement.

For details visit: <http://www.cbec.gov.in/excise/cx-act/notfns-2k8/cent42-2k8.htm>

CUSTOMS

I. Circulars

1. Circular No.14 /2008-Customs dated 26.09.2008

Para 5.3.2 of the Hand Book of Procedures (HBP) (Vol-I), [RE-2008-09], which provides that, the Authorisation holder under the EPCG Scheme shall produce to the concerned Regional Authority, a certificate from the jurisdictional Central Excise Authority, confirming installation of capital goods at factory premises of Authorisation holder or his supporting manufacturer(s) /vendor (s) within six months from the date of completion of imports. *Vide* this Circular it is advised that the officer should invariably complete the verification within 30 days of receipt of intimation.

For details visit: <http://cbec.gov.in/customs/cs-circulars/cs-circulars08/circ14-2k8-cus.htm>

2. Circular No.15/2008-Customs dated 26-09-2008

The issue regarding authentication of supply invoices by the jurisdictional Central Excise Authorities provided in Para 3.b (1) of form ANF 4F of Hand Book of Procedures (HBP) Vol.1 (Ap-

pendices and Aayat Niryat Forms) has been examined by the Central Board of Excise and Customs, and the following guidelines are prescribed in this behalf,-

- (a) The recipient units which are registered with Central Excise shall intimate the fact of receipt of the goods on deemed export basis to the jurisdictional Superintendent of Central Excise and obtain a dated acknowledgement. The Superintendent of Central Excise shall physically verify the goods received, within 5 working days and if the details declared on the invoice match with the goods, the Superintendent of Central Excise shall endorse the invoice/statement of the invoices immediately but not later than 21 days from the date of supply or receipt of intimation, whichever is later.
- (b) In case of recipient units, not registered with Central Excise, a certificate evidencing the receipt of goods may be issued by the Chartered Accountant/Chartered Engineer. Central Excise officers are not required to issue any certificate in such cases.

For details visit: <http://cbec.gov.in/customs/cs-circulars/cs-circulars08/circ15-2k8-cus.htm>

II. Notifications

1. Notification No. 101 /2008-Customs (N.T.) dated 02.09.2008 has exempted all goods falling under the First Schedule to the Customs Tariff Act, 1975 when imported into India and intended for donation for the relief and rehabilitation of the people affected by the floods in the State of Bihar from –

- a. the whole of the duty of customs leviable thereon under the First Schedule to the said Customs Tariff Act; and
- b. the whole of additional duty

of customs leviable thereon under the section 3 of the said Customs Tariff Act,

subject to the following conditions, namely:-

- (i) it is certified by the importer on the relevant clearance documents that the goods are intended to be donated for the relief and rehabilitation of the people affected by the floods in the said State without making any charge therefore;
- (ii) the said imported goods are sent to the Central Government, the Government of Bihar; or as the case maybe, the relief agencies of the Central Government, the Government of Bihar including the relief agencies duly approved by the Government for the purpose; and
- (iii) the importer produces before the Deputy/Assistant Commissioner within six months from the date of importation of the said goods or within such extended period as the said officer may allow, a certificate from the District Magistrate of the affected area in the State of Bihar that the said goods have been donated for use for the aforesaid purpose.

This exemption shall remain in force upto and inclusive of the 28th February, 2009.

For details visit: <http://www.cbec.gov.in/customs/cs-act/notifications/notfns-2k8/cs101-2k8.htm>

2. Notification No. 105/2008-Custom dated 18.09.2008

In exercise of the powers conferred by sub-sections (1) and (5) of section 9A of the Customs Tariff Act, 1975, read with rules 18 and 20 of the Customs Tariff (Identification, Assessment and

Collection of Anti-dumping Duty on Dumped Articles and for Determination of Injury) Rules, 1995, the Central Government, hereby imposes anti dumping duty on the Maleic Anhydride (goods) which are exported from, the People's Republic of China, Chinese Taipei and Indonesia.

The anti-dumping duty imposed under this notification shall be effective from the date of publication of this notification in the Gazette of India. The anti-dumping duty shall be paid in Indian currency.

For details visit: <http://cbec.gov.in/customs/cs-act/notifications/notfns-2k8/cs105-2k8.htm>

3. Notification No.111/2008(NT)-Customs dated 26.09.2008

In exercise of the powers conferred by section 14 of the Customs Act, 1962, and in supersession of the notification of the Government of India in the Ministry of Finance (Department of Revenue) No.102/2008(NT)-Customs, dated 26.08.2008, except as respects things done or omitted to be done before such supersession, the Central Board of Excise and Customs hereby determines that the rate of exchange of conversion of each of the foreign currency specified in column (2) of each of Schedule I and Schedule II annexed to this notification into Indian currency or vice versa shall, with effect from 1st October, 2008 be the rate mentioned against it in the corresponding entry in column (3) thereof, for the purpose of the said section, relating to imported and export goods.

For details visit: <http://cbec.gov.in/customs/cs-act/notifications/notfns-2k8/csnt111-2k8.htm>

SERVICE TAX

I. Circulars

1. Circular No. 105/08/2008 - ST dated 16.09.2008

This circular proposed clarity in the field formations administering service tax as regards the applicability of service tax levy on units located in Special Economic Zones. These are:

1. Non-payment of service tax by SEZ units providing taxable service outside SEZ

SEZs units, providing taxable services to any person for consumption in DTA (or providing any taxable service which is otherwise not exempt), or is otherwise liable to pay service tax under the service tax law, take registration with the jurisdictional service tax authorities and discharge their service tax liability in terms of the Finance Act, 1994. In this regard a time bound survey may be undertaken by the jurisdictional Commissionerates to identify SEZ units which are providing any taxable service to a recipient for consumption outside SEZ, and if so whether or not, they are discharging ST liability correctly. This survey may be completed by 20.10.2008, and a report in this regard may be sent to DGST by 31.10.2008, positively.

2. Refund of Service Tax on taxable services used for the purposes of exports of goods by SEZ units

The SEZ units, claiming refund of service tax, should take registration with the jurisdictional ST authorities (i.e. service tax commissionerates in Delhi, Mumbai, Bangalore, Ahmedabad, Kolkata and Chennai and the jurisdictional central excise commissionerates elsewhere) and file their claims there.

For details visit: <http://www.servicetax.gov.in/stcirmainpg.htm>

II. Notifications

1. Notification No. 31/2008-ST (N.T.) dated 02.09.2008 has amended service tax return Form ST-3 in view of the insertion of sub-rule (1A) in rule 6 of the Service Tax Rules, 1994. Sub-rule (1A) empowers the assessee to pay advance service tax on his own volition and adjust the amount so paid against the service tax which he is liable to pay for the subsequent period.

For details visit: http://www.servicetax.gov.in/servtax_notfns_idx.htm

LEGAL DECISIONS¹

DIRECT TAXES

Section 5 of the Income-tax Act, 1961 - Capital or revenue receipt

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

Incentive subsidy received by the assessee is a capital receipt not includible in the total income

It is required to examine the Memorandum of Association, the Articles of Association, the Return of Income filed with the Department, the status of business indicated in such Returns etc. to grant exemption under Section 80 P(2)(a)(i) [Assessment Year 1986-87]

Commissioner of Income Tax, Madras vs. Ponni Sugars and Chemicals Limited (Supreme Court), 16 September, 2008

The issues before the Supreme Court were (i) whether the incentive subsidy received by the assessee co-operative society is a capital receipt not includible in the total income? and (ii) whether the assessee was entitled to exemption under Section 80 P(2)(a)(i) in respect of interest received from the members of the society?

The Supreme Court observed that the main eligibility condition in the scheme is that the incentive must be utilized for repayment of loans taken by the assessee to set up new units or for substantial expansion of existing units. On this aspect there is no dispute. If the object of the subsidy scheme was to enable the assessee to run the business more profitably then the receipt is on revenue account. On the other hand, if the object of the assistance under the subsidy scheme was to enable the assessee to set up a new unit or to expand the existing unit then the receipt of the subsidy was on capital account. Therefore, it is the object for which the subsidy/assistance is given which determines the nature of the incentive subsidy. The payment received by the assessee under the Scheme

was not in the course of a trade but was of capital nature.

As regards to exemption under section 80P the Supreme Court held that in order to earn exemption under Section 80P(2) a co-operative society must prove that it had engaged itself in carrying on any of the several businesses referred to in sub-section (2). In that connection, it is important to note that under sub-section (2), in the context of co-operative society, Parliament has stipulated that the society must be engaged in carrying on the business of banking or providing credit facilities to its members. Therefore, in each case, the Tribunal was required to examine the Memorandum of Association, the Articles of Association, the Return of Income filed with the Department, the status of business indicated in such Returns etc.. This exercise had not been undertaken at all.

Therefore, the impugned judgments of the High Court were set aside and the matters were remitted back to the Tribunal for de novo consideration in accordance with law. The appeals were partly allowed.

Section 32 read with Sections 80IB and 80HHC of the Income-tax Act, 1961 - Depreciation

One cannot exclude depreciation allowance while computing profits derived from a newly established undertaking for computing deductions under Chapter VI-A [Assessment year 2000-01]

Dabur India Limited vs. Commissioner of Income Tax, New Delhi (DEL), 1 September, 2008

The assessee is in the business of manufacturing herbal products and cosmetics. The Assessing Officer made the necessary adjustment in profits and gains returned by the assessee by deducting the depreciation in order to arrive at the eligible profits for purpose of deduction under sections 80IB and 80 HHC.

The High Court held that in arriving at the extent of the permissible deduction under section 80 IB and section 80HHC, the income which is to be considered is that which is calculated in accordance with the provisions of the Act alone. Thus, in calculating profits and gains of business 'derived' from the industrial

¹These 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 eboard@icai.org. For the convenience of readers full text of these cases have been hosted on the website of the institute at the link: http://www.icai.org/post.html?post_id=2583

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undertakings i.e., eligible businesses, under Section 80-IB or export business under section 80 HHC, one have to bear in mind the provisions of Sections 30 to 43D as referred to in Section 29, Section 80AB and Section 80B(5). A conjoint reading of these provisions leads to the conclusion that depreciation allowance under Section 32 will have to be deducted in arriving at the 'profits and gains' of business derived by an Assessee, from an industrial undertaking specified under Section 80-IB or export business under section 80 HHC.

The assessee can choose to declare and pay tax on a greater amount of income. Where, however, the assessee seeks to claim 'special deductions' under Chapter VI-A, there is no option available to the assessee,

but to provide for depreciation allowance while calculating the eligible profits and gains on which deduction is permissible under the provisions specified in Chapter VI-A.

The Court agreed with the decision of the Bombay High Court in *Indian Rayon Corporation Ltd. vs. Commissioner of Income Tax (2003) 261 ITR 98*, wherein it was held that one cannot exclude depreciation allowance while computing profits derived from a newly established undertaking for computing deductions under Chapter VI-A....appellant's claim for allowance of deduction under section 80HH, without taking into consideration the current depreciation will have to be rejected.

The appeals were dismissed.

Section 54F read with Section 2(7) and Section 54 of the Income-tax Act, 1961 - Capital gain on transfer of certain capital assets not to be charged in case of investment in residential house

An assessee, who after selling his old asset purchased and constructed new property in name of his adopted son, is not entitled for benefit of section 54F

Prakash s/o Timaji Dhanjode vs. Income Tax Officer (BOM) 12 September, 2008

The assessee (Deceased) sold his agricultural lands and purchased a plot in the name his only adopted son and built a house property thereon. The Income Tax Officer held that the assessee did not qualify for exemption and, therefore, he was liable to be pay capital gain taxes. The Commissioner allowed the appeal of the assessee and directed the Assessing Officer to compute relief in accordance with Section 54F.

The High Court observed that to avail the benefit of Section 54F right from the sale of original asset till the purchase and/or construction of the residential house i.e. the new asset, the ownership and domain over the new asset is a must. The new property must be owned by the assessee and/or having legal title over the same. The others may use and occupy the same

along with the assessee but the ownership should be of the assessee of the residential house so purchased from the net consideration/sale proceeds of the sale of original asset by the assessee.

In the instant case the deceased assessee admittedly, sold and purchased the property from the realisation but in the name of the adopted son, who in the scheme of the Act and Section 54F is not an assessee, who after selling the old asset purchased and constructed the new property. The deceased/assessee, admittedly, had no domain and/or right whatsoever on the said property. This fact itself, therefore, disentitled him to claim any exemption as there were various non compliances of the conditions as per the scheme of Section 54 and 54F of the Act.

Section 69A of the Income-tax Act, 1961 – Unexplained Money

Deemed income of the assessee under section 69A cannot be set off against loss due to confiscation of the foreign marked gold bars on the basis of which addition is made [Assessment year 1992-93]

Mahendra D. Jain vs. Income Tax Officer, Mumbai (BOM), 8 September, 2008

The assessee is in the business of making gold ornaments from the gold supplied to him by his clients. The business income of the assessee comprises only of labour charges received on making and polishing gold ornaments. The business premises of the assessee were searched and foreign marked gold bars were recovered and seized.

The High Court held that the assessee who was carrying on a lawful business in gold has committed infraction of law in smuggling gold into the country. Therefore, loss caused to the assessee pursuant to the confiscation of contraband gold cannot be said to be a trade or commercial loss connected with or incidental to the assessee's business. Assessee's claim to the

deduction of value of confiscated gold is unsustainable.

The word “income” used in Section 69A cannot be read only as business income as suggested by the Assessee. The revenue has correctly treated the value of gold as income of the assessee from undisclosed source and the same is not entitled to deduction on

the ground of business loss.

Therefore, the deemed income of the assessee under section 69A cannot be set off against loss due to confiscation of the foreign marked gold bars on the basis of which addition is made in the assessee’s assessment order.

The appeal was dismissed.

Section 115JA of the Income-tax Act, 1961- Deemed income relating to certain companies

Where debt is the amount receivable by the assessee and not any liability payable by the assessee then, any provision made towards irrecoverability of the debt cannot be said to be a provision for liability [Assessment Year 1997-98]

Commissioner of Income Tax-IV, Delhi vs. M/s HCL Comnet Systems & Services Ltd. (Supreme Court) 23 September, 2008

Assessee-company was engaged in trading in data communication equipment and satellite communication services. Assessee had debited an amount on account of bad debts to the ‘profit and loss account’. The AO added the aforesaid amount to the book profits as per *Explanation (c)* to Section 115JA on the ground that it was a provision for bad and doubtful debts. Appeal against the said order was allowed by the Commissioner and that was affirmed by the Tribunal as well as the High Court.

The Supreme Court observed that:

The provision for bad and doubtful debt can be added back to the net profit only if Item (c) stands attracted. Further, all the ingredients should be satisfied to attract Item (c) of the Explanation to Section 115JA.

There are two types of “debt”. A debt payable by the assessee is different from a debt receivable by the assessee. A debt is payable by the assessee where the assessee has to pay the amount to others whereas the debt receivable by the assessee is an amount which

the assessee has to receive from others. In the present case “debt” under consideration is “debt receivable” by the assessee.

The provision for bad and doubtful debt, therefore, is made to cover up the probable diminution in the value of asset, i.e., debt which is an amount receivable by the assessee. Therefore, such a provision cannot be said to be a provision for liability, because even if a debt is not recoverable no liability could be fastened upon the assessee. In the present case, the debt is the amount receivable by the assessee and not any liability payable by the assessee and, therefore, any provision made towards irrecoverability of the debt cannot be said to be a provision for liability. Therefore, Item (c) of the Explanation is not attracted to the facts of the present case. In the circumstances, the AO was not justified in adding back the provision for doubtful debts under clause (c) of the Explanation to Section 115JA.

Therefore, the appeal was dismissed.

Section 220 of the Income-tax Act, 1961- Collection and Recovery of tax- When tax payable and when assessee deemed in default

Where an assessee satisfied the three conditions laid down in Section 220(2A) [Assessment Years 1990-91 to 1995-96]

B.M. Malani vs. Commissioner of Income-tax & anr. (Supreme Court) 1 October, 2008

The Appellant had been carrying on money-lending business and trading in shares and securities. A raid was conducted and shares and a demand draft were seized. The appellant opted to pay taxes from out of the seized shares and securities stating that the shares be expeditiously disposed of and the sale proceeds therefrom be appropriated towards taxes. However,

the request of the appellant was not acceded to. The Department had taken the plea that unless the amount of tax due was ascertainable, the securities could not have been sold and the demand draft could not have been encashed. Interest under Section 220 (2) for the assessment years 1990-91 to 1995-96 was also levied. Appellant’s application for waiver of interest was

rejected by the Commissioner on the ground that the assessee did not satisfy all the three conditions which were required for allowing a waiver petition and the dues against the appellant could be crystallized only after passing of the order of the Settlement Commission 2.12.1999. The High Court rejected the writ petition filed against the order of the Commissioner.

The Supreme Court held that:

The Commissioner has the discretion not to accede to the request of the assessee, but that discretion must be judiciously exercised. He has to arrive at a satisfaction that the three conditions laid down in Section 220(2A) have been fulfilled before passing an order waiving interest. Compulsion to pay any unjust dues per se would cause hardship. But a question, however, would further arise as to whether the default in payment of the amount was due to circumstances beyond the control of the assessee.

Unfortunately, this aspect of the matter has not been considered by the learned Commissioner and the High Court in its proper perspective. The Department had taken the plea that unless the amount of tax due was ascertainable, the securities could not have been sold and the demand draft could not have been encashed. The same logic would apply to the case of the assessee in regard to levy of interest also. It is one thing to say that the levy of interest on the ground of non-payment of correct amount of tax by itself can be a ground for non-acceding to the request of the assessee as the levy is a statutory one but it is another thing to say that the said factor shall not be taken into consideration at all for the purpose of exercise of the discretionary jurisdiction on the part of the Commis-

sioner. Appellant volunteered that the securities be sold. Why the said request of the appellant could not be acceded to have not been explained. It was a voluntary act on the part of the appellant.

It was not even a case where sub-Section (3) of Section 226 was resorted to. As the offer was voluntary, the authorities of the Department subject to any statutory interdict could have considered the request of the appellant. It was probably in the interest of the revenue itself to realize its dues. Whether this could be done in law or not has not been gone into.

The same ground, however, was not available to the appellant in respect of the demand draft, as in relation thereto no such request was made. The demand draft was in the name of a Company. It may be true that when any document is seized, a presumption is raised that the same belongs to the person from whose possession or control it was seized as is laid down in Section 132(4A), but such a presumption is a rebuttable one. In the absence of any request made by the Assessee himself, probably at that point of time, the same could not have been encashed. Appellant did not own the same in law. He did not make any request for its encashment. Whether such a presumption should be raised or not was the subject matter of consideration by the Assessing Officer at the time of making its final assessment as the appellant himself filed an application before the Settlement Commission in terms of Section 245C(1).

Therefore, impugned judgment passed by the passed by the High Court of Judicature of Andhra Pradesh was set aside and the matter was remitted to the Commissioner of Income Tax for consideration of the matter afresh.

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

Non-consideration of a decision of Jurisdictional Court can be said to be a “mistake apparent from the record” which could be rectified under Section 254(2)

Assistant Commissioner, Income Tax, Rajkot vs. Saurashtra Kutch Stock Exchange Limited (Supreme Court), 15 September, 2008

A particular decision of the Jurisdictional High Court was not brought to the attention of the Tribunal while deciding the appeal. On Misc. application, the Tribunal held that there was a ‘mistake apparent from the record’ within the meaning of Section 254(2) and recalled its earlier order.

The Supreme Court observed that a patent, manifest and self-evident error which does not require elabo-

rate discussion of evidence or argument to establish it, can be said to be an error apparent on the face of the record and can be corrected while exercising certiorari jurisdiction. An error cannot be said to be apparent on the face of the record if one has to travel beyond the record to see whether the judgment is correct or not. An error apparent on the face of the record means an error which strikes on mere looking and does not need long- drawn-out process of

reasoning on points where there may conceivably be two opinions. Such error should not require any extraneous matter to show its incorrectness.

Further, non-consideration of a decision of Jurisdictional Court can be said to be a “mistake apparent from the record” which could be rectified under Section 254(2).

It is also well-settled that a judicial decision acts retrospectively. The law has always been the same. If a subsequent decision alters the earlier one, it (the later decision) does not make new law. It only discovers

the correct principle of law which has to be applied retrospectively. To put it differently, even where an earlier decision of the Court operated for quite some time, the decision rendered later on would have retrospective effect clarifying the legal position which was earlier not correctly understood.

Therefore, the Tribunal has not committed any error of law or of jurisdiction in exercising power under Section 254(2) and in rectifying “mistake apparent from the record”.

The appeal was dismissed.

Section 263 of the Income-tax Act, 1961 – Revision of orders prejudicial to revenue

Pendency of petitioner assessee’s appeal against a part of the assessment order would not be an impediment in Commissioner’s exercising his wide jurisdiction under s. 263 [Assessment Year 2005-06]

Raj Kumar vs. Union of India and Others (J&K), 23 September, 2008

The material collected during the course of Survey had revealed that the petitioner was not eligible to claim deductions under Section 80-1B in respect of IInd furnace at 100% because the said furnace was only an extension of the existing undertaking and no new industrial undertaking had been established. On the basis of this fact the Commissioner issued notice under section 263 and came to the conclusion that the assessment framed under Section 143(3) was erroneous because it was prejudicial to the interest of the revenue. On writ petition, the petitioner contented that Commissioner would have no jurisdiction either to issue the show cause notice or exercise power under Section 263, on the basis of the material collected during Survey Action under Section 133-A and part of the assessment order issued by the Assistant Commissioner being subject matter of petitioner-assessee’s appeal, before Commissioner (Appeals), the Commissioner would have no authority to exercise jurisdiction under Section 263.

The High Court observed that reading of Section 263, as a whole, would not, permit restrictive construction of the expression “record” to mean only that material which was available with the Assessing Authority at the time of passing of the assessment order, and not any other records/material which may come to the revisional authority’s notice on the basis of any proceedings under the Act, including those under Sec-

tion 133-A. In view of the plain and unambiguous language of Section 263 there was no merit in petitioner’s submission that while exercising jurisdiction under Section 263, the revisional authority cannot place reliance on the material collected after passing of the assessment order and during the Survey Action under Section 133-A.

The Parliament, in its wisdom, has not provided any restriction on the exercise of power under Section 263 of the Act and, in that view of the matter, pendency of petitioner assessee’s appeal against a part of the assessment order would not, thus, in my opinion, be an impediment in Commissioner’s exercising his wide jurisdiction under Section 263 of the Act to consider exercise or otherwise of his revisional jurisdiction, which may be exercised in case he had found that the order passed by the Assessing officer was erroneous insofar as it was prejudicial to the interest of the revenue.

Yet another reason which dissuades the High Court to exercise its extra ordinary writ jurisdiction is the availability of an alternative efficacious remedy of appeal to the Income Tax Tribunal to the petitioner in case the revisional authority’s order goes against him.

No case for admission of the writ petition to hearing has been made out by the petitioner. Hence, the writ petition is, accordingly, dismissed in limine.

Section 263 read with section 80HHC of the Income-tax Act, 1961 - Revision of orders prejudicial to revenue

Where view taken by the Assessing Officer was a possible view then condition precedent for invoking jurisdiction under section 263 by the Commissioner did not exist [Assessment Year 1995-96]

Commissioner of Income Tax, Mumbai vs. Design and Automation Engineers (Bombay) Private Limited (BOM), 19 September, 2008

The assessee is engaged in the business of exporting garments as well as sales in the domestic market. For the Assessment Year 1995-96 the Commissioner in its power under section 263 held that the deductions to the assessee can be granted only as per provisions of section 80HHC(3)(a) and since the Assessing Officer has not followed the above provision of law in the order under sec.143(3) while allowing the deductions under section 80HHC and as deduction allowed is higher than what is allowable, the order passed by the Assessing Officer is erroneous in so far as it is prejudicial to the interest of the Revenue.

The High Court observed that it is evident from the order of the Assessing Officer that he has considered all detailed particulars filed before him and after discussion allowed the deduction of the entire profit

earned by the assessee pertaining to his export business. The Commissioner has set aside the order of the Assessing Officer only on the ground that the Commissioner did not agree with the view taken by the Assessing Officer and took a view different than that taken by the Assessing Officer. It cannot be said that the Assessing Officer has not applied his mind while granting deduction to the assessee under section 80HHC as regards net profit earned by the assessee pertaining to their export business. The Tribunal is correct in its view that the view taken by the Assessing Officer was a possible view and that the condition precedent for invoking jurisdiction under section 263 by the Commissioner did not exist.

The appeal was dismissed.

Section 269UD of the Income-tax Act, 1961 – Purchase of immovable property by Government - Order by Appropriate Authority

Where no adequate opportunity to meet the case and to respond to the action as proposed to be taken by the authority was given, it is a gross breach of principle of natural justice.

Virendra, Wholesale Cloth Market, Nagpur vs. Appropriate Authority Income Tax and others (BOM), 11 September, 2008

Respondent-society published an advertisement inviting bids for purchase of the suit property. Out of nine bids the bid of the petitioner for purchase of suit property was the highest. After the Charity Commissioner granted necessary permission an agreement was signed. Accordingly, Form No. 37-I was submitted to Appellate Authority. However, the Appellate Authority issued a show cause under section 269UD and accordingly passed an order under Section 269UD(1) and Section 268 UE(2) for pre-emptive purchase of the suit property.

The High Court held that the show-cause notice was vague. There is no material including any sale instance referred therein. No copy of any document relating

to the sale instance, even if any, was furnished to the petitioner along with the notice and/or at any time whatsoever. No justification and/or details were provided to purchase the property in question, which is a gross breach of principle of natural justice as no adequate opportunity to meet the case and to respond to the action as proposed to be taken by the authority was given. Further, such vague show-cause notice deprives the parties to oppose and to raise appropriate defence to the proposed action as there was not a tentative or prima facie view of the value of the property referred therein. There was no material whatsoever to justify that the transaction was undervalued and the basis for the conclusion which was arrived at.

The writ petition was allowed.

Section 278B of the Income-tax Act, 1961 - Offence and prosecution – Offences by Companies

Petitioners, who were not director-in-charge during the commission of offence could not be made liable prosecution within the purview of section 278B(1)

K.C. Palaniswamy and Another vs. Income Tax Officer (DEL), 5 September, 2008

From the books of accounts it was found that for the financial year 2003-04, the Company had deducted tax at source under several heads, but had not depos-

ited it with the Government Treasury. A complaint was filed under Section 279 B read with Section 279 against the company as well as 16 other persons who

were described as Directors or Senior Officers of the said Company. The petitioners filed a petition under Section 482 of the CrPC with the contention that at the time of the alleged commission of offence by the company neither of them was a director in-charge of the affairs of the company or responsible to it for the conduct of its business.

The High Court observed that the section 278B is a penal provision and it is required to be strictly construed. That provision itself does not state that the offence could be a continuing one. On the other hand the language of the provision indicates to the contrary. The language of the provision supports the position that the offence of a failure to deduct or remit the TDS is a one-time offence and not a continuing one. Even assuming that the concept of a continuing

offence, which is usually invoked for the purposes of limitation, is extended ipso facto to fasten liability, it can at best apply to the company in respect of which the offence is “continuing” and not to its Directors who may come on to the Board of the company subsequent to the commission of the offence by the company. This is also indicated from the language of Section 278B(1) which uses the past tense when it talks of “every person who, at the time the offence was committed, was in charge of, and was responsible to, the company...”. The petitioners were not the directors of the Company for the financial year ending 31st March 2004 for which alone the demand has been raised. Therefore, they cannot be made liable for the offence by the Company for that year.

The petition was allowed.

INDIRECT TAXES

Excise & Customs

Section 4 of the Central Excise Act, 1944 - Valuation of excisable goods for the purposes of charging of duty of excise
Merely because the product could be put to cosmetic use that would not by itself make it a cosmetic product

Commissioner of Central Excise, Delhi vs. Ishaan Research Lab Private Limited and Others (Supreme Court), 8 September, 2008

In the present case, the Tribunal held that the products manufactured by the respondent were covered under the Central Excise Tariff Sub-heading 3003.30 and not under Chapter 33 of Central Excise Tariff. Hence, the products would invite the duty as “Ayurvedic medicines” at the rate of 10% ad valorem and not at the rate of 40% ad valorem as claimed by the Revenue. The contention of the Revenue was that the products were cosmetics such as skin beautification creams, lotions, moisturisers, shampoos, etc., and were as such the “cosmetics” and “toilet preparations” chargeable to 40% duty.

The Supreme Court observed that the products con-

tained the elements having Ayurvedic medicinal value. All the products were produced under the drugs licence issued under the Drugs and Cosmetics Act, 1940. There was a claim made in each of the label of the medicinal properties of the product and there was a specific claim that it was not a cosmetic product. Merely because the product could be put to cosmetic use that would not by itself make it a cosmetic product provided there was a rightful claim made that it was an Ayurvedic product on the factual basis, and it contained the medicinal Ayurvedic medicament. The products were medicinal products covered by Chapter 30 and not under Chapter 33.

The appeals were dismissed.

Section 35B of the Central Excise Act, 1944 - Appellate Tribunal - Appeals to

Facet of “sufficient cause” of the Limitation Act applies as Section 35B(5) provides power to the appellate Tribunal to admit an appeal even after expiry of the relevant period, if it is satisfied that there was sufficient cause for not presenting within that period

Uniworth Textiles Limited, through its General Manager, Nagpur vs. Commissioner of Central Excise and Customs, Nagpur and another (BOM), 12 September, 2008

The appellant filed an appeal against the order of the Commissioner (Appeals) wherein it was held that the appellant was liable to pay Additional Excise Duty (Goods of Special Importance) as there was no ex-

emption available. An application for condonation of delay was also filed as there was delay of 65 days. The Tribunal declined to condone the delay which was upheld by the Single Judge.

The High Court observed that when the Legislature has clear intention to give strict meaning or particular meaning to a particular provision as provided in Section 35, it cannot be extended to section 35G which has no such clause or provision. On the contrary as recorded, clause (5) of Section 35B provides power to the appellate Tribunal to admit an appeal even after expiry of the relevant period, if it is satisfied that there was sufficient cause for not presenting within that period. Therefore, the facet of “sufficient cause” of the Limitation Act applies. There is no such bar. The present section nowhere provides any such strict provision as provided in Section 35 of the Act. It is

clear interpretation of that section, which cannot be extended to Section 35B.

In the instant case the delay was because of the change of Officers and the new officer took some time to take decisions and only after going through the record and especially after having knowledge of the records. Hence, there was no intentional delay. Even otherwise, considering the fact that there is delay of 65 days and as case is made out, there is no reason that the said delay should not be condoned and opportunity should not be given to the petitioner.

The appeal was allowed.

Chapter 32 of the Central Excise Tariff Act, 1985 - Products of Chemical & Allied Industries

Marker inks would fall under CSH 3215.10 and are exempt from payment of excise duty

Camlin Limited vs. Commissioner of Central Excise, Mumbai (Supreme Court), 3 September, 2008

The present case deals with classification of the “writing inks” manufactured and captively consumed by the assessee and consequent duty demand thereon. The assessee manufactures various kinds of marker pens and sketch pen sets. The Tribunal held that the “marker ink” are not “writing inks” and, therefore, would be covered by Chapter sub-heading 3215.90 and, consequently, exigible to 16% of excise duty.

The Supreme Court observed that when the entries in the HSN and the Indian Tariff Entry are not aligned, reliance cannot be placed upon HSN for the purpose of classification of goods under the Tariff. Marker inks would fall under CSH 3215.10 as the same are used in marker pens which are exempt from the payment of excise duty.

The appeals were disposed of.

Sales Tax / VAT

Section 5 of the Central Sales Tax Act, 1956 - When is a sale or purchase of goods said to take place in the course of import or export

Matter remitted to the High Court as important question remained unanswered

Commissioner of Sales Tax vs. Tata Iron and Steel Company Limited (Supreme Court), 16 September, 2008

There were two contracts, one was between the respondent and the Indian buyer(s) and the other between the respondent on one hand and Tata Inc. (USA) on the other hand. The Department sought to levy sales tax on sales made by the respondent in favour of Indian buyer(s). The respondent challenged the same on the ground that the sale had occasioned the import and consequently, fell within the first limb of section 5(2).

The Supreme Court held that since the question whether the sales were in any event exempt under the second limb of section 5(2), remained unanswered by the High Court, it was not necessary to examine the question as to whether such sales stood exempted under the second limb of Section 5(2). The matter was remitted back to the High Court.

The appeal was allowed.

Section 37 and Section 38 of the Tamil Nadu General Sales Tax Act, 1959 - Appeal - Jurisdiction of High Court

High Court will have jurisdiction to entertain appeal or revision under Sections 37 and 38 of the TNGST Act, 1959, as the provisions re-emerged as they stood prior to coming into force of Tamil Nadu Taxation Special Tribunal Act, 1992

Commercial Tax Officer, Chennai vs. C. P. D. Computer Peripheral Devices Private Limited, Represented By Director, S. V. Nagendra, Chennai and others (MAD), 2 September, 2008

Issue before the Court was “Whether the High Court has jurisdiction to entertain Tax Case appeal or revision under sections 37 and 38 of the Tamil Nadu General Sales Tax Act, 1959 (1959 Act) after Tamil Nadu Taxation Special Tribunal Act, 1992 (1992 Act) was repealed by Tamil Nadu Taxation Special Tribunal (Repeal) Act, 2004 (Repealing Act)”.

The High Court observed that the 1992 Act has been repealed in its entirety and it is a case of total repeal or pro tanto repeal. As per Section 3 of the Repealing Act, on and from the date of commencement of the repealing Act, all the matters and proceedings pending before the Tamil Nadu Taxation Special Tribunal on the said date shall stand transferred to the High Court and the High Court shall proceed to deal with such matter or proceeding from the stage at which it is transferred or from any earlier stage or de novo as the High Court may deem fit.

The intention of the Legislature is clear that on the coming into force of the repeal of 1992 Act, the original provisions that were eclipsed during the currency of 1992 Act have again come into operation, in the sense, the superimposition of the word “Special Tribunal” for the words “High Court”, faded out by giving way to the word “High Court” and the High Court has jurisdiction to entertain appeal or revision filed under Section 37 and 38 of the 1959 Act. By means of re-introduction of Section 39, the same has to be considered by a Division Bench of the High Court.

Therefore, on and from the date of repeal of 1992 Act, the High Court will have jurisdiction to entertain appeal or revision under Sections 37 and 38 of the 1959 Act, as the provisions re-emerged as they stood prior to coming into force of 1992 Act.

The application was disposed of.

Section 3F of the Uttar Pradesh Trade Tax Act, 1948 - Rate of tax on the right to use any goods or goods involved in the execution of a works contract

Delivery of possession is sine qua non to invoke section 3F [Assessment Years 1990-91, 1991-92, 1992-93 and 1993-94]

Commissioner, Trade Tax, Uttar Pradesh, Lucknow vs. Nand Transport Company (ALL), 14 September, 2008

The respondent a transport company owing tankers, entered into an agreement with Indian Oil Corporation for the transportation of petroleum products from one place to another and received transportation charges. The assessing authority levied tax on the transportation charges on the ground that the tankers were provided on hire for the transportation of the petroleum products. Thus, there was transfer of right to use the tankers and, therefore, such charges were

held liable to tax under section 3F.

The High Court held that for the transfer of right to use the goods and to invoke the provisions of section 3F, it is necessary that there should be transfer of effective control of the goods in favour of the party. Unless possession and control of the goods is transferred, there cannot be transfer of right to use the goods under section 3F.

The revisions were dismissed.

OTHER ACTS

Arbitration Act

Section 45 of the Arbitration and Conciliation Act, 1996 - Power of judicial authority to refer parties to arbitration

Where a charter party agreement existed between the parties

Shakti Bhog Foods Limited vs. Kola Shipping Limited (Supreme Court), 23 September, 2008

In the present case, an appeal was made against an order referring the dispute between the parties to arbitration in London under the provisions of the English Arbitration Act, 1996. A Charter Party Agreement existed between the parties and it contained a clause with regard to the arbitration. However, the appellant

contended that there was no arbitration clause in the Charter Party Agreement.

The Supreme Court observed that on records there existed a charter party between the parties to the suit, as per Section 45, which could be identified from the correspondence between the parties to that effect as

also from the fixture note and the bill of lading signed by the parties. As per the provisions of Section 45, it is clear that at the request of one of the parties or any person claiming through or under him the court shall refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

In the present case, there appears to be no such thing to say that the so called agreement entered into by the parties is in any way to be termed as null and void or inoperative or incapable of being performed. It is further observed by us that the claims raised by the appellant before us about the non-existence of the charter party agreement can also be raised by the same before the arbitral tribunal at London. Under the English Arbitration Act 1996, as per Sections 30 and 31 of the said Act, the arbitral tribunal may rule on its own jurisdiction and also can decide on the existence of a valid arbitration agreement. This

is similar to the provisions under Section 16 of the Act, whereby the arbitral tribunal can decide on its jurisdiction as also on the existence or validity of the arbitration agreement.

Taking all the matters into consideration and after examining all the materials on record, it is necessary to mention that all the facts regarding the existence of the Charter Party Agreement have been extensively deliberated in the courts below and the said courts have unilaterally accepted that there exists a Charter Party Agreement between the parties. No grounds have been raised in this appeal by the appellant satisfying us also that from the records, it could be said that there was no existence of any Charter Party Agreement between the parties. We, therefore, do not find any reason to interfere with the concurrent orders of the courts below and thus, the impugned order must be affirmed.

The appeal was dismissed.

Consumer Protection Act

Section 2(1)(d) read with Section 2(1)(o) of the Consumer Protection Act, 1986 read with Section 1 of the Employees' Provident Funds and Misc. Provisions Act, 1952 – Consumer

An employee by becoming a member of the Employees' Family Pension Scheme, 1971 is a 'consumer' within the meaning of Section 2(1)(d)(ii)

Regional Provident Fund Commissioner vs. Bhavani (Supreme Court) April 22, 2008

The respondent-employee, a member of the Employees' Provident Fund and Family Pension Scheme, 1971, and was making contribution to the Scheme. In her service records maintained by the company her date of birth was shown as 31.12.1935. Aggrieved by the failure and/or the refusal of the Regional Provident Fund Authorities to release pension to her, she filed an application before the District Consumer Disputes Redressal Forum (District Forum). The appellant's contentions were that i) the Consumer Protection Act, 1986 (the Act), would have no application to a claim made under the Employees' Provident Funds and Misc. Provisions Act, 1952 (1952 Act), inasmuch as, the respondent was not a "consumer" within the meaning of Section 2(d) of the Act; ii) according to the records the respondent had attained the age of 60 years in 1992 before the Employees' Pension Scheme Act, 1995, came into operation. The District Forum held that the date of birth of the respondent in the

records of the company was 31.12.1935 and she was eligible for the benefits of the 1995 Scheme and thus, denial of the same amounted to deficiency of service which would attract the provisions of the Act. The District Forum on considering the provisions of Section 2(1)(d) (ii) of the Act, observed that the definition of "consumer" therein was not exhaustive and Section 2(1)(o) exempts only such services as are rendered free of charge or under a contract of personal service. The order of the District Forum was upheld by the State Commission as well as the National Commission.

The Supreme Court as regards to employee's date of birth observed that the dates of birth of the respondents as recorded in their service records with the company are the correct dates of birth of the employees and not the dates of birth as entered in the records of the appellant.

As regards to application the provision of the Consumer Protection Act observed that the Regional Provident Fund Commissioner, who is the person responsible for the working of the 1995 Pension Scheme, must be held to be a 'service giver' within the meaning of Section 2(1)(o) of the Consumer Protection Act. Nor is this a case of rendering of free service or rendering of service under a contract of personal service so as to bring the relationship be-

tween the appellant and respondent within the concept of 'master and servant'. Thus, the respondent comes squarely within the definition of 'consumer' within the meaning of Section 2(1)(d)(ii), inasmuch as, by becoming a member of the Employees' Family Pension Scheme, 1971, and contributing to the same, she was availing of the services rendered by the appellant for implementation of the Scheme.

M RTP

Section 36A of the Monopolies and Restrictive Trade Practices Act, 1969 – Unfair trade practice

Appellant would not acquire any legal right as only a plot was reserved subject to holding of a lottery for the specific plots for allotment however she would be entitled for interest at the rate 18 per cent and not 5 per cent

Manjul Srivastava vs. Government of Uttar Pradesh and Others (Supreme Court), 29 August, 2008

The appellant applied for allotment of a residential plot by the GDA/respondent in its Govindpuram Housing Scheme of the year 1988. The GDA issued a Reservation Letter to the appellant reserving plot in her name. The appellant deposited the entire balance amount with the GDA but she was not put in possession of any plot. The appellant received a Registered Letter from the GDA informing her that she had not been allotted a plot in the Scheme and that the amount deposited by her with the GDA would be refunded with 5% interest. During pendency of the application before the Monopolies and Restrictive Trade Practices Commission, the GDA had issued a Cheque to the appellant towards the amount deposited by her along with interest at the rate of 5%. The appellant received the cheque under protest, but subsequently returned the entire amount by drawing another cheque for the like amount in favour of the GDA. The application was rejected by the Commission primarily on the ground that the appellant not being an "allottee" from the result of the draw held, she was not entitled to any plot, as claimed, and, therefore, the charge of "unfair trade practice" against the GDA could not be established.

The Supreme Court held that the final allotment was to be made as regards specific plots only after the lottery related to such allotment was made. In the draw of lottery, the appellant was unsuccessful as her name did not figure in the same. A plot was reserved for her subject to the final allotment after the

lottery related to such allotment was made. Since the appellant was not allotted any plot and only a plot was reserved subject to holding of a lottery for the specific plots for allotment, the appellant would not acquire any legal right to such plot, only she would be entitled to get refund of her amount deposited with the GDA.

Further, from the brochure itself, it would be clear that in the event, the appellant could not deposit the entire amount after the allotment is made within certain time, 18 per cent interest shall be levied on the appellant. It is an admitted position that the appellant deposited the entire amount as directed by the GDA in the year 1989 and the order of cancellation of reservation of a plot in favour of the appellant was made after more than seven years and, therefore, it was held that the respondent was liable to pay interest not at the rate of 5 per cent but at the rate of 18 per cent. In the facts of the present case, since the GDA had utilized the entire amount of the appellant for their own purpose till they had refunded the amount to the appellant, the order of the Commission confirmed holding that there was no "unfair trade practice", but in the facts and circumstances of the case, these appeals were allowed in part and directed the respondent to refund the money already deposited with the GDA with interest at the rate of 18 per cent and not at the rate of 5 per cent.

The appeals were allowed in part.

