

The Institute of Chartered Accountants of India  
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# THE C HARTERED A C C O U N T A N T

JOURNAL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA



global

IFRS  
FOR  
SMEs

Simplified  
Language

Fewer Disclosure Requirements

Less Voluminous

Cost Effectiveness

Fast Implementation

Easy Compliance

CELEBRATING  
60<sup>th</sup> Year of  
*Excellence*

Volume 58 | No. 5 | November, 2009

THE CHARTERED ACCOUNTANT

Rs. 100

## IFRS FOR SMALL AND MEDIUM-SIZED ENTITIES

Around the world, industry is craving for the Standard for Small and Medium-sized Entities (SMEs) in terms of its contents and cost of compliance. In order to address the concerns of the SMEs, in July 2009 the International Accounting Standards Board (IASB) has come out with a Standard for SMEs, i.e., *IFRS for Small and Medium-sized Entities* (IFRS for SMEs). Moreover, the exposure draft of the IFRS for SMEs Taxonomy has also been issued by the IASC Foundation and is open for comments until November 27, 2009. IFRS for SMEs is a self contained Standard, and is a simplified version of full IFRSs covering applicability of all international accounting standards to the SMEs.

The term 'small and medium-sized entities' has different meanings in different territories. The definition in the context of the IFRS for SMEs is, entities that do not have public accountability and publish general purpose financial statements for external users. An entity has public accountability if its debt or equity are traded in a public market or is in the process of issuing such instruments for trading in public market or it holds assets in a fiduciary capacity as their main business activity. Listed companies, no matter how small, may not use IFRS for SMEs. A subsidiary whose parent or group uses full IFRSs may use the IFRS for SMEs if the subsidiary itself does not have public accountability. This definition could be different for different jurisdictions.

The *IFRS for SMEs* is a stand-alone document, prescribing accounting principles for SMEs, which are mainly based on full IFRSs, however, efforts have been made to simplify the same in following respects:

- Topics not relevant for SMEs have been omitted, e.g., earnings per share, interim financial reporting, segment reporting, special accounting for assets held for sale.
- Some accounting treatments permitted under full IFRSs have been removed, e.g., adoption of revaluation model for property, plant and equipments, and for intangible assets is not allowed, proportionate consolidation for investments in jointly-controlled entities, various options for government grants have been removed. With regard to financial instruments, the Standard has dropped the 'available-for-sale' and 'held-to-maturity' categories given in IAS 39, no fair value option. However, this Standard allows the entities to choose to apply IAS 39 in its entirety instead of the financial instrument

requirements in the *IFRS for SMEs*. This is the only fallback option to full IFRSs in the *IFRS for SMEs*.

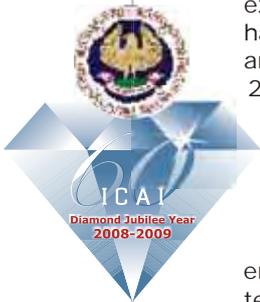
- Many recognition and measurement principles given in full IFRS have been simplified, e.g., hedge accounting and derecognition requirements for financial instruments have been simplified, all borrowing costs, research and development costs are to be recognised as expense. A simplified calculation is allowed if measurement of defined benefit pension plan obligations using the projected unit credit method involves undue cost or effort, cost model is permitted for investments in associates and joint ventures.
- Substantially fewer disclosures are required.
- Language has been simplified.

The above simplifications will substantially reduce the volume of accounting requirements applicable to SMEs as compared to full IFRS requirements. At a recently held meeting of UNCTAD, the Group of Experts has also welcomed with appreciation the publication of IFRS for SMEs by IASB and decided to conduct studies on their practical implementation with a view to facilitating the sharing of experiences gained in different regions of the world.

This Standard also contains some material not covered by full IFRS, e.g., original issuance of shares and other equity instruments, sales of options, rights and warrants, stock dividends and stock splits, etc. IFRS for SMEs contains illustrative financial statements presentation and disclosure checklist to provide guidance on implementation of the Standard. The effective date of the *IFRS for SMEs* will be determined in each jurisdiction that adopts it. The Standard contains a section on transition which contains all of the exemptions in IFRS 1 *First-time Adoption of International Financial Reporting Standards* with additional simplifications in relation to comparative information.

The ICAI is considering the possibility whether in Indian context, a Standard in line with IFRS for SMEs may be formulated for SMEs or the existing Accounting Standards being followed may be continued to be followed for SMEs and the same be amended from time to time or any other appropriate alternative may be followed. In Indian context Regulatory clarity will emerge in days to come to address the concerns of SMEs.

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**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA**  
 ICAI Bhawan, Post Box No.7100, Indraprastha Marg,  
 New Delhi-110002, Tel: +91 (11)39893989.  
 E-mail: journal@icai.org, Website: www.icai.org

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IN THIS ISSUE

Dear CA Parivar,

I am sure most of us are still sharing the Diwali happiness and good wishes with friends and family. The New Year *Vikram Samvat* 2066 has dawned and has already ushered in a positive atmosphere. The markets are doing well; the economy is making strides and should grow by 6.5 per cent this fiscal. The forecast growth for next year at between 7 and 7.5 per cent would most likely retain India's status as the second-fastest growing economy in the world. FDI inflows for financial year 2009-10 have already touched Rs. 51,063 crore in July with 8 months left and a global economic recovery taking place. I expect the Reserve Bank of India to continue its accommodative monetary policy for the current financial year as it seems that the worst is over for the Indian economy with government policies bearing fruits. On the whole, *Vikram Samvat* 2066 promises to be a good year for the country.