DISCIPLINARY CASE

Summary of a disciplinary case The Institute of Chartered Accountants of India Vs. Shri P.V.Mehta¹ (Chartered Accountant Reference No. 3 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 Department of Customs, Government of India (hereinafter referred to as 'Complainant') filed a complaint against Shri P.V.Mehta, Chartered Accountant (hereinafter referred to as 'Respondent') under Section 21 of the Chartered Accountants Act, 1949 (hereinafter referred to as the 'Act') to the Institute of Chartered Accountants of India (hereinafter referred to as the 'Institute') alleging, inter alia, that the Complainant's Department while investigating into cases of some fraudulent imports and clearances had come across a case of issue of false certificates to several parties viz. M/s United Mechanical Works, M/s Laxmi Engineering Works & Others for past exports, by the Respondents for monetary considerations, without verifying any supporting records or documents. On the strength of these false certificates, certain unscrupulous importers were able to obtain import licences, effect imports and clear these free of duty, perpetuating a fraud on Government revenue and depriving the Government of its legitimate revenue to the tune of several crores of rupees.

The Complainant further alleged that the Respondent in his statements recorded in January 1990, under Section 108 of the Customs Act, 1962, had confessed to the above and had also disclosed to have issued these certificates on the instance of another Chartered Accountant, Shri Kamal N. Kanodia. In his statements recorded under Section 108 of the Customs Act, 1962, Shri Kamal N. Kanodia, also confessed his role in this affair as well as the fact that he also got a share in this deal of issuing false certificates.

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 of evidence and hearing of the submissions made by the Respondents came to the conclusion that the Respondent was grossly negligent under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

The Council on consideration of the report of the Disciplinary Committee alongwith the written representations of the parties, accepted the Report of the Disciplinary Committee and found that the Respondent was guilty of professional misconduct within the meaning of Section 21 read with Section 22 of the Chartered Accountants Act, 1949 and clauses (7) of Part I of the Second Schedule to the said Act. The Council recommended to the High Court that the name of the Respondent be removed from the Register of Members for a period of one month. As required under Section 21(5) of the Act, the matter was referred 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 in his examination before the Disciplinary Committee the Respondent admitted that he did not verify the books nor did he verify the turnover of the concerns viz. M/s United Mechanical Works, M/s Laxmi Engineering Works and others. His explanation was that he issued the export performance cer-

tificate relying upon Mr. Kanodia who was said to have referred to him that he was internal auditor of the concerns. According to the Respondent, Mr. Kanodia brought the certificates and he signed the said certificates. The Hon'ble Court also observed that in his statement recorded under Section 108 of the Customs Act, the Respondent admitted that the certificates were issued by him without verifying the relevant records or documents and that he did not examine the correctness expected of a professional chartered accountant and he signed the said certificates without knowing the contents to be true. The Court was of the view that these facts are eloquent enough to hold the respondent guilty for professional misconduct under Clause (7) of Part I of Second Schedule.

The Hon'ble Court, accordingly, concurred with the finding recorded by the Disciplinary Committee and accepted by the Council that the respondent is guilty of professional misconduct within the meaning of Clause (7) of Part I of the Second Schedule of the said Act. As regards the recommendation of the Council that the name of the respondent be removed from the register of members for the period of one month, the Court observed that the Respondent had chosen not to appear to show-cause why the recommendation of the Council be not accepted by the Court. Looking to the misconduct committed by the Respondent, the Court was of the view that the recommendation of the Council cannot be said to be disproportionate.

On overall consideration of the entire material, the Hon'ble Court accepted the recommendation of the Council & ordered that the name of the respondent be removed from the register of members for a period of one month.

¹For full text of the Judgment please see Institute's publication viz. Disciplinary Case Vol.VIII, Part I, p. 786

Abuse of Dominance: An Offence Under Competition Act, 2002

Dominance is the ability of a firm to influence market, make price rise and create monopoly much to the disadvantage of consumers. Abuse of the dominance is a grave offence under Competition Act, 2002. The article explores the provisions of section 4 of the Competition Act, 2002, which prohibits abuse of dominant position by dominant enterprises in India. It also explains the meaning of the term 'dominance', provisions of the Act in relation thereto, investigation approach, and the likely consequences on abuse of dominance.

There is an inherent tendency amongst the large business firms to further strengthen their position by exploiting market power possessed by them. This purpose can be achieved by restricting or eliminating competition in the market. The market power possessed by the firm is also re-

ferred to as 'Dominance' in legal parlance. The *modus operandi* that is followed to achieve the purpose of exploitation of market power in order to eliminate existing competitors and to restrict entry of new competitors with the motive to attain monopoly is referred to as abuse of dominance. A firm can abuse its dominance in various ways, say by imposing unfair or discriminatory



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In case an enterprise or a group is found to have been abusing their dominance then in that case Competition Commission of India has been empowered to pass the necessary orders, levy heavy penalty and even order for division of the enterprise. Thus, it will be in the interest of the enterprises to keep themselves aware as to what constitutes dominance.

conditions in purchase or sale of goods or provision of services; by restricting or limiting production, market, technical and scientific development to the prejudice of consumers; indulging in practices which would deny market access to the new firms; enforcing unreasonable conditions in contracts, or by utilising dominant position in one market to protect position in another market.

Abuse of dominance is a form of anti-competitive practice. The strong firms using their dominance try to eliminate weaker competitors, restrict entry of new competitors and as a result attempt to monopolise the market to their benefit. As a result of their attaining monopoly, direct effect is on the consumer welfare and benefit. Thus, there is a need to protect consumer interest by not allowing the dominant enterprises to abuse their dominance.

Since 1991, in the wake of globalisation, Indian economy has undergone drastic economic reforms as reflected by various path-breaking measures like de-licensing, direct foreign investments, technology imports, putting an end to certain state owned monopolies, permitting private players' entry in the core sectors like civil aviation, insurance, banking etc.

As a result, there has been a significant growth not only in the number of local but also foreign firms in the Indian markets. Consequently Indian industries have been thrown open to face tough competition not only from local but also from foreign firms. In order to survive in this competitive atmosphere, there will be a natural tendency amongst the enterprises to find ways and means to retain and expand their market share and to dominate market. In case the purpose is not fulfilled by legitimate means, the firms may resort to other illegal recourse like abusing their dominant position. The ultimate sufferer of all these activities is the consumer who has to procure goods or avail services at uncompetitive prices.

Protection of consumer interest or consumer welfare is the ultimate goal of any state. Thus in or-

der to keep a vigil on the activities of the market players, till date about 105 countries worldwide has enacted competition laws or anti-trust laws. In India the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act) has been dealing with the competition issues. In the changing economic environment, considering the limitations of that Act, and in order to cope up with the recent developments, a new Act known as Competition Act, 2002 (hereinafter referred to as the "Act") has been enacted to deal with competition issues in India. On becoming operational, the Act will repeal the MRTP Act, 1969. The Act has been recently amended by Competition (Amendment) Act, 2007. It is now all set to become operational. For its purpose, a quasi-judicial body called Competition Commission of India, (hereinafter referred to as "CCI" has been established.

Under the MRTP Act, there were restrictions on the firms to grow beyond a particular size, so that there would not be any dominant players in the market and consequently there won't be any issue of abuse of dominance. However, as result of globalisation, in order become internationally competitive it is necessary for the Indian firms to grow in size. Hence under the new Act, there has been no restriction on the firms to grow beyond a particular size. The restriction imposed is dominance if achieved should not be abused.

Section 4 of the Act deals with abuse of dominant position by an enterprise. In case an enterprise or a group is found to have been abusing their dominance, which causes or is likely to cause appreciable adverse effects on competition in India then in that case CCI has been empowered to pass the necessary orders, levy heavy penalty and even order for division of the enterprise. Thus, it will be in the interest of the enterprises to keep themselves aware as to what constitutes dominance, when dominance can be said to have been abused and what are the likely consequences in case an enterprise is found to have been abusing its dominance.

Size of an undertaking or its market share will not be a deciding factor, but its behaviour which has the effect of eliminating existing competitors or restricting entry to new competitors in the relevant market will be a deciding factor in order to justify whether the dominance has been abused. Charging or paying unfair prices, quantitative restrictions, restrictions on market and technical development are some examples of activities indulged into by the enterprises to abuse their dominance.

What is Dominance?

Dominance is the ability of a firm to influence market and make price rise. The M.R.T.P. Act, 1969, defined a dominant undertaking as an undertaking which by itself or along with interconnected undertakings produces, supplies, distributes or controls not less than 1/4th of the total goods produced or services rendered in India.

Thus under the MRTP Act, irrespective of the product or service, dominance was stuck up at a figure of 25 % of the market share. However, the Act does not give any quantification of the term. In *Explanation* to section 4(2) "Dominant Position" has been defined as a position of strength enjoyed by an enterprise, in the relevant market, in India, which enables it to:

- (i) Operate independently of competitive forces prevailing in the relevant market; or
- (ii) Affect its competitors or consumers or the relevant market in its favour.

Thus, it can be seen that under the Act, the determination of dominance on the basis of calculation of mathematical figures has been done away with. Instead, it is a relative term and has to be worked out depending upon industry-to-industry and market-to-market.

The Central Government under the Chairmanship of Shri S.V.S. Raghavan had set up a High Level Committee on Competition Policy and Law. The Committee in its report submitted on 22nd May, 2000, has observed that the definition as above may appear to be somewhat ambiguous and prone to different interpretations by different judicial authorities. But the ambiguity has justification having regard to the fact that even a firm with low market share of 20% with remaining 80% diffusedly held by a large number of competitors may be in a position to abuse its dominance, while a firm with 60% market share with 40% held by a competitor may not be in a position to abuse its dominance

because of the key rivalry in the market. Specifying a threshold or an arithmetical figure for defining dominance may either allow real offenders to escape (like in the first example as above) or result in unnecessary litigation (like in the second example as above). Hence, in a dynamic changing economic environment, a static arithmetical figure to define dominance will be an aberration. With this suggested broad definition, the Authorities/Tribunals concerned would have the freedom to fix errant undertakings and encourage competitive market practices even if there is a large player around (Para 4.4-5 of Report of the High Level Committee on Competition Policy and Law).

It can thus be seen that the Act does not frown upon dominance but frowns upon abuse of dominance. At the same time responsibility has been fixed on the adjudicating authorities to define dominance from case to case. Thus, the undertakings will have to remain cautious, while framing and executing their trade policies, so that they will not be caught for abusing their dominance.

When Can Dominance be Said to Have Been Abused

As has been clear that under the Act, size of an undertaking or its market share will not be a deciding factor, but its behaviour which has the effect of eliminating existing competitors or restricting entry to new competitors in the relevant market will be a deciding factor in order to justify whether the dominance has been abused. Thus, what behaviour would amount to abuse of dominance will have to be taken into consideration. Charging or paying unfair prices, quantitative restrictions, restrictions on market and technical development are some examples of activities indulged into by the enterprises to abuse their dominance. The Act in section 4(2) provides that there shall be an abuse of dominant position if an enterprise or a group:

- (a) directly or indirectly, imposes unfair or discriminatory

In absence of any specific criteria of dominance, while framing trade policies, the firms will have to remain utmost cautious, so that on executions of such policies, their decisions do not fall within the ambit of abusing their dominance, which has stringent after effects.

- (i) conditions in purchase of sale or goods or services; or
- (ii) price in purchase or sale (including predatory price) of goods or service
- (b) limits or restricts
 - (i) production of goods or provision of services or market therefore; or
 - (ii) technical or scientific development relating to goods or services to the prejudice of consumers; or
- (c) indulges in practice or practices resulting in denial of market access [in any manner]; or
- (d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or
- (e) Uses its dominant position in one relevant market to enter into, or protect other relevant market.

Thus action on the part of an enterprise to enjoy favourable market conditions at the detriment of the competitors or which will cause a threat to the consumer benefit and interest would be covered under abuse of dominance. In case an enterprise is found to have been indulging in any of such activities as listed above, as a result of which there is an appreciable adverse effect on competition in India is strictly prohibited under the Act.

Approach for Investigation by Authorities Concerned

Investigation under the Act shall be carried out by CCI. It shall conduct an enquiry in any matter, either on receipt of any information, or on reference made by Central or any State Government or a statutory authority or even *suo motu*.

Section 18 of the Act casts duty upon CCI “to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interest of the consumers and ensure freedom of trade carried on by the participants, in the mar-

ket in India.” Keeping in view this obligation, the investigation under the Act shall be carried out.

It will be a challenging task before the authority concerned to determine on the basis of facts and figures put before it to conclude as to whether the undertaking is a dominant undertaking and whether the practices indulged into by it amounts to abuse of dominant position. In absence of any fixed quantitative terms, the errant undertaking will always take the plea that it is not dominant at all and hence there is no need to have further investigation. Thus, the investigating authority will have to first decide whether the undertaking is dominant and then to analyse its behaviour to determine whether there is abuse of its dominance or not.

For deciding whether there is abuse of dominance it will be necessary to go in a phased manner. It consists of:

- 1) Ascertainment of Relevant Market.
- 2) Determination of existence of Dominant Position.
- 3) Assessment of specific harmful conduct.

1) Ascertainment of relevant market: Initially it will have to be ascertained as to what is the relevant market. A relevant market may be either a geographical market or a product market. A geographical market determines the boundaries of geographical area within which the competitors are based to provide effective competition to the dominant firm which may consist of a small area, a district, a state, a nation or even the world all over. Relevant product market is a market which comprises all those products or services which are either interchangeable or operate as substitutes, by reason of their characteristics, services, prices or intended use. Say a moped can be an interchangeable or substitute product for a motorcycle.

2) Determination of existence of Dominant Position: On ascertaining the relevant geographical as well as product market, the next step will be to determine the existence of dominant position. A firm may attain dominance by virtue of

various factors that are in its favour. These factors may include superior product quality, better workmanship, low cost of production resulting in low selling price, possession of intellectual property rights, R & D, efficient after sales service etc. The list is only descriptive and not exhaustive.

Apart from these overriding favourable factors, irrespective of the fact that the product or service and other factors may be *at par* with the competitors but with other factors say like innovative advertising, dynamic management, effective selling staff may help the firm to achieve dominance. In India tradition and customary also play a vital role in product choice and preferences, which also help the firms to achieve dominance.

3) Assessment of alleged harmful conduct: After verifying the various factors as above, if the authority concerned reaches to the conclusion that the firm is enjoying a dominant position in the relevant market, then finally it will have to ascertain as to whether alleged conduct of the undertaking tantamount to abuse of its market dominance. If it is observed that the firm is abusing its dominance, which is causing appreciable adverse effects on competition within India, then action will be taken as provided in the Act.

Remedial Actions /Penal provisions

If as a result of investigation, any undertaking or a group is found to have abused its dominance then in that case CCI may direct an enterprise or association of enterprises or person or association of persons that may be involved to discontinue such abuse of dominant position. It may also impose a rigorous penalty, which may extend to ten per cent of the average turnover for the last three preceding financial years, upon such person or enterprises, which are party to abuse. The CCI may pass such orders and further direct that enterprise concerned shall abide by such orders and comply with the directions, including payment of costs, if any (section 27).

Further, as per the provisions of section 28, CCI may direct division of enterprise enjoying dominant position in order to ensure that such enterprise does not abuse its dominant position. The division of enterprise shall be carried out by:

- (a) Transfer or vesting of property, rights, liabilities or obligations;

- (b) Adjustment of contracts either by discharge or reduction of any liability or obligation or otherwise;
- (c) Creation, allotment, surrender or cancellation of any shares, stocks, or securities.
- (d) Formation or winding up of an enterprise or the amendment of the memorandum of association or articles of association or any other instrument regulating the business of any enterprise;
- (e) Extent to which, and the circumstances in which, the provisions of the order affecting an enterprise may be altered by the enterprise and registration thereof;
- (f) any other matter which may be necessary to give effect to the division of the enterprise.

Thus, an errant enterprise will face not only cease and desist orders but may also be required to pay heavy penalty and also face division. Thus it will always be in the interest of the enterprises to refrain from indulging in abusing their dominance, since the short-term benefit may be wiped off by the heavy penalty levied and orders passed by the CCI.

Conclusion

Abuse of dominant position has been identified as an anti-competitive practice world wide and in a fast developing economy like India where chances to grow are still large, there will always be temptation on the part of the enterprises to adopt a short cut of abusing their dominance to eliminate competition and strengthen their position.

In absence of any specific criteria of dominance, while framing trade policies, the firms will have to remain utmost cautious, so that on executions of such policies, their decisions do not fall within the ambit of abusing their dominance, which has stringent after effects. The question before the implementing authority will be that in absence of any strict definition of the term there will be a challenging task in every case to arrive at the conclusion as to whether particular undertaking is dominant and thereafter to further investigate whether the said dominance has been abused. Thus, with this two-tier system of investigation, the responsibility of the concerned authorities has also been raised to a great extent by the law framers. □

Corporate Governance: A Long Term Consciousness Perspective



Today, the corporate world as a whole is in the process of acquiring a moral conscience. The new and emerging concepts in management like corporate governance, business ethics and corporate social responsibility are some of the expressions through which this emerging ethical instinct in the corporate world is trying to express or embody itself in the corporate life. However, effective implementation of an ethical ideal or concept requires two factors: creating an ethical consciousness and promoting ethical conduct and behaviour. But for the outer conduct and behaviour to be authentic, sincere and effective, it has to be a spontaneous expression of a corresponding inner state of consciousness. This article examines the concept and practice of corporate governance in an integral, holistic and consciousness perspective.

Before we dig into the phenomenon of moral conscience building in the corporate world, let's be clear about the term "integral" by which we mean both the inner and outer dimensions of the phenomenon under study. By the term "holistic" we mean what is now called as "systemic"

perspective which views corporate governance as a subset and in the context of the larger corporate environment. By the term "consciousness-perspective" we mean an emphasis on the inner change of consciousness.



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**Towards
Governance**

Self-Governance

In our integral perspective, the

The ideal of corporate governance is to create a corporate consciousness and environment which positively and consciously favours those who display genuine ethical, social and ecological responsibility, not only in Directors' speech and annual reports but in concrete actions. This means the outer environment actively supports the value-conscious corporate citizens and helps them to progress, prosper, succeed and become the leaders of the corporate world.

ideal of corporate governance is to create a corporate consciousness which leads to self-governance. But a corporate manager or entrepreneur may say "O, I am tired of such philosophical sermons and rhetoric, tell me how to do it". This is a legitimate demand of the pragmatic mind provided it is not a demand for immediate results. For implementing or implanting ideas with ethical overtones requires a long persistent and sincere inner and outer discipline. However, the idealists must respect the legitimate demands of the pragmatic mind and must indicate a plan of implementation.

Conversion of an ideal or a concept into reality requires three tasks. The first is to have a clear perception of the ideal, which means to have a clear vision of what would be the condition of the corporate world when the ideal is fully actualised. Second is an equally clear perception of the actual facts and the present evolutionary condition of the corporate world, or in other words the gap between the ideal and the reality. The third is a plan of action by which individually and collectively we can advance consciously towards the ideal.

The ideal of corporate governance is to create a corporate consciousness and environment which positively and consciously favours those who display genuine ethical, social and ecological responsibility, not only in Directors' speech and annual reports but in concrete actions. This means the outer environment actively supports the value-conscious corporate citizens and helps them to progress, prosper, succeed and become the leaders of the corporate world. Conversely, those who are obstinately unethical are either weeded out or feel the consequences of their action. And others who are hovering between the two are given the opportunity and feel the pressure to take a decisive step in the ethical path. In other words, a corporate environment governed by the law of ethical Darwinism by which ethically fittest survive and prosper, the ethically ambivalent are reformed and

the ethically unfit or delinquent become extinct. By the term "ethically fittest" we mean those who have fully internalised the ethical consciousness and do not need the threat of law to be ethical. A biographer of JRD Tata relates an interesting and illustrative episode. Tata was questioning an executive who was trying to save tax returns to Government. The executive justified his action by saying it is not illegal. But JRD asked "Not illegal, yes, But is it right?" We can see here the difference in the mind-set between the legally ethical and the intrinsically ethical.

Corporate Governance in a broader perspective deals with performance, conformance and rapport thereby ensuring greater transparency, better internal control and improved efficiency. Ethical behaviour makes entities' sailing smooth to continually succeed and remain resilient. Lack of ethics caused collapse of Enron and Arthur & Anderson and observance of ethics made Infosys from local to global. In fact, the intangible benefits of ethics to business such as customer loyalty, employees' trust, revered brand, risk reduction leading to least litigation ultimately translates into improved productivity and planned profitability. To be specific, it is not how much profit but how such profit has been made ensures that every transaction is transparent and improves governance standards further in every respect.

The Emerging Corporate Scenario

The second task is to have a clear perception of the present facts and condition of the corporate world. The emerging ethical tendencies like business ethics, corporate social responsibility and environmental sustainability have to be encouraged, strengthened and given a deeper, broader and a more intrinsic orientation. But at present most of these ethical impulses are not intrinsic but the result of external circumstances and environmental pressures like customer demand, social or green

At the governmental level, there must be more incentives for organisations, which display genuine ethical, social and ecological responsibility. The Government has to create a political environment in which organisations, which are governed by higher values, acquire a competitive edge over those which are unethical, insensitive, and irresponsible.

activism. As the well-known founder of Infosys, Narayana Murthy points out: “Investors, customers, employees and vendors have all become discerning and are demanding greater transparency and fairness in all dealings”.

However, there are perhaps a small but growing number of executives, entrepreneurs and leaders in the corporate world who are living in or understood the need of an intrinsic ethical consciousness. For example, when Pramod Bhasin, President and CEO of Genpact was asked: “How do leaders face up to scenarios where there could be a clash between values and pragmatism, especially in the light of intense competitive pressures”, he replied: “The choice is easy if you really understand that integrity is non-negotiable”. This answer comes from a mind, which has understood the intrinsic need of ethics transcending the legal or utilitarian motives. But the question put to Bhasin indicates the predominant temperament of the corporate mind, which is utilitarian, pragmatic. So, most of the ethical motive emerging in business is also utilitarian and pragmatic based overtly or covertly on short-term or long-term self-interests.

To be pragmatic is legitimate in business. But to take the next higher step in evolution the corporate world has to move up towards a higher level of pragmatism based on the Indian concept of Dharma. In this Indian perception when all the movements and activities of our inner and outer being, individually and collectively, is in harmony with the laws of universal Nature, then it leads to inner moral and spiritual development as well as outer material, economic and social efficiency, prosperity and progress. This is because when we are in total attunement with the laws of Nature we are in tune with the creative energies and rhythms of Nature, which is bound to bring its material results. The modern science of ecology reveals the dharma of the physical dimensions of universal Nature. The ethical and spiritual values discovered by the ancient spiritual traditions of the world re-

veals the ecology of the moral, psychological and spiritual dimensions of Nature. The principle and practices of Corporate Governance must be based on an enlightened understanding of the integral ecology of Nature in all the dimensions – physical, moral, psychological and spiritual.

The inner source of ethics is spirituality. The ethical motive or impulse becomes fully, entirely and perfectly conscious, enlightened intrinsic and spontaneous only in the spiritual consciousness. So ultimately ethics must blossom towards spirituality. Here comes the importance of some of the new trend in business and management, which augurs well for the higher evolution of business. It is the recognition of spirituality and the potentiality of spirituality for enhancing the quality of corporate life. For example, Academy of Management in US, a leading and prestigious association of management scholars in America has formed a “Spiritual Group” and launched a magazine called *Journal of Management, Spirituality and Religion*, focusing on the emerging spiritual aspiration in business. The prestigious Harvard Business School organised a conference on Leadership, Values and Spirituality in the spring of 2002. Similarly Indian Institute of Management, Calcutta has formed an institution, Management Centre of Human Value, based on the spiritual teachings of Sri Aurobindo, Swami Vivekananda and Rabindranath Tagore. The concept of spirituality at work is now openly and extensively being discussed in management literature. Two management researchers from Copenhagen Business School, Denmark, Peter Pruzan and Kriesten Pruzan have edited an interesting book “Leading with Wisdom: Spiritual based Leadership in Business” which is compilation of the views and experiences of 31 top corporate leaders from 15 countries who have based their leadership on spiritual and ethical values.

The true meaning of spirituality might not have been fully understood or grasped in most of these new trends of thought in business. What is called

The emerging ethical tendencies like business ethics, corporate social responsibility and environmental sustainability have to be encouraged, strengthened and given a deeper, broader and a more intrinsic orientation. But at present most of these ethical impulses are not intrinsic but the result of external circumstances and environmental pressures like customer demand, social or green activism.

as “Spirituality” in many of these movement falls within the domain of mental and ethical aspirations. However, higher mental and ethical motives and aspirations are an indispensable preparation for spiritual development. So, the spiritual groups and institutions all over the world have to actively support, encourage and enlighten these higher evolutionary trends in business by bringing greater clarity and depth to the meaning and significance of spirituality. And every individual or group in the corporate world with a moral or spiritual aspiration and who are in the decision-making positions have to carefully watch and study these higher trends in business.

We have discussed so far only the positive trends in the corporate world. There are also many negative trends for example the numerous scams and frauds of the Enron-kind. Here comes the role of Law. We must keep in mind individuals and groups are in various levels of inner development. Not all of us, individually or collectively, are in the higher stages of ethical and spiritual development where the ethical consciousness has become intrinsic to our nature. Most of us need an external compulsion to remain ethical and the yoke of law to goad us towards our ethical awakening. This need of Law acquires a special significance in the domain of ecological and environmental responsibility. Though the progressive sections of the corporate world are becoming increasingly conscious of their ecological responsibility, still large sections of the corporate world, for example leather industries, are still insensitive to their environmental dharmas. So in the present critical and precarious ecological condition of our planet, factors related to the ecological well-being of earth have to be strictly enforced under the yoke of Law and all violators have to be firmly dealt with.

We have traversed from the ideal to facts. Let us now examine how to progress from the present facts to the ideal. In our consciousness perspective the plan of implementation would be based on

two strategic principles: first is to create the ethical consciousness through Education and the second is to build an outer environment favourable to this consciousness and its self-expression in the outer life.

Shaping the Self-governing Consciousness

Education is the path to a lasting inner change. However, mere mental or information-oriented education of the kind given in most of the present systems of education can only bring about a superficial change. At the best, it can bring about a change in intellectual orientation or attitude, which is helpful, but not enough for a lasting inner change. This deeper change can be achieved only by a psychological process and discipline. The main psychological factors which have to be developed and internalised to create an enduring ethical consciousness in the individual and the community are as follows:

- ❖ self-knowledge, self-control and self-mastery.
- ❖ calm, peace and tranquility
- ❖ ethical, emotional and aesthetic intelligence, which has an intuitive sensitivity to higher values like truth, beauty, goodness, harmony, unity.
- ❖ faculties and qualities of Will and the Vital force like firmness, persistence, strength, courage, enthusiasm, energy, which are essential for manifesting these values in work, life and action.
- ❖ kindness, compassion and generosity.
- ❖ integrity, which means in a psychological perspective harmonious integration of thought, feeling, will and action around a higher ideal.

In terms of personality and character, calm, clarity and understanding in the mind, kindness, compas-

There is one more important function of self-governing leadership. It is to create a self-governing and sustainable community. For an organisation, in whatever domain it functions, economic, social, cultural or religious, is a social organism, a human community. And the foundational principles of a self-governing, sustainable community are Liberty, Equality and Fraternity.

sion and generosity in the heart, firmness, strength and self-mastery in the will, courage, energy and force in the vitality, aspiration for truth, beauty, and goodness in the soul, and an integrated personality, these are the contours of a fully developed self-governing consciousness, what is called as "Strength of Character."

The inner discipline for developing this consciousness is a triune process. The first step is to have a clearly perceived self-transcending ideal in the moral, aesthetic or spiritual domain around which the whole being can be integrated. The second aspect of the discipline is a dual process of Aspiration-Rejection. Aspiration means a constant and persistent focusing of all the energies of our consciousness, thought, feeling and will on the ideal. The third aspect of aspiration is a conscious and deliberate cultivation of thoughts, emotions, qualities and virtues and capacities which are in harmony with the ideal or which builds the strength of character. The fourth aspect of the discipline is rejection, a catharsis, throwing off of all thoughts, feelings, and impulses which are contrary or hostile to the ideal or which push us towards unethical actions like for example greed, selfishness or vengeance. We have included calm and self-knowledge as part of the discipline, because someone who is calm and peaceful with an alert and vigilant self-awareness of his thoughts, feelings, impulses and motives is less likely to fall into unethical behaviour than the one who is agitated, restless and unconscious.

This is the psychological discipline for building a balanced, self-governing consciousness which has to become an integral part of the corporate education and training programmes for the management student, practising executive, corporate leaders and also other workers in the lower levels of the corporate hierarchy.

Creating the Right Environment

The consciousness approach, which we are dis-

cussing cannot be exclusively internal because the outer environment has an influence and impact on the consciousness. We have to create an outer environment favourable to the growth of the self-governing consciousness and felicitate its self-expression in the outer life. The outer environment includes the material, organisational, social and political environment made of buildings and space, laws and rules, policies, procedures, incentive and practices and many other factors related to the management of the outer life.

The material environment should evoke gentle, pleasant, harmonious sensations in people, which is conducive to ethical and aesthetic development. In the organisational level, there must be active encouragement to ethical, aesthetic or spiritual innovation and excellence. The present motivational strategies in the corporate world encourage only techno-economic innovation and excellence. But for the higher evolution of the corporate world, there must be equal encouragement to what we may call as "value-innovation and excellence" in the mental, ethical, aesthetic and spiritual domain or in other words, there must be quality circles for promoting higher values. Workers and employees must be encouraged to offer suggestions on how to make the collective organism more true, beautiful, harmonious, compassionate, creative, progressive. In this task, the house-magazine and the intranet of the organisation can be of great help in disseminating higher values in the organisation through dialogue, discussion and creative participation. For example, the house-journal of the organisation may publish articles, which help in widening the intellectual, ethical and spiritual horizons of the mind. Similarly professional magazines, apart from technical and specialised knowledge related to the specific professional discipline, should also contain a few articles, which help in the mental, moral and spiritual growth of people or the professional activity. For a professional is first of all an evolving human being, and only secondarily an engineer, accountant or a manager.

Two eminent management thinkers, Richard Boyatzis and Annie McKee in their book on “Resonant Leadership” published by the Harvard Business School Press, state: “People who think they can be truly great leaders without personal transformation are fooling themselves. You cannot inspire others and create the resonant relationship that ignites greatness in your families, organisations or communities without feeling inspired yourself and working to be the best person you can be.”

At the governmental level, there must be more incentives for organisations, which display genuine ethical, social and ecological responsibility. The Government has to create a political environment in which organisations, which are governed by higher values acquire a competitive edge over those which are unethical, insensitive, and irresponsible.

Self-transforming Leadership

Governance is the function of leadership. Most of the modern management thinking on leadership is about outer governance or “organisational transformation”. But as the Indian thought repeatedly emphasised self-government, Swarajya is the foundation for governing the outer world, Samrajya. Similarly self-transformation is the basis for outer transformation. Someone who cannot govern himself cannot govern others. And someone who is governing himself with higher values can evoke, inspire and induce a similar aspiration and effort in others.

This principle applies equally to organisational change and transformation. Whatever difficulty faced by the leaders in his outer life is a reflection of the difficulty within him. If he is able to discover and mend the inner source of the difficulty within him then the outer difficulty sooner, or later tends to resolve itself. As the Mother of Sri Aurobindo Ashram points out: “whatever the external circumstances, they are without exception, the objective projection of what is inside yourself. When in your work you find something giving trouble outside, look within and you will find in yourself the corresponding difficulty. Change yourself and the circumstance will change”.

In the same manner, whatever change the leader wants to bring out in his organisation, if he is able to achieve this change within him or makes a sincere effort towards it, then it becomes easier to enforce the change in the organisation. Interestingly

this concept of self-transforming leadership is beginning to be recognised in modern management. Two eminent management thinkers, Richard Boyatzis and Annie McKee in their book on “Resonant Leadership” published by the Harvard Business School Press, state: “People who think they can be truly great leaders without personal transformation are fooling themselves. You cannot inspire others and create the resonant relationship that ignites greatness in your families, organisations or communities without feeling inspired yourself and working to be the best person you can be.” And in the foreword to this book, the eminent psychologist and the inventor of the concept of emotional intelligence, Daniel Goleman states “For leaders, the first task in management has nothing to do with leading others, the step one poses the challenge of knowing and managing oneself. That includes connecting with deep values that guide us, imbuing our actions with meaning.”

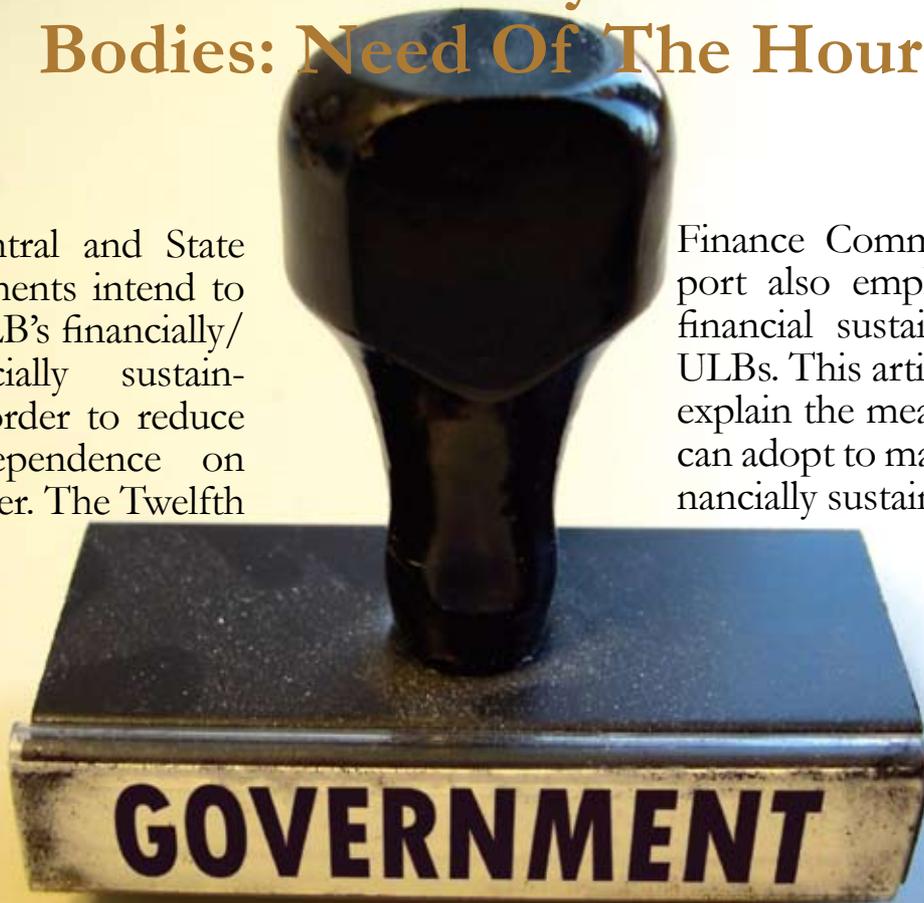
Building a Sustainable Community

There is one more important function of self-governing leadership. It is to create a self-governing and sustainable community. For an organisation, in whatever domain it functions, economic, social, cultural or religious, is a social organism, a human community. And the foundational principles of a self-governing, sustainable community are given for all times by the thinkers of French revolution: Liberty, Equality and Fraternity. So one of the major function of leadership is to create a community in which there is a conscious and continuous effort towards a progressive manifestation of liberty, equality and fraternity not only in the outer life, but more importantly in the consciousness of people. Such a community in which people are empowered with a concrete sense of inner equality and fraternity, expressing itself in a harmonious, equitable and progressive outer life, is a more or less self-governing community, which requires minimum of external laws and rules. □

Financial Sustainability of Urban Local Bodies: Need Of The Hour

The Central and State Governments intend to make ULB's financially/commercially sustainable in order to reduce their dependence on the former. The Twelfth

Finance Commission Report also emphasized on financial sustainability of ULBs. This article seeks to explain the measure ULBs can adopt to make them financially sustainable.



Background

There has been a significant decline in the fiscal balance of the Indian economy over the last few decades with an unprecedented rise in the key deficit indicators. The accentuation of fiscal stress is attributable mainly to the widening deficits in the State budgets. Even though the Central Government has initiated a medium-term fiscal reform MOU with most of the States, the process of consolidation is yet to gain momentum. The delay to turnaround the primary deficits reveal the structural weakness of the Government finance and raises questions about fiscal stability. Both the Centre and States have in-

creasingly resorted to borrowings over the last two decades to finance even a part of their current expenditure increasing the level of Government indebtedness.

The urban sector is facing an acute strain on resources. Augmentation of basic services and urban infrastructure to improve the quality of life of the urban citizens as well as to facilitate economic growth requires huge investments. 6th Pay Commission recommendations will further compound the burden of the States and local Governments. The urban population is expected to increase to 41% by 2021 from 27.8% at present, which would increase the strain on the existing resources and urban services even further. Overall, it stresses the need for



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The financial statement of ULBs reveals that traditionally more than 80 percent of revenue was in the form of grants. To enable municipalities to move toward financial sustainability, their high dependence on the State needs to be reduced. This has been stressed upon in several governmental documents including TFC and SFC reports. This can be achieved through improved revenue generation. For this purpose, it is vital for ULBs to prepare a comprehensive strategy to generate internal resources and revenues.

financial sustainability of ULBs so that they can cope up with this challenge.

Urban Governance : A paradigm shift

The decade of the 90s in India has seen two very fundamental policy shifts:

The first policy shift is about the economy. At the macro level, the Indian Government's development strategy focuses on its role as a facilitator and where unavoidable, as the provider as before, of economic and social development, as a promoter of enabling policy, institutional, and regulatory environment; and also as a forerunner for further broadening and deepening of the reform process. At the State and local levels, ULBs have been given greater freedom to determine their own development priorities, to decide on the modalities of intervention, to decentralise and disinvest in calibrated manners.

The second policy shift is in terms of urban (and rural) governance. Governance issue cannot be delinked from constitutional and legislative framework. The 74th Constitutional Amendment Act, 1992 recognises the ULBs as units of self-governance but does not endow them with commensurate financial powers. Nevertheless, the Amendment has a few prominent features:

- It considers the ULBs no longer as mere service bodies which creates, maintains and operates a certain minimum number of civic facilities like water supply, sanitation and drainage, solid waste management etc. It empowers them to undertake, if so authorised by the State Governments, to plan for social and economic development, urban environment, poverty alleviation, etc. This is a new approach.
- The new constitutional provision also ensures that the ULBs should not remain under prolonged periods of dissolution or super-session.
- The State-municipal financial relationship has been put on a firm basis, by setting up State Finance Commissions (SFCs) for each State. These Commissions would decide on (a) the

distribution of the net proceeds of the revenue to be levied by the State between the State and the ULBs; (b) the revenue which may be assigned to, or appropriated by the ULBs; (c) the grants-in-aid to the ULBs from the State; and (d) other measures needed to improve the financial position of the ULBs. Overall, this measure of introducing the SFCs should remove arbitrariness and *ad hoc*-ism in the State-local financial relationship, which has plagued the system for so long.

- State Election Commissions are to be set up to superintend, direct and control the preparations of electoral rolls, and conduct all elections for both rural and urban local bodies in each State.
- Constitution of Wards Committees, consisting of one or more wards in the ULBs having a population of 30,00,000 or more has been made mandatory. The essence of this provision is to bring about proximity between people and local Governments so that more decentralisation takes place.
- District Planning Committees (DPCs) are to be set up to consolidate the plans prepared by the *panchayats* and the municipalities in a district, and to prepare a draft development plan for the district as a whole.
- Metropolitan Planning Committees (MPCs) are required to be set up to prepare draft development plans for metropolitan areas.

All the States have carried out the consequential compliance legislations in their own laws and have also taken follow-up actions. There are some variations in the legislations in the States within the legal limits.

Financial Sustainability: Concept

Profits and profitability play the same role in a business as blood and pulse in the human body. The survival of human beings is not possible in the absence of adequate blood and ability to generate blood. The same may be applied to ULBs though in a limited

The survival of human beings is not possible in the absence of adequate blood and ability to generate blood. The same may be applied to ULBs though in a limited form these being public service organisations. It is very difficult for ULBs to survive without prospects and ability to earn adequate revenue.

form these being public service organisations. It is very difficult for ULBs to survive without prospects and ability to earn adequate revenue. As profitability is the nerve-knot of a business without adequate financial resources, the existence of a ULB is like a body without the backbone.

Financial wherewithal of an organisation happens to be the most important parameter in any scheme of planning and development. It largely drives institutional capacity of an organization. Creating fiscal capacity nevertheless constitutes a complex task. This is driven by an inter-play of fiscal and non-fiscal parameters. It needs to be appreciated that though fiscal strength and resource base largely determines an effective delivery of municipal services and urban infrastructure, fiscal sustainability itself is driven by a host of factors that are not fiscal in nature.

Financial sustainability, as the phrase depicts, is nothing but the capability to produce money, *i.e.*, the ability to generate enough revenue to survive. Fiscal sustainability is contingent on resource generation from own sources of revenue. Larger the proportion of revenue from own sources, larger the extent of financial autonomy and sustainability a local Government enjoys.

BOX 1: Aspects of Financial Sustainability

- The availability of adequate funds to finance projects expenditures, especially funds drawn from the Government budget
- The recovery of some of project costs from the project beneficiaries
- The financial incentive necessary to ensure participation in the project

Source: Guidelines for the Economic Analysis of Projects: ADB

According to Professor P. Sargant Florence and Professor Gilbert Walker, "The Capitalist test of the efficiencies of an undertaking is profit. Stated in skeleton, out line profit is the difference between aggregate revenue and aggregate costs. In state trading, a surplus or avoidance of loss, when subtracting aggregate costs

from the aggregate of prices, *i.e.*, covering costs or breaking even, seems to us the primary test of efficiency.' In the past, ULBs had little financial sustainability and are still highly dependent on the State. The resource constraint has led to a very low expenditure on services which directly impacts the standard of service to the community. There is a need to address the issue of greater resource mobilisation through improved structure of tax collection, levy of user charges and innovative use of municipal resources for revenue generation.

The operations of ULBs have grown in last few years and are expected to grow even more rapidly in the near future, therefore, it is essential that the accounting and financial system of such large growing ULBs meet the expectations of its citizens as regards delivery of services efficiently and effectively. It is imperative that ULBs are financially independent and achieve all the aspects of financial sustainability (Refer to BOX1).