#### CA-Shiksha

Ever since I became President of this great institution, I have made sure that the institution as a whole becomes IT savvy. To that end, I have implemented an IT programme which has resulted in the development of a robust IT infrastructure and a continuous IT development plan. With this plan in place, I believe it is now time to refocus our priorities towards our future.

"Child is the father of man," so goes the saying, which means that the youth are the future. This is especially true for us when the number of students devoted to our profession has risen to 5,60,000 approximately. It has been my long time dream to provide a unique service to our students - a service that would make available better, regular, systematic and cost effective learning, that too at a time and place of the students' convenience.

This dream has now turned into reality as we have launched a new website called *CA-Shiksha* (<http://www.cashiksha.com>) exclusively for students. CA-Shiksha is an initiative, an idea to transform learning, which will take students from passive e-learning to a dynamic *i-learning* (interactive learning). The CA-Shiksha platform will provide all our students a comprehensive package of online learning + video lectures + mock tests + assessment reports + quick revision notes making it a lot easier to grasp, understand and deliver. This bouquet of education tools will not only give students a better perspective but also prepare them in the most thorough way for their exams. The website will go a long way in making our students technology savvy and proficient in IT.

This online education initiative will cater to the coaching needs of students at no cost which would benefit many students from weaker sections of society who cannot afford classes or tuitions. Students from mofussil areas are on the increase and these students do not have access to guidance and coaching. Their prayers are answered with CA-Shiksha. Today, the personal interaction of teachers with the students is decreasing as the number of students increase. So, through this website we have proactively tried to bring many students in direct touch with mentors and guides who will give them as good a one-on-one interaction as one gets.

I am sure that this initiative will also go a long way in reducing the dependence of students on coaching classes. This would benefit both the students and our members as students now can easily adhere to their office working hours without worrying about leaving office to attend coaching classes as they have a private tutor at their beck and call. This will enable them to focus more on their practical training in office without compromising on their study.

I appeal to all our members to help popularise this website among the students for the ultimate benefit of our CA Parivar. This educational site was launched on the auspicious day of Diwali and I cannot think of a better Diwali gift than this to all our future members.

#### High Court Accords Exemption to ICAI-ARF

All our members are aware of the services provided by our Accounting Research Foundation. By name it is a Research Foundation but in actuality the Foundation works at the behest of local governments across the country to research and implement methods to improve and advance accounting practices used by government bodies. A good example is the Strengthening Rural Decentralisation (SRD) project of West Bengal carried out by us to implement accrual-based accounting reform in the Government.

In view of these voluntary services, we had applied for grant of exemption under Section 10(23C)(iv) of the Income-tax Act, 1961 for the assessment year 2007-08 onwards in 2006 which was refused by the Director General of Income Tax (Exemptions) Delhi. This unfair refusal prompted us to file a writ petition in the Delhi High Court. Once we established the fact that ICAI-ARF as a developer of research papers, quality documents and pronouncements met the description of a 'Charitable Institution', the High Court lost no time in setting aside the previous order by the Director General of Income Tax (Exemptions) and ensuring that ICAI-ARF is granted full status as a Charitable Institution. This is indeed legal attestation that ICAI-ARF is essentially established for the purpose of education and/or for advancement of any other project of general public utility. I take pride in the fact that our voluntary services to the government have been recognised as well as endorsed by our judicial system.

#### Australia Study Tour & Honour from ICAA

During this year, we, at the Institute, have made great efforts in promoting and building relationships between ICAI and other similar organisations on the international platform. Now, I believe, the time has come to recoup our efforts and implement programmes to take advantage of the bilateral ties that we have forged. To that end, the Institute recently organised an International Study Tour to Australia. A 33-member delegation visited different cities in Australia to get a better understanding of the economic and regulatory environment as well as actively look out for opportunities for Indian CAs in Australia. We also ensured an in-depth study by organising meetings with officials of the Institute of Chartered Accountants in Australia (ICAA) and CPA Australia as well as its members belonging to diverse industry groups. The recent MoU that was

signed between ICAI and ICAA will make possible a host of opportunities and more recognition for Indian CAs in Australia.

During this tour, I was pleasantly surprised and highly honoured when Mr. Graham Mayor, CEO of ICAA awarded me an honorary membership of the ICAA. This was a historic moment for our Institute as it was the first time that such an honour was bestowed on any President of the ICAI. The honour was in recognition of efforts made to build ties across our respective organisations at international levels. I dedicate this great honour to our beloved Institute because of which this moment was made possible.

Members of our Institute are spread far and wide across the globe but they never forget their alma mater and their colleagues. This was amply proved by the ICAI Chapter in Australia which organised a members' meet in Sydney, Canberra & Brisbane to commemorate the MRAs between ICAI and ICAA, and ICAI and CPA Australia.

That Australia presents a vast opportunity for us was amply demonstrated by the ICAI Chapter in Australia, which showcased prospects in agri-business, property and mining sectors. This was reinforced by invited specialist speakers from the profession, trade bodies and business houses and more particularly by Director of CA Australia Mr. Bill Palmer, who spoke on the very pertinent topic of "How to do business in Australia".

I am happy to note that the chapter in Australia is actively promoting our profession by opening a host of centres in Adelaide, Brisbane, Canberra, Perth & Sydney with further plans to open centres in Hobart, Darwin, Wollongong and Newcastle, in fact, at any city with more than 10 ICAI Members. Sydney itself hosts two Continuous Professional Development & Networking Events every month.