Municipal Finance: Need to augmented Financial Sustainability

Traditionally, main share of revenue of ULBs has been in the form of 'transfers' and 'grants' from the State and the Central Governments, which are highly erratic and unpredictable, depending upon the exigencies of the State's own financial resources. *Own revenues of ULBs are not sufficient to meet the growing demand of basic civic services and the urban infrastructure. The fiscal domain of ULBs continues to remain weak and deplorable.* Income and expenditure of municipalities -- The income and expenditure of urban local bodies is dependent on:

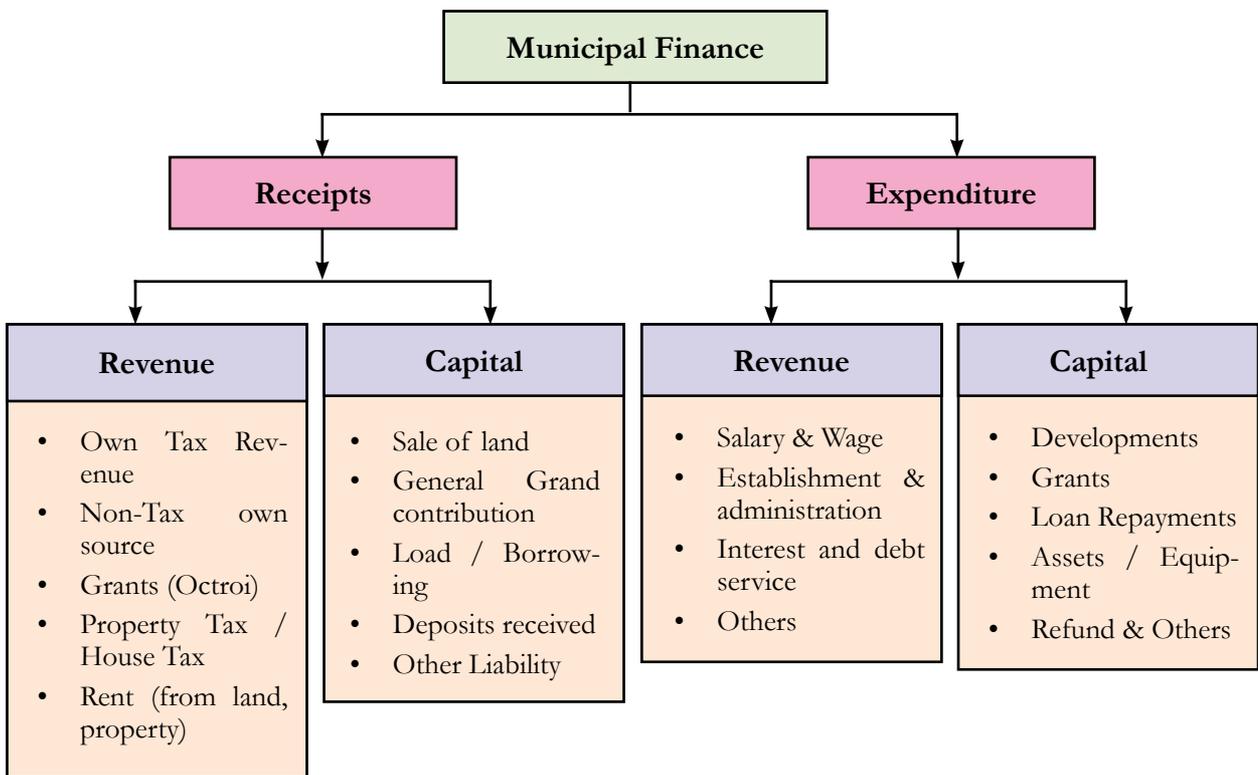
- Adequacy of tax base and its effective exploitation by ULBs,
- Effective use of non-tax sources, such as user charges and land-based non-property Taxes, and
- Transfers from higher levels of Government.

Major components of revenue of ULBs are shown below (**Ref: Figure 1**)

¹P. Sargant Florence and Gilbert Walker, 'Efficiency under Nationalization and its Measurement' in W.A. Robson (ed.): Problems of Nationalized Industry, London: 1952, p.195.

The volume of investment required for removing the backlog and also for augmentation of services is massive. This gap can be met through PSP, which may take the form of total privatization, or contracting-out, or public-private partnership. PSP will bring much needed resources, new technology, enhance efficiency and ease budgetary constraints. The private sector frequently acts as a contractor to build infrastructure facilities and sometimes operates and manages them. Now, a growing pool of domestic and international private finance is available for investing in commercially viable urban infrastructure projects, lack of which has been a serious constraint for accessing the capital market.

Figure 1: Finance Structure of the Municipal Board



Municipalities Act of ULBs provides for the levy of obligatory and other taxes by the ULBs. Income through taxes is available to the Municipal Board primarily through house tax as octroi on good taxes etc., has been withdrawn by most of the State Governments, as in Rajasthan it was withdrawn *vide* notification dated July 31, 1998. The financial statement of ULBs reveals that traditionally more than 80 per cent of revenue was in the form of grants. To enable municipalities to move toward financial sustainability, their high dependence on the State needs to be reduced. This has been stressed upon in several

governmental documents including TFC and SFC reports. This can be achieved through improved revenue generation. For this purpose, it is vital for ULBs to prepare a comprehensive strategy to generate internal resources and revenues. This would need to be done by efficiency enhancement of existing revenue streams, identification of alternative revenue sources as well as a phased introduction of cost recovery on services like solid waste and lighting.

Measurement of Commercial Viability

As stated above that in the concept of Financial Sustain-

The user charges levied are basically of two types – (1) for direct measurable benefit & (2) for presumptive benefits. Direct measurable benefit charges are basically for specialised services such as removal of bio-medical waste, use of Corporation machinery such as Road Rollers and for restoration of roads. The other charges are usually levied on a presumptive basis.

ability, profitability is an indication of the efficiency with which the operations of the business are carried on.

For knowing financial Sustainability of ULBs, the analyst is particularly interested in the following:

1. What is the total revenue of the ULBs?
2. What has been the trend of revenue over the years?
3. The sources from which the income of the ULBs is increasing or decreasing.
4. What control measures can be adopted? Whether the reasons of declining incomes are controllable or uncontrollable and how can they be controlled?

To deal with such questions, revenue has to be expressed in relation to the factors resulting in revenue. In order to achieve financial sustainability, ULBs can/shall adopt the following components as in section 6.

6. Components of Financial Sustainability

As stated earlier, the financial position of ULBs needs to be strengthened significantly. There is a need for substantial improvement in revenue generation as well as expenditure controls on sustainable basis. Therefore, it is important that selected ULBs proactively attempt to increase significantly their self-generated revenues, especially the property tax (now UDT), under its planned reform initiatives. With significant enhancement in revenue, ULBs shall not only be able to maintain effectively their existing assets and infrastructure facilities reasonably well but shall also be able to extend and expand the range of urban services it is mandated to provide satisfactorily. Strong political will and timely implementation would be required to achieve a lasting improvement in the financial performance.

This section proposes to enhance the existing efficiency in operations to enable ULBs to be more creditworthy and financially independent through five focus areas: Improved financial systems & practices, Revenue enhancement, Expenditure management, Capacity building and Public private partnerships.

Components of FS

Component 1: Establishing a reliable accounting and financial management system

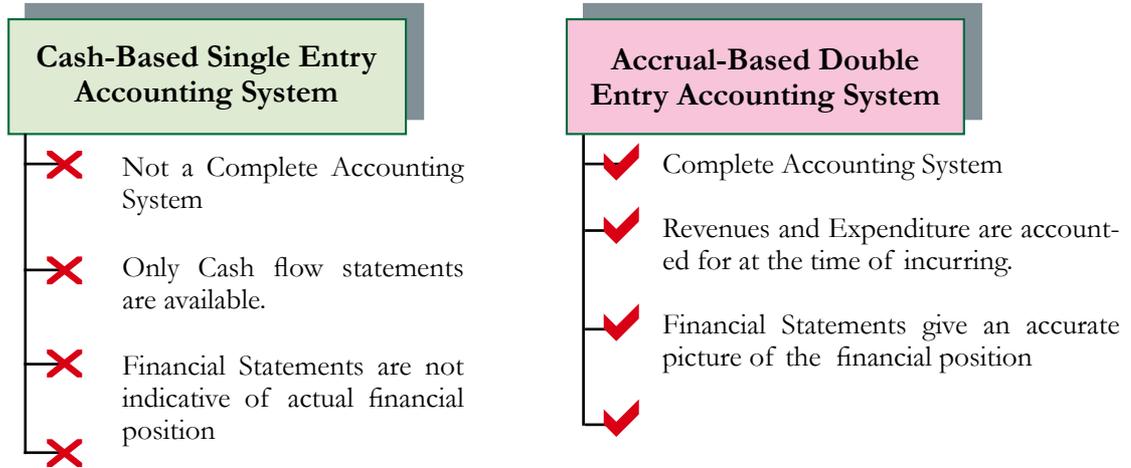
Financial management system forms the backbone of financial performance by providing the environment for efficient management of resources and proper monitoring of results. An improvement in the financial management systems would underpin the success of other financial reform initiatives in ULBs and would cover the following areas:

- Financial policies and framework;
- Budgeting practices;
- Systems and controls;
- Decentralisation and Accountability; and
- Financial information systems.

Till date, the accounting and financial management system in most of the ULBs is archaic. The ULBs are operating on a single entry cash based system and financial reporting was minimal as only Receipts and Payments account is prepared. The arrears in revenue collection and outstanding payment obligations are accounted separately and not juxtaposed with revenue account figures. Besides, reliable and timely data on receivables and payables are not available.

Under single entry cash-based accounting system, transactions are recorded when the related cash receipt or the payment takes place. Thus, revenue, e.g., from for property taxes, is recognized when the cash is collected. Similarly expenditure on acquisition or maintenance of assets used in rendering of service as well as employee remuneration and other items is recorded when the related payment takes place. This leads to lack of information needed in generating Financial Statements from which decisions may be made. Such financial statements include income and expenditure A/C and balance sheet. Thus, presently in the name of financial statement only one financial statement is prepared i.e., Receipts and Payments which limits financial MIS. Thus, in order to have good financial reporting system, it is imperative that Double Entry Accrual Accounting System as envisaged in JNNURM should be implemented so that its benefits can be availed. Refer to Figure 2.

Figure2: Single Entry Cash based vs. Double Entry Accrual Accounting System



In order to face the challenges in the coming years it would be necessary for ULBs to (a) improve the accounting system and make it more sophisticated so that accounting and financial reports are available, (b) create mechanisms to control costs and overall expenditure, (c) ensure that all the revenues raised should be spent with due regard to prudence and propriety and must also be properly accounted for, (d) be and remain informed about the financial health and financial position of the entity at all times, and (e) institute effective systems of internal control. Therefore, following measures are required for effective financial system:

BOX 2: Accrual based Accounting in Tamil Nadu

The State of Tamil Nadu has taken the lead in implementing state-wide accrual based accounting in ULBs. The State developed a manual for double entry accounting in ULBs in 1998. In 1999-2000, the system was tested in 12 selected cities. From 2000-01, accrual based accounting was started in the remaining 96 municipalities.

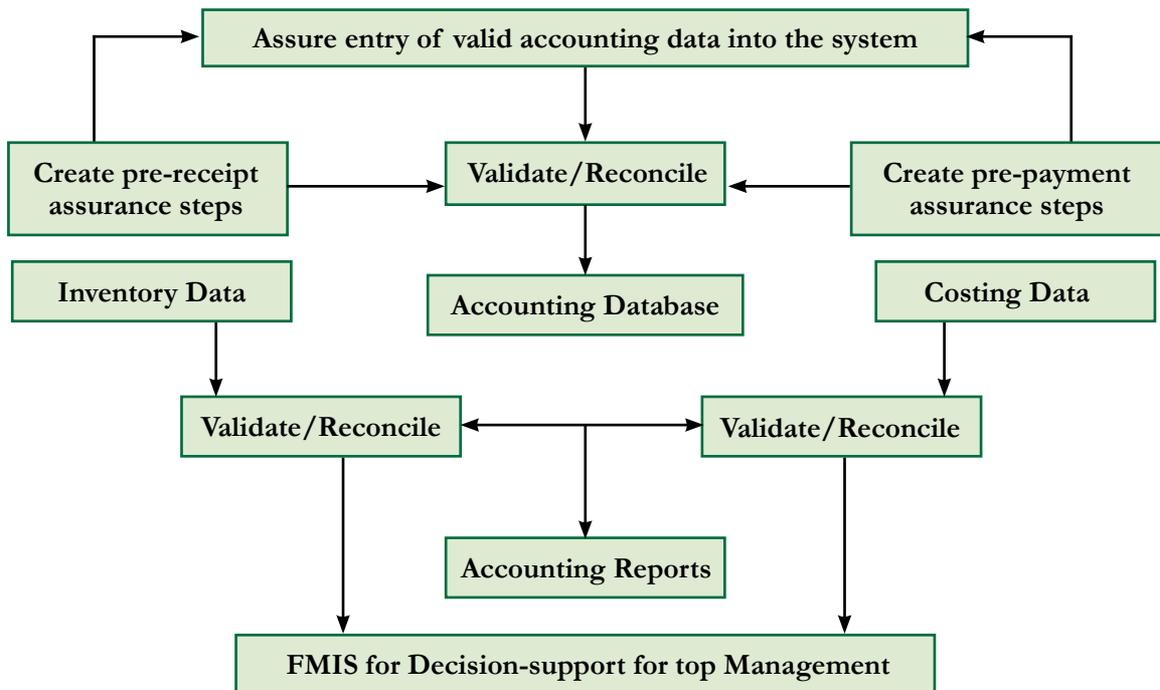
- Introduction of accrual-based double entry system of accounting including preparation and implementation of a uniform municipal accounting manual based on guidelines issued by The Institute of Chartered Accountants of India (ICAI).
- Developing costing systems for identifying the cost of services to facilitate cost recovery and for this public awareness programme is required so as to make them aware that unless

they contribute towards least-cost factor, it will be difficult to provide efficient services.

- In order to ensure correction and verification at each stage of accounting process, introduction of internal audit at ULBs is of paramount significance as it will strengthen internal control system.
- ULBs do not have any cash flow as on date. It is necessary to design a proper cash flow statement and to implement the same. Presently, outflow is subject only to budget availability, and cash availability. Cash Flow planning is a management process and is dependent on accounting reports to the extent that expenses on a given date (the date of preparation of the cash flow) should be accurately obtained. This shall be introduced once DEAS has been implemented. However, the process needs professional guidance for the first few months through expert intervention. Refer to Box 2.
- Overall, the financial management component can improve only if there is an attitudinal change in the mindset of the management. This needs to be built upon.

The major part of financial management stresses upon accounting reports and budgetary reforms. A program for the preparation of accounting reports and budgetary reforms can be undertaken only after some capacity has been built in this direction and the accounting data-base itself is in shape. The flow of the various steps towards sustainability of the reforms program in accounting and financial management can be schematically depicted in Figure 3.

Figure 3: Reforms Program In Accounting and Financial Management



II. Component 2: Revenue Enhancement

The financial analysis has shown that more than 80 per cent of revenue of ULBs is in the form of grants. To enable municipalities to move towards financial sustainability, their high dependence on the State needs to be reduced. This has been stressed upon in several governmental documents including TFC and SFC reports. This can be achieved through improved revenue generation. For this purpose, it is vital for ULBs to prepare a comprehensive strategy to generate internal resources and revenues. This would require efficiency enhancement of existing revenue streams, identification of alternative revenue sources as well as a phased introduction of cost recovery on services like solid waste disposal and street lighting. The areas which need immediate attention are discussed below:

2.1 Property Tax Enhancement

The yield of Property Tax is distant far from its potential. Most of the ULBs have not been able to exercise with due diligence, its “enforcement role” as evidenced from following:

- Ineffective and almost extinct MIS reports and information for effective management;

- Breakdown of its Demand, Collections and Balance (DCB) system of reporting on arrears in most of the cases is not readily available;
- Revenue Inspectors not trained to perform their role of “monitoring”;
- Penalties and interest rates as envisaged in RMA not being enforced strictly;
- Recovery procedures not enforced seriously;
- Absence of separate valuation department/valuers

Some of the above reasons are ascribed to political self interest/pressures and due to this the enforcement of penalties, interest on arrears and recovery procedures as stipulated in the ULBs appear to be lax and not being enforced strictly. Refer to Box 3.

Specific areas requiring interventions include:

- (a) Strengthening of the self-assessment procedures including follow up on submission is required. Increasing the frequency of valuation; rationalisation of tax rates linked to market value every 2 years; support initiatives including the establishment of an inter-departmental

revenue collection committee at each ULB to resolve the huge arrears within a specified time frame; efforts to realise outstanding taxes from Centre/State through:

Box 3 :Property Tax - Good Practices

- Reduction of property tax rate from 43.75 percent to 9 percent and conversion to area based system for valuation in Patna resulted in increased demand.
- Self-assessment procedure in Bangalore leading to increased revenues.
- Detailed field survey, GIS mapping and reconciliation of tax records in Agra, Mirzapur and Mysore – identified un-assessed and under-assessed properties.
- Privatisation and computerisation of property tax collection for efficiency and improved collection – such as in Barrack-pore.

- inter-departmental transfers;
 - development of information and payment gateways for online payment;
 - reduction in the payment frequency from quarterly to half-yearly/annually;
 - resolving the issue of tax arrears of sick/closed industries & litigation cases through one time settlement;
 - enforcement of legislative powers strictly against chronic defaulters for recoveries and ;
 - increased involvement of ward committees in collection of property tax.
- (b) In order to have complete and accurate database, a detailed survey of properties under the tax-net duly reconciled with existing records to help identify non-assessed/under-assessed properties. Initiatives like computerisation of property tax records, preparation of GIS and digitised maps, training of tax inspectors and an extensive public awareness campaign for property tax applicability and valuation methodology is required to achieve this.
- (c) The assessment and collection department of some sample ULBs can obtain the database of all electricity customers and match it with the

data base under its jurisdiction. There is a good potential for significant improvement for extending and enlarging customer base. However, ULBs needs to examine this option as against other available options against various criteria like estimated time to complete the exercise, costs, benefits, its staff commitment to match and reconcile the two data bases.

- (d) The ULBs should also adopt measures such as incentives and effective penalty system, use of ABC analysis and development of payment gateways for improved collection.

Incentives

- Rebates for prompt payment at higher rates for self-occupied properties than tenanted properties as practiced by municipal corporations of Delhi, Ahmedabad and others.
- A system of rebate for advance payment of tax.
- Incentive to the municipal staff for exceeding the collection target.

Penalties

- Application of penalty in all cases of delays and default by the assesseees
- Enforcement of disciplinary action against the employees for deviant behaviour and corrupt practices.

Such rebates/penalties are envisaged in new legal provisions of UDT, now it needs to be enforced by each ULB.

A-B-C Analysis

A-B-C Analysis serves as a scientific and rational management tool for focused intervention to enhance tax collection. Classification of payers in ULBs into A, B, and C categories would enable to concentrate on the class of taxpayers who contribute the largest, medium and the lowest tax revenue to the municipal government. Giving priority to categories A and B would help in augmenting tax collection. Entrusting the task of monitoring of tax collection from A, B, and C categories to the top, middle and frontline functionaries would help in augmenting tax collection.

(e) Public information and dissemination

The characteristic of an efficient tax system is that it is easily understood and widely accepted. For ac-

ceptance of the proposed system of property tax, it is necessary that maximum possible publicity is given to it and ratepayers have a chance to understand and appreciate the new system of taxation. For this it is proposed that:

- There should be intensive discussions with all affected stakeholders before finalising the unit area rates/DLC rates for application
- Adequate publicity and information availability to citizens through media, website, property tax camps and user handbooks.

2.2 Cost Recovery

For the ULBs to become self-sustainable, a realistic cost-recovery mechanism is a pre-requisite. Cost recovery for all civic services has been a grey area in the financial management. Under the present system of cost accumulation, the cost-benefit analysis of various types of services is neither possible due to non-availability of data, nor any attempt has been made by the ULBs in this regard. Most of the ULBs are not accustomed to charging users for cost recovery of services. As a result, they are unable to recover the O & M costs.

Box 4: Municipal Property Develop

The Municipal Corporation of Ludhiana, conducted a verification of its land inventory and installed an asset management system for its owned properties. During the exercise, over 800 unrecorded properties were identified, estimated to value almost ₹25 million. The Corporation now proposes to develop the vacant properties and regularise encroached property thereby raising significant revenues.

Innovative development of commercial properties has been undertaken in Jalgaon, Vijaywada and Indore.

A very small portion of ULBs revenues comes through user charges. The user charges levied are basically of two types – (1) for direct measurable benefit & (2) for presumptive benefits. Direct measurable benefit charges are basically for specialised services such as removal of bio-medical waste, use of Corporation machinery such as Road Rollers and for restoration of roads. The other charges are usually levied on a presumptive basis. Design &

implementation of an effective costing system which records the detailed cost of services should be made mandatory for all municipalities. A mechanism for citizen interface and participation while levying user charges should also be supported to enable acceptance². There is a need to immediately revise water charges; other charges may be subsequently introduced. Clear political commitment & time frame for implementation of select user charges should be considered upfront for the sustainability of ULBs.

2.3 Land Inventory, Database Management & Revenue Generation from Passive Assets

The importance of property/asset management in ULBs can hardly be overemphasized. This is essential to improve the fiscal base and quantify the capital supporting the assets. ULBs should put together all scattered assets of land and buildings, which are possibly being eroded through encroachments or unauthorized takeovers. With computerization and a management information system in place, this technique will help to preserve, maintain and compute the orderly growth of assets, comprising lands, buildings and other municipal properties, which must be inventoried for recovery of rents and rates and the most economic use of assets.

Most ULBs have a large resource of land acquired over a period. All such information is maintained in several registers prepared manually which restrict the readily availability of information. Thus, once a detailed land inventory is prepared and an asset management system for its owned properties is installed, then such properties can also be leveraged for market and other borrowings to generate funds for investment in infrastructure services for the poor. Most of the municipalities have not sufficiently utilised their assets for revenue generation. Some municipalities in West Bengal such as Bally and Kamarhati have used innovative measures such as letting out municipal buildings and joint ventures with private builders for commercial complexes. The municipal discussions have also identified the need to review the legal documents, digitisation of the plans and preparation of a master file on each property owned by the ULB. Refer to Box 4.

2.4 Rationalisation of Taxes/Fees

Other taxes such as on advertisement, carriages, Mobile towers etc. are not fully utilised/explored. The

²Earlier studies (US AID's study on Water Charges in Dehradun - 'Willing to pay, Unwilling to charge') have shown that the citizens are willing to pay for quality services.

municipalities should consider and levy the additional taxes within their jurisdiction. There is an immediate need for one time revision in tariffs, fees and charges followed by phased if not yearly inflation-linked increase. These actions have to be initiated by individual ULBs themselves and they should learn a lesson from other ULBs in the states like in Tamil Nadu, Ahmedabad etc. Amongst others, the main emphases of the recommendations that follow are targeted to suggest adequate cost recovery mechanism for project sustainability. Increase in user fees and charges are required to adjust the normal inflationary pressures, which have not been adjusted periodically in the past. A mechanism for citizen interface and participation while levying user charges to enable acceptance needs to be established.

III. Component 3: Expenditure Management

The municipal finance analysis shows that there exist no norms and control mechanisms to evaluate performance. Refer to Box 5. There is no incentive for the municipalities to improve performance and control their operating expenses. Salaries constitute the single largest item of expenditure in ULBs. The staffing pattern administered by the DLB may not match the actual requirements of the ULB keeping in mind the future requirements. The absence of a voluntary retirement scheme (VRS) results in resource mismatch and a mounting salary bill. The low revenue base along with high expenses on salary and establishment has led to inadequate budgeting for operations and maintenance. Infrastructure services are not maintained properly and this inevitably leads to poor functioning/obsolescence of these assets. There is no provision for a separate O & M plan.

Box 5: Sample select indicators

- Increase in per capita expenditure on core services
 - Salary as a percentage of own revenues
 - Reduction in share of State non-plan support to total revenue receipts
 - Increase of own revenues over last year
 - Proportion of expenditure spent on O&M of assets
- To enable a more objective evaluation there is a need to complete a detailed analysis of expenses

under various heads and establish norms for expenditure management and evaluation. These norms could also at a later date be used in other states. Laying down norms/caps for expenditure on salary and other establishment costs linked to own revenue receipts and expenses and evaluate block grants instead of the salary linked non-plan grants to provide an incentive for rationalisation/reduction of staff. Unauthorised expenditure on irregular appointments needs to be immediately stopped.

- In order to minimise expenses on account of electricity, fuel, water leakage and other operating expenses, ULBs should have an ongoing efficiency audit by external team of consultants initially. This support is required to identify and control leakage, corruption and wasteful expenditure.
- The excessive expenditure on staff is also due to unplanned expenditure on ad hoc and temporary workforce for sanitation, roads, water supply, etc. The TFC considered this matter and recommended that measures should be taken to reduce excessive expenditure on the establishment and the limits on it up to a permissible percentage of the income must be adhered to. The State Government should exercise its authority to ensure that the cadre strength of various services is not inflated.

IV. Component 4: Capacity Building

Training and human resource development, backed by research, has a key role in strengthening the ULBs to cope with the challenges in the context of the 74th CAA. Capacity-building of elected representatives of ULBs will help in institutional development and functional strengthening of local self-government. The strategy for capacity-building of urban administrators/managers includes realistic assessment of human, financial and technical resources required by ULBs. The elected and appointed officials of ULBs should be aware of the salient features of the 74th CAA, the institutional/organizational set-up, preparation and implementation of development plans, innovative municipal management through people's and private sector participation and regulation of the private sector in the delivery of municipal services. An orientation for raising funds through internal resources, borrowings from institutions and the debt market are the other essential features of the training

of functionaries of ULBs.

The staff responsible for the municipal finance functions needs training, exchange visits & up gradation of skills for efficient and sustained financial management. This would lead to benefits such as better planning and service delivery, improved management, increased accountability and greater financial discipline. To achieve this, following measures need to be undertaken:

- There should be core team of financial experts within individual ULBs. This will assist in preparation of a database of good practices in financial management & greater exchange of information; workshops for familiarizing and sensitizing the councilors and staff on finance related issues;
- Exchange tours for municipal finance staff to see best practices in uniform accounting, resource mobilisation etc should be organised;
- Courses on computerization, accounting standards, costing, budgeting for municipal finance staff should be planned and implemented
- On the job computer training should be continued for all personnel on a continuous basis
- Training on stores and inventory management should be given to persons concerned with procurement and stores
- Training on management of contracts should be given to staff of Department of Sanitation
- Training on Accounting matters should be provided to persons from the treasury and accounting functions

V. Component 5: Public - Private partnerships

Private Sector Participation (PSP) is a potential option to cope with the challenges of growing needs of financing urban infrastructure. The volume of investment required for removing the backlog and also for augmentation of services is massive. This gap can be met through PSP, which may take the form of total privatization, or contracting-out, or public-private partnership. PSP will bring much needed resources, new technology, enhance efficiency and ease budgetary constraints. The private sector frequently acts as a contractor to build infrastructure facilities and sometimes operates and manages them. Now, a growing pool of domestic and international private finance is

Box 6: PPPP – Illustrative Best Practices

- Introduction of private sector participation in solid waste disposal on Build-Own-Transfer basis in several cities in India.
- Involvement of communities and women in solid waste management in Ludhiana, Hyderabad and Vijayawada.
- Sewage project in Alandur with private sector participation and community resources.
- Energy generation project from solid waste on BOT basis in Nagpur and Lucknow.

available for investing in commercially viable urban infrastructure projects, lack of which has been a serious constraint for accessing the capital market. It is expected that PSP can establish sustainable partnership between the public and private sectors. The community will benefit through PSP, as it brings in management efficiency, quick and effective decision making and capacity-building for more efficient delivery of services leading to greater consumer satisfaction. PSP can help in off-loading the financial, functional, administrative and managerial burdens of ULBs. There is need to expand the scope of PSP to attract investment in large- and medium size infrastructure projects. Municipalities in small and medium towns can raise loans/debt from private sector financial institutions, through the 'pooled financing mechanism', for financing their urban infrastructure projects.

Specific private sector initiatives in municipal services like tax collection; solid waste management (collection, transportation and disposal); O&M of various municipal assets; creation of Infrastructure facilities under various financial models (BOOT, BOLT, BOT etc.) need to be evaluated. Mobilising community support and funds through ward committees and other social structures to expand this initiative into a Public-Private-People partnership (PPPP) needs to be studied in depth. Refer to Box 6.

Once ULBs are financially/commercially sustainable/viable, it would be easier for them to access to capital market and issue Municipal Bonds for raising funds as done by Ahmedabad Municipal Corporation (AMC)

Case Study: Ahmedabad Municipal Corporation (AMC)

In last five years, AMC has taken several major steps

for Financial Turnaround and, thus, make itself financially sustainable. They have undergone organizational restructuring as a part of administrative reforms; Recruitment of MBA, Chartered Accountants and Cost Accountants, Engineers and professionals at middle-level cadre so as to infuse professionalism in AMC working. They introduced Double-Entry Accounting System to improve their financial management system. In order to curb Octroi evasion Market research cell comprising of Chartered Accountants was created and random physical verification of goods to prevent under invoicing was also introduced. In order to augment revenue from Property tax, Series of Coercive measures were taken against the property tax defaulters like Disconnection of Water supply and drainage connections, issue of warrants for attachment of property etc. All these efforts have contributed to financial turn around of AMC. Some of the major highlights of their initiatives are discussed below:

surplus which is essential requirement for financial sustainability. Refer to Diagram 1.

Role of Professionals

In order to introduce an element of professionalism in the management of ULBs, there is a need to involve Chartered Accountants, Cost Accountants, MBAs, etc., either internally or externally as done by Ahmedabad Municipal Corporation.

Recruitment of these professionals as employees shall immensely help in revolutionising the financial management of ULBs as can be seen from the case study of ULBs like Ahmedabad Municipal Corporation. This will not only help in capacity building and introduction of latest techniques and practices but also getting rid of non-value adding activities (NVA).

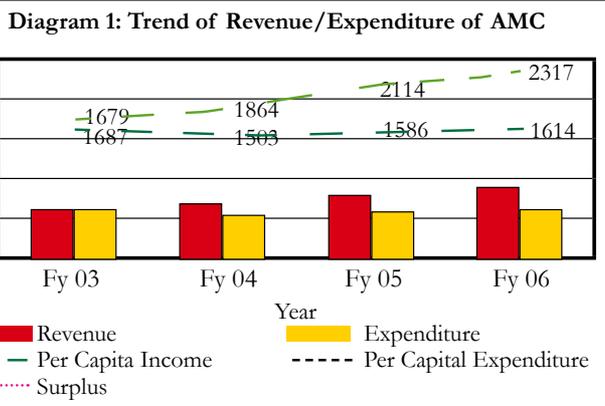
Externally, professionals can provide valuable consultancy & advisory services for system improvements, methodology to be adopted for financial restructuring, implementation of DEAS, devising the approach road for accessing the capital market, etc.

Chartered Accountants in designing an effective auditing system to act as a powerful control & administration mechanism for safeguarding the property and management of funds of urban local bodies.

Concluding Remarks

India is going through rapid urbanisation process. It is estimated that 60% of national income is contributed by urban India. In order to achieve planned growth of 8-9% it is necessary that urban India be managed well to give a boost to the economy. Urban local bodies all over the country, therefore, require a restructuring of organisation, functional & financial positions for capacity building.

Major investments are required in urban basic services such as water supply, sanitation, roads, solid waste management etc that will ultimately enhance economic activity and in-turn contribute to national income. This shall require proper resource mobilisation and strong financial base and financial management, thus, attains apex importance. Incentive led schemes such as Urban Reform Incentive Fund (URIF) & JN-NURM have certainly provided financial support but ULBs need to keep searching for newer and better alternatives for attaining financial sustainability like some ULBs have opted for new avenues such as capital market through bonds. □



- Daily income from Octroi duty doubled
- Annual Property tax income increased by over 90%
- Non-tax revenue substantially increased
- All cash losses & overdrafts accumulated over 10 years wiped off and the financial year 1994-1995 ended with a surplus.
- Accessing to market borrowing through Municipal Bond
- In FY 05 more than 70 percent income was generated from Taxes, Octroi & Property Tax which is significant.
- Over the period of last four years, their revenue has increased at faster rate than expenditure. This has also led to higher per capita income and

Compliance Management In Banks

Banking

Compliance and good corporate governance go hand in hand in Indian banking industry, which is considered to be one of the well-regulated, if not over-regulated, sectors in the Indian economy, as huge amount of public funds and public interest is involved. The compliance processes revolve around Ghosh Committee Report (1992) and Consultative Group Report (2001) prepared by a team headed by Dr. Ganguly. The need for corporate governance in banks has also been emphasised by Basel Committee on Banking Supervision (2005), which has recognised the benefits of bank boards establishing certain specialised committees.

Compliance function in banks is one of the key elements in a bank's corporate governance framework and it needs to be adequately enabled and made sufficiently independent. Basel Committee also articulates this view.

Committees for Compliance Management

In a number of countries, bank boards have found it beneficial to establish certain specialised committees that ensure better compliance of regulatory

framework and advice on various issues relating to compliance function. In the interest of greater transparency and accountability, where such committees are established, their mandate, composition including members who are considered to be independent and

working procedures should be well-defined and subject to disclosure. It may be useful to consider occasional rotation of membership and chairmanship of such committees.

According to Basel Committee on Banking Supervision, it is common internationally for all



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Compliance Policy, outlining the compliance philosophy of the bank, role and set up of the Compliance Department, composition of its staff and their specific responsibilities duly approved by the board of directors should be in place. The policy should be reviewed annually by the Board. The Board is expected to review compliances on a regular (daily, quarterly) basis.

banks to have the following committees:

Audit Committee

This committee is typically responsible for providing oversight of bank's internal and external auditors, except where appointed by shareholders directly, approving their appointment, compensation and dismissal, reviewing and approving audit scope and frequency, receiving audit reports, and ensuring that management takes corrective actions timely to address control weaknesses, non-compliance with policies, laws and regulations, and other problems identified by auditors. To achieve sufficient objectivity and independence, audit committee should be comprised of a majority of board members who are not executives of the bank, whereas it often consists of independent and non-executive directors. While executives do serve on the audit committee to promote discussion, it may be beneficial for non-executive members of the committee to meet separately. It may also be beneficial for appointment or dismissal of internal and external auditors to be made only by a decision of independent, non-executive committee members. Minimum the chairman or one member of the committee should possess expert knowledge - commensurate with the complexity of the banking organisation and duties performed in financial reporting, accounting or auditing and all members should have backgrounds compatible with the duties of the committee. If required, training should be imparted to such members in specialised areas such as risk management.

Risk Management Committee

It is responsible for providing oversight of senior management's activities in managing credit, market, liquidity, operational and legal compliance, and reputation and other risks of the bank. This role should include receiving periodic information on risk exposures and risk management activities from senior management.

Compensation Committee

It is responsible for providing oversight of remuneration of senior management and other key personnel, and ensuring that compensation is consistent with bank's culture, objectives, and strategy, and control environment as reflected in the formulation of com-

penensation or remuneration policy.

Nominations/Corporate Governance Committee

It is responsible for providing assessment of board effectiveness and directing the process of renewing and replacing board members.

Compliance Risk and Compliance Function in Banks

Undoubtedly, compliance function is an integral part of governance, particularly in banks owing to its sensitive and fragile character. Compliance function, if not supported by management, does not bring in desirable results. Compliance in banks has to be a function of size, operations, organisational structure, etc. In fact, management of compliance risk itself is a major issue in banks. Compliance risk is basically the risk of legal and regulatory sanction, material financial losses or loss to reputation that a bank may suffer as a result of its failure to comply with laws, rules, regulations, regulatory standards, code of conduct applicable to banking activities and board formulated internal policies for banking operations.

In case of listed banks, capital market related regulatory framework is also to be complied with. Not only this, nowadays issues confronting various tax laws, money laundering and right to information need to be properly addressed. Compliance area is relevant and crucial in identifying, evaluating and addressing legal, operational and reputation risk. These issues ought to be addressed at board level only to ensure enterprise-wide compliance programme so that management and board understands the concentration, if any, of such risks, provide comparison of risk levels and changing nature of risks and identification of risks requiring attention. The compliance function should, therefore, ensure that the prevailing procedures, systems and controls capture the desired information so as to allow board to better perform their risk management function.

It is said and it should be understood that compliance starts at the top. One cannot expect the compliance officer to be compliant and function in an isolated environment. Compliance is supposed to be effective in a corporate culture where board (or audit committee) leads by example. For ensuring this, bank board

should ensure that a well formulated compliance policy is in place and have proper and qualified resources to manage compliance risks including overseeing its implementation. A robust compliance system in a bank should include a well documented compliance policy.

Compliance Policy, outlining the compliance philosophy of the bank, role and set up of the Compliance Department, composition of its staff and their specific responsibilities duly approved by the board of directors should be in place. The policy should be reviewed annually by the Board. The Board is expected to review compliances on a regular (daily, quarterly) basis. In banks, it is generally seen that too many functions are performed by same set of people but ideally oversight of audit function and compliance function should be kept separate. For this to happen, it may be so that audit committee and compliance committee are two separate committees of the board. However, inspection/audit findings should serve as a feedback mechanism for the Compliance Department for assessing the areas of compliance breaches/failures. The Chief Compliance Officer should be an invitee to the meetings of the ACB. A check-list on the compliance aspect may be made part of the inspection report for

the inspectors / concurrent auditors to verify the level of compliance. The audit function should keep the Head of Compliance informed of audit findings related to compliance.

It is also important to recognise and appreciate the performance of human resource dealing with compliance related issues. The Compliance function should on a proactive basis identify, document and assess the compliance risks associated with banks' business activities and products. For example, the compliance risks in all new products and processes should be thoroughly analysed and appropriate risk mitigates by way of necessary checks and balances should be put in place before launching. The Chief Compliance Officer should be a member of the 'new product' committee/s to ensure that the new products/processes have clearance from all perspectives including compliance. All new products may be subjected to intensive monitoring for the first few months of introduction to ensure that the indicative parameters of compliance risk are adequately monitored.

The code of conduct for employees should envisage working towards earning the trust of the society by dealing with customers in a fair manner and con-

The PSBs strictly follow RBI regulations in letter and spirit (not always). The corporate banks have to follow both - RBI norms as well as company law requirements. Of course, in case of listed entities, SEBI norms on corporate governance are also required to be complied with. When it comes to the appointment of compliance officer as stipulated in corporate governance norms, it is generally seen that all banks appoint compliance officers but not really in true sense.

ducting business operations consistent with rules and regulations. Due weightage could be given to record of compliance during performance appraisal of staff at various levels. Staff accountability should be examined for all compliance failures. This is a must.

The activities of the compliance function should be subject to annual review by the internal or management audit. Compliance risk shall be included in the risk assessment methodology of the internal audit function and the audit programme should cover the adequacy and effectiveness of the bank's compliance function including testing of controls commensurate with the perceived level of risk.

Instances of all material compliance failures which may attract significant risk of legal or regulatory sanctions, financial loss or loss of reputation should be reported to the Board/ACB/Board Committee promptly. Apart from the exhaustive annual review, a monthly report on the position of compliance risk may be put up to the senior management/CEO by the Chief Compliance Officer. A brief report on the compliance position may also be placed before the Board/ACB/Board Committee, as the case may be on a quarterly basis.

Need for Compliance Officer

While most of the Public Sector Banks (PSBs) are body corporates, the new generation banks are limited companies incorporated under Companies Act, 1956. The PSBs strictly follow RBI regulations in letter and spirit (not always). The corporate banks have to follow both - RBI norms as well as company law requirements. Of course, in case of listed entities, SEBI norms on corporate governance are also required to be complied with. When it comes to the appointment of compliance officer as stipulated in corporate governance norms, it is generally seen that all banks appoint compliance officers but not really in true sense. In case of companies, usually the Company Secretary, already employed is designated as a compliance officer. In fact, ideally it should be the Company Secretary only who should act as a compliance officer and discharge duties diligently. In case a qualified secretary

for some reason is not a possibility, preference should be given to a professional drawn from legal, accountancy or management disciplines.

In case of public sector banks, this is more of a ritual and any middle level manager is designated as a compliance officer who may or may not report to a general manager who may be having a portfolio of finance or inspection or operations. It is imperative that compliance officers in PSBs should also be qualified professionals, who, unlike a core banker, are better suited to discharge the functions of a compliance officer and also ensure corporate governance measures, shareholder's grievance redressal system and safeguard investor's interests. Reserve Bank ought to take a lead in this direction and emphasise appointment of a qualified professionals as compliance officer and secretary to the bank board.

Need for Compliance Committee

The compliance function has already been emphasised above. Bank boards must have a compliance committee of the board to oversee the level of compliance and ensure that banks comply not only with the banking laws but with all the laws to which a banking company is exposed. It could be labour and industrial laws, international laws, various taxation laws, accounting standards and even the environmental laws. Now a days, new generation legislations such as Money Laundering Act, Fiscal Responsibility Act, Right to Information Act, etc. are also in place to which banks are exposed. A slight non compliance could invite financial and reputation risk. Apart from the bank itself, there are compliance issues in relation to bank's vendors, suppliers, constituents and outsourced agencies. These are also important and require appropriate addressing.

Conclusion

All said and done, compliance in Indian banking industry is by and large satisfactory irrespective of size, profitability or Non-Performing Assets (NPA) level in the banks. The role of compliance officer and compliance committee can go a long way in effective compliance related governance in banks. □

SHARE BUYBACK REGULATIONS IN INDIA: A CRITICAL ANALYSIS

At present share buyback has become an important tool of corporate finance and has got recognition the world over. Share buyback by companies was launched in India in 1998 and a regulatory framework was put into force subsequently for the governance of this corporate practice in the country. Although the buyback regulatory framework is quite stringent in India compared to the developed countries like US, it leaves an adequate room for misuse and malpractices by unscrupulous corporate managements. The present article identifies and examines the possible loopholes prevailing in existing buyback regulatory framework and suggests possible policy implications in order to bring desired level of transparency in corporate practices in tandem with best international practices.

India recognised the need for the share buyback system in late 1998. Till then, the Companies Act, 1956, had prohibited Indian companies from repurchasing their own shares. According to the section 77(1) of this Act, 'No company limited by shares, and no company limited by guarantee and having a share capital, shall have power to buy its own sections 100 and 104 or of section 402'. However, section 77A of the Companies Act, 1956 that was inserted in the Companies Act by the Companies (Amendment) Act, 1999 with retrospective effect from October 31, 1998, is an exception to the prohibition under section 77 and section 100. Section 77A

allows companies to repurchase their own shares as well as other specified securities.

The United States has the longest history in the regime of share buybacks. The share buyback practice was introduced in the U.S. in the late 1960s. It got popularity by mid 1980s. But in India, it is a new practice. There were some specific reasons behind the introduction of share buyback system in India. Around 1996, the prolonged depression in Indian stock market compelled both business groups as well as Government to be very much concerned about the fact. All the efforts of the Government to revive the situation of the stock market became unsuccessful. Its revival had become a sensitive issue in the economy which caused a wide public debate. In



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After the amendments made in 2001 in the Companies Act, shareholders' resolution is not essential for approving any buyback of up to 10% of paid up capital and reserves, only the board's resolution is sufficient for such authorisation. This system has made share buyback easier but it violates an important principle of corporate law that any change in share capital should be approved by the general body of shareholders.

that situation, share buyback practice had been considered an effective mechanism for reviving the stock market, as share buybacks by companies are believed to inject some buoyancy into share prices as buyback price is generally higher than the prevailing current market price. Companies repurchase their own shares from different motives which are not same for all the companies and such motives are very much associated with the specific situation. Some common motives of share buyback are returning surplus cash to shareholders, disseminating or communicating management's view to shareholders that the market is currently undervaluing its shares and the company has enough confidence on its future prospects, enhancing earning per share, eliminating the takeover threats, re-designing the capital structure of the company etc.

After the introduction of share buyback practice in India in 1998, a regulatory framework was put into force in order to govern this corporate practice. This regulatory framework is quite stringent and conservative in India in comparison to developed countries like U.S.A. Despite this, its regulation in India has some major flaws that leave adequate room for mis-

use by unscrupulous and dishonest corporate managements. The present article critically examines such loopholes prevailing in the regulatory framework for share buybacks in India. In this context, it should be mentioned that share buyback by companies in India are regulated by sections 77A, 77AA and 77B of the Companies Act, and by the SEBI (buyback of securities) Act, in the case of listed companies. Moreover, in the case of unlisted public and private limited companies, the rules of the Central Government known as Private Limited Company and unlisted Public Limited Company (buyback of securities) Rules, 1999 are applicable.

Objectives of the Study

The present study seeks to attain the following objectives

1. To identify and explain the major lacuna or loopholes prevailing in the regulatory framework of share buyback in India.
2. To suggest possible remedial measures with policy implications with a view to make the share buyback practice fair, transparent and genuine.

International Share Buyback Regulations and Practices:

Country	Approving Body	Buy-back Period	Price Restriction	Volume Restriction	Trading Condition	Use of Shares bought back	Source of Financing Buyback
U.S.A	Board	None	Not more than the highest current independent bid-price or the last independent sale price, whichever is higher.	None	Repurchases are not allowed as opening transaction or during the last half hour of a trading day. None block buyback volume does not exceed the higher of (a) one round lot or (b) the No. of round lots closest to 25% of the average daily volume for the preceding four calendar weeks.	After buying back, the shares are cancelled or granted to employees when stock options are exercised. Use of repurchased shares in financial transactions should be authorized by the meeting of the shareholders.	Both equity as well as borrowed capital.

It is worth while to note that, in comparison to open market method, tender offer method is absolutely perfect, clear and transparent. Under this method, a company commits itself to repurchase a definite number of shares at a fixed price and in that case, the entire buyback programme should be completed within a period of 30 days.

Country	Country	Country	Price Restriction	Volume Restriction	Trading Condition	Use of Shares bought back	Source of Financing Buyback
U.K.	Board	18 months	Not more than 5% of 5 day price.	15% of the total shares.	N.A.	Shares so bought back are cancelled and cannot be held as treasury stock.	Distributable profits.
Canada	Board	12 months	Not more than recent trade price which is the price arising from transactions unrelated to share buyback or insider' trading activity.	5% of total shares or 10% of public float.	Cumulative repurchases over the trailing 30 day period must not exceed 2% of the number of outstanding shares.	N.A.	N.A.
Australia	Board and /or shareholders' meeting.	12 months.	Not higher than 5% above the average (calculated over the last 5 days price) of the market price.	None	N.A	Repurchased shares are systematically cancelled.	Not prejudice to the ability to pay creditors.
Germany	Shareholders' meeting.	18 months.	Maximum and minimum prices are determined in the shareholders meeting.	10% of the total shares.	N.A	Companies may hold the repurchased shares in treasury. But such shares are not entitled to voting rights and dividend payouts.	Distributable profits.
Hong-Kong	Shareholders' meeting	18 months	None	10% of the total shares, 25% of monthly volume (for open market repurchases only).	A company cannot buy back its shares for the one month period prior to the annual earnings announcement.	Repurchased shares are cancelled.	Distributable profits or the proceeds of a fresh issue of shares for the purpose.
Mexico	Shareholders' meeting	N.A	At current market price.	Maximum of 3% of shares in a period of 20 days, unless through a public offering.	N.A	Selling of repurchased shares is treated as new distribution.	Not exceeding the amount of retained earnings.

As an important technique of corporate finance, the share buyback system has achieved world-wide popularity and India is no exception. In India, this practice is in a nascent stage and the corporate practices in this regard are still evolving. Indian corporate sector is basically family-controlled unlike US or UK. Hence, the regulatory framework governing share buyback in India should be, to some extent, stringent with a view to make this practice transparent and successful.

Country	Approving Body	Buy-back Period	Price Restriction	Volume Restriction	Trading Condition	Use of Shares bought back	Source of Financing Buyback
Netherlands	Shareholders' meeting	18 Months	Maximum and minimum prices are determined in shareholders' meeting.	10% of total shares	N.A	N.A	Distributable profits.
Japan	Board	N.A	Not more than the previous trading day's closing price	10% of total shares	Buyback company cannot engage in buyback trading during the last half hour of a trading day and during one week period prior to the end of the fiscal year. Also the maximum number of share to be repurchased in a day should be limited to 25% of the average daily trading volume of the previous month.	Repurchased shares may be sold out but it enquires specific disclosure (i.e., in addition to general disclosure rules concerning price sensitive information)	Distributable profits.
Switzerland	Board	None	Not more than the last independent transaction or official price.	10% of total shares	N.A	Repurchased share may be sold out but it requires specific disclosure	The buyback company has to show reserves in the amount of acquisition value.
Brazil	Board and for shareholders meeting.	N.A	At market price	10% of free float shares	N.A	N.A.	Upto the amount of capital reserves
Malaysia	Shareholders' meeting for all types of share buy backs.	N.A	Not higher than 15% above the average (calculated over the last 5 days) of the market price	10% of total shares.	N.A	Repurchased shares are all owed for selling purpose but it requires specific disclosure.	Retained earnings and /or share premium account.

Country	Approving Body	Buy-back Period	Price Restriction	Volume Restriction	Trading Condition	Use of Shares bought back	Source of Financing Buyback
Singapore	Shareholders meeting	N.A	Not higher than 5% above the average (last 5 days of the market price.	10% of total shares	N.A	Repurchased shares are cancelled out.	Distributable profits.
Italy	Shareholders meeting	N.A	Not more than just recent price.	10% total shares, 25% of monthly volume.	N.A	Selling of repurchased shares is allowed but it requires specific disclosure	Distributable profits.
France	Shareholders meeting	18 months	The buyback price cannot be less than the lowest market price and not more than the highest market price recorded on the date when buyback is done /made.	10% of total shares.	The number of repurchased shares must not exceed 25% of the average daily trading volume as computed for three previous trading days. Firms are prohibited from buyback trading for 15 days prior to the public announcement of the annual reports or when the firm is in possession of information, which is made public, can impact the market.	Repurchased shares may be used to grant shares to the employees, exchange stocks as part of Merger and Acquisition transactions, reduce or eliminate dilution related to conversion of convertible bond, or hold the shares, within the limit of 10%.	Distributable profits.

Major Faults in Buyback Regulations in India

The buyback regulatory framework was put into force in India with a view to govern and control the possible misuses of this practice by the dishonest corporate managements and also to bring transparency in this corporate practice. But if we critically examine the existing framework of share buyback regulations in India, a number of imperfect areas may be noticed:

Lack of Transparency in open Market Buyback

Under the open market system of buyback, a company doesn't commit itself to repurchase any definite number of shares at any fixed price unlike tender offer method. Only the maximum price limit for repurchase of shares is announced. Thus, the number and the price of the shares to be purchased are not disclosed to the public and its disclosure is the discretion of the top management of the company. This system lacks transparency and leaves much opportunity for price manipulation for the benefit of a particular section of

the shareholders, who are closed to the management. Announcement of only maximum price is of no importance from the viewpoint of common shareholders. From the analysis of share buyback cases of the period from 1998-99 to 2002-03, it appears that the actual buyback price is less than one half of the maximum price in nearly 50% of the cases analyzed (L. C. Gupta: *Share Buybacks in India*, p.67).

Moreover, there are few more instances of open market buyback offers, where companies did not purchase a single share in spite of the situation that the market price of the shares was much below the maximum authorized price for buyback. Reliance Industries Ltd., SRF Polymers, Deepak Fertilizers and Sirpur Paper Mills are some of the examples of such companies. These facts obviously raise doubts in the minds of the shareholders about the intension and sincerity of the management regarding such corporate practice.

Requirement of shareholders' approval

After the amendments made in 2001 in the Com-

panies Act, shareholders' resolution is not essential for approving any buyback of up to 10% of paid up capital and reserves, only the board's resolution is sufficient for such authorization. This system has made share buyback easier but it violates an important principle of corporate law that, any change in share capital should be approved by the general body of shareholders. In various countries like U.K., France, Germany, Denmark, Netherlands, Finland, Sweden and Norway, shareholders' approval is mandatory for authorization for share buybacks irrespective of the size of share buyback. With this system, shareholders are being deprived of their lawful and fundamental right to vote on crucial decisions regarding alternation or other changes in share capital. In practice, some companies made share buyback of up to 10% of paid up capital and reserves. These companies are Arati Industries (5.16%), Bhagyanagar Metals II (9.97%), Finolex Cables (10%), Fortune Financial I (5.16%), India Nippon (7.68%), Jay Shree Tea (10%), Motor Industries I (5.30%) etc.

Fresh issue of shares after buyback

With the amendments made in the Companies Act in 2001, Indian companies are now permitted to undertake fresh issue of share immediately after 6 months of its repurchase. This time period is too much less and may be favourable for encouraging the promoter in unfair practices. With this opportunity, they may undertake the strategy of reducing the floating stock through buyback at low prices and push up the share price and thereafter emerging with a fresh issue of shares at a higher price. This provision is suitable for price manipulation by top managements. It would be very confusing, if a company repurchases its shares with a view to distribute surplus cash to shareholders and then it goes for fresh issue of shares for raising capital within the same year.

Disclosure and Reporting requirements

There are some critical faults in the requirement of disclosures and reporting of share buybacks in India. In the case of open market repurchase, the announcement of only maximum price is quite meaningless to the ordinary shareholders. International best practices follow the announcement of both 'maximum' as well as 'minimum price' for buyback. Moreover, in India, it is not compulsory to disclose actual buyback data under any repurchase programme in the quarterly reports of companies that have undertaken share buybacks, unlike USA. As per the new rule of the Securities Exchange Commission (SEC) in the USA in March 2004, in their quarterly report companies are required

to disclose information like total number of shares purchased in the last quarter, average buyback price paid per share and maximum number or approximate value of shares that may be repurchased under the buyback programme. But India lacks this important practice. In many countries details of actual buyback transactions are to be reported to the stock exchanges and/ or supervisory or regulatory authorities. In UK, Australia, Japan, Netherlands and Hong Kong, actual buyback information has to be reported immediately or on the same day on a continuous basis during the period of buyback. Such reports are to be submitted on a monthly basis in Canada, France and Italy.

Tendering Promoters' shares for buyback

The SEBI regulations allow the promoters of a company to tender their own shares under the fixed price tender offer method of buy back but not in the case of open market buy back. Practically in most of the cases, promoter shareholders do not respond to that and they do not tender their shares for repurchase. The main reason behind it is that promoters are more willing to retain their control and increasing voting power in the company. If they are allowed to tender their shares for buyback, the chances of price manipulation would be more. Ultimately they may fulfill their own objectives without ensuring proper judgment to the interests of common shareholders with the help of this strategy of share buyback.

Necessary Policy Implications and Suggestions

In recent time, buyback of shares has become an effective and useful tool of corporate finance around the world. In order to make this practice transparent and fair, a strong regulatory framework governing such share buyback activity is essential. At present, Indian buyback regulatory framework leaves wide scope for misuse of this practice. With a view to overcome such possibilities, some policy implications may be suggested. We would like to recommend the following policy implications strongly.

- In the case of open market buyback, both the "maximum limit price" as well as "minimum support price" should be made compulsory to disclose. From shareholder's point of view and also from the angle of market stabilization, the disclosure of "minimum support price" is expected to play a vital role. This will facilitate the protection of interest of the shareholders, since the repurchasing company will have to pay at least the minimum support price. Hence, SEBI regulations should be amended and declaration

of “minimum support price” should be made mandatory for buyback companies. This will bring some advantages:

- It will provide an assurance to the shareholders regarding the genuine and perfect motive of the company to prevent the under valuation of its shares.
- It will reduce the chance of price manipulation by the management through open market buy- back. It will also help in reducing the price volatility in the market.
- It will ensure the sincerity and positive intentions of the top management about such buyback and reflect the realistic approach of repurchase prices.

In this context, it should be worth while to note that, in comparison to open market method, tender offer method is absolutely perfect, clear and transparent. Under this method, a company commits itself to repurchase a definite number of shares at a fixed price and in that case, the entire buyback programme should be completed within a period of 30 days. The empirical data in India for the period 1998-1999 to 2002-2003 revealed that, under the tender offer method, the actual buyback price, on an average, was 35-40 per cent higher than the market price before the announcement of buyback programme [Share Buy backs in India by L.C.Gupta– p.67].

- The detail information of the entire buyback programme should be disclosed by a company in its quarterly report highlighting the following aspects:
 - The total number of shares offered for buyback and the actual number of shares repurchased during the last quarter; the amount of total consideration paid for such buyback should also be reported,
 - The authorized buyback price at the time of announcement and the actual average price paid per share, and
 - What extent of the announced buyback programme has been implemented during the past quarter in terms of total consideration paid and also the extent of the remaining programme which is expected to be implemented in coming future.
- Due to buyback of shares, the share capital of

a company is changed and we feel that such change in share capital should be approved by the shareholders. The sole approval of the board should not be considered adequate in such an important corporate event. Hence, shareholders’ approval by a special resolution should be considered as an essential prerequisite for buyback of shares. Shareholders should not be deprived from their basic rights regarding important affairs of the company.

- As regards to the reissue of shares, we feel that in India, companies should not be allowed to make fresh issue of shares just after the elapse of 6 months after the buyback. For fresh issue of shares companies should at least wait for one and half year keeping pace with the best international practices. This will facilitate in eliminating the problems arising out of the quick issue of shares after the buyback.
- We feel that promoter shareholders should not be allowed for tendering their shares for repurchase under both tender offer as well as open market method. This will facilitate in preventing the chances of price manipulation by promoter shareholders for their own interest.

Conclusion

As an important technique of corporate finance, the share buyback system has achieved world-wide popularity and India is no exception. In India, this practice is in a nascent stage and the corporate practices in this regard are still evolving. Indian corporate sector is basically family-controlled unlike US or UK. Hence, the regulatory framework governing share buyback in India should be, to some extent, stringent with a view to make this practice transparent and successful. But due to the existence of some crucial faults in the prevailing regulatory framework, the possibility of misuses of such practices cannot be denied. We hope that, the suggestive policy implications that we have pointed out in this article will help in reducing the possible misuses as well as malpractices of share buyback system in India. This is most important because of the fact that the corporate governance in India is not so strong unlike that in developed nations. Indian companies, which are mostly family-controlled, do not duly follow the principles of corporate governance to their best both form legal and ethical angles. Had our corporate governance system been strong, the possibilities of malpractices of share buyback by the unscrupulous and dishonest managements would not have been a close reality. □

WORKING WITH MS - EXCEL

The Microsoft Office Excel, which is a proprietary spreadsheet application for Microsoft Windows and Mac OS X, is one of the most popular microcomputer applications to date. Because of its vast yet simplified computing and data analysis power, it is particularly popular among the auditors, especially of small and medium size organisations. It offers almost all facilities in one way or another that the specialised audit software usually offers. This article discusses some of the techniques of working with MS-Excel, particularly useful from the point of view of professionals.

Lakhs of people throughout the world use MS-Excel on a regular basis. However, greater part uses Excel as a calculating tool instead of using its incredible power to work as data analysing tool.

One of the main objectives behind development of this wonderful software is to provide vast information analysis power to the user. And one of the primary roles of an auditor is to analyse the information. MS-Excel offers a number of computing and analysing tools in a simplified way. It offers almost all facilities in one way or another that the specialised audit software usually offers. That's why

MS-Excel is considered to be the best option available to auditor, especially of small and medium size organisations where data volume is manageable with an Excel Sheet.

It features calculation, graphing tools, pivot tables and, except for Excel 2008 for Mac OS X, a macro programming language called VBA (Visual Basic for Applications). It is overwhelmingly the dominant spreadsheet application available for these platforms and has been so since version 5 in 1993, and is bundled as part of Microsoft Office.

Some of the techniques of working with MS-Excel, which I find very useful in my working, are talked about here.

(Note: - The whole discussion in



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Investments made by the banks in securities are market related and are subjected to risk with regard to their yield and market value. If the yield of the particular security increases, the result is the fall in the market value of the securities and vice versa.

this article is based on the features available in MS-Excel 2003)

I. Verification of Formula while Formula Auditing

Verification of formula is one of the common problems for Excel users. Especially for auditor, when data provided by the client is in a worksheet that contains formula for working like - calculation of depreciation, variance analysis, budget v/s actual expense etc. It becomes important to confirm the accuracy of the calculation before accepting the same for auditing.

Excel's Formula auditing feature can be helpful here. With following steps it would be easy to make sure that formulas are properly defined and entered.

Steps

1. Select the cell that contains the formula you want to check.(F15 in this case)
2. Select Tools →Formula Auditing → Trace Precedents.
3. Repeat this and Excel will take you to the basic input of the formula.
4. Observe the pattern of the flow from where the values are being taken and where the values are being put.

	A	B	C	D	E	F	G
1	Asset Value	RDR	ADR	Reg. Depre		Addi. Depre	
2	4,987.00	0.15	0.2	997.40		997.40	
3	2,620.00	0.15	0.2	393.00		524.00	
4	7,300.00	0.15	0.2	3,460.00		3,460.00	
5	3,992.00	0.15	0.2	2,098.80		2,798.40	
6	5,237.00	0.15	0.2	1,758.55		1,147.40	
7	6,960.00	0.15	0.2	1,044.00		1,392.00	
8	8,368.00	0.15	0.2	1,555.20		2,073.60	
9	5,900.00	0.15	0.2	885.00		1,180.00	
10	9,236.00	0.15	0.2	1,385.40		1,847.20	
11	6,864.00	0.15	0.2	1,029.60		1,029.60	
12	2,500.00	0.15	0.2	375.00		500.00	
14	85,964.00			19,984.55		10,968.20	
15		Total Depreciation				4,952.75	
16		ADR=Additional Depreciation Rate					

It can be clearly seen without any explanation as to what is wrong with the above stated depreciation calculation. If you observe carefully, you would notice that there are total eight mistakes in the calculation.

Tip:

1. Activate "Formula Auditing" toolbar for speedy working. For this select "View"→"Toolbars"→"Formula Auditing"

2. Double click the arrow head/tail to switch between formula cell and reference cell

II. Find Duplicate Entry

No specific command is available for verification of the duplicate entry, if any. However, it is possible to find out duplicate entries from data. Follow these steps.

1. Select the area you want to verify. (A2:C10, here)
2. Select Format →Conditional Formatting.
3. Change first drop down box to "Formula Is" and Enter this formula in formula box

=COUNTIF (\$A\$2:\$C\$10, A2)>1

(Take note of the reference style for first portion of the formula. (Area you want to check). Set a fixed reference for it. The second part of the formula is relative reference. i.e. without \$ sign.)

4. Press Format button and Select red font color from the font color palette.
5. Press OK→OK.

The duplicate entries in given area will get formatted as per Step No. 4 (Red in this case) as shown in following figure.

	A	B	C
1	Party Name	Bill No.	Amount
2	Deep Marketing	MM 209482	2,15,334.00
3	Arihant Enterprises	39	59,641.00
4	Shree Rathi Agency	7030213749	1,46,256.00
5	Daya Fibres Ltd.	60117305	5,27,366.00
6	Comfy Distributors	7308	66,100.00
7	R. K. Syntex	225-U	1,63,911.00
8	Daya Fibres Ltd.	60117305	5,27,366.00
9	Prem Industries	37374	1,14,559.00
10	Reactive Limited	20728	22,414.00

Result summary

Bill no. 60117305 of Daya Fibres Ltd. has been entered twice.

III. Special selection

You would probably need to locate special cells in Excel sheet - for example you may want to locate all cells containing formulas or all cells containing numbers. Excel provides an easy way of doing this by using "Go to Special" command. Press Ctrl+G (or F5). "Go To" dialog

If one bank purchases the securities in secondary market at a particular date, which falls between the stipulated periods of payment of interest, the bank, which purchases the security, has to pay interest to the bank, which sells the security.

box will appear. Press “Special...” Button and Excel will show you different options available for selection.

Here are some tricks/tips for efficient use of this command.

- Filling up the gaps between the entries

It is commonly faced problem that the report files generated by the accounting software do not repeat the same item until new entry comes. See the following report.

	A	B	C	D
1	03-May-06	Arvind Mills Ltd.	Bags	55
2				76
3	07-May-06	Annapurna Overseas Ltd.	Tins	34
4				8
5	10-May-06	Dashrathbhai Prajapati	Bags	50
6	11-May-06			13
7				24
8				5
9	19-May-06	Navsarajan Trust	Bales	6

It would be difficult to analyse such data until you fill up the gap of blank cells between the entries.

Do this way.

1. Select the range containing the gap (A1:D9 in this example)
2. Press Ctrl+G
3. Click “Special...” Button
4. Select Blank Option (Radio Button) Click OK.
5. Press “=”, and press Up arrow button.
6. Press Ctrl + Enter
7. Reselect the original range (A1:D9 in this example)
8. Press Ctrl+C, then Select Editg → Paste Special, Choose “Value” option (Radio Button) and click OK.

- **Removing data keeping the formula**

This is required when you want to distribute only format of the calculation or you want to save only formula to use the same format in future.

Select the range you want to work on.

Press F5, Click on “Special...” Button

Select second radio button “Constants”. When you select the “Constants” button the four check boxes will get enabled. Keep all the check boxes selected and press OK.

Press “Delete” button

- **Protect all cells containing formula leaving other cells open for accepting values.**

Select any single cell in the sheet.

1. Press F5, Click on “Special...” Button.
2. Select Constants Option (Radio button) and keep the all check boxes selected.
3. Press OK
4. Go to Format → Cells → Click on “Protection” tab and turn off the “Locked” check box and press OK.
5. Go to Tools → Protection → Protect Sheet.

If you are using MS-Excel 2002 or higher version you can make your workbook more interactive by selecting some options available while protecting the sheet. E.g. “Select unlocked cells” from the option list available in the protection dialog box. This will limit the movement of the cursor to unlocked cells.

If you are using a MS-Excel version below 2002, Select View → Toolbars → Control tool box. This will open a new tool bar named as Control Tool Box. Press button. Select “Enable Selection” Entry and then select “1-xlUnlockedCells” from the dropdown and close that window. It will restrict the movement of the cursor to unlocked cells only. However, as the Excel does not save this setting and hence when you close the workbook, this setting will be lost. You have to again do it when you reopen the workbook.

IV. Cell Formatting

Custom number format enables you to design your own format. Select the intend range and select “Format: → “Cells...” → “Number format Tab”. Select “Custom” in the category list. It will show you pre designed formats. Select any one of them or you can create your own by typing the code in “Type:” box.

In case the bank, which sells the security, had purchased the security before 30/09, it will receive the interest up to 30/09 on the due date of payment of interest. When it sells the security on 30.12.2007, the purchasing bank will have to pay interest only for the period from 01.10.2007 to the date of purchase of the security.

The coding of format is divided in to four sections, i.e. to be arranged in four categories namely, (1) Positive Number (2) Negative Number (3) Zero (4) Text. Categories are separated by a semicolon (;).

This enables the presentation of information in convenient way, especially numbers i.e., presentation of number in the way it is generally written.

- **Displaying amount in Indian Comma grouping style.**

Select the intend cell/range and Go to format → Cells... → Click on “Number” Tab Select Custom in category list and type the following code in the “Type:” Box.

[<99999.99]##,##0.00;[>9999999.99]##\,##\,##\,##0.00; ##\,##\,##0.00

This will work well up to 99 crore, for positive values only. For negative values you can use the following

[>-100000]##,##0.00;[<-9999999.99]-##\,##\,##\,##0.00;##\,##\,##0.00

Following code will work well for both negative and positive values limited up to 99 Lakh.

[<-99999.99]-##\,##\,##0.00;[>99999.99]##\,##\,##0.00; ##,##0.00

My favorite number format for financial values is

-* ## ## ## ##0.00- ;[Magenta]_>(* ## ## ## ##0.00)_-;_-* "-_";_@_-

A comparison of normal and formatted view is given in the image below.

	A	B	C	D
1	Months	Rs.	Rs.	
2	January	2363736	23 63 736.00	
3	February	232323	2 32 323.00	
4	March	-423423	(4 23 423.000)	
5	April	0	-	
6	May	5534	5 534.00	
7	June	123123	1 23 1230.00	

- **Hiding Zeros**

Select the range you want to apply for, and Go to format → Cells... → Click on “Number” Tab Select Custom in category list and type the following code in the “Type:”

Box.

0;-0;;@

Press OK

It will hide the figures of zero values of all cells in selected range. However, you can see the zero value in formula bar.

- **Negative Sign on Right Side**

Enter the code given below in the “Type” box of the “Custom” Category of number format.

0 ;0_-;0 ;@ (Three spaces between first zero and semicolon and two underscores before minus sign, then again three spaces between last zero and last semicolon)

A comparison between normal view and formatted view is given in following figure.

	A	B	C
1	Months	Rs.	Rs.
2	January	2363736	2363736
3	February	232323	232323
4	March	-423423	423423
5	April	0	0
6	May	5534	5534
7	June	123123	123123

- **Inserting Fraction Number**

Generally we enter the non-integer values using decimal points in Excel. However, some type of data is displayed in fraction usually. If you want to enter fractional number to appear like 8 1/5 and you want to perform some calculations on the same.

Do this way

Type 8 → Space g type 1/5 → Enter

Note: If numerator is higher than denominator, Excel will further calculate to make it more accurate. For example if you enter 5 17/3, it will be converted in to 10 2/3. If you want to enter only fractional value say 1/5, do this way

Type 0 → Space → type 1/5 → Enter

- **Changing Colour Based on Value**

Enter the code given below in the “Type” box of the

Prior to the issue of Circular No.4/2007 of CBDT, Hon'ble Supreme Court and various High Courts have held that securities of Bank is trading asset.

“Custom” Category of number format.

[color3][>1000]; [color5][<=0];[color4];general

The following figure shows color with their code. You can go for any color. For selecting the color, change the color code given in square bracket. [color_]

	A	B	C	D	E	F	G	H	I	J
1	1	2	3	4	5	6	7	8	9	10
2	11	12	13	14	15	16	17	18	19	20
3	21	22	23	24	25	26	27	28	29	30
4	31	32	33	34	35	36	37	38	39	40
5	41	42	43	44	45	46	47	48	49	50
6	51	52	53	54	55	56				

- **Hiding all Data in the Sheet**

Enter the code given below in the “Type” box of the “Custom” Category of number format.

;;; (Type three semicolons in the type box)

- **Leading Zeros**

Enter the code given below in the “Type” box of the “Custom” Category of number format.

000000;-000000;000000;

It will look like this

	A	B	C
1	Months	Rs.	Rs.
2	January	150	000150
3	February	100	000100
4	March	50	000050
5	April	-39	-000039
6	May	500	000500
7	June	1000	001000

V. Paste Special

Paste special offers some excellent features and facilities. With various methods we can use this facility in an effective way.

- **Replacing the Formula with its Value**

To replace a formula with its value for a single cell, put the cursor in the formula bar and press F9.

For a range of cells, select the intended range and Press Ctrl + C, Alt +ESV, Enter

- **Converting Values in lakh**

To convert all values in lakh perform following steps.

1. Type 100000 in any of the blank cells.
2. Copy it (Press Ctrl + C)
3. Select the range you want to convert values in lakh.
4. Select Edit → Paste Special... (Alt + E S)
5. Click on Value option in Paste frame and click on “Divide” option in Operation frame.
6. Press OK.

If the range you have selected includes any formula, the Excel will further extend the formula adding “/100000” at the end.

You may want to convert only constants into lakh and not formula. For this, before applying paste special as mentioned above go through following steps. (After step no. 3 and before step no. 4)

- a. Press Ctrl + G
- b. Press “Special...” button
- c. Select Constants and press OK.

The cells containing formula will left be unselected. Now carry on with the step No. 4 mentioned above.

- **Transposing the Value**

You can transpose the data from horizontal to vertical and vice versa.

Steps

1. Select the range you want to transpose.
2. Press Ctrl + C
3. Select the cell from where you want to put the transposed data.
4. Select Edit → Paste Special...
5. Select “Transpose” Check box and press OK.

The following figure shows the data before and after the transpose.

	A	B
1	January	150
2	February	100
3	March	50

Before
After

	A	B	C
1	January	February	March
2	150	100	50

Reserve bank of India has instructed the banks to treat the broken period interest as expenditure under profit and loss account.

• Skip Blanks

Conventionally a trial balance is generated with two separate columns, one for accounts showing debit balances and one for credit balances. However, you may want all the account balances (whether debit or credit) to appear in a single column to analyse the data, it can be done by showing debit balances as positive sign and credit balances as negative sign in a single column. Following is a conventional trial balance sample.

	A	B	C
1	Accounts	Dr	Cr
2	Capital A/C	1,23,450.00	
3	Current Assets		81,700.00
4	Current Liability	67,546.00	
5	Differed Tax Liability		7,453.00
6	Fixed Assets		1,56,745.00
7	Investments		23,987.00
8	Secured Loans	2,346.00	
9	Unsecured Loans	76,543.00	
10	Total Rs.	2,69,885.00	2,69,885.00

“Skip Blank” option in paste special can be helpful here. Follow given steps.

1. Enter -1 in a blank cell
2. Copy that cell
3. Select Credit entry range (C2:C9 in given example)
4. Press Ctrl + G → “Special...”
5. Select “Constants” (radio button)
6. Press “OK”
7. Press Alt +ES
8. Select “Value” in “Paste” radio button array and select “Multiply” in “Operation” radio button array.
9. Press “OK”
10. Select Debit Entry Range (B2:B9 in this example) and Copy that range to the adjacent blank column (D column in this case)
11. Select Credit Entry Range (C2:C9 in this case) and copy it.
12. Select First cell of the merged column (D2 in this case)
13. Press Alt +ES

14. Select “Value” in “Paste” radio button array and click on “skip Blank” check box.

15. Press “OK”

Result of the above process is given in following figure.

	A	B	C	D
1	Accounts	Dr	Cr	Rs
2	Capital A/C	1,23,450.00		1,23,450.00
3	Current Assets		- 81,700.00	- 81,700.00
4	Current Liability	67,546.00		67,546.00
5	DTL		- 7,453.00	- 7,453.00
6	Fixed Assets		- 1,56,745.00	- 1,56,745.00
7	Investments		- 23,987.00	- 23,987.00
8	Secured Loans	2,346.00		2,346.00
9	Unsec. Loans	76,543.00		76,543.00
10	Total Rs.	2,69,885.00	-2,69,885.00	0.00

Note: - Another way to achieve this result is to use formula. For this case, Select range “D2:D9” and type “=IF(C2>0,C2*-1,B2)” in formula bar and press Ctrl + Enter

VI. Comparing Two Lists

Comparing two lists is common task. There can be a few more ways for this. However, I find this trick a very simple and effective.

Suppose you have two lists, one containing actual consumption and second a standard consumption as per technical specification and you want to compare Actual v/s standard consumption. You would certainly like to check the cost and quantity used as well as name of the items.

Following figures shows two lists i.e. Standard List (Batch Constitution or Budget) and second list is of actual consumption.

	A	B	C	D	E	F
1	Standard			Actual		
2	Item	Rate	Qty.	Item	Rate	Qty.
3	PART E	45	1	PART L	10	1
4	PART G	33	9	PART E	45	1
5	PART A	5	10	PART B	24	5
6	PART H	6	10	PART H	6	10
7	PART I	9	1	PART C	10	1
8	PART F	12	7	PART J	3	1
9	PART B	23	5	PART K	13	6
10	PART C	10	1	PART G	33	9
11	PART D	5	1	PART A	5	10
12	PART J	3	1	PART D	4	2

Securities purchased and kept unsold as on the last date of the year interest paid at the time of purchase of security is not to be included along with cost of the security since the entire interest paid has been offered as income either by way of accrued interest or actual receipt of interest.

Go through the following steps. (Note: - The steps are given keeping above data in view to give an idea about how it works)

Step 1

1. Select the Item list of first portion i.e. Standard (Range A3:A12 in given example)
2. Select Format → Conditional formatting ...
3. Select “Formula is” in first drop down box.
4. Enter the following formula in the adjacent box
5. =COUNTIF (\$D\$3:\$D\$12,A3)=0
6. Press Format... button
7. Select Red color in font color box.
8. Press OK → OK

Step 2

1. Select the Rate list of first portion i.e. Standard (Range B3:B12 in given example)
2. Select Format → Conditional formatting ...
3. Select “Formula is” in first drop down box.
4. Enter the following formula in the adjacent box
5. =VLOOKUP (A3,\$D\$3:\$E\$12,2,FALSE)-<>B3
6. Press Format... button
7. Select Red color in font color box.
8. Press OK → OK

Step 3

1. Select the Qty. list of first portion i.e. Standard (Range C3:C12 in given example)
2. Select Format → Conditional formatting ...
3. Select “Formula is” in first drop down box.
4. Enter the following formula in the adjacent box
5. =VLOOKUP (A3,\$D\$3:\$F\$12,3,FALSE) <>C3
6. Press Format... button
7. Select Red color in font color box.

8. Press OK → OK

Step 4

1. Select the Item list of Second portion i.e. Actual (Range D3:D12 in given example).
2. Select Formatg → Conditional formatting ...
3. Select “Formula is” in first drop down box.
4. Enter the following formula in the adjacent box
5. =COUNTIF (\$A\$3:\$A\$12,D3)=0
6. Press Format... button
7. Select Red color in font color box.
8. Press OK → OK

Step 5

1. Select the Rate list of second portion i.e. Actual consumption (Range B3:B12 in given example)
2. Select Formatg → Conditional formatting ...
3. Select “Formula is” in first drop down box.
4. Enter the following formula in the adjacent box
5. =VLOOKUP (D3,\$A\$3:\$B\$12,2,FALSE) <>E3
6. Press Format... button
7. Select Red color in font color box.
8. Press OK → OK

Step 6

1. Select the Qty. list of second portion i.e. Actual (Range C3:C12 in given example)
2. Select Formatg → Conditional formatting ...
3. Select “Formula is” in first drop down box.
4. Enter the following formula in the adjacent box
5. =VLOOKUP (D3,\$A\$3:\$C\$12,3,FALSE) <>F3
6. Press Format... button
7. Select Red color in font color box.
8. Press OK → OK

The above process will give you the following result.

	A	B	C	D	E	F
1	Standard			Actual		
2	Item	Rate	Qty.	Item	Rate	Qty.
3	PART E	45	1	PART L	10	1
4	PART G	33	9	PART E	45	1
5	PART A	5	10	PART B	24	5
6	PART H	6	10	PART H	6	10
7	PART I	9	1	PART C	10	1
8	PART F	12	7	PART J	3	1
9	PART B	23	5	PART K	13	6
10	PART C	10	1	PART G	33	9
11	PART D	5	1	PART A	5	10
12	PART J	3	1	PART D	4	2

Result Summary

- Part I and F are not used. Instead, Part L and K are used.
- Rate of Part B and D is not as per standard, which is shown in red in both lists.
- Quantity used of part D does not tally with the standard list.

VII. Formulas and Functions

Some basics about formula and functions

- Functions are predefined formulas, which calculate values and take predefined decisions while calculating the values.
- Function generally requires input values called arguments. In MS-Excel arguments are separated by comma sign.
- Excel starts evaluating the formula from the right side of innermost bracket in the formula.
- Within bracket first it will perform calculation in following order.
 - % (Percent)
 - ^ (Exponentiation)
 - * and / (Multiplication and division)
 - + and - (Addition and subtraction)
 - & (Connects two strings of text (concatenation))
 - = < > <= >= <> (Comparison)
- For example if you enter $= \frac{n+1}{2} \times n$ as $=n+1/2*n$ in Excel, it gives a wrong result. The right way to enter this formula is $=(n+1)/2*n$. ("n" here can be a constant or reference to a cell)

- Function is an inbuilt named formula in Excel. It also provides facility to develop your own formula but that will require bit knowledge of VBA.
- Function cannot change format of the cell.
- A function can produce only one value as a result at a time.
- A function cannot change value of a cell in which it is not residing.
- While copying the formula, the excel changes the reference cell address based on the position of the cell containing original formula. For example $"=D19+D18"$ in E19 will become $"=D20+D19"$ in E20
- If you wish to keep a fixed reference while you are copying the formula from one cell to another cell, use non relative (or say absolute/fixed) reference. Put "\$" sign before row/column header or select that reference from the formula bar and press F4. Repeat pressing F4 and it will give you different combinations of reference.

Some useful functions and formula

- To check PAN use following formula. This will give TRUE/FALSE result.

```
=AND(MEDIAN(65,CODE(A1),90)=CODE(A1),MEDIAN(65,CODE(MID(A1,2,1)),90)=CODE((MID(A1,2,1)),MEDIAN(65,CODE(MID(A1,3,1)),90)=CODE(MID(A1,3,1)),OR(MID(A1,4,1)={"P","F","B","H","A","L","C","T","J"}),MEDIAN(65,CODE((MID(A1,5,1)),90)=CODE(MID(A1,5,1)),N(MID(A1,6,4)*1)>0,MEDIAN(65,CODE(MID(A1,10,1)),90)=CODE(MID(A1,10,1)),LEN(A1)=10)
```

(It is assumed that the PAN is entered in cell A1. this formula will check that (1). All characters are in CAPS. (2). Alphanumeric pattern of the PAN is observed (3). Forth alphabet is one of the specified alphabets for the type of assessee and (4). Complete PAN is entered.

- Some time you would be required to convert number as an ordinal one. Like 1st, 2nd, 36th etc. Use this formula

```
=A1&(IF(OR(VALUE(RIGHT(A1,2))=11,VALUE(RIGHT(A1,2))=12,VALUE(RIGHT(A1,2))=13),IF((OR(VALUE(RIGHT(A1,2))=11,VALUE(RIGHT(A1,2))=12,VALUE(RIGHT(A1,2))=13),"th",""),IF(OR(VALUE(RIGHT(A1,1))=1,VALUE(RIGHT(A1,1))=2,VALUE(RIGHT(A1,1))=3),CHOOSE(VALUE(RIGHT(A1,1)),"st","nd","rd"),"th")))
```

(It is assumed that the value is in cell A1)

- To calculate age of a person use this formula.

=TEXT((TODAY()-A1),"Y") & "y"
 "&TEXT((TODAY()-A1),"M") & "m"
 "&TEXT((TODAY()-A1),"DD") & "d "

(There is a space after y, m and d)

(Assumed that birth date is in cell A1)

4. Suppose you have to rank your different departments based on the rating given on the basis of predefined criteria. Use RANK function.

Following sheet shows a worksheet that use RANK function for rating different department.

	A	B	C
1	Departments	Total Marks	Rank
2	Purchase	72	5
3	Marketing	80	2
4	Manufacturing	67	6
5	Service After Sale	76	4
6	Canteen	77	3
7	Human Resource	89	1
8	Research	45	7
9	=RANK (B2,\$B\$2:\$B\$8		

5. After developing some complicated formula, you would certainly like to note some explanation about how it works or for what purpose it was developed. For example it is quite difficult to understand the purpose of following formula by looking at it.

=SQRT((2*B1*B2)/B3)

Of course you can insert a comment in that cell but that will make it look unattractive. Another way to explain the formula is to use very rarely used N function. The same formula can be explained in the same cell as under

=SQRT((2*B1*B2)/B3)+N("EOQ where B1 is Annual Consumption, B2 stands for Buying Cost and B3 is Carrying Cost")

Try it on your PC. You can write comment on your formula. The only limitation is that the total characters in one cell should not exceed 256.

6. One of the traditional methods of sampling is fixing of limit of transaction verification. Say vouching of all purchase transactions exceeding Rs. 10 thousand in value. Readymade software are available that can help in sample drawing and quantification of audit coverage. In Excel you can do this with steps given below.

- Sort the purchase register in ascending order by transaction value.
- Add three new columns after transaction value. Give following headings: (1) Retrogressive Totals (2) Percentage. (3) Voucher count

3. Following is the view of register after sorting the data on the basis of transaction values)

	A	B	C	D
1	Rs.	Retrogressive Totals	Percentage	Voucher Count
2	100			
3	230			
4	2000			
5	2400			
6	2500			
7	4000			
8	5200			
9	11250			
10	20000			

Note: - Other columns of Purchase Register are not shown.

- Type following formula in cell B2 (First cell in retrogressive total column).=SUM (A2:\$A\$10)
- Type following formula in cell C2 that is first cell in percentage column.=(B2/SUM(\$A\$2:\$A\$10))*100
- And type following formula in cell D2 that is first cell in Voucher column.=COUNT(A2:\$A\$10)
- Select Range B2:D2
- Press Ctrl + C
- Select Range B2:B10
- Press Enter

The result will be as under.

	A	B	C	D
1	Rs.	Retrogressive Totals	Percentage	Voucher Count
2	100.00	47,680.00	100.00	9
3	230.00	47,580.00	99.79	8
4	2,000.00	47,350.00	99.31	7
5	2,400.00	45,350.00	95.11	6
6	2,500.00	42,950.00	90.08	5
7	4,000.00	40,450.00	84.84	4
8	5,200.00	36,450.00	76.45	3
9	11,250.00	31,250.00	65.54	2
10	20,000.00	20,000.00	41.95	1

Result Analysis

If you fix you transaction verification limit at Rs. 5200/- (shown in red color), you will be covering 76.45% of

total purchase value in term of percentage and Rs. 36450/- in term of value of transaction. To do this, you have to verify 3 transactions.

11. In case you want to convert upper case text to Title Case, use PROPER function. For example =PROPER(“BHARAT M ZINZUVADIA”) will return “Bharat M Zinzuvadiah”

12. Array formula:

Array formula is also one of the very rarely used features of Excel. Array formula can perform multiple calculations depending on the dimension of the array. You can create array formula in the same way you create other normal formula, the only difference is, you have to press CTRL+SHIFT+ENTER instead of pressing only ENTER.

For example a list containing weight in Kg. and rate per Kg. is given to you and you want to find out total value. It can be done in two ways — first by adopting the normal regular procedure that calculates value for each entry by multiplying weight with rate in third column and then sum of values in third column. Alternatively you can use array formula. The following figure will make it clear.

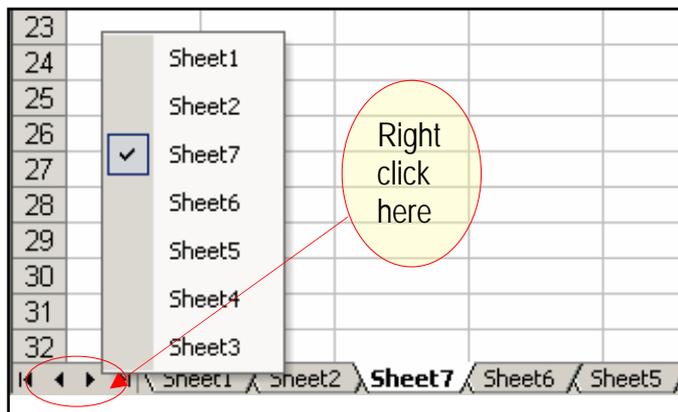
={SUM(A2:A7*B2:B7)}			
	A	B	C
1	Weight(Kgs)	Rate	
2	874987.500	0.15	
3	40873.450	0.16	
4	11040.430	0.43	
5	26202.455	0.76	
6	217300.230	0.56	
7	13992.100	0.33	
8	Total		2,88,754.65

Type following formula in Cell B8

=SUM(A2:A7*B2:B7) and press CTRL+SHIFT+ENTER. Excel will add curly brackets on entering of formula as array formula.