Due to this overwhelming response, we are enthused to organise a similar tour to United States of America in December which would provide our members a first hand experience to explore professional opportunities there.

#### Visit by Lord Mayor of London

The ICAI and ICAEW share a strong bond of friendship and respect for each other. To supplement and enhance this relationship, we had recently signed a MoU that brought the UK and Indian accountancy profession closer. This bond was further strengthened when the Lord Mayor of the City of London, Hon'ble Ian Luder recently visited us. This was truly a historic occasion as it was for the first time in history that the Lord Mayor of London specially came to India to visit a regulatory body. Never has it happened before and I am proud that it was our Institute that was bestowed this rare honour. During his visit, a conference on "A New Vision for Financial Services" was jointly hosted by ICAI & ICAEW in Mumbai. This event explored the implications of recent experiences for financial services and the businesses they serve and attempted to develop a vision for the future of a global financial architecture which would restore confidence in financial services. This event was attended by the top CEOs/CFOs of major corporates and banks, and senior members of the accountancy and legal profession who were part of the Lord Mayor's business delegation. Senior experts from UK & India regulatory bodies, financial service



providers and business also gave us the benefit of their expertise during the visit.

#### New Online Facility from Central Board of Excise & Customs

A new online facility has been launched by the Central Board of Excise & Customs (CBEC) on 14<sup>th</sup> October. This new online service is called 'Automation of Central Excise & Services Tax' (ACES). The Chief Commissioner of Central Excise & Service Tax, New Delhi sent a special invitation to our Institute inviting me as Guest of Honour for the launch. This is the first time that such an honour was bestowed to our Institute which indicates that increasingly the Government bodies recognise the Institute as a true partner in nation building.

This new service is a new centralised web-based software application of CBEC which provides us an online electronic interface with the department. ACES aims to reduce paperwork, visits to the department and transaction costs while increasing accountability, responsiveness, efficiency and transparency in indirect tax administration. The online facilities offered are many and include services such as registrations, filing of service tax returns, refund claims, filing of intimations, tracking, dispute resolutions and online viewing of our records. The Institute highly appreciates this service as it will make our work more efficient and linear.

Very few of our members have entered the excise and customs field of practice. However, now with ACES, I am sure it would attract more and more of our members to enter this field of practice, and would go a long way in widening the scope of professional opportunity. I hope that this service also enables our members to become more IT savvy while doing their work.

#### Status of Bank Branch Auditors' Panel 2009-10

The draft Bank Branch Auditors panel for the year 2009-10 was hosted on the website on 6<sup>th</sup> October, 2009 for members' information. We have received about 5,400 complaints till date, out of which 5,150 have already been resolved. Most of the pending complaints pertain to those corrections which have been noted for updating the draft bank branch auditors' panel but have not yet been closed and the correction process is on. In fact, by the first week of November, 2009 all the complaints and communications from members will be resolved during the finalisation of the panel.



President

**Initiatives on Direct Taxes Code Bill, 2009**

As you are aware, we had invited members to submit their opinions on the Direct Taxes Code Bill, 2009 for consideration. The suggestions sent in by the members covered some vital points ranging from Ability to pay, Equitable Principle of equity, Principle of Natural Justice, Simplification in favour of assessee to what extent, Law of evidence - to what extent being ignored to the Negative impact on economic development of India and as a business centre. To ensure a clear understanding and any other clarifications regarding these issues we organised a lecture series in Mumbai, Kolkata and Bangalore on this Bill in co-ordination with the Ministry of Finance to generate discussions and bring about awareness about the proposed law.

These lectures brought about a lot of constructive and practical submissions which were deliberated upon very seriously by CBDT officials. Along parallel lines, we formed a Central Study Group comprising myself and Central Council members to look in-depth into the ramifications of the proposed law. This Central Study Group worked in close collaboration with senior CBDT officials to have a thorough understanding of the basic concepts behind the major policies adopted in the proposed Direct Taxes Code. The group then formed sub-groups across the country to discuss, collate and revert back with final inputs from members. These detailed inputs and their implications have been comprehensively discussed by us and we will soon give our final recommendations and proposals to the Ministry of Finance for consideration. This thoroughly comprehensive research, which is our hallmark, has been highly appreciated by the ministry and CBDT officials.

**Interaction with the Insurance Sector**

To foster a better understanding of new professional opportunities that have been provided to us by way of internal audit for insurance companies, I arranged a meeting with the CEOs, CMDs and CFOs of several insurance companies. This was to enable our members to gain an insight into the working of the insurance industry and to obtain the observations and suggestions from the industry itself regarding the implementation of several new regulations. I felt it important to record their observations coupled with their views on the upcoming GST, challenges in implementation of IFRS in the insurance industry, the impact of new Direct Taxes Code on the insurance sector and finally whether they had any definite opinions concerning the existing Accounting Standards pertaining to their industry.

I also stressed that their rich experience in the industry would be useful to our members if they could compile a handbook of compliances which would then be published by the ICAI as part of its initiative to pool this specialised knowledge for the benefit our fraternity. To further our understanding of this new sector, I invited them to work on research projects of their choice relating to insurance industry which could be funded by the Accounting Research Foundation of ICAI. Knowing that their continued inputs would be a guiding light for us in insurance sector, I urged all the invitees to add to our knowledge base by contributing articles and write-ups to our publications, particularly to *The Chartered Accountant* journal.