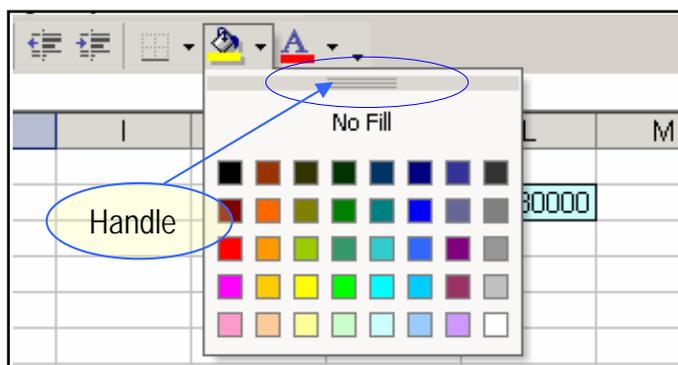
VIII. Other Tricks

1. When you are working in a workbook having 10 to 12 worksheets. Navigation between sheets becomes difficult and also time consuming. For easy switching between sheets right click on CD player button set at the bottom left of your Excel window and select the sheet you want from the pop up Menu.



2. Many users believe that sorting of data at more than three different levels is not possible as the SORT dialog box offers only up to 3 level sorting. Actually you can sort any number of columns. For example, if you have a worksheet containing five columns namely Period, Division, Product, Packing Size and Amount, and you want to sort it in Month wise, then by division wise, then by product wise, then by packing wise and then by amount wise. To be able to do this, start sorting from least important column and end with most important column. In other words, first sort it by amount wise, then sort it by packing size wise, then sort it by product wise, then by division wise and finally by Period wise.

3. Wherever a handle is available on top of the sub-menu, it can be dragged by picking it up at the handle. It becomes floating toolbar and you can put it anywhere on the sheet and make it easy and speedy to work on .



4. You can keep a constant watch on the value of a particular cell by using Watch Window option. E.g while making correction to the different schedules of profit and loss account you would like to have a watch on figure of profit/loss.

Select “Tools” g “Formula Auditing...” g “Show Watch Window”. Press Add Watch button and give reference to the cell you want to keep watch and press “Add” Button. The cell reference will be added to the Watch List and now you can monitor that cell irrespective of your current sheet. □

Effort

Managing the Risk – Impact of the Recent Developments in General Insurance Industry

Cost

With the fast paced globalisation, liberalisation and surge of economic activities in the past few years, the concept, process and ways of risk management have undergone a sea change across the financial and business world. The General Insurance Industry, which has become very vibrant in the last few years particularly since the opening up of the Industry, is no exception. The Chartered Accountants can play a very important role in any organisation, particularly in insurance sector, in preparing a Risk Management Policy Programme to be followed and implemented. A follow up of insurance Audit review programme can also be developed to ensure close monitoring and also for taking corrective action. The article explores the concept of risk management in modern times and the role of CAs in the process, particularly in General Insurance Industry.

This has put heavy responsibility on the part of the insurers to charge the premium rate for any risk based on proper evaluation. The premium rate should be such that it is the proper price for that product so that the entire portfolio to which the product belongs gives operating surplus every year. Therefore, Risk Management assumes importance both for the Insurers and the Insured.

There is no unanimously accepted definition of risk. It connotes different things for different people. For economists and statisticians risk is associated with variability (like variability of return on investment in an equity share of a corporation). Some use the term 'risk' for insured items, some others to the chance of loss (the risk of loss in this venture or investment is high) and yet others to the cause of loss (insurance is available against the risk of burglary or risk of



– CA. V. Ramasaamy

(The author is a member of the Institute serving as Chairman-cum-Managing Director, National Insurance Co. Ltd. He can be reached at v.ramasaamy@nic.co.in)

fire). Risk is defined as variation in the range of possible outcomes. The greater the potential variation, the greater the risk.

Risk and Uncertainty

The terms “risk” and “uncertainty” are used interchangeably. However, a distinction needs to be drawn between the two.

- Risk is often thought of in terms of chance (or probability) of loss.
- Uncertainty falls into two broad categories. There are those for which the probability of occurrence is calculable either on a priori grounds or through the statistical analysis of a series of similar events that have occurred in the past. The remainder do not lend themselves to such measurement either because their occurrence follows no discernible pattern or because they are unique events.

When we take a risk, we are betting on an outcome that will result from a decision we have made, though we do not know for certain what the outcome will be.

- Bernstein

While risk is a state of nature, uncertainty is a state of human mind. It is, therefore, possible to consider a situation risky if a number of outcomes are possible and the actual outcome that materialises is not known

in advance. Thus, risk is defined as the relative variation of the actual outcome from the anticipated or expected outcome. For instance, for a manufacturing firm, the development of a new product is risky as the profits from the sale of the product in the market are uncertain before the actual sale. Likewise, the development of a new drug by a pharmaceutical company is characterised by risk because of the range of possible outcomes with regard to the market reception for the drug.

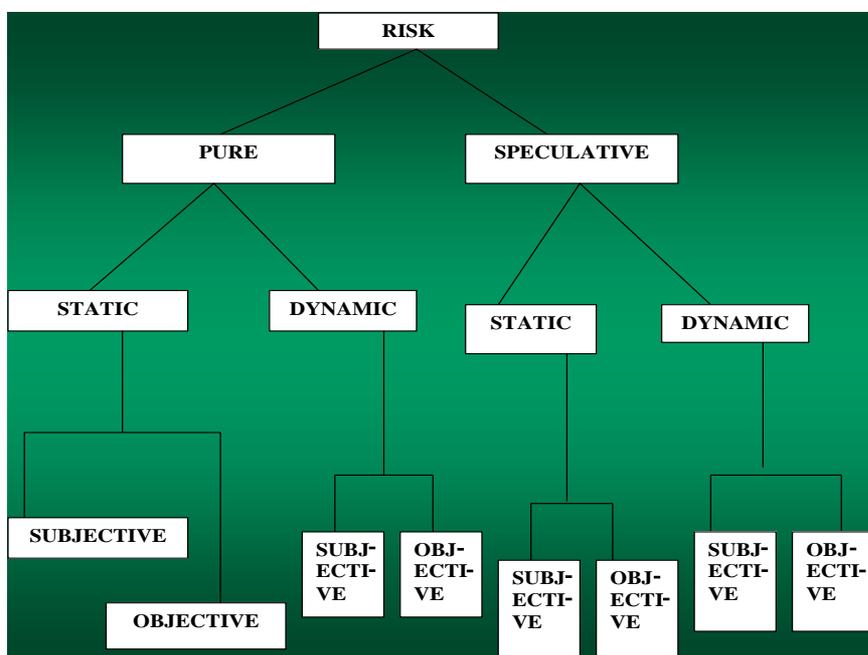
Risk, Peril and Hazard

The concept of risk is to be distinguished from the terms ‘peril’ and ‘hazard’.

- ‘Peril’ is defined as the cause of loss. Perils that cause damage to property include theft, burglary, fire, hailstorm, windstorm, lightning and earthquakes. An example of peril is: if Rama’s car is damaged in a collision with Ramesh’s car, collision is the peril or cause of loss.
- A hazard is a situation which poses a level of threat to life, health, property or environment. Most hazards are dormant or potential, with only a theoretical risk of harm, however, once a hazard becomes 'active', it can create an emergency situation.

Classification of Risk

Risks are classified in many different ways. Four ways to classify risks are given below.



Risk Management

Risk management is the process whereby organisations methodically address the risks associated with their activities with the objective of achieving sustained benefit within each activity and across the portfolio of all activities. It is a vital part of any organisation's strategic management.

Risk Management also aims to add maximum sustainable value to all the activities of the organisation. It marshals the understanding of the potential upside and downside of all those factors which can affect the organisation. It reduces both the probability of failure and the uncertainty of achieving the organisation's overall objectives and thereby increases the probability of success.

Risk management should be a continuous and developing process which runs throughout the organisation's strategy and the implementation of that strategy. It should address methodically all the risks surrounding the organisation's activities past, present and in particular, future.

Risk Management must be integrated into the culture of the organisation with an effective policy and a pro-

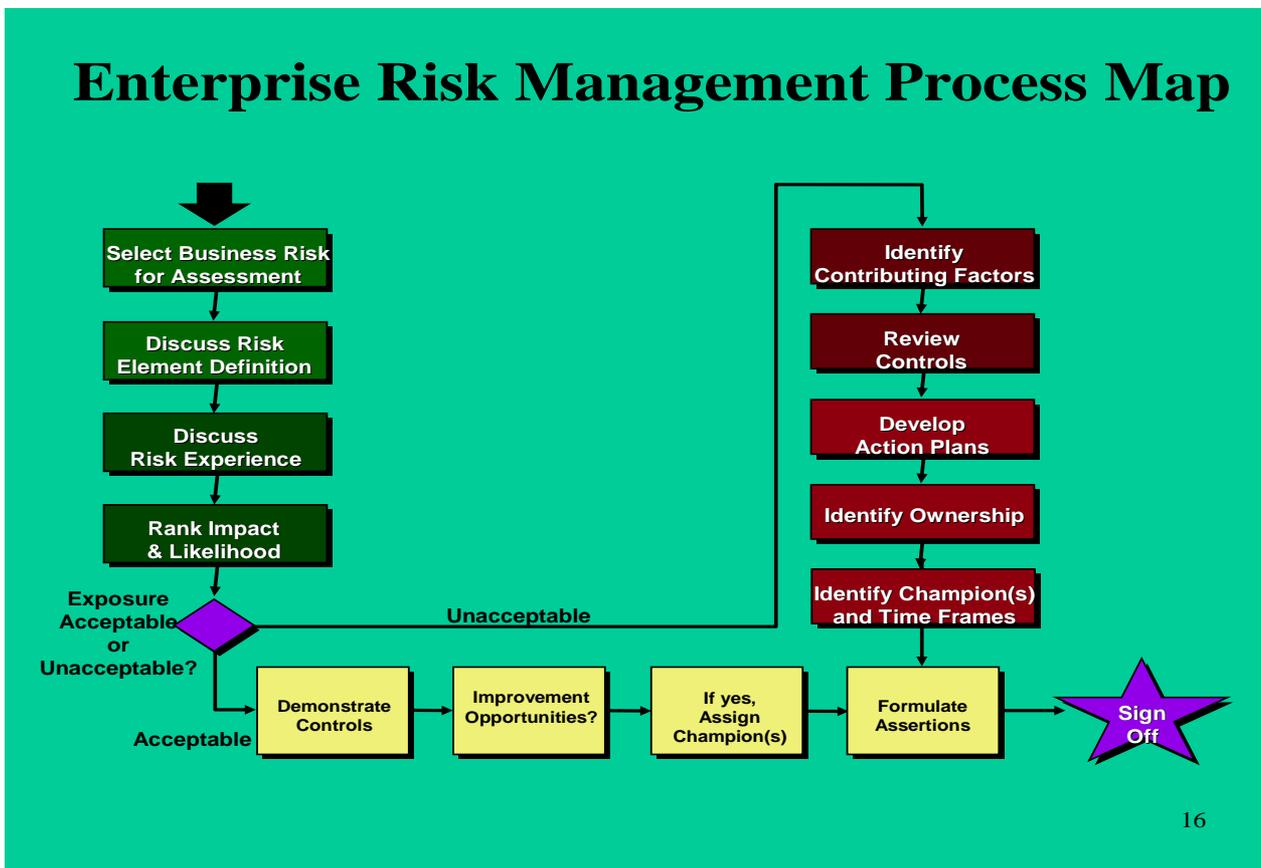
gramme led by the most senior management. It must translate the strategy into tactical and operational objectives, assigning responsibility throughout the organisation with each manager and employee responsible for the management of risk as part of their job description. It supports accountability, performance measurement and reward, thus promoting operational efficiency at all levels.

Need for Risk Management

This has put heavy responsibility on the part of the insurers to charge the premium rate for any risk based on proper evaluation. The premium rate should be such that it is the proper price for that product so that the entire portfolio to which the product belongs gives operating surplus every year. For example, it is a known fact that the losses incurred by the insurance companies in respect of Group Medclaim Policies were being cross subsidised by the profit in Fire Portfolio. Therefore, Risk Management assumes importance both for the Insurers and the Insured.

Risk Management Process

The business enterprise risk management function involves the following processes:



- 1. Identification:** Any organisation is exposed to various uncertain events and these are to be identified.
- 2. Evaluation:** After identifying, evaluation should be done on the likely impact of these uncertain events and measure the potential losses for the enterprise.
- 3. Selection/Protection:** Initiatives are taken to reduce the happening of uncertain events by reducing the chances of the event happening, avoiding, even if it happens how much the organisation can bear the

loss and lastly identify the risk to be transferred to a third party.

- 4. Implementation:** The next step is to implement the decision. Some of the examples are erection of fire proof door, installation of sprinkler system for reducing the happening or to minimise the loss even if it happens. Another example which can be given for the organisation to bear some portion of the loss is to opt for excess deductible or to go for self insurance in respect of Marine Transit Insurance.



If the decision is taken to transfer the risk after thorough study, then this process is commonly known as Insurance and Insurance companies undertake to indemnify the Insured due to the happening of uncertain event for a consideration known as Premium. Therefore, the crucial decision to be taken both by the Insurer and Insured is to work out the nature of risk to be transferred, the amount called Sum Insured to be worked out and the premium to be charged by the Insurer for accepting the risk.

Identifying Challenges of the Organisation in Dealing With Various Risks

The management of the organisation is exposed to various types of risks, external and internal. One has to study the respective Industry/Organisation profile, manufacturing activities, layout, exposure to external environment and all these have to be done in a professional manner by the Management, Insurers and the

Intermediaries, if they are also involved. It is possible that many of the internal risks factors can be managed effectively by the Management, but the following Risk factors have to be understood properly from an operational risk management perspective.

1. Loss due to Fire and Natural Calamities like Flood:

Fire can occur due to various factors and continuous inspection has to be carried out to take all possible remedial measures like installation of Fire Proof door, sprinkler system, identifying and segregating hazardous and non-hazardous materials, checking electrical installations for any possible leakage etc. There are certain areas which are regularly flood prone and adequate steps have to be taken to protect the assets from flood damage.

2. Another Risk which should be considered is loss of Profit/Revenue due to any unforeseen happening.

3. Product Liability Risk:

Manufacturing Companies are generally exposed to this kind of risk and the risk is usually associated with the final product.

4. Director and Officers Liability Risk (D&O Policy):

The Management is not only responsible for running the organisation profitably and manage the affairs in a professional manner but also responsible for various legal requirements as follows. The above Insurance Policy takes care of risk exposure due to any claim for damages to be borne by the Management.

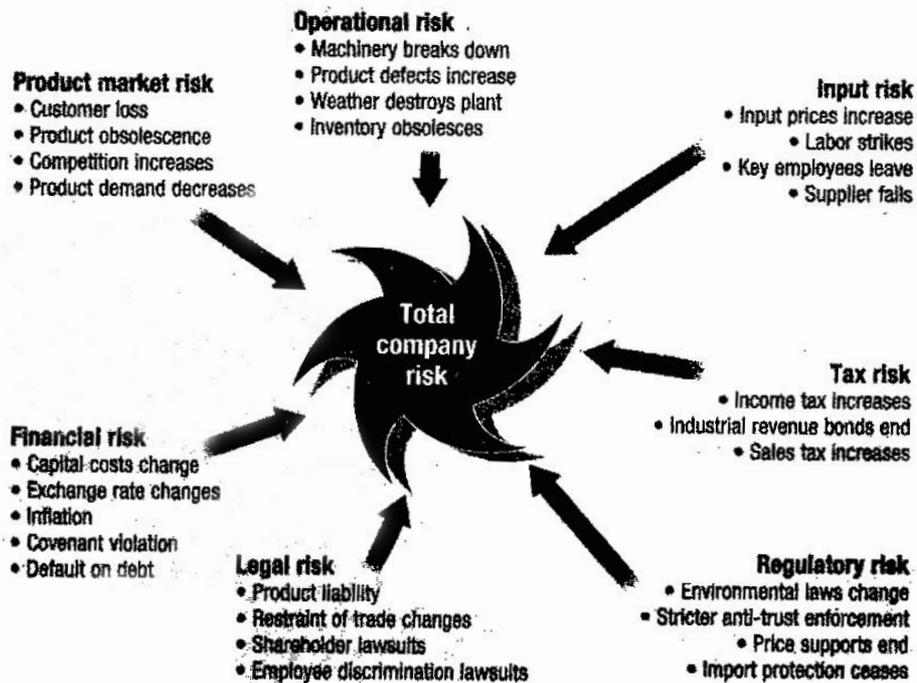
- a) Deduction and payment of statutory dues like PF, Bonus, Gratuity, ESI Contribution etc. Another important area is protection of Female employees against sexual harassment.
- b) Compliance of various tax provisions like Income Tax, Service Tax, Excise Duty, Custom Duty etc.
- c) It is the primary duty of any organisation not to pollute the environment and any company violating the directive will face penal action.
- d) At the time of Public Issue of Shares, corpo-

rates opt for D&O policy to protect the Directors from any possible litigation against them.

5. There are various risk exposures in respect of a manufacturing company producing an international product and these have to be studied carefully and appropriate measures have to be taken to protect them. The following exposures can be taken as few of those items.

- i) After the manufacture and before delivery the contract may be cancelled due to financial difficulties of the purchaser.
- ii) After delivery there are cases of non-adherence of payment terms with the result the payments may not be realised in full or part payment is realised.
- iii) In case of export consignments, possibility of sinking of the vessel, damage to goods during transit, rejection of goods due to non-acceptance by the buyer.
- iv) Fire and Explosion occurring in a factory located in a Residential locality can result not only in shifting the plant but may also result in paying huge compensation to the residents.

Figure 1: Integration of ways to manage risk



RECENT DEVELOPMENTS IN THE GENERAL INSURANCE INDUSTRY

Worldwide insurance premium amounted to US\$ 4061 billion in 2007 comprising of US\$ 1668 billion

in general insurance business and rest in life insurance business. The global non-life business grew by 0.7%. Non-life premium growth continued to follow divergent trends in the industrialised and the emerging markets. While industrialised countries had shown

a decline in growth of 0.3% in 2007, the merging markets exhibited a robust growth of 10.2% in the non-life business. In India, the General Insurance Industry has become very vibrant in the last few years after the opening up of the Industry. Approximately 80% of the premium rates were under tariff till 31.12.2006 and except for Motor Third Party premium, other premium rates in respect of Fire, Engineering and Motor were detariffed with effect from 1.1.2007 with few restrictions imposed by IRDA. From 1.1.2008, these were also removed and Insurers can charge premium as per their own underwriting guidelines, approved by their Board and filed with IRDA. In other words as on date except for Motor Third Party premium in respect of commercial vehicles and passenger buses, other premium rates are not governed by any tariff.

Role of Chartered Accountants in Risk Management

Any business activity is exposed to various types of risks like financial, compliance of statutory requirement and various legal aspects, operating risks, which include running the organisation taking into account the technology, sale, marketing, profitability etc. environmental risk and various other types of risks peculiar to the Industry.

The Chartered Accountants can play a very important role in an organisation in preparing a Risk Management Policy Programme to be followed and implemented by various departments. A follow up of insurance Audit review programme can also be developed to ensure close monitoring and also for taking corrective action.

For preparing the detailed programme Chartered Accountants have to co-ordinate with various departments in identifying the potential losses, evaluate them, decide the steps to be taken and finally implement them. In view of their strong accounting and finance background it is felt that, with appropriate technical inputs, they can become full-fledged Risk Management Consultants / Risk Managers.

It may not be out of context to mention that the recent **IRDA (Investment) (Fourth Amendment) Regulations, 2008**, has made Internal Audit / concurrent audit mandatory for the investment function of insurance companies vindicating the role of CAs in one of the most crucial functional areas of insurance business.

Conclusion:

The general perception of various organisations is to consider Risk Management as an activity linked to Insurance but it is much more as explained in the previous paragraphs. Some of the risks like, loss of image, market share etc., will not fall in the category of insurable risk. Unfortunately, Insurance purchase is still regarded as an additional financial burden and not considered as one of the essential requirements by the Public. This is one of the reasons why Health Insurance Policy which should be considered as one of the basic requirements due to the increased cost of hospitalisation treatment has not been taken by many.

To conclude, the corporates should undertake Risk Management in their own interest and the responsibility should be taken by the entire Corporate Management in preparation of Risk Management programme and implement it properly in the overall interest of all the stakeholders. □

Future Trends That Will Shape the World of Corporate Finance

With the ongoing fast paced changes and emerging future trends in global business environment, the world of corporate finance is set for a major rejig and revamp in times to come. The factors that are going to make a difference to the world of corporate finance include globalisation, Enterprise Wide Information Systems and Technology Convergence, Accounting Standards and Complexities, Financial Innovations, Information Security, Environment & Global Warming, International Taxation, Corporate Governance, Risk Management etc. This article explores these factors from professional angle.

GLOBAL BUSINESS

Globalisation

From the position of a cocooned economy with high tariff barriers, quantitative restrictions and isolation from world economy, India has moved towards an open economy, welcoming foreign capital, technology and management into the country. It is not about being a reservoir of low

cost manpower. Our IT skills and entrepreneurship have earned us a position of respect in the world. But tariff and non-

tariff barriers still exist. Trans-border movement of capital is not yet seamless and the bureaucratic juggernaut rolls on at its own pace. Visa and entry restrictions in the western world, though relaxed, do still exist and are a major impediment in free movement



—CA. Prem S. Khamesra

(The author is a member of the Institute and CFO of Mirza International Ltd. New Delhi. He can be reached at pkhamesra@gmail.com)

Inflation adjusted accounts, Fair value accounting are some of the concepts which are still in the nascent stage and once adopted will change the accounting landscape altogether. A decade down the line, with a giant leap to IFRS, accountants will sit relaxed. Inflation adjusted accounts, Fair value accounting are some of the concepts which are still in the nascent stage and once adopted will change the accounting landscape altogether. A decade down the line, with a giant leap to IFRS, accountants will sit relaxed.

of people. Over the next few decades the global economy would be more unified than ever before and would bring real challenges to corporations and professionals who will have to raise the bar to the competence levels of corporations and professionals of the developed world.

Enterprise Wide Information Systems and Technology Convergence

From hard bound hand written ledgers and mechanical FACIT calculators, the modern Finance Departments have moved to ERP solutions that merge computing and wide area networking spanning several geographical locations. Implemented as quick fix solutions for growing corporate needs for instant information, there are a lot of glitches and efficiency issues with these standardised, all pervading solutions. Companies are now experimenting with customised technologies that will deliver higher efficiencies and focused information. The technology landscape itself is changing. The major ERP solution providers are consolidating their platforms through mergers. JD Edwards was taken over by Peoplesoft who in turn has been taken over by Oracle. Interestingly the technology vendors are gradually realising the futility of an all-in-one platform and fluid partnerships with small focused solution providers are emerging. There are issues about points of integration and a Service Oriented Architecture is falling into place. Issues of the big and the small will dominate the technology landscape. In an atmosphere like this IT Governance will become an important function in a Corporate. Companies, specially the Finance Departments will be faced with the trade off of risks between “What if I do it” vs. “What if I do not do it”.

Accounting Standards and Complexities

Looking back, accounting three decades earlier was like the Dark Ages. Companies neither needed to adopt uniform accounting policies from year to year nor needed to disclose them. There were no Accounting Standards. In a free for all, each Corporate

had its own convenient way to present its accounts. For the accountants, an arithmetically correct accounting & compliance with rudimentary standards like depreciation accounting mandated by the Companies Act, was the end. But, if those were the Dark Ages, even today, we are evolving. Inflation adjusted accounts, Fair value accounting are some of the concepts which are still in the nascent stage and once adopted will change the accounting landscape altogether. A decade down the line, with a giant leap to IFRS, accountants will sit relaxed. There would be no country or economic region designated GAAPs necessitating restated accounts for each financial market one wanted to address. Catching up with the need to address different financial markets, technology will come up with newer platforms to instantaneously present accounts across various currencies and languages. Between now and then, the transition will be fraught with complexities and difficulties for the accounting professionals who will have to spend many a sleepless night to ensure that the transition takes place smoothly.

Financial Innovations

A few decades earlier the terms Hedging, Futures, Options, Derivatives, Super derivatives, Collateralised Obligations, would have sounded alien to all of us. With cross border trades, multiple currencies, multiple markets, technology assisted web-enabled trading platforms and extreme price volatility, today almost every finance professional is, vaguely if not fully, familiar with these terms. The recent turbulence in the US economy, is a clear pointer that financial innovations, if not properly understood and harnessed can have devastating consequences.

Despite calamitous consequences financial innovations are here to stay and will be put to more and more use by Corporations for hedging risks and profit maximisation. Finance professionals will have to grapple with issues like proper understanding, cause and effect analysis and the right fit of a financial innovation to the corporation’s unique business

With increased transparency and additional regulation there would be greater CEO, CFO and Board involvement in Risk Management in coming times. Finance professionals will have to play a pivotal role in the identification of key risks and scientific evaluation of alternatives for risk minimisation and management. As focus shifts from operational, credit and market risks to strategic and business risks, CFO involvement in the entire process is likely to become very intense.

situation, before resorting to such financial innovations for maximisation of profits or minimisation of risks.

Corporate Governance

Clause 49 of the Listing Agreement has emerged as a major Corporate Governance Tool. External agencies like auditors, regulators and credit rating agencies, taking cue from the spirit of the law, have become pro-active and this has raised the level of compliance demands on companies. Regulatory requirements coupled with pressures from organised and/or large investors will force Company Boards to act independent of promoters and managements. The first level of complying with form has been achieved and as companies move to the next level of compliance *i.e.*, with the spirit of the regulations, CFOs will have to lead the change from the front.

Risk Management

The concept of risk management began with Banks striving to manage risks that threatened their profitability & capital adequacy. With corporate governance norms made mandatory, the concept has taken wings and has engulfed the entire corporate world. Today, Enterprise Risk Management is the best-practices standard for Corporates striving for loss minimisation, performance optimisation and business continuity. While each good corporate aspires for the four tenets of Risk Management *viz.*, identification, quantification, creation of governance structure and Board discussion on quantified risks, only a select few have institutionalised the concept with a scientific rigour and holistic thoroughness.

With increased transparency and additional regulation there would be greater CEO, CFO and Board involvement in Risk Management in coming times. Finance professionals will have to play a pivotal role in the identification of key risks and scientific evaluation of alternatives for risk minimisation and management. As focus shifts from operational, credit and market risks to strategic and business risks,

CFO involvement in the entire process is likely to become very intense.

Information Security

Wide area networks, ERP based Information Systems, IT enabled services and business process outsourcing has brought to fore the importance of information assets. A laptop or a CD or a small flash drive may contain gigabytes of Corporate information. The hazards of the portability of such immense amounts of data cannot be over-emphasised. The malicious penetration of corporate networks could wreak havoc and would have the potential of bringing corporate operations to a halt. The leakage of client data could bring about unwanted litigation. Fraudsters could take control of corporate networks to misappropriate large amounts of money. Corporates are gradually waking up to the importance of security of information assets.

Going forward there will be a greater emphasis on the confidentiality, integrity and availability of information. CFOs will not only have to ensure that their companies institute appropriate information security policies in place but would also have to ensure their compliance through a regular audit by an independent agency.

Intellectual Property

The importance of intellectual property is another area where a silent revolution is taking place. From a time when intellectual property protection was restricted to national boundaries and a very loose enforcement regime was in place we have now come a long way. The TRIPS agreement under WTO and setting up of World Intellectual Property Organisation has brought IPs under a universal regulation. Companies now increasingly recognise the importance of their IP assets and the need to protect them. Yet this zeal is currently restricted to high technology and premium branding companies. Cross border enforcement of IP rights is restricted to large companies only.

The Kyoto protocol has given a financial angle to environment protection and adoption of clean technologies. The market of carbon credits is in a nascent stage but will gain momentum over years. Disaster recovery plans will have to factor in the changes in the global topography arising from global warming. A large number of investment and operational decisions will have to be taken keeping the impending climatic changes in mind.

As the global economy emulsifies further, recognition of IP assets and their zealous protection around the globe will gain greater momentum.

Environment & Global Warming

Concerns about the environment were the preserve of some environment activists and Government in the past. But the near accuracy of the predictions about the earth's warming trends and drastic climate changes noticed in various geographical locations, have made companies sit up and take note. The regulatory activism has also played its role. Farsighted companies are now taking into account the impact of climatic changes in their decision making process.

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Demographics

Demographics, at one time, were never a part of the business thought process. It was left to the statisticians and the planners in the Government. Busi-

nesses have suddenly woken up to the impact that a changing demographic landscape has on the future of business. The aging populations in Europe and Japan, the teeming young millions in India and China, have given a new meaning to business plans and focus.

In future, it would not be possible to take any long-term decision without considering the demography of the business locales.

International Taxation

With globalisation has come the global taxman. The tax policies of a particular country would have its resonance in several nations of the world. Businesses will have to constantly evaluate and track the tax policies of the various geographies that they operate in. Transfer pricing legislations are in place in almost all economies around the world. It would not be possible any more to take pricing decisions in isolation. Computing arms length pricing and putting in place a transparent transfer price fixation mechanism will require active involvement of the CFO. Cross border movement of technical manpower gives rise to issues of origin, source and residence. CFOs will have to participate in design of tax efficient compensation packages for the company's mobile workforce. Cross border mergers, acquisitions and sell offs would require sound knowledge of tax legislations and tax treaties. □

Non-Receipt of Journal

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The Institute Of Chartered Accountants Of India

Notification

New Delhi, the 25th September, 2008

No.1-CA(7)/116/2008. - Whereas certain draft amendments further to amend the Chartered Accountants Regulations, 1988, were published by the Council of the Institute of Chartered Accountants of India, as required by sub-section (3) of section 30 of the Chartered Accountants Act, 1949 (38 of 1949) at pages 1 to 18 of the Gazette of India, Part III Section 4, dated the 5th May, 2008 under the notification of the Institute of Chartered Accountants of India No.1-CA(7)/116/2008 dated 5th May, 2008;

And whereas objections and suggestions were invited before the expiry of a period of forty five days from the date on which the copies of the said Gazette were made available to the public;

And whereas the said Gazette was made available to the public on 8th May, 2008;

And whereas no objection or suggestion or comment was received from any person with respect to the said draft notification and that the matter has been considered by the Council of the Institute of Chartered Accountants of India and approved by the Central Government;

Now, therefore, in exercise of the powers conferred by sub-section (1) of section 30 of the said Act, the Council, with the approval of the Central Government, hereby makes the following amendments in the Chartered Accountants Regulations, 1988, namely:-

1. (1) These regulations may be called the Chartered Accountants (Amendment) Regulations, 2008.

(2) They shall come into force from the date of their publication in the Official Gazette.

2. In the Chartered Accountants Regulations, 1988,-

(a) after regulation 3, the following regulation shall be inserted, namely:-

“3A. List of members. — The list of members of the Institute as on the 1st day of April each year published, under sub-section (3) of section 19, may be sent to any member, on his request and on his making payment at the following rates, -

- (i) Western Region – Rupees 500/- per copy
- (ii) Southern Region – Rupees 500/- per copy
- (iii) Eastern Region – Rupees 300/- per copy
- (iv) Central Region – Rupees 400/- per copy
- (v) Northern Region – Rupees 500/- per copy
- (vi) All India – Rupees 750/- per copy”

(b) in regulation 5, in sub-regulation (1),

(i) in clause (a), for the words, “the fee prescribed in these regulations”, the words, “such fee as may be determined by the Council under sub-section (3) of section 4”, shall be substituted.

(ii) in clause (b), for the words, “the prescribed entrance fee”, the words, “such fee as may be determined by the Council under sub-section (3) of section 5” shall be substituted:

Provided that an associate on being admitted as a fellow in the course of the year shall pay, for that year, only the differential amount.”;

(c) for regulation 6, the following regulation shall be substituted, namely:-

“6. Fees

(1) (a) The annual membership fee shall become due on the first day of April in each year.

(b) Every member shall pay such annual membership fee as may be determined by the Council under sub-section (4) of section 19.

(2) (a) The annual fee for certificate of practice shall become due on the first day of April in each year.

(b) Every member in practice shall pay such annual certificate of practice fee, as may be determined by the Council under sub-section (2) of section 6.

(3) A member seeking restoration of his membership shall pay, such additional fee, as may be determined by the Council under sub-section (3) of section 20.”;

(d) in regulation 10, for sub-regulations (1) and (2), the following shall be substituted, namely:-

“(1) A certificate of practice issued under sub-section

(1) of section 6 shall be liable for cancellation, if -

(i) the name of the holder of the certificate is removed from the Register under sub-sections (1) and (2) of section 20; or

(ii) the Council is satisfied, after giving an opportunity of being heard to the person concerned, that such certificate was issued on the basis of incorrect, misleading or false information, or by mistake or inadvertence; or

(iii) a member has ceased to practise; or

(iv) a member has not paid annual fee for certifi-

Don't judge each day by the harvest you reap, but by the seeds you plant

cate of practice till 30th day of September of the relevant year.

(2) The cancellation of a certificate shall be effective:-

- (a) in a case falling under clause (i) of sub-regulation (1), on the date on which and during the period for which the name of the holder of the certificate was removed from the Register;
- (b) in a case falling under clause (iv) of sub-regulation (1), from the 15th day following the date of issue of notice by the Secretary on or after the 1st day of October; and
- (c) in any other case from such date and for such period, as may be decided by the Council.”;

(e) for regulation 11, the following regulation shall be substituted, namely:-

“11. Restoration of certificate of practice. – The Council may, on an application made in the approved Form and on payment of such fee, as may be determined by the Council under sub-section (3) of section 20, restore the certificate of practice with effect from the date on which it was cancelled, to a member whose certificate has been cancelled due to non-payment of the annual fee for the certificate of practice and whose application, complete in all respects, together with the fee, is received by the Secretary before the expiry of the relevant year.”;

(f) in regulations 12, 13, 14, 15, 16 and 17, after the headings, the following words in brackets shall be inserted, namely:-

“[Applicable to a complaint or information pending before the Council or any inquiry initiated by the Disciplinary Committee or any reference or appeal made to a High Court prior to 17.11.2006]”;

(g) after regulation 17, the following regulation shall be inserted, namely:-

“17A. Fee and procedure for investigation of a complaint or information to be followed by the Director (Discipline), Disciplinary Directorate and procedure for inquiry by the Disciplinary Committee.

[Applicable to a complaint or information received on or after 17.11.2006]

(1) Every complaint, other than a complaint filed by or on behalf of the Central Government or any State Government or any statutory authority, shall be accompanied by a fee of Rs.2,500/-;

(2) Each such complaint or information shall be dealt with in accordance with the procedure specified in the Chartered Accountants (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007.”;

(h) for regulation 19, the following regulation shall be substituted, namely:-

stituted, namely:-

“19. Restoration to membership. – (1) The Council may, on an application in the appropriate Form, received in this behalf from a member whose name has been removed from the Register under clause (c) of sub-section (1) of section 20, restore his name, if he is otherwise eligible to such membership, on his paying the arrears of annual membership fee, entrance fee and additional fee determined by the Council under the Act.

(2) The restoration under sub-regulation (1) shall be with effect from the date on which the application and fee are received:

Provided that where such an application for restoration, complete in all respects, is received within the same year in which the name was removed, the Council may restore the name on his paying the annual membership fee due for that year, entrance fee and the additional fee for restoration, with effect from the date on which it was removed from the Register:

Provided further that the restoration of a member’s name which was removed under the orders of the Board of Discipline or the Disciplinary Committee or the Appellate Authority or the High Court shall be effected only in accordance with such orders.”;

(i) after regulation 53, the following regulations shall be inserted, namely:-

“53A. Other professional bodies. – (1) For the purposes of Items (2), (3) and (5) of Part I of the First Schedule to the Act, a person has to be a member of any of the following professional bodies, namely:-

(a) The Institute of Company Secretaries of India established under the Companies Act, 1980 (No.56 of 1980);

(b) The Institute of Cost and Works Accountants of India established under the Cost and Works Accountants Act, 1959 (No.23 of 1959);

(c) Bar Council of India established under the Advocates Act, 1961 (No.25 of 1961);

(d) The Indian Institute of Architects established under the Architects Act, 1972 (No.20 of 1972);

(e) The Institute of Actuaries of India established under the Actuaries Act, 2006 (No.35 of 2006).

(2) The membership of the professional bodies or institutions outside India whose qualifications relating to accountancy are recognised by the Council under sub-section (2) of section 29 shall also be taken into consideration for the purposes of Items (2), (3) and (5) of the Part I of the First Schedule to the Act.

(3) For the purposes of Items (2), (3), (4) and (5) of Part I of the First Schedule to the Act, the following shall be the persons qualified in India, namely:-

What lies behind us and what lies before us are small matters compared to what lies within us

- (i) Company Secretary within the meaning of the Company Secretaries Act, 1980;
- (ii) Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959;
- (iii) Actuary within the meaning of the Actuaries Act, 2006;
- (iv) Bachelor in Engineering from a University established by law or an Institution recognised by law;
- (v) Bachelor in Technology from a University established by law or an institution recognised by law;
- (vi) Bachelor in Architecture from a University established by law or an institution recognised by law;
- (vii) Bachelor in Law from a University established by law or an institution recognised by law;
- (viii) Master in Business Administration from Universities established by law or technical institutions recognised by All India Council for Technical Education.

53B. Membership of professional bodies for partnership. – (1) For the purposes of entering into partnership under Item (4) of Part I of the First Schedule to the Act, a person shall be a member of any of the following professional bodies, namely:-

- (a) Company Secretary, member, The Institute of Company Secretaries of India, established under the Company Secretaries Act, 1980;
- (b) Cost Accountant, member, The Institute of Cost and Works Accountants of India established under the Cost and Works Accountants Act, 1959;
- (c) Advocate, member, Bar Council of India established under the Advocates Act, 1961;
- (d) Engineer, member, The Institution of Engineers, or Engineering from a University established by law or an institution recognized by law.
- (e) Architect, member, The Indian Institute of Architects established under the Architects Act, 1972;
- (f) Actuary, member, The Institute of Actuaries of India, established under the Actuaries Act, 2006.

(2) Professional bodies or institutions outside India whose qualifications relating to accountancy are recognised by the Council under sub-section (2) of section

29 of the Act.”;

- (j) Regulations 82 to 126 shall be omitted;
- (k) in regulation 137, in sub-regulation (9), for the words “such other persons belonging to the region as may be co-opted by the Regional Council, not exceeding two-thirds of the members of the committee, so however, that at least one-half of such coopted persons shall be members of the Institute” the words “such other members belonging to the region as may be co-opted by the Regional Council, not exceeding one-third of the members elected to the committee as above” shall be substituted.

(l) After regulation 174, the following shall be inserted, namely:-

“174A. Committees of the Council. – The Standing Committees constituted by the Council under section 17 shall at all times function under the control, direction and supervision of the Council.”

(m) for regulation 175, the following regulation shall be substituted, namely:-

“175. Executive Committee. – (1) The Executive Committee shall perform the following functions, namely:—

- (a) enrolment of members with or without certificate of practice, admission of fellows, removal and restoration of names of members, cancellation of certificate of practice, prosecution of members on the findings of the Council, granting exemption to chartered accountants in practice or firms of such chartered accountants from the operation of sub-section (1) of section 27 and publication of the list of members;
- (b) grant of permission to a chartered accountant in practice to engage in any business or occupation other than the profession of accountancy in accordance with, and subject to, the restrictions specified in this behalf by the Council;
- (c) condone the delay in supplying requisite information under regulation 190;
- (d) maintenance of the Register of articled assistants and Register of audit assistants and all other statutory registers which are prescribed by the Act or these regulations;
- (e) custody of the property, assets and funds of the Institute;
- (f) maintenance of office of the Council and for this purpose the Executive Committee may employ, suspend, discharge or re-employ the necessary staff on such terms and conditions as it may deem fit;
- (g) according approval, on recommendation

In the Midst of movement and chaos, keep stillness inside of you

of Finance Committee, to the likely expenditure upto twenty percent in excess of the estimates previously sanctioned by the Council in the respective heads of the annual budget:

Provided that where the Executive Committee does not agree with the recommendation of the Finance Committee, the matter shall be decided by the Council.

- (2) Except as otherwise provided by these regulations, the Executive Committee shall exercise all the functions and powers of the Council in relation to articled assistants and audit assistants, except those contained in regulations 44, 67 and 80.
- (3) The Council shall have the power to review any decision taken by the Executive Committee in the performance of the functions assigned to it.”

(n) after regulation 176, the following regulation shall be inserted, namely:-

“176A. Finance Committee. – (1) The Finance Committee shall control, implement and supervise the activities related with and incidental to the following areas, namely:-

- (a) maintenance of true and correct accounts of all the receipts and payments on behalf of the Council and the matters in respect of which such receipts and payments take place and of all the property, securities, debts, funds and liabilities of the Institute;
- (b) formulation of annual budget of the Institute and presenting it to the Council for approval, after obtaining the recommendation of the Executive Committee;
- (c) control of funds of the Institute;
- (d) investment of the funds of the Institute in securities and to vary such investments from time to time subject to the guidelines approved by the Council;
- (e) disbursements from the funds of the Institute for expenditure, both revenue and capital, based on the estimates previously sanctioned by the Council:

Provided that expenditure in excess of the estimates previously sanctioned by the Council may be incurred with the recommendation of the Executive Committee, wherever considered expedient, but such excess expenditure shall be brought to the notice of the Council at its next meeting;

- (f) making recommendation to the Executive Committee for sanction of likely expenditure upto twenty percent in excess of the estimates previously sanctioned by the

Council for the respective heads of the annual budget.

(2) The Council shall have the power to review any decision taken by the Finance Committee in the performance of the functions assigned to it.”

(o) for regulation 194, the following regulation shall be substituted, namely:-

“194. Maintenance of accounts. – (1) It shall be the duty of the Secretary to cause to maintain proper books of accounts with respect to–

- (a) all sums of money received and expended by the Institute and the matters in respect of which the receipt and expenditure takes place;
- (b) all sales and purchases of goods;
- (c) all the assets and liabilities of the Institute.