At the same time, keeping our *Parivar* in mind, I requested the officials present to formulate an insurance scheme for our members and students, the cost of which would be borne by ICAI as a part of its corporate social responsibility.

I am sure that future collaboration with the insurance industry in the knowledge area will be very fruitful for them as well as for our institute and profession.

**Disciplinary Action in Satyam Case**

As you know, the Institute has been at the forefront of the investigations into the Satyam fiasco. Being the arbitrators of discipline, we have gone ahead and started the procedure necessary to bring the investigations to a just conclusion. We have taken steps to bring the guilty to book. Show-cause notices have been issued to the auditors of M/s. Satyam Computer Services Ltd., viz. M/s Price Waterhouse, Bangalore.

We have also proceeded against the members who have been accessory to the fraud with show-cause notices issued to Mr. S. Gopalakrishnan, Mr. Srinivas Talluri, Mr. P. Shiva Prasad, Mr. C.H. Ravindranath, Senior Vice-President (Internal Audit Cell) of Satyam Computer Services Ltd. Shri V. S. Prabhkara Gupta and Chief Finance Officer of Satyam Computer Services Ltd. Mr. V. Srinivasu. All of the above have been found to be *prima facie* guilty of Professional and Other Misconduct and it has been decided to proceed further in the matter under clause (b) of sub rule (2) of rule 9 of the Chartered Accountants (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007.

The case will continue till the Disciplinary Committee concludes its enquiry and passes judgement. Rest assured, I am doing everything in my power to bring this case to a swift and just end.

**Geneva Session of UNCTAD Working Group of Experts on ISAR**

I recently had the privilege of attending the UNCTAD's 26<sup>th</sup> Session of the Inter-governmental Working Group of Experts on International Standards of Accounting & Reporting (ISAR) in Geneva. This was a great honour for our Institute as only the world's top regulators and professional bodies were invited.

As you know, ISAR assists developing countries and economies in transition to implement best practices in corporate transparency and accounting in order to facilitate investment flows and economic development. It seeks to achieve this objective through an integrated process of research, inter-governmental consensus building, information dissemination and technical cooperation. ISAR is very broad based, covering areas such as IFRS implementation, accounting by SMEs, corporate governance disclosure, corporate responsibility reporting and environmental reporting.

In this session, discussions centred on capacity building efforts to strengthen accounting and reporting institutions. Also taken into consideration was the number of regional and international organisations that were active in the area of corporate transparency.

I presented my observations on behalf of the ICAI on the practical implementation of

International Financial Reporting Standards (IFRS), accounting by small and medium sized enterprises, and corporate governance and corporate responsibility reporting. Secretary, MCA, Mr. R. Bandyopadhyay and Director, MCA, Mr. Manoj Arora also attended the session from our country.

#### Special Meeting of the Council

As per requirement of clause (5A) of Section 18 of the Chartered Accountants Act, 1949 a special meeting of the Council was convened on September 25, 2009, in which annual accounts of the Institute for the year ended March 31, 2009 were considered and approved. In the morning, the meeting was graced with the presence of Mr. R. Bandyopadhyay, Secretary, Ministry of Corporate Affairs (MCA) and Mr. Mark Bolgiano, President and CEO of XBRL US jurisdiction. In the evening, the meeting was addressed by Mr. Anurag Goel, former Secretary, MCA.

Mr. Mark Bolgiano, President and CEO of XBRL US jurisdiction of XBRL International made a presentation to the Council mainly on the state of XBRL in the United States of America. He highly appreciated the ICAI for taking initiative to establish XBRL India jurisdiction and pointed out that in US also the XBRL initiative was taken by the AICPA as the accounting profession has a very crucial role in the development of XBRL in a country. He promised support of XBRL US jurisdiction to various activities being undertaken by the XBRL India jurisdiction established by the ICAI.

#### Infrastructure

The Institute grows with us and we grow with the Institute. This is the relationship which encourages us to provide better infrastructure for our members and students. You will be happy to know that the drive to boost the infrastructure is going on in full swing. In this regard, I firmly believe that we should move swiftly to ensure that we benefit from cost advantage in our infrastructure-related dealings. This is exactly why we purchased 500 sq. yards of land for our Kakinada Branch from Srimati Plivela Satya Raju Memorial Trust on lease for 35 years. The deal involves an annual lease rent of just Rs. 10,000 with a provision of renewal of lease with mutual consent. I have already laid the foundation stone of this branch building and construction work has begun. I am sure this upcoming ICAI premises will immensely benefit all our members and students under the Kakinada Branch of SIRC. Further, I have recently laid the foundation stone for a new Study Centre for Excellence at Kottayam, Kerala.

I am happy to note that our dream of putting in place a world class infrastructure for our members and students across the country is shared by members too, many of whom have in fact come forward to donate vast tracts of land to turn this dream into reality. You will appreciate that a member has donated seven acres of land to set up a centre of excellence in Pune district while two other members have donated several acres of land in Hyderabad and Chennai respectively. These members feel the need to give back to their *alma mater* which has been instrumental in sculpting their success and social standing.

#### Proposal for Centre of Excellence in Goa

Our Centres of Excellence are symbols – symbols of the Institute as a world class education and professional foundation. Hyderabad Centre of Excellence is already on the world map as a centre par excellence. To that, I am proud to say, we will soon be adding a Centre

of Excellence in Goa. This centre, whose plans have been finalised and where construction will begin shortly, will be dedicated to our future – our students. It will be the finest centre of accounting education in the world.