(2) The annual accounts of the Council shall be prepared for every year. Such annual accounts shall comprise of the Balance Sheet of the Institute, Income and Expenditure Account of the Institute comprising the surplus or deficit of the Institute for that year, and Cash Flow Statement for that year.”;

(p) for regulation 197, the following regulation shall be substituted, namely:-

“197. Comparison of actual income and expenditure with budget estimates. –

- (1) The Council shall approve the budget prior to the commencement of each financial year indicating expenditure proposed to be incurred and anticipated revenues for the forthcoming year. Such a budget apart from the other things shall separately distinguish capital items and the revenue items.
- (2) The budget for the capital items shall provide proposed expenditure apart from the other items on land, building, capital equipments, books and library.
- (3) The budget for revenue items should provide anticipated income and proposed expenditure for the forthcoming year in relation to, apart from the other items, in respect of distance education, examination, services to members and salary and establishment.
- (4) The budget so approved may be revised during the year to incorporate the expected changes.
- (5) The auditors of the Council shall also compare the actual income and expenditure with the budget estimates approved by the Council and submit a report to the Council on the material departures.”

Sd/-
(T. Karthikeyan)
Acting Secretary

The human heart feels things the eyes cannot see, and knows what the mind cannot understand

Note:- The principal regulations were published in the Gazette of India, Extraordinary, dated the 1st June, 1988 vide number 1-CA(7)/134/88 dated 1st June, 1988 and subsequently amended by the following numbers:-

- | | |
|---|--|
| <ul style="list-style-type: none"> (i) Notification No.1-CA(7)/1/89 published in the Gazette of India dated 7th October, 1989 (ii) Notification No.1-CA(7)/10/90 published in the Gazette of India dated 19th January, 1991 (iii) Notification No.1-CA(7)/11/90 published in the Gazette of India dated 19th January, 1991 (iv) Notification No.1-CA(7)/12/91 published in the Gazette of India dated 23rd February, 1991 (v) Notification No.1-CA(7)/13/90 published in the Gazette of India dated 2nd February, 1991 (vi) Notification No.1-CA(7)/19/92 published in the Gazette of India, dated 7th March, 1992 (vii) Notification No.1-CA(7)/28/95 published in the Gazette of India dated 1st September, 1995 (viii) Notification No.1-CA(7)/30/95 published in the Gazette of India, Extraordinary dated 13th March, 1996 (ix) Notification No.1-CA(7)/31/97 published in the Gazette of India, dated 16th August, 1997 (x) Notification No.1-CA(7)/44/99 published in the Gazette of India dated 26th February, 2000 | <ul style="list-style-type: none"> (xi) Notification No.1-CA(7)/45/99 published in the Gazette of India, dated 26th February, 2000 (xii) Notification No.1-CA(7)/51/2000 published in the Gazette of India, Extraordinary, dated 17th August, 2001 (xiii) Notification No.1-CA(7)/59/2001 published in the Gazette of India, Extraordinary dated 28th September, 2001 (xiv) Notification No.1-CA(7)/64/2002 published in the Gazette of India, Extraordinary dated 31st March, 2003 (xv) Notification No.1-CA(7)/64A/2003 published in the Gazette of India, Extraordinary dated 4th December, 2003 (xvi) Notification No.1-CA(7)/83/2005 published in the Gazette of India, Extraordinary dated 28th July, 2005 (xvii) Notification No.1-CA(7)/84/2005 published in the Gazette of India, weekly dated 17th June, 2006 (xviii) Notification No.1-CA(7)/92/2006 published in the Gazette of India, Extraordinary dated 13th September, 2006 (xix) Notification No.1-CA(7)/102/2007(E) published in the Gazette of India, Extraordinary dated 17th August, 2007 |
|---|--|

Branch Notification

(To be Published in Part III, Section 4 of the Gazette of India)

NOTIFICATION

(Chartered Accountants)

13th October, 2008

No.1-CA(7)/(124)/2008: In pursuance of Regulation 159(1) of the Chartered Accountants Regulations 1988, the Council of the Institute of Chartered Accountants of India is pleased to notify the setting up of a branch of Central India Regional Council at Beawar with effect from 5th October, 2008.

The Branch shall be known as Beawar Branch of Central India Regional Council.

The jurisdiction of the Branch shall, besides Beawar, include the following cities/towns falling within a radius of 50 kms from the Municipal limits of Beawar.

1. Jaitaran
2. Gulabpura
3. Bijainagar

As prescribed under Regulation 159(3), the Branch shall function subject to the control, supervision and Directions of the Council through Central India Regional Council and shall carry out such directions as may, from time to time, be issued by the Council.

(T. Karthikeyan)

Acting Secretary

Whatever the mind can conceive and believe, the mind can achieve.

Issuance of Exposure Draft of Accounting Standard (AS) 3 (revised), Statement of Cash Flows

Members of the institute are hereby informed that the Exposure Draft of Accounting Standard (AS) 3 (revised), *Statement of Cash Flows* was issued in October 2008 on the website of the Institute by the Accounting Standards Board, inviting Comments not later than by November 10, 2008. The Exposure Draft of the Accounting Standard is based on International Accounting Standard (IAS) 7, *Statement of Cash Flows*.

The exposure draft of revised AS 3 contains more disclosure requirements as compared to the existing AS 3, *Cash Flow Statements* and contains specific treatment for various items, such as, bank overdrafts, cash flows from changes in interests in a subsidiary that do not result in a loss of control, etc. for which the existing AS 3 does not provide for any specific treatment. The draft also differs from IAS 7 in that it removes the alternative to classify the interest paid, interest and dividends received, and dividends paid as an item of operating activity, which is the position in the existing AS 3. It may be noted that in spite of the afore-mentioned differences with IAS 7, the standard would still be considered as converged as the IASB permits removal of alternatives.

Issuance of Exposure Draft of the Guidance Note on Accounting for Service Concession Arrangements

Members of the institute are hereby informed that the Exposure Draft of the Guidance Note on Accounting for Service Concession Arrangements was issued in October 2008 on the website of the Institute by the Accounting Standards Board, inviting Comments not later than by November 10, 2008. The Exposure Draft of the Guidance Note is based on International Financial Reporting Interpretation Committee (IFRIC) Interpretation 12, Service Concession Arrangements.

The Exposure Draft of the Guidance Note provides guidance on the accounting by operators for public-to-private service concession arrangements. Service concessions are arrangements whereby a government or other public sector entity grants contracts for the supply of public services—such as roads, airports, prisons and energy and water supply and distribution facilities—to private sector operators. Control of the assets remains in public hands but the private sector operator is responsible for construction activities, as well as for operating and maintaining the public sector infrastructure. It applies to both infrastructural facilities that the operator constructs or acquires from a third party for the purpose of the service arrangement and existing infrastructural facilities to which the grantor gives the operator access for the purpose of the service arrangement.

The Exposure Draft of the Guidance Note does not address accounting for the government side of service concession arrangements.

This Guidance Note is proposed to come into effect for annual periods beginning after April 1, 2009.

Committee on Information Technology, ICAI

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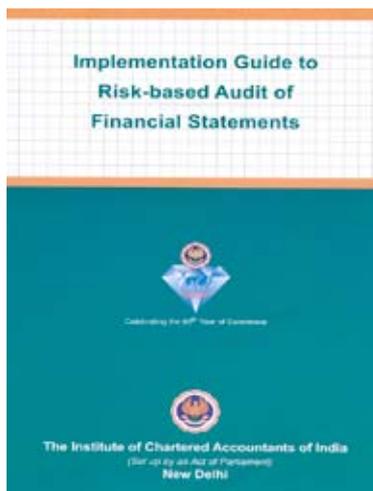
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Mumbai	CAAT Tools	November 15-16
Mumbai	Advance Excel & Macro	November 29-30

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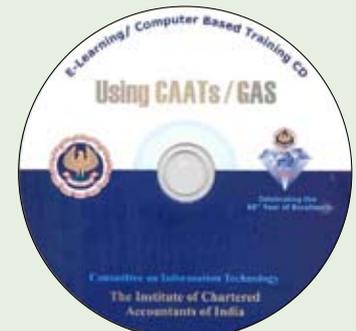
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AUDITING AND ASSURANCE STANDARDS BOARD (AASB)	
Exposure Drafts	Comments Due by
Revised Standard on Auditing (SA) 402, “Audit Considerations Relating to an Entity Using a Third Party Service Organisation” (Published in the October, 2008 Issue of the Journal) http://www.icaai.in/post.html?post_id=3239	December 1, 2008
Revised Standard on Auditing (SA) 510, "Initial Audit Engagements—Opening Balances” (Published in the October, 2008 Issue of the Journal) http://www.icaai.in/resource_file/12607Annexure-I[1].pdf	October 31, 2008
Revised Standard on Auditing (SA) 540, “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures” (Published in September, 2008 issue of the Journal) http://www.icaai.in/resource_file/11880annex_cdsa540.pdf	October 31, 2008
Revised Standard on Auditing (SA) 550, “Related Parties” (Published in September, 2008 issue of the Journal) http://www.icaai.in/resource_file/11901announ220808.pdf	October 31, 2008
Standard on Auditing (SA) 265, “Communicating Deficiencies in Internal Control” (Published in August, 2008 issue of the Journal) http://www.icaai.in/resource_file/7835announ1489.pdf	September 30, 2008
Revised Standard on Auditing (SA) 500, “Considering the Relevance and Reliability of Audit Evidence” (Published in the August, 2008 issue of the Journal) http://www.icaai.in/resource_file/8370announ1491.pdf	September 30, 2008
Revised Standard on Auditing (SA) 600, “Special Considerations – Audits of Group Financial Statements (Including The Work of Component Auditors)” (Published in June, 2008 issue of the Journal) http://www.icaai.in/resource_file/292announ1453.pdf	July 31, 2008
Revised Standard on Auditing (SA) 260, “Communication with Those Charged with Governance” (Published in May, 2008 issue of the Journal) http://www.icaai.in/resource_file/293announ1379.pdf	June 15, 2008
Revised Standard on Auditing (SA) 530, “Audit Sampling” (Published in March, 2008 issue of the Journal) http://www.icaai.in/resource_file/294announ1321.pdf	April 30, 2008
Revised Standard on Auditing (SA) 250, “The Auditor’s Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements” (Published in February, 2008 issue of the Journal) http://www.icaai.in/resource_file/295announ1296.pdf	April 30, 2008
Revised Standard on Auditing (SA) 570, “Going Concern” (Published in October, 2007 issue of the Journal) http://www.icaai.in/resource_file/296expd_sa_570.pdf	December 15, 2007

Note: Though, for the benefit and information of the interested readers, an exposure draft shall continue to be hosted on the website of the AASB even after its last date for comments has expired, no comments thereon, after the expiry of the said date, would be considered by AASB/IAASB, as the case may be.

An exposure draft would be removed from the AASB’s website when the final standard is issued or if the project is dropped.

Do what you can, with what you have, where you are

Appeal to Articled Assistants to Contribute Towards Chartered Accountants Students Benevolent Fund

For the welfare of students registered with the Institute, a Trust in the name of Chartered Accountants Students Benevolent Fund has been set up with the aims and objects to give financial aid, welfare measures including medical aid, to establish hostels, grant fellowships or scholarships for higher studies or research in accountancy, auditing and / or allied areas, establishing training and computer centers, providing insurance coverage and such other acts / functions which are not for commercial gain or profit motive.

In order to take up activities as stated above, the articled assistants are urged to contribute a sum equivalent to their one month's stipend towards Chartered Accountants Students Benevolent Fund on voluntary basis.

The contribution may be sent by way of demand draft / cheque payable at New Delhi drawn in favour of "Chartered Accountants Students Benevolent Fund" and to be sent to 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**

The contribution so received will be gratefully acknowledged. The income tax authorities have been requested to register the Chartered Accountants Students Benevolent Fund for the purpose of exemption under Section 80(G).

04th October, 2008

**Ved Jain
President**

Committee on Economic and Commercial Laws Certificate Course on Arbitration

The Council of the Institute of Chartered Accountants of India, recognising the role of alternate dispute resolution mechanism in the emerging economic scenario, has decided to launch Certificate Course on Arbitration for its members.

The objective of this Course is to familiarize the members with the relevant laws which impact the arbitration process and the practical procedural aspects and to build the competency level of the members of the Institute to position them as multidisciplinary consultants in the global service market.

The course is targeted at members who are desirous of building their expertise and skills in the area.

Apart from the comprehensive theoretical aspects, this course, will also cover practical and procedural aspects of the arbitration process with case studies and mock arbitration proceedings.

The Course will be launched at New Delhi, Mumbai, Kolkata, Chennai, Kanpur and other mega cities. The registration for the course is already open from 1st October 2008. The classes from the New Delhi centre is expected to commence on 1st November 2008. Registrations will be on first come first served basis. The date/s and venues of the course at various centres will be announced shortly. Details of the course contents, fee structure and registration form etc. have already been hosted on the website of the Institute at www.icai.org

Opportunities? They are all around us... There is power living latent everywhere waiting for the observant eye to discover it

Reference Books on GST/VAT

As you are aware the Government of India's aim is to introduce 'Goods and Services Tax (GST) by 2010. For the purpose The Institute of Chartered Accountants of India has formed a GST Work Group to undertake research work for submitting Concept Paper to the Government. Following is the list of books which are found to be useful for the interested members.

S.No.	Name of the Book	Writer/Editor	Publisher
1	Value Added Tax	Ahan Schenk and Oliver Oldman	Cambridge University Press, 32 Avenue of the Americas, New York, NY 10013-2473, USA
2	GST in Retrospect and Prospect	Richard Krever and David White	Brookers Lt., Level Guardian Trust House, 15 Willeston st., PO Box 43 Wellington, New Zealand
3	A Guide to VAT in the EU of 27 Countries, 2007 Update	Herman Van Kesteren	Pricewaterhousecoopers Tax Consultants Woluwedal 18 B-1932 Sint-Stevens- Woluwe (Brussels)
4	A Guide to VAT/GST in Asia Pacific (2006)	Robert Morris (Global Tax Network Leader Pricewaterhousecoopers)	Pricewaterhousecoopers Tax Consultants Woluwedal 18 B-1932 Sint-Stevens- Woluwe (Brussels)
5	Value Added Tax (2004) 1st Edition	Robert Wareham, Bsc (Eco) & Alan Dolton MA(Oxon)	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
6	VAT Planning 2004-05	Robert Wareham, Bsc (Eco)	Tottel Publishing Maxwelton House, 41-43 Boltro Road, Haywards Heath West Sussex, RH161BJ
7	VAT Cases (2005) Twentieth edition	Robert Wareham, Bsc (Eco) & Alan Dolton MA(Oxon)	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
8	VATwise 2004-05	Nick Lawrence BA, Arnold Homer FCA, CTA & Rita Burrows MBA, ACIC CTA	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
9	Taxpayer rights & Revenue Power	Peter Howarth AIT & Robert Mass FCA, FTII, FIIT, TEP	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
10	VAT for Charities & other Voluntary organisations, Second Edition	Paul Bradley & Steve Chamberlain, ATII	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
11	Taxpayer rights & Revenue Power	Peter Howarth AIT & Robert Mass FCA, FTII, FIIT, TEP	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
12	VAT for Social Housing	RSM Robson Rhodes	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
13	VAT & Technology	Honathan Ivinson	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
14	Taxation of E-commerce, Second Edition	William J. Craig	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
15	Tax Loses	David Smailes, FCA & Kevin Walton BA(Hons)	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
16	Hamilton on VAT & Duties Appeals, Second Edition	Penny Hamilton, LLB, FTII & Sarah Dunn, MA(Oxon)	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
17	VAT in Central & Eastern Europe, Second Edition	Antoni Turczynowicz & Toby O'Reilly, LLB(Hons)	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
18	International Tax Planning for inward Investment	Allan Cinnaman & Richard Citron	LexisNexisUK, Halsbury House 35 Chancery Lane, London WC2A1EL
19	Intellectual Property and Taxation	Sudhir Raja Ravindaran	LexisNexis Butterworths, New Delhi.

Happiness is not a destination. It is a method of life

20	VAT & E.finance	Christine Sanderson LLB, ACA, Teresas Filby, Bsc.(Hons), Richard Collier BA, ATI, ATII & Andy Morgan Bsc.(Hons)	LexisNexisUk, Halsbury House 35 Chancery Lane, London WC2A1EL
21	Understanding VAT, 3rd Edition	William Lovell	Pitman Publishing,128 Long Acre, London WC2E9AN
22	Taxation of Intellectual Property	Anne Fairpo,MA(Oxon) ATII	LexisNexisUk, Halsbury House 35 Chancery Lane, London WC2A1EL
23	Classification & Valuation in Customs and Central Excise Laws	Dr. J.Sridharan, I.R.S	Business Datainfo Publishing Co. Pvt. Ltd., 103/C-7, Sec-8, Rohini, Delhi-85
24	Guide to the Tax Treatment of Specialist Occupations	Keith Gordon MA(Oxon),ACA	LexisNexisUk, Halsbury House 35 Chancery Lane, London WC 2A1EL
25	Indirect Taxes Guide 2006	Gary Harley KPMG U.K Global Partner	KPMG'sGlobal Indirect Tax Practice
26	European VAT Directives, Volume-1 2006, Introduction to European VAT & other Indirect Taxes	Ben Terra & Julie Kajus	IBFD Publications BV
27	European VAT Directives, Volume-II, Cases on European VAT 1970-2005 Part-1 Cases 9/70 to C-437/97	Ben Terra & Julie Kajus	IBFD Publications BV
28	European VAT Directives, Volume-3, Cases on European VAT 1970-2005, Part-2-cases from C-12/98	Ben Terra & Julie Kajus	IBFD Publications BV
29	European VAT Directives, Volume-4, Integrated Tax of the Sixth VAT Directive 2006	Ben Terra & Julie Kajus	IBFD Publications BV
30	Value Added Tax Tribunals Reports 1973, Vol-1		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
31	Value Added Tax Tribunals Reports 1974, Vol-2		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
32	Value Added Tax Tribunals Reports 1975, Vol-3		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
33	Value Added Tax Tribunals Reports 1976, Vol-4		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
34	Value Added Tax Tribunals Reports 1977, Vol-5		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
35	Value Added Tax Tribunals Reports 1978, Vol-6		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY

You have succeeded in life when all you really want is only what you really need

36	Value Added Tax Tribunals Reports 1979, Vol-7		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
37	Value Added Tax Tribunals Reports 1980, Vol-8		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
38	Value Added Tax Tribunals Reports 1981, Vol-9		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
39	Value Added Tax Tribunals Reports 1982, Vol-10		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
40	Value Added Tax Tribunals Reports 1983, Vol-11		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
41	Value Added Tax Tribunals Reports 1984, Vol-12		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
42	Value Added Tax Tribunals Reports 1985, Vol-13		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
43	Value Added Tax Tribunals Reports 1986, Vol-14		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
44	Value Added Tax Tribunals Reports 1987, Vol-15		Publication under the direction of the President of the Value Added Tax Tribunals 17, North Audley Street, London, W1YZPY
45	Tax Planning & compliance in Asia, Volume-1 first Edition, (China & Hong Kong)	Asia Business Law Series	Kluwar Law International , P.O. Box 85889 2508 CN The Hague, The Netherlands
46	Tax Planning & compliance in Asia, Volume-2 first Edition, (India & Indonesia)	Asia Business Law Series	Kluwar Law International , P.O. Box 85889 2508 CN The Hague, The Netherlands
47	Tax Planning & compliance in Asia, Volume-3 first Edition, (Japan & Korea)	Asia Business Law Series	Kluwar Law International , P.O. Box 85889 2508 CN The Hague, The Netherlands
48	Tax Planning & compliance in Asia, Volume-4 first Edition, (Korea & Malaysia)	Asia Business Law Series	Kluwar Law International , P.O. Box 85889 2508 CN The Hague, The Netherlands
49	Tax Planning & compliance in Asia, Volume-5 first Edition, (Phillippines & singapore)	Asia Business Law Series	Kluwar Law International , P.O. Box 85889 2508 CN The Hague, The Netherlands
50	Tax Planning & compliance in Asia, Volume-6 first Edition, (Singapore, Taiwan & Thailand)	Asia Business Law Series	Kluwar Law International , P.O. Box 85889 2508 CN The Hague, The Netherlands

It's faith in something and enthusiasm for something that makes life worth living

ICAI's Corporate Forum Ascent to pinnacle

CMII of ICAI is organising a comprehensive Corporate Forum at Mumbai from 23rd to 25th January, 2009. Corporate Forum is a unique program in which three concurrent events i.e Career Ascent, Corporate Conclave & ICAI Awards will be organized.

Creation of Employment opportunities, Enhancing Knowledge & Skill sets, & Recognition of the Exemplary work of members in Industry are the primary goals of the Committee. Keeping this in mind, the CMII has organized Corporate Forum consisting of all these activities concurrently.

Career Ascent Mid Career Campus

23rd- 24th- 25th January 2009 ,Hotel JW Marriot, Juhu, Mumbai

OBJECTIVE

Career Ascent provides Chartered Accountants who have 1 year or more of industry experience and passed C.A. final Examination on or before November 2007 with growth and career prospects enabling them to realise their full potential and aspirations and widen their horizon. It also ensures that they are provided with careers that best suit their skill sets.

As a measure to develop employment opportunities for Chartered Accountants, The Committee for Members in Industry of ICAI has been successfully organizing placement programmes twice a year for Newly Qualified Chartered Accountants, wherein prospective employers and new members interact and explore the possibility of taking up employment careers in various organisations.

Career Ascent is a step ahead as an extension to the same programme but with a different objective. It aims at providing the experienced Chartered Accountants with a platform to assess their potential and refinement in work, which they have acquired during their working tenure.

CHARTERED ACCOUNTANTS: MEET THE PROFESSIONALS

Chartered Accountants are considered as complete business solution providers in this energetic business world. They are thoroughly trained practically in all avenues of finance and accounting, auditing, finance and management and information technology. They can undertake responsibilities ranging from carrying out feasibility study, raising financial resources, compliance with regulatory framework, capital structure and planning, organisational development, installation of efficiency accounting, budgetary control, information system apart from giving advice on complex issues such as joint ventures, foreign collaborations, amalgamation, merger, diversification, modernisation, product pricing, BPO, KPO, restructuring, etc.

ADVANTAGE FOR CORPORATES

If you are looking for a complete business solution provider then end your search by participating in Career Ascent, wherein you would have access to a vast database of Chartered Accountants who have more than 1 year of industry experience. You can select your candidates from this pool of talent for a face-to-face interview.

The event would provide the companies to select Chartered Accountants as per their requirement criterion.

Utmost care would be taken to ensure that the confidentiality of the candidates would be maintained during the entire process.

ELIGIBILITY OF CANDIDATES

Chartered Accountants who have more than 1 year of industry experience and passed C.A. final Examination on or before November 2007 are eligible to take part in Career Ascent.

GUIDELINES FOR THE PARTICIPATING COMPANY

Timings of the event: 10.00 a.m. to 6.00 p.m.

- The companies participating will have to register online on placement portal www.cmii.icaai.org
- The participation fees should be remitted at ICAI head office New Delhi only
- Access to the candidate database shall be allowed only after the receipt of participation fee by CMII Secretariat
- The companies can access the database from 5th January 2009
- Last Date of registration for participating companies shall be 31st December 2008
- Participating companies will have to provide the list of shortlisted candidates online on placement portal www.cmii.icaai.org by 19th January 2009.
- Final list of candidates appearing for interview will be available online on placement portal www.cmii.icaai.org by 22nd January 2009.
- Shortlisting of the candidates by the company is restricted to 10 times of the number of vacancies in that particular organization
- Once a company has selected any candidate and the offer is accepted by the candidate it is the responsibility of the company to inform the organizers providing the offer letter duly signed by both
- The companies participating have to offer a minimum CTC of Rs.5.00 lakhs to the candidates in Career Ascent
- The entire process above would be done online on portal www.cmii.icaai.org

GUIDELINES FOR THE CANDIDATES

Timings of the event: 10.00 a.m. to 6.00 p.m.

- The candidates have to register on-line with Placement portal www.cmii.icai.org
- No registration fees would be charged from the candidates
- The candidates would be identified by the code and not by their Name
- The last date for filling up On-line application forms for the candidates will be 31st December 2008.
- Candidates will be informed about their shortlisting by companies on-line placement portal www.cmii.icai.org by 19th January 2009.
- Candidates would have to confirm On-line their selection of companies for interviews by 20th to 21st January 2009.
- There is no restriction on the number of interviews a candidate can attend
- Once finally selected by any company and accepting the offer by signing the offer letter, the candidate cannot appear for any other interview
- The candidates would be provided with waiting cum refreshment lounge at the venue
- A help desk for the assistance of the candidate would be

provided at the venue

- The entire process above would be done online on placement portal www.cmii.icai.org.

Payment Terms : Participation fee shall be payable by way of Cheque / Demand Draft in favour of "The Secretary, The Institute of Chartered Accountants of India" payable at New Delhi only.

For details contact :

<p>CA. Sanjeev Maheshwari — Chairman, CMII of ICAI Mob: +91 098211 19043 Email: sanjeev.maheshwari@icai.org CA. B. M. Aggarwal Chairman, WIRC of ICAI Mob: +91 098201 88573 • Email: brij@bnmca.com</p>	<p>Dr. Surinder Pal — Secretary, CMII Tel: +91 (11) 30110442 /450 • Email: spal@icai.org, placements@icai.org Mrs. S. Kapoor — Senior Faculty, ICAI Tel: +91(22) 39802911 • Email: kapoor@icai.org</p>
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Corporate Conclave In pursuit of Excellence

23rd-24th-25th January 2009 ,Hotel JW Marriot, Juhu, Mumbai

An opportunity to Enrich knowledge and enhance skill set

Three full day Conclave on IFRS, Direct Taxes & Raising of Financial Resources

IFRS VS INDIAN GAAP: 23rd January, 2009- 6 CPE Hrs	DIRECT TAXES: 24th January, 2009- 6 CPE Hrs	RAISING OF FINANCIAL RESOURCES: 25th January, 2009- 6 CPE Hrs
<ul style="list-style-type: none"> • Constitution of Board, Preface to IFRS · • Business Combinations (IFRS 3) v/s Amalgamations · • Property Plant and Equipment, Leasing, ARO · • Presentation of Financial Statements · • Revenue Recognition · • Accounting Policies, Changes in Accounting Estimates, Errors, Events after Balance Sheet date · • EPS · • Income Taxes · • Share Based Payments and Employee Benefits · • Consolidation · • Segments - IFRS 8 <p>(Organised by Committee for Members In Industry jointly with Continuing Professional Education Committee)</p>	<ul style="list-style-type: none"> • With Holding Tax on International Transactions- Sec195 · • Issues in Transfer Pricing Assessment · • Survey – Rights & Obligations · • Adjustments u/s 14A, 40A, 43B 80IE · • Captitalisation Principles- Captilisation of Interest & Preoperative Expenses · • Issues in FBT & MAT <p>(Organised by Committee for Members In Industry jointly with Direct Taxes Committee)</p>	<ul style="list-style-type: none"> • Restructuring & reorganization of Corporate Debt · • NPA's ,One time settlement , Securitisation Act · • Venture Capital Funding including Angel investors · • Rating Methodology & Credit Risk Assessment · • Listing for medium sized companies in International market · • Merger & Amalgamation- Deal Making , Structuring , sourcing & role of professionals <p>(Organised by Committee for Members In Industry jointly with Committee on Financial Markets and Investor's Protection)</p>

Participation Fees	Members of ICAI	Non-Members
• One day conclave for IFRS Vs Indian GAAP	Rs. 2,500/-	Rs. 3,500/-
• One day conclave for Direct Taxes	Rs. 2,500/-	Rs. 3,500/-
• One day conclave for Raising of Financial Resources	Rs. 2,500/-	Rs. 3,500/-
• Participation Fees for all three conclaves	Rs. 7,500/-	Rs. 9,500/-

THE PACKAGE WOULD INCLUDE

- Course material, morning tea, lunch and high tea

Payment Terms : All payments accepted by way of Cheque / Demand Draft in favour of 'The Secretary, The Institute of Chartered Accountants of India' payable at Mumbai.

For details contact :

CA Sanjeev Maheshwari, — Chairman, CMII of ICAI • Mob: +91 98211 19043 • Email: sanjeev.maheshwari@icai.org

CA. K. Raghu — Chairman, CPE of ICAI • Mob: +91 93412 19091 • Email: kraghu@icai.org

CA. Mahesh P. Sarda - Chairman, DTC of ICAI • Mob: +91 98250 76020 • Email: mps@sardaandsarda.com

CA. Charanjot Singh Nanda — Chairman, CFMIP of ICAI • Mob: +91 98111 30985 • Email: cnanda@icai.org

Dr. M.S.Turan - Additional Director • Tel: +91 (11) 30110536 • Email: ms.turan@icai.org

Mrs. S. Kapoor — Senior Faculty, ICAI • Tel: +91(22) 39802911 • Email: kapoor@icai.org

ICAI's Award 2008

Corporate CA Achievers Acclaim

25th January 2009 , Goregaon Sports Club, Mumbai

"The Highest Recognition for a man is to be honored by his alma mater"

THESE AWARDS SEEK

- To acknowledge Chartered Accountants in industry who have demonstrated excellence in the way in which they conduct their profession.
- To acknowledge Chartered Accountants who are exemplary role models in the industry.
- To acknowledge Chartered Accountants who have created value to their company's stakeholders on a sustainable basis.

AWARDS CATEGORIES

Awards 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 sub-categories:

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 / Profes-

sional 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 last date for receipt of nominations by the committee is 31st December, 2008

For Nomination requirements, Guidelines and Form Kindly visit www.icai.org and www.cmii.icai.org

For details contact :

CA Sanjeev Maheshwari, — Chairman, CMII of ICAI
• Mob: +91 98211 19043 • Email: sanjeev.maheshwari@icai.org

Dr. Surinder Pal — Secretary, CMII • Tel: +91 (11) 30110442 • Email: spal@icai.org, placements@icai.org

Management Development Programme on Risk Management

Organised by Committee on Insurance and Pension and Committee on Internal Audit of ICAI in collaboration with The Department of Public Enterprises (Ministry of Heavy Industries and Public Enterprises), Government of India

Theme: The public sector have traditionally been seen to adopt a more risk-averse approach to management generally. It is when entities are not able to adequately explain their approach to risk management that issues arise from time to time. The programme is aimed to develop and enhance the skill sets of the senior management of public sector enterprises towards assessment and management of the various risks surrounding their organisation.

Date & Time 19 th -21 st November, 2008 (9.30 am to 6.00 pm)	Venue Hotel Crown Plaza New Friends Colony, New Delhi - 110025	Fees Rs. 7500/- per participant for entire programme
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Topics to be Discussed

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| <ul style="list-style-type: none"> Developing and Implementing a Risk Management Framework Methodology of Risk Assessment How to Implement Effective ERM for Government: Integrating Risk Management Into Business Planning Develop Effective Processes Across their Organisation Embedding Risk Management into the Culture of the Organisation Methodology of Driving Senior Management Support to Develop a Risk Management Culture | <ul style="list-style-type: none"> Promoting Good Governance within Risk Management Methodology for Integrated Enterprise Risk Management Methodology for Moving from Hazard-Based Risk Management to Opportunity-Based Risk Management Providing Assurance to Senior Executives Using A Risk-Based Audit Approach Getting the Right Information to the Right People at the Right Time Spreading the Awareness among the Participants for Developing Capabilities and Retaining Staff |
|--|---|

Speakers: Eminent speakers from the industry, risk management consultants, experts from insurance companies providing risk management tools.

Programme Directors	CA. Pankaj I. Jain , Chairman, Committee on Insurance and Pension of ICAI, 98332 25025 CA. Abhijit Bandyopadhyay , Chairman, Committee on Internal Audit, 98310 59999
Programme Coordinator	Dr. T. Paramasivan , Secretary, Committee on Insurance and Pension of ICAI, Phone No. (011) 30110491, 30110439, 9350799934, Fax No. (011) 30110583, Email: coip@icai.org
Payment of participation Fee	The participation fee should be paid by Demand Draft favouring The Institute of Chartered Accountants of India payable at New Delhi and should be sent only to the Secretary, Committee on Insurance and Pension, The Institute of Chartered Accountants of India, ICAI Bhawan, Indraprastha Marg, New Delhi – 110 002.

Programme on AS-15 (Revised) on Employee Benefits with inputs on Actuarial Sciences

Organised by Committee on Insurance and Pension of ICAI and Hosted by NIRC of ICAI

Theme: AS-15 (Revised) on Employee Benefits contains intricate issues like measurement and disclosure of Post Employment Benefits, Long Term Employee Benefits, Termination Benefits, etc., necessitating through analysis and discussion so that the members of the Institute could play their roles in the most appreciable manner either as auditors or preparation of financial statements.

Date & Time 28 th November, 2008 (9.30 am to 5.30 pm)	Venue India Habitat Centre, Lodhi Road, NEW DELHI - 110003	Fees* Rs. 1000/- for member of ICAI, Rs. 1500/- for others	CPE Credit 6 Hours
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Topics to be discussed

Speakers

An overview of AS-15 (Revised) Employee Benefits	Dr. Avinash Chander, Technical Director, ICAI
Actuarial principles with specific reference to gratuity and pension products	Shri K.K. Wadhwa, Consulting Actuary
Case Study on AS 15 (Revised) with relevant Actuarial Principles	Shri A. D. Gupta, Consulting Actuary
Checking of compliance with AS-15 (Revised) on Employee Benefits: From Enterprises' perspective From Auditor's perspective	CA. C.V. Sajan

Programme Chairman	CA. Pankaj I. Jain , Chairman, Committee on Insurance and Pension of ICAI 98332 25025	
Programme Directors	CA. Vijay Kumar Gupta, FCA , Vice Chairman, Committee on Insurance and Pension, 9810050029, (011)23314525-26	CA. Sudhir Kumar Agarwal , Chairman, Northern India Regional Council of ICAI 011-2248189, 9811021049, sudhiricai@yahoo.com
Programme Coordinator	Dr. T. Paramasivan , Secretary, Committee on Insurance and Pension of ICAI, Phone No. (011) 30110491, 30110439, 9350799934, Fax No. (011) 30110583, coip@icai.org	
*Payment of participation Fee	The participation fee should be paid by Demand Draft favouring The Institute of Chartered Accountants of India payable at New Delhi and should be sent only to the Secretary, Committee on Insurance and Pension, The Institute of Chartered Accountants of India, ICAI Bhawan, Indraprastha Marg, New Delhi – 110 002.	

International Conference on Corporate Governance

**Organized by: Committee on Corporate Governance (CCG) of ICAI
in partnership with
The National Foundation for Corporate Governance (NFCG)**

Date	: 23 rd January, 2009	CPE (Credit)	: 5 Hours
Venue	: Vigyan Bhawan, New Delhi	Fees	: Rs 2500/-

Discussion Sessions

Inaugural/Keynote Session:

Relevance of Corporate Governance in Nation Building

1st Technical Session:

Role of Regulators beyond issue of Guidelines

- Develop Mechanisms to prevent/detect/correct poor Governance

2nd Technical Session:

Risk Management and Role of Directors

- Decision making during turbulent times
- Who is really in charge of Risk Management?

3rd Technical Session:

Corporate Failures

- Lessons from Financial Turmoil- Prevent corporate failures by good governance
- Directors' Responsibilities in failed companies

4th Technical Session:

Panel Discussion

- Political Governance for Economic Development

Concluding Session & Vote of thanks

Contact Persons and Contact Details

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Mobile: 09841073008, **Email id:** skca@sandsca.com, ssca@vsnl.com, sk@icai.org

CA. Harinderjit Singh, Member, CCG, ICAI., **Programme Director**,
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Note: For faculty names and other details please visit the ICAI website or refer the December'08 issue of this Journal.

Classifieds

4674 A partner of a Mumbai based CA firm is moving to Udaipur (Raj.) and opening branch office there, seeks professional work on Assignment/Sub-Contract basis. Contact: miudaipur@gmail.com

4675 Gujarat based Mid-size CA Firm having team of around 30 CA members across Gujarat- working on Network basis since 7 years, seeks Attested/Non-Attested Professional work with single point contact for whole Gujarat on Assignment/Network/Sub-Contract/Sharing Basis: Contact: bipin.co@gmail.com 098240 15889.

4676 Kanpur based CA firm requires qualified /semi qualified Chartered Accountant. Contact Goenka & Agarwal.

Mobile No. 9415044277, Telefax- 0512-2534427, Email: goenka_agarwal@rediffmail.com

4677 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. Phone 9811084340.

4678 Required Chartered Accountants on partnership/employment assignment/retainership/sub-contract basis, semi-qualified and articulated assistants (for the state of Jammu & Kashmir). Remuneration no bar. Apply Box: 4678, C/o The Chartered Accountant, The Institute of Chartered Accountants of India, ICAI Bhawan, C-1, Sector-1, Noida-201301.

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

Organised by the International Affairs Committee and Hosted by Jaipur Branch of CIRC of ICAI

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 Hours
20-22 November, 2008 9:30 AM -5:30PM	Birla Auditorium, Jaipur	18 hrs

Discussion Sessions

DAY ONE (20/11/2008)

Technical Session –I

Session Theme: Changing Dimensions of Accounting and Reporting : Issues and Strategies

Global Convergence of Accounting – Road Ahead
Sustainability Reporting
Challenges Confronting Emerging and Developing Countries: Shifting from Diagnostics to Capacity Development

Technical Session –II

Session Theme: Adapting to Emerging International Horizons

Competency Mapping for Professional Development: Approaches
Accounting professionals becoming Global – Critical Analysis

Technical Session-III

Session Theme: BFSI Sector and Accountancy Profession

Insurance Sector – Role of CA in Risk Management
Mutual Fund Industry– Challenges & Opportunities

Technical Session-IV

Session Theme: Harmonization of Profession Beyond Frontiers

SAFA Region: Perspective

DAY TWO (21/11/2008)

Technical Session V

Session Theme: Auditing- Adding Value to Governance

Corporate Fraud – Prevention, Detection and Deference in Changing milieu
Compliance Procedure in e-Environment – Challenges
Convergence with International Standards on Auditing
Special Address: Meeting the Challenges of Capital Market – Way Forward

Technical Session VI

Session Theme: IFRS: Preparing Industry for Compliance

Indian GAAP: Road to IFRS
IFRS: Preparing Industry for Compliance
Banking Sector : Roadmap for Readiness

Technical Session: VII

Session Theme: Leveraging Information Technology: For Better Tomorrow

XBRL: Future of Financial Reporting
Information Security Audit: International Perspective
Knowledge Management: Achieving Competitive Edge

Technical Session-VIII

Session Theme: Accounting Profession-Emerging Challenges

Accounting Profession in 2020
Harmonization of Profession Beyond Frontiers

DAY THREE (22/11/2008)

Technical Session-IX

Session Theme: Emerging Taxation Regime

International Taxation: Global Perspective

GST : Tax for Future Generation

Special Address

Positioning India on Global Canvas

Leveraging Knowledge Economy

Technical Session-X

Session Theme: Landscaping Indian Capital Market on Global Canvas

Landscaping Indian Capital on Global Canvas

Corporate Governance : Enhancing Stakeholders Value

Value Creation: Perspective of an Independent Director

Panel Discussion: Stakeholder Promotion in growing equity cult era

Valedictory Session

REGISTRATION DETAILS

Category	Up to 20 th October, 2008	After 20 th 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

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- CA Vjiay Garg, Conference Director

Conference Convenors

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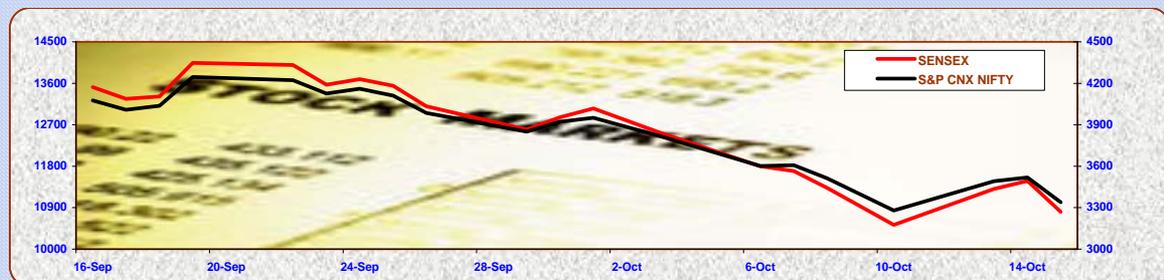
New e-initiatives of the Committee on Trade Laws and WTO

With a view to equip the Chartered Accountants with the sufficient knowledge and relevant expertise in the field of international trade laws and WTO and to enable them to present a strong and positive face in the fast changing world trading environment, the Committee on Trade Laws and WTO of the Institute of Chartered Accountants of India has taken following E-initiatives for the benefit of the members, which the members may like to visit :-

- **Launching of a WTO Portal :** The WTO Portal which can be accessed at <http://wto.icaai.org> intends to provide useful and relevant information on the basic understanding of the WTO. In order to meet the emerging needs of the members, apart from having innovative and dynamic features, the portal also intends to serve as a useful tool of information for the ICAI's Post Qualification Course in International Trade laws and WTO.
- **Hosting of E-newsletter 'Gateway to International Trade':** In the context of increasing profile change and to provide newer direction to the professional development of Members, the first issue of an e-newsletter titled 'Gateway to International Trade E-Communiqué of the Committee on Trade Laws and WTO' has been hosted at the website of the Institute <http://www.icaai.org>.

Chairman, Committee on Trade Laws and WTO

Economic Indicators



Selected Indicators

Item	Unit/Base	2007	2008					
		Sep. 28	Aug. 22	Aug. 29	Sep. 5	Sep. 12	Sep. 19	Sep. 26
Cash Reserve Ratio	per cent	7.00	8.75	8.75	9.00	9.00	9.00	9.00
Bank Rate	Per cent per annum	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Prime Lending Rate	Per cent per annum	12.75-13.25	13.25-14.00	13.25-14.00	13.25-14.00	13.25-14.00	13.25-14.00	13.75-14.00
Deposit Rate	Per cent per annum	8.00-9.50	8.75-10.00	8.75-10.00	8.75-10.00	8.75-10.00	8.75-10.00	8.75-10.00
Call Money Rate (Low/High)	Per cent per annum	2.75/9.50	7.75/11.50	4.55/10.04	6.25/10.00	5.25/11.00	7.00 /16.00	6.35/15.25

Readers are Invited to contribute write-ups or any relevant and interesting piece of information for this feature at eboard@icai.org.

Finance Ministry to Float Paper on I-T Code

The Finance Ministry is likely to float a discussion paper in October on the proposed new income tax law, which aims to simplify the existing law and phase out tax exemptions. Information emanating from North Block indicates that the full draft income tax code may not be made public now. "Looking at the present complexities involving tax exemptions and deductions in India, simplification will not be possible by mere rephrasing of the existing Act," a finance ministry official said. Most of the court cases, which run into several thousands, are mainly due to refusal of income tax exemptions or deductions, the official said.