This is not a dream but a much needed requirement. Today we have around 560,000 students who are a part of our Institution and who need a dedicated centre of education. Many students are from far flung places, small towns and villages which do not have access to proper educational infrastructure, libraries, study centres, etc. We must cater to these students' needs. We must provide students from weaker sections of society their rightful education and place in society. I believe that to secure our future tomorrow we have to take action today.

The Goa Centre of Excellence will offer our students a complete and comprehensive educational experience – mentally as well as physically. Students will have complete access to world class educational infrastructure offering the latest modern technological innovations for education. The Centre will encourage students to enhance their skill sets in myriad ways through research projects. From the students' perspective, this centre will facilitate a direct interaction with educators and mentors instead of one dimensional distance learning. But most importantly, this centre will foster amongst students a sense of pride and belonging to the Institute. It will build long lasting relationships which will greatly benefit the Institute in the long run.

The Council had committed to realise the dream of having 12 Centres of Excellence across the country, and now the Goa centre will soon be one of them.

#### Elections on Anvil

As you are all aware, elections to Central Council & Regional Councils are fast approaching and it is the duty of each and every responsible member of our Institute to select such leaders who will continue the good work carried out by our predecessors and who will uphold the traditions of our great Institute. Please select candidates based on their dedication, ability and commitment and not on their propaganda, personal interest and election campaign.

#### ICAI's Corporate Forum and Achievers' Awards

I had the opportunity to institute these awards which was an integral part of the mammoth event Corporate Forum when I was Chairman of CMI during 2007-08. I am pleased to inform you that the next event will be held from 29-31st January 2010. More details are available in this Journal and on the Institute's website.

As I conclude my message, I appeal to all of you to resolve to achieve more and accomplish even more in this New Year. Let us be inspired and remember *"Keep your dreams alive. Understand to achieve anything requires faith and belief in yourself, vision, hard work, determination, and dedication. Remember all things are possible for those who believe."*

My Pranaams to all,

-CA. Uttam Prakash Agarwal  
New Delhi, October 24, 2009

**Journal Has Become Attractive and More Informative**

It is heartening to note that the Institute's journal has become more attractive and informative over the years, much to the benefit of professionals. The layout and the content of the journal now conform to high standards and is proving to be very beneficial to members and students. The journal takes the professionals to the new vistas of opportunities which lay before the Chartered Accountants of this century. With the comprehensive coverage and detailed insights into the various issues concerning a professional's domain, *The Chartered Accountant* journal has truly grown with time. Particularly, the Cover pages of the September and October issues of the journal were very appealing and inviting. Keep up the good work.

- CA. Sumit Kr. Dhanuka, Mumbai



**President's Message Informative**

The President's Message for the month of October 2009 was informative and made us aware of the latest developments related to our profession. I appreciate the electronic mode in which the message was delivered to us, which proves that we Chartered Accountants are technologically at par

with the best in the world. Further, I suggest that we aggressively showcase before the world our yeoman services and institute a distinct global award.

- CA. C.S.Kameswaran

**CA Shiksha Portal is Highly Welcome**

I highly appreciate the ICAI's noble and futuristic initiative of launching CA Shiksha Portal for the benefit of CA fraternity. This will surely provide a very big relief to those students who face problems of timings. We all know that in current CA course, it's very difficult for a student to get time from articleship for his or her coachings. It's obvious that a student needs coaching to clear exams and if some students get time for coachings then they are not getting the right coaching. In this background, it is highly welcome that our institute has come forward to give coaching to students, much to the advantage of particularly a large number of students who cannot afford coachings. Although, at present only CPT lectures are available on this portal, I am sure that PCC and final lectures will also be uploaded on the portal soon.

- CA. Gourav Kapoor, Amritsar

**ICAI's Futuristic Initiatives are Commendable**

It's a matter of pride that ICAI leadership is taking futuristic initiatives and is commendably leading the profession's progress march. The President's Message of October 2009 gave us enough indications of that. Further, I wish to pay my tributes to Andhra Pradesh Chief Minister Mr. Rajsekhar Reddy's, who died a tragic death. As a great admirer of Mr Reddy, I fully agree with our President's remarks that his untimely death is a great loss to the CA Parivaar too.

- CA. Prakash Somani

**Publication of Accounting, Auditing Standards Very Useful**

The practice of publishing of accounting and auditing standards in the journal is very beneficial and useful for members, both in practice as well as in industry. It provides adequate knowledge and acts as a guide to proceed further in our profession. This practice should continue for all times to come for the benefit of members as well as students.

- CA. N. Syed Nafiz Ahamed, Chennai

**Increase Font Size of EDs, Standards**

I would like to draw your attention towards font size of *The Chartered Accountant* journal, particularly those of "exposure drafts" and "standards" published in it. The font size, particularly of these contents, are very small and it pains the eyes when read in detail. This problem is faced more so by senior and veteran members of our profession like me. So it is suggested to kindly use the standard font size so that these contents are easily readable, even by the aged members.

- CA. Babu Lall Pandiya

EDITOR

**For the Attention of Readers**

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

**Write to Editor**

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



PHOTOGRAPHS



Joint Ceremonial Reception

CA. Uttam Prakash Agarwal, President, ICAI presenting memento (from left to right) to Mr. Ian Luder, Lord Mayor of the City of London and Mr. Martin Hagen, President of ICAEW at Joint Ceremonial Reception held at Mumbai on October 20, 2009.



Launch of ACES

Mrs. Sreela Ghosh, Chief Commissioner, Central Excise and Service Tax launching "Automation in Central Excise and Service Tax (ACES)" at New Delhi on October 14, 2009 while CA. Uttam Prakash Agarwal, President, ICAI and Guest of Honour on the occasion, looks on.



Career Counselling Seminar at Dundlod Vidyapeeth

ICAI President CA. Uttam Prakash Agarwal inaugurates career counselling programme/seminar on Chartered Accountancy & Accounting Technician Courses at Dundlod Vidyapeeth in Dundlod on 27<sup>th</sup> September 2009 as Mr. Ramakant Sharma, Chairman of the Vidyapeeth and Mr. S C Karnatak, Principal of the Vidyapeeth look on (left), and addresses the students at the above programme(right)



UNCTAD Meeting

CA. Uttam Prakash Agarwal, President, ICAI during twenty-sixth session of UNCTAD- Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting held at Geneva from 7<sup>th</sup> to 9<sup>th</sup> October, 2009.



Kottayam

CA. Uttam Prakash Agarwal, President, ICAI with Hon'ble Oommen Chandy, MLA, Leader of Opposition, Kerala, during the foundation stone laying ceremony of the study centre of excellence at Kottayam on October 21, 2009.



ICAI's Council Meeting

ICAI President CA. Uttam Prakash Agarwal presents a memento (from left to right) to Mr. R. Bandyopadhyay, Secretary, Ministry of Corporate Affairs; Mr. Anurag Goel, former Secretary, Ministry of Corporate Affairs; and Mr. Mark Bolgiano, President and CEO, XBRL US at the 290<sup>th</sup> ICAI Council meeting held in ICAI Headquarters in New Delhi on 25<sup>th</sup> September, 2009.

# Know Your Ethics

(Continued from October 2009 issue)

## Ethical Issues in Question-Answer Form

**Q. Can a Chartered Accountant in practice accept original professional work emanating from the client introduced to him by another member?**

**A.** No, a Chartered Accountant in practice should not accept the original professional work emanating from a client introduced to him by another member. If any professional work of such client comes to him directly, it should be his duty to ask the client that he should come through the other member dealing generally with his original work.

**Q. Can a member in practice solicit clients or professional work by advertisement?**

**A.** No. The CA Act prohibits a member in practice from soliciting clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, there are following exceptions to it:-

(i) A member can respond to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence.

(ii) A member may advertise changes in partnerships or dissolution of a firm, or of any change in the address of practice and telephone numbers, the advertisement being limited to a bare statement of facts and consideration given to the appropriateness of the area of distribution of the newspaper or magazine and number of insertions.

(iii) A member is permitted to issue a classified advertisement in the Journal/Newsletter of the Institute intended to give information for sharing professional work on assignment basis or for seeking professional work on partnership basis or salaried employment in the field of accounting profession provided it only contains the accountant's name, address, telephone, fax number and E-mail address.

**Q. Whether sponsorship or prizes can be instituted in the name of Chartered Accountants firms?**

**A.** Yes, as per the CA Act it is not objectionable to institute prizes in the name of the individual Chartered Accountant and also in the firm's name provided the designation "Chartered Accountant",

is not indicated in the prize and the clause relating to advertisements and publicity are complied with.

**Q. Can a Chartered Accountant in practice/firm of Chartered Accountants post the particulars of himself/itself on a website?**

**A.** Yes, the Council has approved the detailed guidelines for posting the particulars on Website by Chartered Accountants in practice and firm(s) of Chartered Accountants in practice. For Guidelines, please refer pages 140-144 of Code of Ethics, 2009.

**Q. Whether a Chartered Accountant in practice can give public interviews and also whether he can furnish details about himself or his firm in such interviews?**

**A.** Chartered accountant in practice can give public interviews. While doing so, due care should be taken to ensure that such interviews or details about the members or their firms are not given in a manner highlighting their professional attainments, which may hit clauses (6) and (7) of the First Schedule of the CA Act.

**Q. Whether the information contained in the website of the Chartered Accountants and/or Chartered Accountants' firms can be circulated on their own or through E-mail or by any other mode or technique?**

**A.** The Code of Ethics provides that the Chartered Accountants and/or Chartered Accountants' firms should ensure that none of the information contained in the website be circulated on their own or through E-mail or by any other mode or technique except on a specific "pull" request. The Chartered Accountants and/or Chartered Accountants' Firms would ensure that their websites are run on a "pull" model and not a "push" model of the technology to ensure that any person who wishes to locate the Chartered Accountants or Chartered Accountants' firms would only have access to the information and the information should be provided only on the basis of specific "pull" request.

**Q. Can a member put up his photograph on the website?**

**A.** Yes, as per the website guidelines, display of Passport size photograph by a member on the website is permitted.

(...To be Continued)

\*Contributed by Ethical Standards Board of ICAI

# LEGAL DECISIONS<sup>1</sup>

## DIRECT TAXES



### Section 37 read with Section 31 of the Income-tax Act, 1961 – Business Expenditure

**In textile mills, each separate machine is an independent entity; replacement of such an old machine with a new one would constitute bringing into existence of a new asset in place of old one and not repair of old and existing machine; such replacement expenditure would be capital in nature.**

**Commissioner of Income Tax, Madurai vs. Sri Mangayarkarasi Mills (P) Ltd., July 21, 2009 (SC.)**

The assessee, engaged in the manufacture and sale of cotton yarn, claimed an amount being expenditure incurred on replacement of machinery, as revenue expenditure. The assessee believed that such expenditure was merely expenditure on replacement of spare parts in the spinning mill system and, therefore, amounted to revenue expenditure. According to the Assessing Officer (AO), each machine in a spinning mill does a different function and all the machines are, not integrally connected. Based on this reasoning, the AO disallowed the above claim of the assessee and held the said expenditure to be of a capital in nature.