More Large Taxpayers' Units Likely

The Department of Central Excise and Customs is likely to increase the number of large taxpayers' units (LTUs) and the matter is being examined, said Mr P.C. Jha, Chairman, Central Board of Excise and Customs. The LTUs facilitate payment of all three taxes (central excise, customs and service tax) by a taxpayer at a single office in a single transaction. "We have opened LTUs at Bangalore, Chennai, Mumbai and Delhi. After opening a unit at Kolkata, we may open similar units at other places," Mr Jha said.

www.thehindubusinessline.com

Grievances to be Registered Online

Tax payers will now be able to lodge their grievances with the taxman at the click of a mouse, with the launch of an online complaint redressal mechanism on the lines of the existing e-filing facility of tax returns. The facility will soon be available on the official web site of the Income-Tax (IT) Department, with the completion of the trial run of this maiden initiative in the next few months. The trial run of this facility named 'Sevottam' is already being experimented on a pilot-basis in Mumbai and Udaipur, the official said. While registering online complaints, the tax payer will also receive an acknowledgment number, which would have a fixed time limit that will ensure that it is redressed within a stipulated duration.

SEBI Tells ICAI to Suggest Accounting Rules for IPOs

Even as the Institute of Chartered Accountants of India (ICAI) is wrapping up its study on the valuation process in initial public offers, capital market regulator SEBI has asked the accounting body to study IPO reforms. ICAI will suggest ways to make accounting treatment of IPOs more stringent, and find out ways for an efficient oversight on management of IPO funds. The proposed study would look into ways to raise the accountability of companies floating IPOs. This is seen by the government and SEBI as an area of concern. While SEBI has fast-tracked introduction of a mechanism to make the process of IPOs investor-friendly, the ministry of corporate affairs is looking into the discrepancies in valuation of IPOs.

Tax with Inflation Rate

Inflation might bring relief for taxpayers in future. The government is considering a proposal to link taxable income with inflation rate. Discussions are on among policymakers in North Block on how salaried employees, especially pensioners, can be protected from price rise — which, in recent times, has brought down the purchasing power of common man. The argument is based on the premise that if professionals and businessmen are allowed deduction for full expenses relating to their professions/business, then why denies deduction to salaried individuals for employment-related expenses.

India may Exempt Taxes on Coal Transfer by JV Firms

Press Trust of India reported that government has asked states to exempt local taxes on coal transfers by JV firms from captive coal blocks. In a letter to chief secretaries the Coal Ministry has made it clear that handing over of the raw material to a partner in a joint coal block could not be treated as trading.

Federal Regulators and Auditors warn American International Group Inc

Federal regulators and auditors warned American International Group Inc (AIG) about a lack of transparency in monitoring its financial activities before the conglomerate nearly collapsed last month, a top Democratic lawmaker investigating the credit crisis said Tuesday October 7, 2008.

Zero Growth Rates

The IMF has stated that as per its best forecast the global growth will be around 3 percent in 2009. What is more interesting is that it has predicted close to zero or even negative growth rate for advanced countries until at least the middle of 2009, with a slow recovery during the rest of the year. World growth will be instead driven by growth in emerging and developing economies. We predict that even they will grow at a substantially lower rate than they have in the recent past: 7 percent in 2008, 6 percent in 2009, said IMF officials in Washington.

Tax Court Amends Whistleblower Rules

The Tax Court in Washington has amended its rules of practice and procedure for whistleblower actions, making it easier for informants to keep their identities confidential. The amendments were issued on October 3. One of the rules was amended to enhance privacy by requiring only an individual taxpayer's state of legal residence for venue purposes on a petition for additional disclosure, petition to restrain disclosure or petition to disclose identity. If the taxpayer resides in the District of Columbia or any commonwealth, territory or possession of the United States, or in any foreign country, the taxpayer should provide that information instead.

www.webcpa.com

Bankers ask SEC to Overrule FASB on Fair Value

The American Bankers Association has written to the Securities and Exchange Commission demanding that it override the Financial Accounting Standards Board's guidance on fair value accounting. The ABA wants the SEC to override FASB's guidance "and replace it with guidance that clarifies that fair value in an illiquid market does not include forced or distressed sales." The group also wants the SEC to provide guidance on "other than temporary impairments" and to suspend the proposed guidance on accounting for securitizations.

www.webcpa.com

FASB Issues Exposure Drafts on Going Concern and Subsequent Events

The Financial Accounting Standards Board (FASB) on October 9, 2008 issued two separate but related Exposure Drafts (EDs) for public comment. The documents contain two proposed FASB Statements, Going Concern and Subsequent Events, intended to improve financial reporting by incorporating accounting guidance that originated as auditing standards into the body of authoritative literature issued by the FASB while converging U.S. generally accepted accounting principles and International Financial Reporting Standards. Including this guidance in authoritative accounting literature as well as in auditing standards emphasizes that accounting and reporting are the primary responsibility of an entity and its management, not its auditor. Feedback of the EDs be submitted by December 8, 2008. The EDs, including information about how to submit comments on the proposed guidance, are available at www.fasb.org.

www.fasb.org

FASB Proposes Improvements to Reporting of a Discontinued Operation

The Financial Accounting Standards Board (FASB) on September 25, 2008 issued proposed FASB Staff Position (FSP) FAS 144-d, Amending the Criteria for Reporting a Discontinued Operation. The FSP is intended to improve the quality and consistency of financial reporting by defining a discontinued operation and establishing disclosure requirements for all components of an entity that have been disposed of or are classified as held for sale. Constituents have until January 23, 2009, to review and provide comment on the proposals contained in the document.

www.fasb.org

IAASB Issues Seven Revised ISAs, Including Updated Standard on Scope of Audit and Auditor's Role

The IAASB on October 2, 2008 released seven International Standards on Auditing (ISAs) following the consideration and approval of due process by the Public Interest Oversight Board (PIOB). The ISAs are in the new style following the conventions developed in the IAASB's project to improve the clarity, and therefore the application, of its standards. Some of the standards released today have been substantively revised, while others have been redrafted to apply the new conventions. The standards will provide further momentum toward achieving convergence and contribute to enhancing understanding of the purpose and scope of audits, and their effective conduct.

<http://www.ifac.org/>

New IAASB Audit Practice Alert Focuses on Fair Value Accounting Estimates

To assist auditors in addressing the challenges of auditing fair value accounting estimates, the IAASB on October 6, 2008 released an audit practice alert. The alert was developed following consultation with the IAASB's Task Force on Fair Value Auditing Guidance, which is considering the need for new or modified guidance in light of current marketplace issues. The purpose of the alert is to highlight areas within the International Standards on Auditing (ISAs) that are particularly relevant in the audit of fair value accounting estimates in times of market uncertainty.

<http://www.ifac.org/>

Forum of Firms Focus on Audits of Financial Institutions

Over 60 partners from 21 international networks of accounting firms met on October 8, 2008 to share their experiences, industry insights and current practices for audits of financial institutions at a symposium on the Audit of Financial Institutions organized by the Forum of Firms. Several panels of experts were assembled with the support of the six large networks to lead discussions on various topics including valuation and impairment, liquidity, market confidence, and going concern.

<http://www.ifac.org/>

IASB Proposes Amendments to the Retrospective Application

The International Accounting Standards Board (IASB) on September 25, 2008 published for public comment an exposure draft of proposed amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards. The proposals address the retrospective application of IFRSs in selected areas and are aimed at ensuring that entities applying IFRSs will not face undue cost or effort in the transition process. The exposure draft is available on <http://www.iasb.org>. It is open for comment until 23 January 2009.

<http://www.iasb.org>

IASB Proposes Revised Definition of Discontinued Operations

The International Accounting Standards Board (IASB) on September 25, 2008 published for public comment an exposure draft of proposed amendments to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations. The proposals are to revise the definition of discontinued operations and require additional disclosure about components of an entity that have been disposed of or are classified as held for sale. The proposals are the result of a joint project by the IASB and the US Financial Accounting Standards Board (FASB) to develop a common definition of discontinued operations and require common disclosures about them. The FASB is publishing parallel proposals to amend its standards.

<http://www.iasb.org>

IASB Announces Next Steps in Response to Credit Crisis

The International Accounting Standards Board (IASB) on Friday October 3, 2008 announced the current status of its response to the credit crisis and its next steps. The IASB has already taken a number of actions to address issues related to the credit crisis. In publishing additional steps, the IASB reaffirms its commitment as a standard-setter to bring transparency to investors and other users of financial statements. In responding to the credit crisis, the IASB recognises the need to clarify International Financial Reporting Standards (IFRSs) to address new market developments. The IASB's response has primarily focused on the recommendations of the Financial Stability Forum (FSF), which had the support of the Group of Seven (G-7) Finance Ministers. The IASB is closely monitoring developments in the United States and other jurisdictions to avoid unnecessary inconsistencies in accounting treatments under IFRSs and US generally accepted accounting principles (GAAP).

At their meeting in Beijing on October 9, 2008, the Trustees of the IASC Foundation announced their unanimous support for the approach that the International Accounting Standards Board (IASB) laid out last Friday October 3, 2008, to accelerate its response to the credit crisis.

<http://www.iasb.org>

IASB Amendments Permit Reclassification of Financial Instruments

The International Accounting Standards Board (IASB) on October 13, 2008 issued amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures that would permit the reclassification of some financial instruments. The amendments to IAS 39 introduce the possibility of reclassifications for companies applying International Financial Reporting Standards (IFRSs), which were already permitted under US generally accepted accounting principles (GAAP) in rare circumstances. These amendments are the latest in a series of steps that the IASB has undertaken to respond to the credit crisis. The amendments today address the desire to reduce differences between IFRSs and US GAAP in a manner that produces high quality financial information for investors across the global capital markets.

<http://www.iasb.org>

IASB Proposes Improvements to Financial Instruments Disclosures

The International Accounting Standards Board (IASB) on October 15, 2008 published for public comment proposals to improve the information available to investors and others about fair value measurements of financial instruments and liquidity risk. The proposals form part of the IASB's response to the credit crisis and follow recommendations of the Financial Stability Forum, which had the support of the Group of Seven (G-7) Finance Ministers. The proposals also reflect discussions by the IASB's Expert Advisory Panel on measuring and disclosing fair values of financial instruments when markets are no longer active. The exposure draft Improving Disclosures about Financial Instruments (proposed amendments to IFRS 7) is open for public comment until 15 December 2008.

<http://www.iasb.org>

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.

Training Programmes for Staff (including Article and Audit Clerks) concerned with Attestation Functions, including Appropriate Infrastructure

- Inadequate Training Programme for staff including audit staff concerned with attestation functions and non-maintenance of records thereof.
- Non-compliance of CPE hours by partner as well as other CA employees.
- Staff files having necessary information regarding the training programmes undergone during employment and periodical developments were not maintained.
- No introductory procedures established for new employees like discussion regarding requirements of the ICAI, Continuing Professional Education and Independence.
- Most of the Practising Units (PUs) does not organizing any orientation programme for new employees.
- Procedure for documenting orientation of new appointees missing.
- No information as to training programme for staff made available.
- The unit does not maintain formal records for the continuous professional education imparted to its staff members; the unit does not have a written policy of review of audit.
- There is need to develop library for continuing education of staff containing developments in Auditing and Assurance Standards, Guidance Notes and monitoring continuing professional education of staff.
- Though the Audit in-charge are well versed about technical pronouncements of the Institute like Accounting and Auditing Standards, there is need to apprise the junior staff also about these pronouncements which may be done even in-house.
- The PU is not maintaining any register for in-house training imparted.
- The PU is not maintaining any Register for lectures, seminars, workshop, etc. attended by qualified as well as other staff members. □

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

ACCOUNTANT'S BROWSER

"PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE"

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

1. ACCOUNTING

Accounting Doctoral Education- 2007: A Report of the Joint AAA/APLG/FSA Doctoral Education Committee by Bruce K. Behn etc. *Issues in Accounting Education*, Aug. 2008, pp. 357-367.

Accounting for Non-profit Sector & Its Environment in India by S. Shankarappa & B. Mahadevappa. *Indian Journal of Accounting*, June- 2008, pp. 56-65.

Accounting Measures & International Pricing Models: Justifying Accounting Homogeneity by Javier Gomez-Biscarri & German Lopez-Espinosa. *J. Account. Public Policy*, Vol.27, 2008, pp. 339-354.

Adoption of Annual Accounts of Companies – Important Issues by Naresh Kumar. *Corporate Law Adviser*, Vol. 86, 2008, pp.10-16.

Derivatives & Hedging: Accounting vs. Taxation by Robert Bloom & William J. Cenko. *Journal of Accountancy*, Oct, 2008, pp. 54-58.

Trends in Accounting Student Characteristics: Results From a 15-year Longitudinal Study at FSA Schools by Irvin T. Nelson etc. *Issues in Accounting Education*, Aug. 2008, pp.373-389.

2. AUDITING

Audit Committee Forums by Lee white. *Charter*, September 2008, pp.66.

Audit Methodology in Information Systems Environment: A Case Study of Indian Banks by Anisa Attari & G. Soral. *Indian Journal of Accounting*, June- 2008, pp.38-45.

Comparison of Error Rates for EVA, Residual Income, GAAP-Earnings & other Metrics using a long-window Valuation Approach by John Forker & Ronan Powell. *European Accounting Review*, vol.17/3, 2008, pp. 471-502.

Earnings Management & Audit Quality in Europe: Evidence from the Private Client Segment Market by B.V. Tendeloo & Ann Vanstraelen. *European Accounting Review*, vol.17/3, 2008, pp. 447-469.

Networks & Audit Conflicts by Louisa Thomson. *Charter*, Sep. 2008, pp. 52-53.

3. ECONOMICS

Effect of Globalisation & Legal Environment on Voluntary Disclosure by Kimberley A. Webb etc. *The International Journal of Accounting*, Sep. 2008, pp. 219-245.

Equity-linked Certificates of Deposit: A

Simple Alternative to Unit-linked Insurance Products by Steve Swidler. *Pravartak*, April-June 2008, pp. 40-44.

Financial Sector Reforms by Gurbachan Singh. *Eco. & Pol. Weekly*, Sep. 6, 2008, pp. 70-71.

Forecasting Economic Growth Using an Artificial Neural Network Model by R.P. Pradhan & Ankit Kumar. *Journal of Financial Management & Analysis*, Vol.21/1, 2008, pp. 24-31.

Future of the International Monetary fund by Warren Coats. *Eco. & Pol. Weekly*, Aug. 30, 2008, pp. 72-73.

Issues Before the Thirteenth Finance Commission by M. Govinda Rao etc. *Eco. & Pol. Weekly*, Sep. 6, 2008, pp.41-53.

Payment & Settlement System in India by V. Leeladhar. *RBI Bulletin*, Sep. 2008, pp. 1487-1499.

Performance of Private Corporate Business Sector, 2007-08. *RBI Bulletin*, Sep. 2008, pp.1511-1529.

Report of the Internal Working Group on Currency. *Company Law Journal*, Vol.3, 2008, pp.117-167.

Strengthening Links Between Central & State Finance Commissions by A.C. Minocha. *Eco. & Pol. Weekly*, Sep. 20, 2008, pp.70-74.

4. INVESTMENT

Credit Rating Agencies in India by Tarun Jain & Raghav Sharma. *Company Law Journal*, Vol.3, 2008, pp.89-109.

Regulation of Mergers & Amalgamations (M&As) under Indian Competition Law by G.R. Bhatia. *Chartered Secretary*, Sep. 2008, pp.1233-1238.

Use of Valuation Models by UK Investment Analysts by Shahed Imam etc. *European Accounting Review*, vol.17/3, 2008, pp.503-535.

5. LAW

Anti Trust Laws – In Global Business by R. Soundara Rajan. *Chartered Secretary*, Sep. 2008, pp.1221-1230.

Dispute Resolution Scheme, 2008 by Rajkumar S. Adukia. *Service Tax Today*, Sep. 12-18, 2008, pp.25-27.

Evolution of Competition Law by M.R. Madhavan. *Chartered Secretary*, Sep. 2008, pp.1239-1241.

The Interface Between Competition Law & Securities Law in India by S. Sarat. *Chartered Secretary*, Sep. 2008, pp.1215-1220.

Right to Information Act, 2005: Key for Ef-

fective Implementation by Anil Monga & Akshat Mehta. *The Indian Journal of Public Administration*, April-June 2008, pp. 297-314.

6. MANAGEMENT

Dealing With Difficult People: Exert your Persuasive Power to Turn Different Characters at Work into Assets by Harry Wong. *A Plus*, August 2008, pp. 50-51.

Empirical Evaluation of Analysts Herding Behavior Following Regulation Fair Disclosure by Yaw M. Mensah & Rong Yang. *J. Account. Public Policy*, Vol. 27, 2008, pp.317-338.

New Arsenal of Risk Management by Kevin Buehler etc. *Harvard Business Review*, Sep. 2008, pp.93-100.

Owning the Right Risks by Kevin Buehler etc. *Harvard Business Review*, Sep. 2008, pp.102-110.

Performance Measurement Systems for Corporate Sustainability by Lineke Sneller. *The Management Accountant*, Sep. 2008, pp. 671-675.

Towards Reformulation of the Capital Asset Pricing Model (CAPM) focusing on Idiosyncratic Risk & Roll's Meta-analysis: Methodological Approach by Edward J. Lusk & Michael Halperin. *Journal of Financial Management & Analysis*, Vol.21/1, 2008, pp. 1-23.

7 Ways to Fail Big: Lessons from the Inexcusable Business Failures of the Past 25 years. *Harvard Business Review*, Sep. 2008, pp.82-91.

7. TAXATION & FINANCE

Disclosure of Information by Income-Tax Department Under Right to Information Act by Surender Kumar Jain. *Taxman*, Sep. 27- Oct.3, 2008, pp. 70-71.

Indian States' Fiscal correction: An Unfinished Agenda by V.J. Ravishanker etc. *Eco. & Pol. Weekly*, Sep. 20, 2008, pp. 57-62.

Inter-se Adjustment of Tax Deducted at Source (TDS) from Salaries is not Permissible – A case study by T.N. Pandey. *Company Law Journal*, Vol.3, 2008, pp.115-116.

Reimbursement Rules in Service Tax & Valuation of Taxable Service by Sachin Sharma. *Service Tax Today*, Sep. 12-18, 2008, pp.20-24.

Taxation of Shareholder Capital Gains & the Choice of Payment Method in Takeovers by M. Bugeja & R.D.S. Rosa. *Accounting & Business Research*, Vol.38/4, 2008, pp. 331-350. □

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

Explanatory Memorandum to the Exposure Draft Revised Standard on Auditing (SA) 210 Agreeing the Terms of Audit Engagements

Background

The Institute of Chartered Accountants of India had in January, 2003 issued the Standard on Auditing (SA) 210¹, “Terms of Audit Engagements”, effective for all audits relating to accounting periods beginning on or after April 1, 2003. The Institute is a member of the International Federation of Accountants (IFAC). Therefore, as a part of its membership obligations, while formulating any Standard on Auditing, 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 January 2008, issued the Exposure Draft of the Redrafted ISA 210 meaning thereby that the IAASB proposed a **Redrafted** version of ISA 210, 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”², issued by the IAASB in July, 2006.

ICAI’s Response

The Council of the Institute, at its 267th 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 Services³, published in the July, 2007 issue of the Journal. This revised Preface is effective from April 1, 2008.

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 (SRs)**, to be applied to engagements involving application of agreed upon procedures to information, compilation engagements, and other related services engagements, as may be specified 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)**s 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 five distinct sections, namely, Introduction including scope and effective date, Objectives, Definitions, Requirements and Application and Explanatory Material. A brief description of each of these Sections is given below:

- **Introduction:** The ‘Introduction’ section deals the purpose and scope of the Standard, subject matter of the Standard and effective date of the Standard.
- **Objectives:** The ‘Objectives’ section provides the reference in which the Requirements are elaborated in the Standard. The aim of the auditor is to achieve the Objectives as specified in all Standards of Auditing (SAs).
- **Definitions:** The ‘Definitions’ section deals with the meaning attributed to certain expressions for the purpose of SAs. The aim is to assist the auditors to ensure consistent application of the Standards.
- **Requirements:** The fundamental principles of the Standard are contained in the Requirements section and presented 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. The ‘Requirements’ section also contains cross reference to the relevant Application and Other Explanatory Material.
- **Application and 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 carry-

¹Hitherto known as Standard on Auditing (SA) 210 (AAS 26).

²The full text of the Policy Position can be downloaded free of charge at http://www.ifac.org/IAASB/downloads/Modification_Policy_Position.pdf.

³The full text of the Preface can be downloaded free of charge at http://www.icaai.org/resource_file/7744announ1050.pdf.

ing out, the requirements of an SA, along with the background information on the matters addressed in the SA. It may include examples of procedures, some of which the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement. Appendices which form part of Application and Other Explanatory Material are an integral part of a Standard.

In view of this format of writing, the standard portion or principles enunciated in a Standard are no longer given in **bold face**.

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) 210, "Agreeing the Terms of Audit Engagements", is based on the corresponding Exposure Draft of Redrafted ISA 210 issued by the IAASB in January, 2008 and follows the same writing style. In addition to the other things, the title of the then existing SA 210, "Terms of Audit Engagements" has been changed to "Agreeing the Terms of Audit Engagements" thereby imposed a condition on the auditor that until the auditor and the management agrees on the terms of the audit engagement, the auditor shall not start the audit of an entity. 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 20 and the paragraphs in the Application and Other Explanatory

Material are numbered as A1 to A34.

Topics Covered by Revised SA 210

The Standard contains the following main aspects:

- i) Scope
- ii) Effective date
- iii) Objectives
- iv) Requirements
 - (a) Preconditions for an Audit
 - (b) Agreement on Audit Engagement Terms
 - (c) Recurring Audits
 - (d) Acceptance of a Change in the Terms of the Audit Engagement
 - (e) Additional Considerations in Engagement Acceptance
- v) Application guidance on the above aspects

Highlights of Revised SA 210

1. SA 210 (Revised) deals with the auditor's responsibilities in agreeing the terms of audit engagement with the entity and also to respond to a request by an entity to change the terms of audit engagement.
2. The objective of auditor under SA 210 (Revised) is to accept audit engagement only when the preconditions for an audit and common understanding between him and the client exist and to perform necessary procedures for the same. Further, it states that if the preconditions to the audit are not present, the auditor shall discuss the matter with management or those charged with governance or shall not accept the proposed audit engagement.
3. SA 210 (Revised) requires the auditor not to accept the engagements where the management or those charged with governance imposes such a limitations on the scope of the engagement that leads to the disclaimer of opinion by the auditor, unless required by law to do so.

4. SA 210 (Revised) requires the auditor to judge whether there is any conflict between the financial reporting standards and the additional requirements of the applicable laws and regulations and if yes, discuss the same with management and those charged with governance. Further, it also requires providing the effect of the same in the auditor's opinion.

5. As per SA 210 (Revised), agreement on audit engagement terms includes the objective and scope of the audit of the financial statements, responsibilities of the auditor, responsibilities of management and, where appropriate, those charged with governance, identification of the applicable financial reporting framework for the preparation and presentation of the financial statements, expected form of any reports to be issued by the auditor and peer review mechanism.

6. SA 210 (Revised) requires the auditor in case of recurring audits to consider whether circumstances requires that the terms of the audit engagement needs to be revised and whether there is a need to remind the entity about the existing terms of the audit engagement.

7. SA 210 (Revised) requires the auditor to obtain written representation as per SA 580 so as to support other audit evidence relevant to the financial statements.

8. SA 210 (Revised) contains the detailed guidelines on the Financial or General Reporting Framework and its acceptability that the auditor is required to consider while accepting the audit engagement. If auditor has determined that the financial reporting framework prescribed by law or regulation is unacceptable, the auditor may agree to accept the audit engagement only if the management agrees to provide additional disclosures in the financial statements.

9. SA 210 (Revised) also provides the appropriate wordings to be used by an auditor while expressing an opinion on the financial statements.

*Your comments on the Exposure Draft should reach us by **December 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

Exposure Draft Standard on Auditing 210 (Revised)* Agreeing the Terms of Audit Engagements

[Proposed] Standard on Auditing (SA) 210 (Revised), "Agreeing the Terms of Audit Engagements" should be read in conjunction with "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services⁴," which sets out the authority of SAs.

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibilities in:

- (a) agreeing the terms of the audit engagement with the entity; and
- (b) responding to a request by an entity to change the terms of an audit engagement for an audit of financial statements. It is to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

Effective Date

2. This SA is effective for audits of financial statements for periods beginning on or after-----.

Objective

3. The objective of the auditor is to accept an audit engagement only when the basis upon which it is to be performed has been agreed, through: (Ref: Para. A1-A2)

- (a) Establishing whether necessary preconditions for an audit are present; and
- (b) Confirming that there is a common understanding between the auditor and the entity of the terms of the audit engagement

and of the respective responsibilities of the auditor, management and those charged with governance.

Requirements

Preconditions for an Audit

4. In order to establish whether necessary preconditions for an audit are present, the auditor shall:

- (a) Determine whether the financial reporting framework⁵ to be applied in the preparation and presentation of the financial statements is acceptable; and (Ref: Para. A3-A10)
- (b) Obtain the agreement of management and, where appropriate, those charged with governance that they acknowledge and understand their responsibility: (Ref: Para. A11-A13, A17)
 - (i) For the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due

to fraud or error; and (Ref: Para. A14-A16)

- (ii) To provide the auditor with:
 - a All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;
 - b Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and
 - c Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.

In the case of a fair presentation framework, management and, where appropriate, those charged with governance, are 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.

Limitation on Scope Prior to Audit Engagement Acceptance

* Earlier known as Standard on Auditing (SA) 210 (AAS 26), "Terms of Audit Engagements".

⁴Published in the July, 2007 issue of the Journal.

⁵Proposed SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with International Standards on Auditing", Paragraph 13 (a) defines the applicable financial reporting framework as "The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

(i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

(ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

5. If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

Reasons for not Proceeding with the Audit Engagement

6. Where the preconditions for an audit are not present, the auditor shall discuss the matter(s) with management and, where appropriate, those charged with governance. Unless the requirements of paragraph 19 are met, or the auditor is required by law or regulation to do so, the auditor shall not accept the proposed audit engagement if the auditor has determined that the applicable financial reporting framework is unacceptable or if the agreement referred to in paragraph 4(b) has not been obtained.

Agreement on Audit Engagement Terms

7. The auditor shall agree the terms of the audit engagement with management or those charged with governance.

8. The agreed terms of the audit engagement shall include: (Ref: Para. A2-2-A23)

- (a) The objective and scope of the audit of the financial statements;
- (b) The responsibilities of the auditor;
- (c) The responsibilities of management and, where appropriate, those charged with governance (including those in paragraph 4(b));
- (d) Identification of the applicable financial reporting framework for the preparation and presentation of the financial statements; and

(e) The expected form of any reports to be issued by the auditor.

9. Subject to paragraph 10, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. (Ref: Para. A21)

10. If law or regulation prescribes in sufficient detail the terms of the engagement, it may not be necessary to record them in an audit engagement letter or other suitable form of written agreement, except for the agreement of management and, where appropriate, those charged with governance that they acknowledge and understand the responsibilities set out in paragraph 4(b). (Ref: Para. A18-A20).

11. If law or regulation prescribes the responsibilities of management and, where appropriate, those charged with governance in relation to financial reporting, the auditor may determine that the law or regulation includes responsibilities that are equivalent in effect to those set out in paragraph 4(b). For such responsibilities that are equivalent, the auditor may use the wording of the law or regulation to describe them in the engagement letter or other suitable form of written agreement. For those that are not prescribed by law or regulation such that their effect is equivalent, the engagement letter or other suitable form of written agreement shall reflect the description in paragraph 4(b). (Ref: Para. A20)

Recurring Audits

12. On recurring audits, the auditor shall consider whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. (Ref: Para. A24)

Acceptance of a Change in the Terms of the Audit Engagement

13. The auditor shall not agree to a change in the terms of the audit en-

gagement where there is no reasonable justification for doing so. (Ref: Para. A25-A27)

14. If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that provides a lower level of assurance, the auditor shall determine whether it is appropriate to do so. (Ref: Para. A28-A29)

15. Where the terms of the audit engagement are changed, the auditor and management or those charged with governance shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

16. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted to continue the original audit engagement, the auditor shall, unless prohibited by law or regulation:

- (a) Withdraw from the audit engagement; and
- (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances necessitating the auditor's withdrawal from the audit engagement to other parties, such as those charged with governance or shareholders.

Additional Considerations in Engagement Acceptance

Wording Used to Express the Opinion

17. In some cases, law or regulation prescribes the wording of the audit opinion in terms that are significantly different from the requirements of SAs. In these circumstances, the auditor shall evaluate:

- (a) Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,
- (b) Whether additional explanation in the auditor's report

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above".

can mitigate possible misunderstanding.⁶

If the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor shall not accept the audit engagement, unless prohibited by law or regulation from doing so. An audit conducted in accordance with such law or regulation does not comply with SAs.

Accordingly, the auditor shall include no reference within the auditor's report to the audit having been conducted in accordance with SAs. (Ref: Para. A30 and A33)

Financial Reporting Standards Supplemented by Law or Regulation—Conflicts

18. If financial reporting standards established by an authorised or recognised standards setting organisation are supplemented by law or regulation, the auditor shall determine whether there are any conflicts between the financial reporting standards and the additional requirements. If such conflicts exist, the auditor shall discuss with management and, where appropriate, those charged with governance the nature of the additional requirements and shall agree whether:

- (a) The additional requirements can be met through additional disclosures in the financial statements; or
- (b) The description of the applicable financial reporting framework in the financial statements can be amended accordingly.

If neither of the above actions is possible, the auditor shall determine whether it will be necessary to modify the audit opinion in the auditor's report in accordance with [proposed] SA 705.⁷(Ref: Para. A31)

Financial Reporting Framework Prescribed by Law or Regulation—Determined as Unacceptable

19. If the auditor has determined that the financial reporting framework prescribed by law or regulation is unacceptable, the auditor may nevertheless agree to accept the audit engagement but shall do so only if: (Ref: Para. A3-2-A33)

- (a) Management or those charged with governance agree to provide additional disclosures in the financial statements, to avoid the financial statements being misleading; and
- (b) It is recognised in the terms of the audit engagement that:
 - (i) The auditor's report on the financial statements will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures in accordance with [proposed] SA 706; and
 - (ii) Unless the auditor is required by law or regulation to express the auditor's opinion on the financial statements by using the phrases "give a true and fair view" or "present fairly, in all material respects" in accordance with the applicable

financial reporting framework, the auditor's opinion on the financial statements will not include such phrases.

20. If management or those charged with governance refuse to provide additional disclosures and the auditor is prohibited by law or regulation from refusing to undertake the audit engagement, the auditor shall:

- (a) Evaluate the effect of the misleading nature of the financial statements on the auditor's report; and
- (b) Include appropriate reference to this matter in the terms of the audit engagement.

Application and Other Explanatory Material

Objective (Ref: Para. 3)

A1. Establishing whether the necessary preconditions for an audit are present and agreeing on the terms of the audit engagement are complemented by acceptance and continuance requirements in [proposed] SA 220 (Revised)⁸.

A2. The responsibilities of management and those charged with governance for agreeing the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant legislation.

Preconditions for an Audit

The Financial Reporting Framework (Ref: Para. 4(a))

A3. A condition for acceptance of an assurance engagement is that the criteria referred to in the definition of an assurance engagement are suitable and

⁶At present, there is no separate Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 706, "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report". However, the concept of 'emphasis of matter paragraph' has been discussed in SA 700, "The Auditor's Report on Financial Statements". The Auditing and Assurance Standards Board will issue an Exposure Draft of the Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 706, "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report" in the near future.

⁷At 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". The Standard is being revised in the light of the corresponding International Standards. The Auditing and Assurance Standards Board will issue an Exposure Draft of the Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 705, "Modifications to the Opinion in the Independent Auditor's Report" in the near future.

⁸Currently, SA 220 (AAS 17), "Quality Control for Audit Work" is in force. The standard is being revised in the light of the corresponding International Standard.

available to intended users. Criteria are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. For purposes of the SAs, the applicable financial reporting framework provides the criteria the auditor uses to evaluate or measure the preparation and presentation of the financial statements.

A4. Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation and presentation of the financial statements and the auditor does not have suitable criteria for evaluating the financial statements. In many cases the auditor may presume that the financial reporting framework is acceptable, as described in paragraphs A8-A9.

Determining the Acceptability of the Financial Reporting Framework

A5. Factors that may affect the auditor's determination of the acceptability of the applicable financial reporting framework include:

- The nature of the entity (for example, whether it is a business enterprise or a not-for-profit organisation);
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users or the financial information needs of specific users);
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement); and
- Whether applicable legislative

and regulatory requirements prescribe the applicable financial reporting framework.

A6. Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. While all the information needs of specific users cannot be met, there are financial information needs that are common to a wide range of users. Financial statements prepared and presented in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users are referred to as general purpose financial statements.

A7. In some cases, the financial statements will be prepared and presented in accordance with a financial reporting framework designed to meet the financial information needs of specific users. Such financial statements are referred to as special purpose financial statements. The financial information needs of the intended users will determine the applicable financial reporting framework in these circumstances. [Proposed] SA 800⁹ discusses the acceptability of financial reporting frameworks designed to meet the financial information needs of specific users.

General purpose frameworks

A8. At present, there is no objective and authoritative basis that has been generally recognised globally for judging the acceptability of general purpose frameworks. In the absence of such a basis, financial reporting standards established by organisations that are authorised or recognised to promulgate standards to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared and presented by such entities, provided the organisations follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders.

Examples of such financial reporting standards include:

- International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board;
- International Public Sector Accounting Standards (IPSASs) promulgated by the International Public Sector Accounting Standards Board; and
- Accounting Standards promulgated by Accounting Standards Board (ASB) of the Institute of Chartered Accountants of the India (ICAI) or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards) Rules, 2006.
- Accounting Standards for Local Bodies promulgated by Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India (ICAI).

These financial reporting standards are often identified as the applicable financial reporting framework in legislative and regulatory requirements governing the preparation and presentation of general purpose financial statements.

Financial reporting frameworks prescribed by law or regulation

A9. In accordance with paragraph 4(a), the auditor is required to determine whether the financial reporting framework, adopted in the preparation and presentation of the financial statements, is acceptable. In some cases, law or regulation may prescribe the financial reporting framework to be used in the preparation and presentation of general purpose financial statements for certain types of entities. In the absence of indications to the con-

⁹At present, there is no corresponding SA issued by AASB on the subject. The Auditing and Assurance Standards Board will issue an Exposure Draft of the Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 800, "Special Considerations Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement," in the near future. Attention of the reader is also drawn to the *Guidance Note on Audit Reports and Certificates for Special Purposes* issued by the Institute of Chartered Accountants of India (ICAI).

trary, such a financial reporting framework is presumed to be acceptable for general purpose financial statements prepared and presented by such entities. (In the event that the framework is not considered to be acceptable, paragraphs 19 and 20 apply.)

Jurisdictions that do not have authorised or recognised standards setting organisations or financial reporting frameworks prescribed by law or regulation

A10. When an entity is registered or operating in a jurisdiction that does not have an authorised or recognised standards setting organisation, or where use of the financial reporting framework is not prescribed by law or regulation, management or those charged with governance identify an applicable financial reporting framework. **Appendix 2** contains guidance on determining the acceptability of financial reporting frameworks in such circumstances.

Agreement of the Responsibilities of Management and, where appropriate, Those Charged with Governance (Ref: Para. 4(b))

A11. An audit in accordance with SAs is conducted on the premise that management and, where appropriate, those charged with governance have the responsibilities set out in paragraph 4(b)¹⁰. This premise is fundamental to the conduct of an effective independent audit. To avoid misunderstanding, agreement is reached with management and, where appropriate, those charged with governance that they acknowledge and understand their responsibilities, as part of agreeing and recording the terms of the audit engagement in paragraphs 7-11.

A12. SA 580 (Revised) requires the auditor to request management and, where appropriate, those charged with governance to provide written repre-

sentations that they have fulfilled these responsibilities.¹¹ It may therefore be appropriate to make them aware that receipt of such written representations will be expected, together with written representations required by other SAs and, where necessary, written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

A13. Where management and, where appropriate, those charged with governance will not agree to their responsibilities, or to provide the written representations, the auditor will be unable to obtain sufficient appropriate audit evidence.¹² In such circumstances, it may not be appropriate for the auditor to accept the audit engagement. In some cases, however, law or regulation may prohibit the auditor from declining an audit engagement. In these cases, the auditor may need to explain to management and, where appropriate, those charged with governance the importance of these matters, and the implications for the auditor's report.

Internal Control (Ref: Para. 4(b)(i))

A14. "Internal control" is defined as: "The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control assists management in fulfilling its responsibility for the preparation and presentation of the financial statements."¹³ The entity's objective with regard to the reliability of financial reporting includes the preparation and presentation of financial statements that are in accordance with the appli-

cable financial reporting framework and free from material misstatement, whether due to fraud or error.

A15. Internal control is an important aspect of the responsibility of management and, where appropriate, those charged with governance for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework. Accordingly, the auditor obtains their written agreement that they acknowledge and understand that this responsibility 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.

A16. In some cases, law or regulation may refer to the responsibility of management and, where appropriate, those charged with governance for the adequacy of accounting books and records, or accounting systems. As books, records and systems are an integral part of internal control as defined in paragraph A14, no specific reference is made to them in paragraph 4(b) for the description of the responsibility of management and, where appropriate, those charged with governance. However, if this responsibility of management and, where appropriate, those charged with governance is described using the wording of the law or regulation, as provided for in paragraph 11, it may include a reference to books, records and systems in addition to a reference to internal control. To avoid misunderstanding, it may be appropriate for the auditor to explain to management and those charged with governance the scope of this responsibility.

Considerations Specific to Smaller Entities (Ref: Para. 4(b))

A17. One of the purposes of agreeing

¹⁰ Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the AASs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200.

¹¹ Published in October, 2008 issue of the Journal.

¹² SA 580 (Revised), paragraph A28.

¹³ SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment," paragraph 4(c).

the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and, where appropriate, those charged with governance and the auditors. For example, when a third party has assisted with the preparation and presentation of the financial statements, it may be useful to remind management and, where appropriate, those charged with governance that the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework remains its responsibility. This may be particularly relevant in the case of smaller entities.

Agreement on Audit Engagement Terms

Audit Engagement Letter or Other Form of Written Agreement¹⁴ (Ref: Para. 10-11)

A18. It is in the interest of both entity and auditor that the auditor sends an audit engagement letter before the commencement of the audit, to help avoiding misunderstandings with respect to the audit. In some cases, however, the objective and scope of an audit and the responsibilities of management and, where appropriate, those charged with governance, and of the auditor may be sufficiently established by law, that is, they prescribe the matters described in paragraph 8. Even in those situations, the auditor may still find an audit engagement letter informative for these entities.

A19. In case of certain entities, law or regulation governing the operations of that entities may mandate the appointment of the auditor and also commonly set out the auditor's responsibilities and powers, including the power to access an entity's records and other information. When law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor may nonetheless consider that there are benefits in is-

uing audit engagement letters. When law or regulation does not prescribe in sufficient detail the terms of the audit engagement, a letter setting out those elements of paragraph 8 not sufficiently covered by law or regulation would satisfy this requirement.

Responsibilities of Management and, where appropriate, Those Charged with Governance Prescribed by Law or Regulation

A20. If, in the circumstances described in paragraphs A18-A19, the auditor concludes that it is not necessary to record the terms of the engagement in an engagement letter, the auditor is still required by paragraph 10 to obtain the written agreement from management and, where appropriate, those charged with governance that they acknowledge and understand the responsibilities set out in paragraph 4(b). However, in accordance with paragraph 11, such written agreement may reflect the wording of the law or regulation if such law or regulation establishes responsibilities for management that are equivalent in effect to those described in paragraph 4(b). The accounting profession may provide guidance as to whether the description in law or regulation is equivalent.

Audits of Components¹⁵ (Ref: Para. 9)

A21. When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that may influence the decision whether to send a separate audit engagement letter to the component include the following:

- Who appoints the auditor of the component;
- Whether a separate auditor's report is to be issued on the component;
- Legal requirements in relation to audit appointments;

- The extent of any work performed by other auditors;
- Degree of ownership by parent; and
- Degree of independence of the component's management.

Form and Content of the Audit Engagement Letter (Ref: Para. 8)

A22. The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on [proposed] SA 200 (Revised). Paragraphs 4(b) and 11 of this SA deal with the description of the responsibilities of management and, where appropriate, those charged with governance. In addition to including the matters required by paragraphs 4(b) and 8, an audit engagement letter may make reference to, for example:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, SAs and ethical and other pronouncements of professional bodies to which the auditor adheres.
- The form of any other communication of results of the audit engagement.
- The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that even some material misstatement may remain undiscovered.
- Arrangements regarding the planning and performance of the audit.
- The expectation that management and, where appropriate, those charged with governance will provide written representations (see also paragraph A12).

¹⁴ In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement.

¹⁵ Proposed SA 600 (Revised), "Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)", paragraph 9(a) defines component as "An entity or business activity for which group or component management prepares financial information that should be included in the group financial statements".

- The agreement of management or those charged with governance to make available to the auditor draft financial statements and any accompanying other information in time to allow the auditor to complete the audit in accordance with the proposed timetable.
- The basis on which fees are computed and any billing arrangements.
- A request for management or those charged with governance to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.
- Peer review mechanism under the Chartered Accountants Act, 1949.

A23. When relevant, the following points could also be made in the audit engagement letter:

- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
- Arrangements concerning the involvement of internal auditors and other staff of the entity.
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit.
- Any restriction of the auditor's liability when such possibility exists.
- A reference to any further agreements between the auditor and the entity.
- The agreement of management or those charged with governance to inform the auditor of facts, that may affect the financial statements, of which management or those charged with governance may become aware during the period from the date of the auditor's report to the date the financial statements are issued.
- Any obligations to provide au-

dit working papers to other parties.

An example of an audit engagement letter is set out in **Appendix 1**.

Recurring Audits (Ref: Para. 12)

A24. The auditor may decide not to send a new engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior management or those charged with governance.
- A significant change in ownership.
- A significant change in nature or size of the entity's business.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation and presentation of the financial statements.
- A change in other reporting requirements.

Acceptance of a Change in the Terms of the Audit Engagement

Request to Change the Terms of the Audit Engagement (Ref: Para. 13)

A25. A request from the entity for the auditor to change the audit engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit as originally requested or a restriction on the scope of the audit engagement, whether imposed by management or those charged with governance or caused by circumstances. The auditor, as required by paragraph 13, considers the reason given for the request, particularly the implications of a restriction

on the scope of the audit engagement.

A26. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement.

A27. In contrast, a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. An example might be where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified audit opinion or a disclaimer of opinion.

Request to Change to a Review or a Related Service (Ref: Para. 14)

A28. Before agreeing to change an audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with SAs may need to assess, in addition to the above matters, any legal or contractual implications of the change.

A29. If the auditor concludes that there is reasonable justification to change the audit engagement to a review or a related service, the audit work performed to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the related service would not include reference to:

- (a) The original audit engagement; or
- (b) Any procedures that may have been performed in the original audit engagement, except where the audit engagement is changed to an engagement to undertake agreed upon procedures and thus reference to the procedures performed is a normal part of the report.

Additional Considerations in Engagement Acceptance

Wording Used to Express the Opinion (Ref: Para. 17)

A30. SAs require that the auditor shall not represent compliance with SAs unless the auditor has complied with all of the SAs relevant to the audit. When law or regulation prescribes the wording of the auditor's report in terms that are significantly different from the requirements of SAs and the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor may consider including a statement in the auditor's report that the audit is not conducted in accordance with SAs. The auditor is, however, encouraged to apply SAs, including the SAs that address the auditor's report, to the extent practicable, notwithstanding that the auditor is not permitted to refer to the audit being conducted in accordance with SAs.

Financial Reporting Standards Supplemented by Law or Regulation—Conflicts (Ref: Para. 18)

A31. In some cases, legislative or regulatory requirements may supplement the financial reporting standards established by an authorised or recognised standards setting organisation with additional requirements relating to the preparation and presentation of financial statements. This may, for example, be the case when legislative or regulatory requirements prescribe disclosures in addition to those required by the financial reporting standards or when they narrow the range of acceptable choices that can be made within the financial reporting standards.

Financial Reporting Framework Prescribed by Law or Regulation—Determined as Unacceptable (Ref: Para. 17, 19-20)

A32. Deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable may be encountered after the audit engagement has been accepted. When use of that framework is prescribed by law or regulation, the requirements of paragraphs 19 and 20 apply. When use of that

framework is not prescribed by law or regulation, management or those charged with governance may decide to adopt another framework that is acceptable. When management or those charged with governance do so, new terms of the audit engagement may need to be agreed to reflect the change in the framework as the previously agreed terms may no longer be accurate.

A33. Law or regulation may prescribe that the wording of the auditor's opinion use the phrases "give a true and fair view" or "present fairly, in all material respects," although the auditor concludes that the applicable financial reporting framework prescribed by law or regulation is unacceptable. In this case, the terms of the prescribed wording of the audit opinion are significantly different from the requirements of SAs (see paragraph 17).

A34. In case of certain entities, specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to the regulator or the legislative body or the stakeholders if the entity attempts to limit the scope of the audit.

Material Modifications to ISA 210, "Agreeing the Terms of Audit Engagements"

Additions

1. Paragraph A8 of ISA 210 provides the examples of the financial reporting standards, which can be used for the preparation and presentation of general purpose financial statements. Since in India, financial reporting standards, used for the preparation and presentation of financial statements, can be 'Accounting Standards promulgated by the Accounting Standards Board of the Institute of Chartered Accountants of India or Accounting Standards, notified under Companies (Accounting Standards) Rules, 2006' or 'Accounting Standards for Local Bodies promulgated by Committee on Accounting Standards for Local Bodies (CASLB) of the Institute of Chartered Accountants of India (ICAI)',

these have been added in the list of examples of financial reporting standards. References have accordingly been changed.

2. Paragraph A22 of ISA 210 provides the forms and contents of the engagement letter, reference of which the auditor may provide in the engagement letter. Since in India, audit process performed by an auditor may be subjected to 'peer review' under the Chartered Accountants Act, 1949, an example, "peer review mechanism under the Chartered Accountants Act, 1949" has been added in the list of the matters that can be provided in the engagement letter.

Deletions

1. Paragraph A19 of ISA 210 deals with the condition where the law or regulation governs the operations of public sector audits, and mandate the appointment of a public sector auditor and also prescribes the public sector auditor's responsibilities and powers. 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 condition of governing the entity by law or regulation, and mandating the appointment of an auditor and also prescribing the auditor's responsibilities and powers 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 A19, highlighting the fact that in some cases, there may be a condition of governing the entity by law or regulation, and mandating the appointment of an auditor and also prescribing

the auditor's responsibilities and powers.

2. Paragraph A34 of ISA 210 deals with the specific reporting requirements within the legislation governing the audit that may mandate; for example, the auditor may be required to report directly to a minister or the legislature or to public if the entity attempts to limit the scope of the audit in case of public sector entities. Since as mentioned in the "Preface to the Standards 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 reporting requirement to the legislature 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 A34, highlighting the fact that in some cases, there may be a specific reporting requirement within the legislation governing the audit.

Appendix 1

(Ref: Para. A23)

Example of an Audit Engagement Letter

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared and presented in accordance with Financial Reporting Standards¹⁶. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this SA. It will

need to be varied according to individual requirements and circumstances. It is drafted to refer to the audit of financial statements for a single reporting period and would require adaptation if intended or expected to apply to recurring audits (see paragraph 12 of this SA). It may be appropriate to seek legal advice that any proposed letter is suitable.

To the appropriate representative of senior management:¹⁷

[The objective and scope of the audit]

You have requested that we audit the financial statements of, which comprise the balance sheet as at, and the statement of profit & loss, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.

[The responsibilities of the auditor]

We will conduct our audit in accordance with Standards on Auditing (SAs). 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements may remain undiscovered.

In making our risk assessments, we consider 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. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.

[The responsibilities of management and, where appropriate, those charged with governance, and identification of the applicable financial reporting framework (for purposes of this example it is assumed that the auditor has not determined whether the law or regulation prescribes those responsibilities in appropriate terms; the description in paragraph 4(b) of this SA is therefore used).]

Our audit will be conducted on the basis that management and, where appropriate, those charged with governance acknowledge and understand their responsibility:

- (a) For the preparation and fair presentation of the financial statements (or preparation and presentation of financial statements that give a true and fair view) in accordance with Financial Reporting Standards; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

¹⁶ In India, financial reporting standards can be accounting standards promulgated by Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) or Accounting Standards, notified by the Central Government by publishing the same as the Companies (Accounting Standards) Rules, 2006.

¹⁷ The addresses and references in the letter to management or those charged with governance would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction.

(b) To provide us with:

- (i) All information, such as records and documentation, and other matters that are relevant to the preparation and fair presentation of the financial statements;
- (ii) Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and
- (iii) Unrestricted access to those within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from management and, where appropriate, those charged with governance, written confirmation concerning representations made to us in connection with the audit.

We also wish to invite your attention to the fact that our audit process is subject to 'peer review' under the Chartered Accountants Act, 1949. The reviewer may examine our working papers during the course of the peer review.

We look forward to full cooperation from your staff during our audit.

[Other relevant information]

[Insert other information, such as fee arrangements, billings and other spe-

cific terms, as appropriate.]

[Reporting]

We expect to report as follows:

[Insert text of sample report or include as an attachment.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Chartered Accountants

(Signature)

Date : (Name of the Member)

Place : (Designation¹⁸)
 Acknowledged on behalf of
 ABC Company by
 (Signature)
 Name and Designation
 Date

Appendix 2

(Ref: Para. A10)

Determining the Acceptability of General Purpose Frameworks

Jurisdictions that Do Not Have Authorised or Recognised Standards Setting Organisations or Financial Reporting Frameworks Prescribed by Law or Regulation

1. As explained in paragraph A10 of this SA, when an entity is registered or operating in a jurisdiction that does not have an authorised or recognised standards setting organisation, or where use of the financial reporting framework is not prescribed by law or regulation, management or those charged with governance identify an applicable financial reporting framework. Practice in such jurisdictions is often to use the financial reporting standards established by one of the organisations described in paragraph A8 of this SA.

2. Alternatively, there may be established accounting conventions in a particular jurisdiction that are generally recognised as the financial reporting framework for general purpose financial statements prepared by certain specified entities operating in that jurisdiction. When such a financial reporting framework is adopted, the auditor is required by paragraph 4(a) of this SA to determine whether the accounting conventions collectively can be considered to constitute an acceptable financial reporting framework for general purpose financial statements. When the accounting conventions are widely used in a particular jurisdiction, the accounting profession in that

jurisdiction may have considered the acceptability of the financial reporting framework on behalf of the auditors. Alternatively, the auditor may make this determination by considering whether the accounting conventions exhibit attributes normally exhibited by acceptable financial reporting frameworks (see paragraph 3 below), or by comparing the accounting conventions to the requirements of an existing financial reporting framework considered to be acceptable (see paragraph 4 below).

3. Acceptable financial reporting frameworks normally exhibit the following attributes that result in information provided in financial statements that is useful to the intended users:

- (a) Relevance, in that the information provided in the financial statements is relevant to the nature of the entity and the objective of the financial statements. For example, in the case of a business enterprise that prepares general purpose financial statements, relevance is assessed in terms of the information necessary to meet the common financial information needs of a wide range of users in making economic decisions. These needs are ordinarily met by presenting the financial position, financial performance and cash flows of the business enterprise.
 - (b) Completeness, in that transactions and events, account balances and disclosures that could affect conclusions based on the financial statements are not omitted.
 - (c) Reliability, in that the information provided in the financial statements:
 - (i) Where applicable, reflects the economic substance of events and transactions and not merely their legal form; and
 - (ii) Results in reasonably consistent evaluation, measurement, presentation and disclosure, when used in similar circumstances.
 - (d) Neutrality, in that it contributes to information in the financial statements that is free from bias.
 - (e) Understandability, in that the information in the financial statements is clear and comprehensive and not subject to significantly different interpretation.
4. The auditor may decide to compare the accounting conventions to the requirements of an existing financial reporting framework considered to be acceptable. For example, the auditor may compare the accounting conventions to financial reporting standards. For an audit of a small entity, the auditor may decide to compare the accounting conventions to a financial reporting framework specifically developed for such entities by an authorised or recognised standards setting organisation. When the auditor makes such a comparison and differences are identified, the decision as to whether the accounting conventions adopted in the preparation and presentation of the financial statements constitute an acceptable financial reporting framework includes considering the reasons for the differences and whether application of the accounting conventions, or the description of the financial reporting framework in the financial statements, could result in financial statements that are misleading.
5. A conglomeration of accounting conventions devised to suit individual preferences is not an acceptable financial reporting framework for general purpose financial statements. Similarly, a compliance framework will not be an acceptable financial reporting framework, unless it is generally accepted in the particular jurisdictions by preparers and users. □

¹⁸ Partner or proprietor, as the case may be.

Explanatory Memorandum to the Exposure Draft Standard on Auditing (SA) 720 The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements

Background

The Institute is a member of the International Federation of Accountants (IFAC). Therefore, as a part of its membership obligations, while formulating any Standard on Auditing, 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. At present, there is no Standard on Auditing corresponding to International Standard on Auditing (ISA) 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements". Therefore, the Auditing and Assurance Standards Board (AASB) decided to take up the project of preparation of SA corresponding to ISA 720 so that the credibility of the audited financial statements may not to be undermined by material inconsistencies between the audited financial statements and other information.

IAASB's Clarity Project

The IAASB had, in December, 2006, issued the Exposure Draft (ED) of the **Redrafted** ISA 720 meaning thereby that the IAASB proposed a Redrafted version of ISA 720, written pursuant to the style adopted under the Clarity Project. As a part of its Clarity Project, an International Standard on Au-

ditng 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 Modifications¹", issued by the IAASB in July, 2006.

ICAI's Response

The Council of the Institute, at its 267th meeting held in April, 2007, has 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 Services²**, 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) 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements", is based on the correspond-

ing Redrafted ISA 720 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 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 16 and the paragraphs in the Application and Other Explanatory Material are numbered as A1 to A11.

Topics Covered by SA 720

The Standard contains the following main aspects:

- i) Scope
- ii) Effective date
- iii) Objective
- iv) Definitions
- v) Requirements
 - (a) Reading Other Information
 - (b) Material Inconsistencies
 - (c) Material Misstatements of Fact
- vi) Application guidance on the above aspects

¹The full text of the Policy Position can be downloaded free of charge at http://www.ifac.org/IAASB/downloads/Modification_Policy_Position.pdf.

²The full text of the Policy Position can be downloaded free of charge at http://www.icai.org/resource_file/7744announ1050.pdf.

Highlights of SA 720

1. SA 720 deals with the auditor's responsibility in relation to the other information in documents containing audited financial statements and the auditor's report thereon. Further, the SA 720 provides that the auditor does not require giving his opinion on the other information and not having any responsibility of determining whether or not other information is properly stated if there is no separate requirement in the particular circumstances of the engagement. However, the auditor reads the other information because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information.
2. The objective of the auditor under SA 720 is to respond appropriately when documents containing audited financial statements and the auditor's report thereon include other information that could undermine the credibility of those financial statements and the auditor's report.
3. SA 720 requires the auditor to read the other information to identify material inconsistencies and if found, to determine whether the audited financial statements or other information needs to be revised.
4. SA 720 requires the auditor to make appropriate arrangements with management or those charged with governance to obtain the other information prior to the date of the auditor's report. If it is not possible to obtain all the other information prior to the date of the auditor's report, the auditor shall read such other information as soon as practicable.
5. SA 720 states that if the material inconsistencies are identified prior to the date of the audit, and the revision of audited financial statement is necessary and the management refuses to make the revision, the auditor is required to modify his opinion. Further, if the revision of other information is necessary, and the management refuses to make the revision, the auditor is required to communicate the matter to those charged with governance and also to provide paragraph in the auditor's report on other matter; or withdraw from the engagement, if permitted by laws or regulations.
6. SA 720 states that if the material inconsistencies are identified subsequent to the date of the audit, and revision of audited financial statement is necessary, the auditor is required to perform the procedures given in SA 560, "Subsequent Events". Further, if the revision of other information is necessary and if management agrees then to carry out the procedures necessary in the circumstances, otherwise, communicate the same to those charged with governance and take further appropriate actions.
7. SA 720 provides that if, on reading the other information for the purpose of identifying material inconsistencies, the auditor becomes aware of an apparent material misstatement of fact, the auditor shall discuss the matter with management and if the management refuse to correct it, communicate the same to those charged with governance and take further appropriate actions. Further, the auditor can also request the management to take a legal advice of entity's legal counsel.

*Your comments on the Exposure Draft should reach us by **December 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

Exposure Draft Standard on Auditing 720 The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements

Standard on Auditing (SA) 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements" should be read in conjunction with "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services³," which sets out the authority of SAs.

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibility in relation to other information in documents containing audited financial statements and the auditor's report thereon. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion does not cover other information and the auditor has no specific responsibility for determining whether or not other information is properly stated. However, the auditor reads the other information because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information. (Ref: Para. A1)
2. In this SA "documents containing audited financial statements" refers to annual reports (or similar documents), that are issued to owners (or similar stakeholders), containing audited financial statements and the auditor's report thereon. This SA may also be applied, adapted as necessary in the circum-

stances, to other documents containing audited financial statements. (Ref: Para. A2-A4)

Effective Date

3. This SA is effective for audits of financial statements for periods beginning on or after -----.

Objective

4. The objective of the auditor is to respond appropriately when documents containing audited financial statements and the auditor's report thereon include other information that could undermine the credibility of those financial statements and the auditor's report.

Definitions

5. For purposes of the SAs the following terms have the meanings attributed below:
 - (a) Other information – Financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included, either by law, regulation or custom, in a document containing audited financial statements and the auditor's report thereon.
 - (b) Inconsistency – Other infor-

mation that contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.

- (c) Misstatement of fact – Other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing audited financial statements.

Requirements

Reading Other Information

6. The auditor shall read the other information to identify material inconsistencies, if any, with the audited financial statements.
7. The auditor shall make appropriate arrangements with management or those charged with governance to obtain the other information prior to the date of the auditor's report. If it is not possible to obtain all the

³ Published in the July, 2007 Issue of the Journal.

other information prior to the date of the auditor's report, the auditor shall read such other information as soon as practicable. (Ref: Para. A5)

Material Inconsistencies

8. If, on reading the other information, the auditor identifies a material inconsistency, the auditor shall determine whether the audited financial statements or the other information needs to be revised.

Material Inconsistencies Identified in Other Information Obtained Prior to the Date of the Auditor's Report

9. When revision of the audited financial statements is necessary and management refuses to make the revision, the auditor shall modify the opinion in accordance with [proposed] SA 705⁴.
10. When revision of the other information is necessary and management refuses to make the revision, the auditor shall communicate this matter to those charged with governance; and
 - (a) Include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with [proposed] SA 706; or
 - (b) Where withdrawal is legally permitted, withdraw from

the engagement. (Ref: Para. A6- A7)

Material Inconsistencies Identified in Other Information Obtained Subsequent to the Date of the Auditor's Report

11. When revision of the audited financial statements is necessary, the auditor shall follow the relevant requirements in SA 560 (Revised)⁵.
12. When revision of the other information is necessary and management agrees to make the revision, the auditor shall carry out the procedures necessary under the circumstances. (Ref: Para. A8)
13. When revision of the other information is necessary, but management refuses to make the revision, the auditor shall notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action. (Ref: Para. A9)

Material Misstatements of Fact

14. If, on reading the other information for the purpose of identifying material inconsistencies, the auditor becomes aware of an apparent material misstatement of fact, the auditor shall discuss the matter with management. (Ref: Para. A10)
15. When, following such discus-

sions, the auditor still considers that there is an apparent material misstatement of fact, the auditor shall request management to consult with a qualified third party, such as the entity's legal counsel, and the auditor shall consider the advice received.

16. When the auditor concludes that there is a material misstatement of fact in the other information which management refuses to correct, the auditor shall notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action. (Ref: Para. A11)

Application and Other Explanatory Material

Scope of this SA (Ref: Para. 1-2)

- A1. The auditor may have additional responsibilities, through statutory or other regulatory requirements, in relation to other information that are beyond the scope of this SA. For example, certain statutory and regulatory requirements may require the auditor to apply specific procedures to certain of the other information such as required supplementary data or to express an opinion on the reliability of performance

⁴ At present, there is no separate Standard on Auditing (SA) corresponding to International Standards on Auditing (ISA) 705, "Modifications to the Opinion in the Independent Auditor's Report" and ISA 706, "Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report". However, the concepts of 'modified audit report' and 'emphasis of matter paragraph' have been discussed in SA 700, "The Auditor's Report on Financial Statements". The Standards are being revised in the light of the corresponding International Standards. The Auditing and Assurance Standards Board will issue the Exposure Drafts of SA 700, SA 705 and SA 706 corresponding to ISA 700, ISA 705 and ISA 706 in the near future.

⁵ Proposed SA 560 (Revised), "Subsequent Events," paragraphs 10-17.

indicators described in the other information. When there are such obligations, the auditor's additional responsibilities are determined by the nature of the engagement and by law, regulation and professional standards. If such other information is omitted or contains deficiencies, the auditor may be required by law or regulation to refer to the matter in the auditor's report.

A2. Other information may comprise, for example:

- A report by management or those charged with governance on operations.
- Financial summaries or highlights.
- Planned capital expenditures.
- Financial ratios.
- Selected quarterly data.

A3. For purposes of the SAs, other information does not encompass, for example:

- A press release or a transmittal memorandum, such as a covering letter, accompanying the document containing audited financial statements and the auditor's report thereon.
- Information contained in analyst briefings.
- Information contained on the entity's web site.

Considerations Specific to Smaller Entities (Ref: Para. 2)

A4. Unless required by law or regulation, smaller entities

are less likely to issue documents containing audited financial statements. However, an example of such a document would be where a legal requirement exists for an accompanying report by those charged with governance.

Reading Other Information (Ref: Para. 7)

A5. Obtaining the other information prior to the date of the auditor's report enables the auditor to resolve possible material inconsistencies and apparent material misstatements of fact with management on a timely basis. An agreement with management as to when the other information will be available may be helpful.

Material Inconsistencies

Material Inconsistencies Identified in Other Information Obtained Prior to the Date of the Auditor's Report (Ref: Para. 10)

A6. When management refuses to revise the other information, the auditor may base any decision on what further action to take on advice from the auditor's legal counsel.

A7. In case of certain entities such as, Central/State governments and related government entities (for example, agencies, boards, commissions), withdrawal from the engagement may not be an option. In such cases the auditor may issue a report to the appropriate

statutory body giving details of the inconsistency.

Material Inconsistencies Identified in Other Information Obtained Subsequent to the Date of the Auditor's Report (Ref: Para. 12-13)

A8. When management agrees to revise the other information, the auditor's procedures may include reviewing the steps taken by management to ensure that individuals in receipt of the previously issued financial statements, the auditor's report thereon, and the other information are informed of the revision.

A9. When management refuses to make the revision of such other information that the auditor concludes is necessary, appropriate further actions by the auditor may include obtaining advice from the auditor's legal counsel.

Material Misstatements of Fact (Ref: Para. 14-16)

A10. When discussing an apparent material misstatement of fact with management, the auditor may not be able to evaluate the validity of some disclosures included within the other information and management's responses to the auditor's inquiries, and may conclude that valid differences of judgment or opinion exist.

A11. When the auditor concludes that there is a material misstatement of fact that management refuses to correct, appropriate fur-

ther actions by the auditor may include obtaining advice from the auditor's legal counsel.

Material Modifications to ISA 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements"

Deletions

1. Paragraph 10 of ISA 720 deals with the circumstances where the revision of the financial statements is necessary and management refuses to make the revision. In these circumstances, the auditor shall communicate this matter to those charged with governance and include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with ISA 706; or withhold the auditor's report; or where withdrawal is legally permitted, withdraw from the engagement. Since in India, the practice of withholding the auditor's report is not in vogue, an option of

withholding the auditor's report by the auditor has been deleted. Similarly in paragraph A7 of SA 720, an option of withholding the auditor's report by the auditor has been deleted.

2. Paragraph A2 of ISA 720 provides the examples of the other information including 'employment data' and 'names of officers and directors'. Reference to these two specific examples has been deleted so that the auditor can focus on more relevant aspects of other information.
3. Paragraph A4 of ISA 720 provides an example of the other information that may be included in a document containing the audited financial statements of a smaller entity are a detailed income statement and a management report. Since, in India, the terminology of "detailed income statement" and a "management report" do not exist; these have been deleted completely from the SA.
4. Paragraph A7 of ISA 720

provides that in case of public sector entities, withdrawal from the engagement or withholding the auditor's report may not be the options. In such cases the auditor may issue a report to the appropriate statutory body giving details of the inconsistency. 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 withdrawal from the engagement may not be an option even in case of non public sector entities pursuant to a requirement under the statute or regulation under which they operate. Paragraph A7 has, accordingly, been made more generic in its application. □

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 / journal@icai.in or by post to The Editor, The Chartered Accountant, Journal Section, ICAI Bhawan, C-1, Sector -1, Noida - 201301.

BE AN EFFECTIVE COMMUNICATOR

This article presents the importance of communication skills in contemporary times. It deals with the complete process of communication and different attitudes speakers have, e.g. aggressive, assertive etc. It also discusses the barriers in communication and also explains how miscommunications occur in communication. It eventually recommends its readers that nobody can afford to ignore acquiring communication skills.

We communicate all the time, but are we always good, effective communicators?

Effective communication is very important, especially in business. Effective communication is necessary to achieve smooth and productive working within your enterprise and to obtain a good image for your business outside the enterprise. This becomes more important considering the changing scenario of business and industry. To put it briefly, the need for effective communication is great and increasing.

What is communication?

Communication is a process through which we transfer our thoughts, needs, feelings, ideas and messages to others. It is said that communication may not save us, but without communication we will not be saved.

Today the process of communication has advanced greatly. With communication technology today, we are in a position to establish both audio and visual contact anywhere on earth. But what about communication with people? It still needs progress. All said and done, irrespective of the medium, the sender, who



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(The author is a member of the Institute. He can be reached at rathi-harsh@yahoo.co.in)

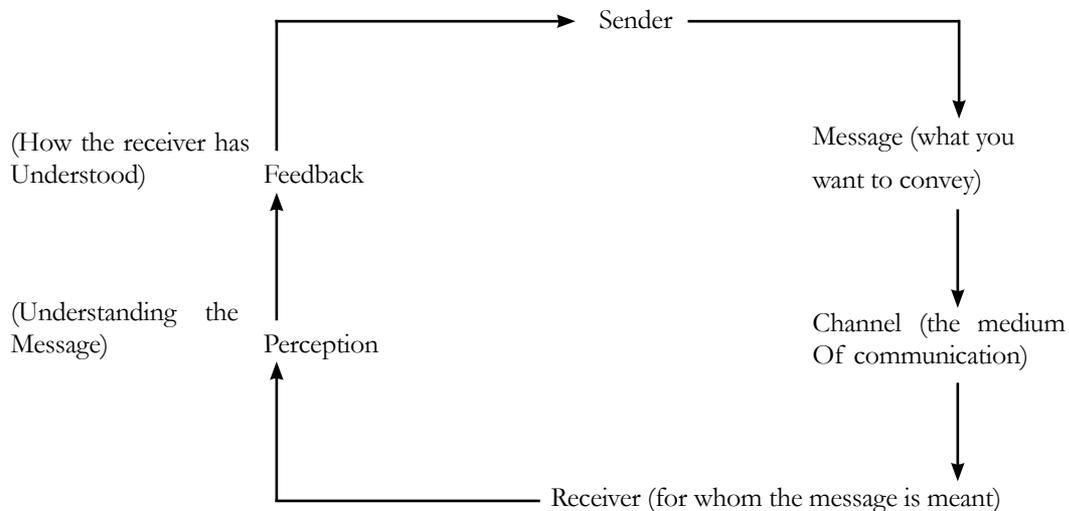
The receiver receives, interprets the message based on his/ her perception and gives a feedback, an answer or understanding of the message. So, as we mentioned earlier, a lot depends on how a message is sent and how it is received. The problem is that we all consider ourselves to be good communicators. We think that we can put across to others what we want to or intend to. Do we?

communicates, and the receiver, who receives the message, are human beings. What happens when people talk together, when they write to each other, when they read some text? It sometimes happens that they are unsuccessful in exchanging their thoughts clearly in a comprehensive manner. How is that that when one person speaks, the other person does not understand him/her properly? This happens because both are complex personalities with different feelings, values,

ideas, attitudes, needs and motives. Each understands and accepts the communication which he/ she sends or receives depending upon his/ her capacity to interpret based on his/ her objectives, interests, needs, desires and so on. And that is the reason why skills are required to communicate to be direct, precise, honest and understandable.

Before we go any further, let us understand the process of communication:

THE COMMUNICATION PROCESS:



The above figure shows us that when you send a message to another person, it involves a channel. This channel or medium could be spoken or written word, television, radio, newspaper etc. The receiver receives, interprets the message based on his/ her perception and gives a feedback, an answer or understanding of the message. So, as we mentioned earlier, a lot depends on how a message is sent and how it is received. The problem is that we all consider ourselves to be good communicators. We think that we can put across to others what we want to or intend to. Do we? This image of ourselves, which is a kind of defense mechanism, requires that we see ourselves as straight-talking, level-headed, able, honest people who are above all effective communicators. Yet, very often we fail to see ourselves as others see us.

Look at the following comments:

- Every time she opens her mouth, she puts her foot into it...

- He is alright as long as it is the computer he is talking to!
- You are as beautiful as a Picasso painting.

These are just a few examples of the fact that too often there is a difference between what we say and what we really mean, and between how we feel we have handled people and how they think they have been handled. When such gaps occur between our intention and action, it is said that there is a breakdown in communication.

There are six stages in communication:

Stage 1: Conceiving the message:

At this stage, a decision is made by the sender to communicate a message. Some messages are made involuntarily, e.g a scream of fright or pain. Some might be impulsive. Other messages may be a careful result of reasoning and thinking or responses to external factors.

Communication is more than spoken or written words. Psychologists in the nineteenth century discovered non-verbal communication, also known as meta-verbal, kinesics, body language or paralanguage. In fact, it has been observed that words contribute only 7% of the total impact of the message, 38% is contributed by tone of the voice, and the balance 55% is by facial expressions and body gestures.

Stage 2: Language of the message:

Before a message is sent to a receiver, sender has to encode it into an appropriate language. The channels of communication include:

- Spoken word
- Written word
- Number
- Picture or symbol
- Non-verbal: Expression, gestures, posture.

Stage 3: Selecting the medium for communication:

Once an appropriate language is chosen by a sender, he/ she needs to select the right medium. Some messages need to be written and transmitted. Alternatively, for quick exchange of opinions, a meeting would be the best medium. Some factors influencing the choice of the medium are:

- Effectiveness
- Need for tact
- Simultaneous reception of information by receivers
- Need for written record
- Need for instant feedback
- Complexities of message
- Time
- Cost
- Need for speed

Stage 4: Decoding the message:

A message has to be understood before it can be absorbed or acted upon. Messages can become ineffective if they are not properly understood by the receiver. Some reasons for the failure to understand a message are:

- Lack of knowledge of the sender
- The sender's vocabulary is specific and not known to the receiver

Education, culture, outlook and attitude also create blocks between sender and receiver.

Stage 5: Interpreting the message:

Apart from understanding the language of a sender, a receiver also needs to be able to interpret it correctly. The underlying message may be rather different from what words actually speak.

For example: *I liked Mr. Parikh, head of the marketing division, a lot. I am sure they will now be looking for someone with*

experience of marketing to head the division...

What is the real message here? The remark on Mr. Parikh is sarcastic, and not genuine.

Stage 6: Providing feedback:

All the above stages are important. But, need for feedback from the receiver is the most essential one. It is a means of reassuring the sender that:

- The message has been received
- It has been interpreted and understood correctly
- The receiver is ready for the next one

So now you know what communication and process of communication is.

When does miscommunication occur?

Miscommunication occurs when:

- Without understanding the meaning of a message you make your judgment about it, and reply accordingly.
- Both parties give meaning to the message as per their own perceptions.
- What the other party says is incorrect and irrelevant.
- You are emotional and hence you miss the real message.

Human beings act and react differently to different situations. Sometimes we act like a parent (controlling or nurturing), an adult (reasonable and rational), or a child (natural and rebellious, obedient, or precocious).

Meta-verbal communication

Communication is more than spoken or written words. Psychologists in the nineteenth century discovered non-verbal communication, also known as meta-verbal, kinesics, body language or paralanguage. In fact, it has been observed that words contribute only 7% of the total impact of the message, 38% is contributed by tone of the voice, and the balance 55% is by facial expressions and body gestures. Before we go any further and discuss this, you must know that meta-verbal language can be learnt and used consciously to supplement the meaning of words.

Meta-verbal communication consists of four major components:

- *Your appearance:* How you appear is the first sig-

The space that we maintain between us and others can be divided into four kinds: intimate, personal, social and public. The intimate space is reserved for close relationships like those between husband and wife, parents and children etc. Personal space is shared with friends and colleagues, social space is with your boss, and public space is with a gathering.

nal by which others try to understand you. Your dress and grooming announce your profession, social and economic status, and attitude to tidiness and neatness.

- *How you sound while talking:* Tone, pitch and rhythm of the sound/ voice supplement or contradict the verbal communication. These also depend on who you are talking to, your subordinate, friend, colleague or boss. It also depends on the situation, e.g. conversation in a small group, a speech or a presentation in a conference.
- *How you use body language:* Body language has three aspects: posture (standing or sitting), movement (walking), and gestures. When we speak, the whole body comes into action. Our face (eyes, eyebrows, nose, lips, ears and facial muscles) and neck are the most important communicative zones of our body. Shoulders, hands and fingers are the next critical zone. Legs and feet form the third zone. All these parts signal a host of emotions which convey more than words.
- *How you handle space:* The space that we maintain between us and others can be divided into four kinds: intimate, personal, social and public. The intimate space is reserved for close relationships like those between husband and wife, parents and children etc. Personal space is shared with friends and colleagues, social space is with your boss, and public space is with a gathering. Take the example of a husband and wife sitting together and holding a conversation. A third person that can be their own child, when approaches them, they do not even glance at him/ her. They are sharing an intimate space. One interesting aspect of space is that it is also used to include into or exclude from a group. A group of four friends are standing close to one another and talking, and a newcomer walks up to the group. If the group wants to share their discussion with the newcomer, it expands and provides a space to him/ her to join. Otherwise it may not give out any space to signal - 'get lost'.

Meta-verbal ability and maturity

What is important for you now is how you can improve your ability and maturity in non-verbal communication. These are a few initial steps you can take:

- Become aware that we send messages beyond words while interacting with others
- Become aware that non-verbal messages, like words, have multiple meanings
- Recognise the non-verbal messages that originate from others
- Look for non-verbal clues from others
- Pay attention to your own non-verbal communication
- Observe successful speakers and their body language.

Developing Communication Skills

We offer some guidelines to help you develop your communication skills.

As a sender

- While composing a message, carefully decide what response you desire from receiver.
- Choose a language most suited to your needs and situation.
- Take time to express your ideas logically and thoughtfully. Give some thought to the language you intend to use.
- Select the most appropriate medium, letter, circular or a telephone call, and so on.
- Make sure that you choose a language that is understood by the receiver.
- Ensure your message to be clear enough to avoid misinterpretation.
- Make sure to get a feedback from the receiver.

As a receiver

- Give full attention to the message being communicated.
- Check that the medium of communication of the sender meets your needs.
- Make sure you understand and interpret the message correctly.
- Give feedback to the sender.

Barriers to communication

It is equally important to eliminate barriers of communication:

- *Obstinacy:* Unwillingness to discuss any problem or difference in opinion.
- *Prejudice:* Fixed or rigid views, or ignorance of the topic.
- *Disinterest:* Lack of interest in the topic.

- *One way communication:* Without caring for the opinion of the other side's.
- *Anger, emotion:* Loud noise/tone or action of an abnormal type.
- *Ego:* Status consciousness.

Then there are aggressive, assertive and non-assertive communication and behaviour. The objectives are to:

- Help you distinguish between assertive, aggressive and non-assertive behaviour.
- Ensure that you understand the advantages of being assertive.
- Outline the skills which support assertive behaviour.

Assertive Communication

When we are assertive, we tell people what we want, need or prefer, clearly and confidently. It is a positive way of behaving; direct, honest and respectful. Above all, assertive behaviour is appropriate behaviour.

Look at the following conversations:

- (A) 'Where would you like to go to eat?'
 'Wherever you like-they say that the new Italian restaurant is quite good'.
 (Non-assertive)
- (B) 'Where would you like to go to eat?'
 'I'd like to go that new restaurant.'
 (Assertive)

The advantages of being assertive are:

- The more positively we act, the more capable

we feel.

- The more assertive we are, the less likely we are to be aggressive.

Aggressive Communication

Aggressive behaviour / communication expresses feelings and opinions in a way which punishes, threatens or puts the other person down. The aim is to get his/ her way at all cost. Aggressive people often stand too close to others, or they stand when others sit. They point with their fingers and use a loud, bullying tone of voice. Examples of such communication are:

- You must complete the job now, and no arguments.
- Why haven't you completed the job I asked you to do?
- You've got to listen to me.

Non-assertive communication

People who lack self-esteem or self-confidence may feel that they are so unimportant that they do not deserve attention and tend to communicate in a non-assertive manner. Non-assertive body language can include a hesitant posture, a bowed head, shifting from one foot to the other, not looking people in the eye and looking embarrassed.

Their communication is such because they fear that their request may be turned down, and/ or they are anxious about embarrassing someone. A typical statement would be:

- I am sorry to bother you, but may I have a word with you?

A Checklist for Assertive, Aggressive and Non-Assertive behaviour

Assertive	Aggressive	Non-Assertive
You do	You do	You do
• ask for what you want	• try to get what you want	• hope that you will get what you want
• ask directly and openly	• try in any way that works	• suppress your feelings
• appropriately without bad feelings	• often give rise to bad feelings	• rely on others to guess what you want
• have rights	• threaten, cajole, manipulate, use sarcasm, fight	
• ask confidently and without undue anxiety		
You don't	You don't	You don't
• violate other people's egos	• respect that other people have a right to have their needs met	• ask for what you want
• expect other people to guess what you want	• look for situations in which you both might be able to get what you want (win-win situations).	• Express your feeling
• freeze up with anxiety		• usually get what you want/get noticed

Listening

You cannot be a good communicator unless you are a good listener too. Listening is such a common activity that we often take it for granted. Frankly, we confuse it with hearing and think that listening is easy and natural. But listening is a complex skill that you have to master and this skill is necessary for everyone.

What is listening?

Listening is a complex, skilled behaviour that involves the following:

- Preparation: It is a deliberate mental and physical preparation.
- Absorption: It is absorbing the message with complete ear, eye and brain.
- Processing: It is processing and interpreting the received information.
- Feedback: It is to give both verbal and non-verbal feedback to communicate you are listening.

Barriers to listening:

There can be many barriers to listening effectively:

- The inability to relax and concentrate on the moment: You may be preoccupied with your own thoughts and you may not listen. The speaker may also realise this and then there is no real communication.
- Preconceived ideas and thoughts: Sometimes you have your own ideas and thoughts about certain matters, so you do not really listen to the other person effectively.
- Talking too much, too often: This happens when you talk on and on, and even if the other person responds, you do not register.
- Thinking of responses while the speaker speaks
- Lack of interest in the conversation.

You may ask how can you become a good listener and acquire listening skills. There are some key suggestions:

- Find an area of interest.
- Judge content, not delivery.
- Hold your fire (do not be impatient to speak)
- Listen for ideas.
- Be flexible.
- Resist distractions.
- Exercise your mind.

Remember, listening improves attitudes, and builds positive relationships. It is a growth experience. Effective listening depends on:

- Positive attitudes: Seeking to understand the speaker's frame of reference, not imposing one's own.
- Interaction: Using non-verbal techniques to build synergy with the speaker.

- Concentration: Often helped by note-taking.
- Questioning technique: Clarification with open-ended questions, e.g. what, who, how, when and why.

Importance of communication skills

We reiterate that effective communication is important to all of us, but more so for professionals/entrepreneurs like us. You would need to be a good communicator from the point of starting the process of setting up your practice/industry. It is important to have effective communication skills, as you communicate with employees of financial institutions and banks, of support agencies when you need land, building, licenses, no objection certificates etc., your workers, suppliers, and customers, and other entrepreneurs in a similar business. Unless you can convince, influence and get your work done, you will not achieve your targets.

When you set up your enterprise, communication between you and your workers has to be cordial, complete and effective in order to ensure the greatest possible productivity and achievement of your production/professional targets. Due to a lack of good communication, otherwise, situations may develop into strikes/lockouts/bad results. Make sure that communication in your enterprise is a two-way street. Regular discussions on a topic of importance affecting the mutual goodwill of the management and the personnel should be tackled by sitting across the table. Lack of knowledge of the system is not good for the health of a business/profession. Both labor and management should be able to communicate their problems to each other and should take decisions to avoid breaks in production.

Let us consider a hypothetical situation: You go to a banker with your proposal for the purpose of obtaining a loan for your project. Here the importance of communication cannot be underscored enough. Of course, the feasibility and viability of your project is very important, so are the projections made by you. But what is more important is how you put across your proposal to the banker to convince him/her not only of the viability of the project, but also of your determination, managerial ability and other abilities. Unless you are a good communicator, you will not be able to manage.

And do not forget your customers/clients. You will produce goods and provide services, but what the use of doing that is, if you cannot sell them. You have to have a market and to get a market you will have to convince your potential customers of the positive points of your product/service. Why is it advisable for them to buy your offering? You should be able to influence them. So the same argument holds in this case too, *be a good communicator to achieve your goal.*

There is no other option than to develop your as an effective communicator for being successful. □

Smile Please

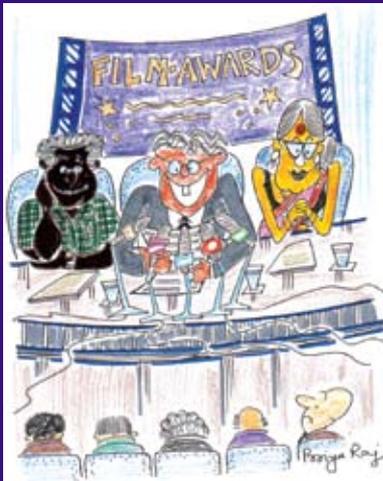
Two women were comparing notes on the difficulties of running a small business.

"I started a new practice last year," the first one said. "I insist that each of my employees take at least a week off every three months."

"Why in the world would you do that?" the other asked.

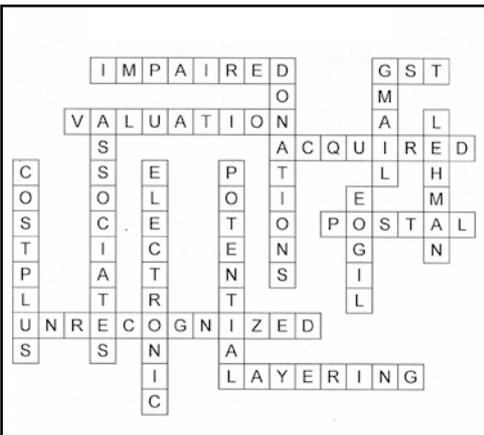
She responded, "It's the best way I know of to learn which ones I can do without."

OUT OF THE BOX

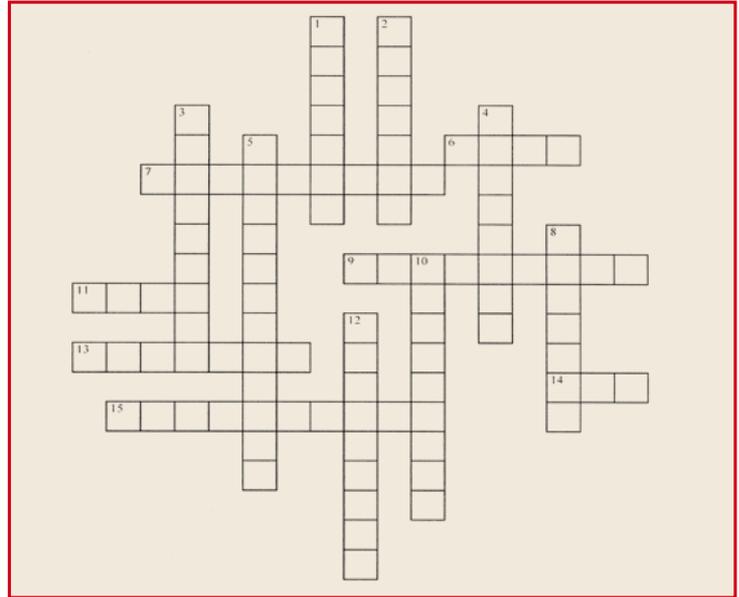


The award are out but the jury will continue to be out in gossip and controversy columns. We are in the entertainment business, you know!

Crossword 028 - Solution



CROSSWORD 029



ACROSS

- 6 Six Sigma's acceptable level of defects per million. (4)
- 7 Standard for comparisons. (9)
- 9 Mail objective of the Six Sigma is to motivate _____. (9)
- 11 Six Sigma prescribes at least this many roles. (4)
- 13 Six Sigma's success requires an organisation to change its _____. (7)
- 14 Six Sigma's predecessor in process controls in short form. (3)
- 15 Six Sigma concept is based on _____. (10)

DOWN

- 1 Six Sigma name coined by _____ Crosby. (7)
- 2 Six Sigma also _____ the employees. (7)
- 3 One of the role, not a Karate champion. (5,4)
- 4 Six Sigma was initially developed at this company. (8)
- 5 Comparison of process, product or service. (12)
- 8 Six Sigma focuses on elimination of _____. (7)
- 10 One of the three basic concepts of Six Sigma. (9)
- 12 Sigma in other words called Standard _____. (9)

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.