The Supreme Court held that in *CIT vs. Saravana Spinning Mills (P) Ltd.* (2007) 7 SCC 298 it was held that "each machine in a segment of a textile mill has an independent role to play in the mill and the output of each division is different from the other". Further, it is

accepted that each machine in a textile mill is part of the integrated process of manufacture of yarn and is integrally connected to the other machines in the mill for production of the final product. However, this inter-connection does not take away the independent identity and distinct function of each machine. Thus, each machine in a textile mill should be treated independently as such and not as a mere part of an entire composite machinery of the spinning mill. As stated above, it can at best be considered part of an integrated manufacture process employed in a textile mill.

The entire textile mill machinery cannot be regarded as a single asset, replacement of parts of which can be considered to be for mere purpose of 'preserving or maintaining' this asset. All machines put together constitute the production process and each separate machine is an independent entity. Replacement of such an old machine with a new one would constitute the bringing into existence of a new asset in place of the old one and not repair of the old and existing machine. Also, a new asset in a textile mill is not only for temporary use. Rather it gives the purchaser an enduring benefit of better and more efficient production over a period of time. Thus, replacement of assets as in the instant case cannot amount to 'current repairs'. The expenditure made by the assessee could not be allowed as a deduction under section 31.

In the instant case, the assessee had not claimed any of the two exceptions - (i) Where old parts are not available in the market (as seen in the case of *CIT vs. Mahalakshmi Textile Mills Ltd.* (AIR 1968 SC 101), or (ii) Where old parts have worked for 50-60 years. In this case, replacement of

machine could at best amount to a repair made to the process of manufacture of yarn and could not be said to be 'current repairs'. Repair implies existence of a part of the machine, which has malfunctioned, which is impossible in the case of such replacement.

The expenditure of the assessee in this case is capital in nature as the replacement, in this case, amounted to bringing into existence a new asset and also an enduring benefit for the assessee. The expenditure of the assessee here was not of a revenue nature and thus, could not be claimed as a deduction under section 37.

### Section 80-IB of the Income-tax Act, 1961 – Deductions – In respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings

**Duty drawback receipt/DEPB benefits do not form part of the net profits of eligible industrial undertaking for the purposes of Sections 80-I/80-IA/80-IB**

**M/s. Liberty India vs. Commissioner of Income Tax, August 31, 2009 (SC.)**

The appellant, a partnership firm, owns a small scale industrial undertaking engaged in manufacturing of fabrics out of yarns and also various textile items such as cushion covers, pillow covers etc. out of fabrics/yarn purchased from the market. It claimed deduction under Section 80-IB on the increased profits of Rs. 22,70,056 as profit of the industrial undertaking on account of DEPB and Duty Drawback credited to the Profit & Loss account, which was denied mainly on the ground that the assessee(s) had failed to prove the nexus between the receipt by way of duty drawback/DEPB benefit and the industry.

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

The Supreme Court held that section 80-IB provides for allowing of deduction in respect of profits and gains derived from the eligible business. The words "derived from" are narrower in connotation as compared to the words "attributable to". In other words, by using the expression "derived from", Parliament intended to cover sources not beyond the first degree.

The devices adopted to reduce or inflate the profits of eligible business has got to be rejected in view of the overriding provisions of sub-section (5) of Section 80-IA, which are also required to be read into Section 80-IB [see Section 80-IB(13)]. Sections 80-I, 80-IA and 80-IB have a common scheme and if so read it is clear that the said sections provide for incentives in the form of deduction(s) which are linked to profits and not to investment. On analysis of Sections 80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-section(2), would be entitled to deduction under sub-section (1) only to the extent of profits derived from such industrial undertaking after specified date(s). Hence, apart from eligibility, sub-section (1) purports to restrict the quantum of deduction to a specified percentage of profits. This is the importance of the words "derived from industrial undertaking" as against "profits attributable to industrial undertaking".

**DEPB** – It is an incentive. It is given under Duty Exemption Remission Scheme. Essentially, it is an export incentive. No doubt, the object behind DEPB is to neutralise the incidence of customs duty payment on the import content of export product. This neutralisation is provided for by credit to customs duty against export product. Under DEPB, an exporter may apply for credit as percentage of FOB value of exports made in freely convertible currency. Credit is available only against the export product and at rates specified by DGFT for import of raw materials, components etc.. DEPB credit under the Scheme has to be calculated by taking into account the deemed import

content of the export product as per basic customs duty and special additional duty payable on such deemed imports. Therefore, in our view, DEPB/Duty Drawback are incentives which flow from the Schemes framed by Central Government or from Section 75 of the Customs Act, 1962, hence, incentives profits are not profits derived from the eligible business under Section 80-IB. They belong to the category of ancillary profits of such Undertakings.

**Duty drawback** – Section 75 of the Customs Act, 1962 and Section 37 of the Central Excise Act, 1944 empower Government of India to provide for repayment of customs and excise duty paid by an assessee. The refund is of the average amount of duty paid on materials of any particular class or description of goods used in the manufacture of export goods of specified class. The Rules do not envisage a refund of an amount arithmetically equal to customs duty or Central Excise duty actually paid by an individual importer-cum-manufacturer. Sub-section (2) of Section 75 of the Customs Act requires the amount of drawback to be determined on a consideration of all the circumstances prevalent in a particular trade and also based on the facts situation relevant in respect of each of various classes of goods imported. Basically, the source of duty drawback receipt lies in Section 75 of the Customs Act and Section 37 of the Central Excise Act.

Analysing the concept of remission of duty drawback and DEPB, it is clear that the remission of duty is on account of the statutory/policy provisions in the Customs Act/Scheme(s) framed by the Government of India. In the circumstances, we hold that profits derived by way of such incentives do not fall within the expression "profits derived from industrial undertaking" in Section 80-IB.

Analysing AS-2 and relevant Guidance Note issued by the Institute of Chartered Accountants of India (ICAI), it was to be held that duty drawback, DEPB benefits, rebates etc. cannot be credited against the cost of

manufacture of goods debited in the Profit & Loss account for purposes of Sections 80-IA/80-IB as such remissions (credits) would constitute independent source of income beyond the first degree nexus between profits and the industrial undertaking.

In the circumstances, it is to be held that Duty drawback receipt/DEPB benefits do not form part of the net profits of eligible industrial undertaking for the purposes of sections 80-I/80-IA/80-IB.

### **Section 271(1)(c) of the Income-tax Act, 1961 – Penalty – Concealment of income**

**Penalty spoken of in Section 271(1)(c) is neither criminal nor quasi-criminal but a civil liability; albeit a strict liability; such liability being civil in nature, mens rea is not essential**

**Commissioner of Income-tax, Delhi vs. Atul Mohan Bindal, August 24, 2009 (SC.)**

During the assessment proceedings, it transpired that assessee worked with Singapore DHL during the previous year and was paid salary and received an amount as retrenchment compensation and also received an interest amount from the Bank in Singapore. The Assessing Officer added all these three receipts to the total income of the assessee and also imposed penalty under Section 271(1)(c). The assessee accepted the order of assessment but challenged the order of penalty in appeal before the CIT (Appeals). The CIT (Appeals) set aside the order of penalty on the ground that the assessee has neither concealed the particulars of his income nor he furnished any inaccurate particulars thereof. The order of CIT (Appeals) was accepted by the Tribunal as well as the High Court.

The Supreme Court held that the penalty spoken of in Section 271(1)(c) is neither criminal nor quasi-criminal but a civil liability; albeit a strict liability. Such liability being civil in nature, mens rea is not essential.

In the case of Union of India and Others vs. Dharamendra Textile Processors (2008) 306 ITR 277, this Court held that the Explanation

appended to Section 271(1)(c) indicates element of strict liability on the assessee for concealment or for giving inaccurate particulars while filing the return.

Insofar as the present case was concerned, as noticed above, the High Court relied upon its earlier decision in *Ram Commercial Enterprises* which is said to have been approved by this Court in *Dillip N. Shroff*. However, *Dillip N. Shroff* has been held to be not laying down good law in *Dharamendra Textiles*. *Dharamendra Textiles* is explained by this Court in *Rajasthan Spinning and Weaving Mills*. Therefore, the matter was to be reconsidered by the High Court in the light of the decisions of this Court in *Dharamendra Textiles* and *Rajasthan Spinning and Weaving Mills*.

### **Section 115JB of the Income-tax Act, 1961 – MAT companies – Payment of tax**

**During 3-4-2001 to 1-4-2005, for the purpose of computing book profit under section 115JB, MAT companies cannot exclude export profits at figure other than that allowed u/s. 80HHC(1B); for purpose of calculating book profit under section 115JB under Explanation 1 sub-clause (iv) export profits to be excluded from the book profits would be export profits allowed as a deduction u/s. 80HHC after restricting deduction as per provisions of sub-section (1B) of section 80HHC and not export profits calculated as per sub section (3) and (3A) of section 80HHC before applying restriction contained in sub-section 1B of section 80HHC**

### **Commissioner of Income Tax, Mumbai vs. Ajanta Pharma Limited, Mumbai, May 7, 2009 (Bom.)**

Sub-section (1B) was introduced in section 80HHC by the Finance Act, 2000 with effect from 3.4.2001. That section was applicable to all, engaged in the business of export. By virtue of insertion of sub section (1B), i.e., the sun set clause, the deductions of export profits was to be discontinued from the beginning of 1.4.2005. The deductions available from April 1, 2001 were percentage-wise as set out beginning with 80% for 2001 and

ending with 30% for assessment year beginning on 1.4.2004. No deduction was available after 1.4.2005 and subsequent years.

In so far as MAT companies are concerned, reduction of export profit while computing book profits was not available when Section 115J was introduced from 1.4.1988. The benefit was given subsequently from 1.4.1989. Similarly the reduction was not available in the case of section 115JA which was introduced w.e.f. 1.4.1997. The benefit was extended only from 1.4.1998. This intent of the Legislature must be considered while interpreting the provisions. The other aspect would be that if sub-section (1B) is not read while computing the book profits (and which contains the sun-set clause), it would mean that even after 1.4.2005, MAT Companies could claim deduction of export profits, while computing book profits, which would be an absurdity.

It is clear that whether it be section 115J, 115JA or 115JB, the express language used is eligible for deduction under Section 80HHC and computed under clause (a) or clause (b) or clause (c) of sub section (3) or sub-section (3A) as the case may be. What this means is that sub-sections (3) and (3A) provide for the method for computation of profits. Once the profits are worked out, then only the profit which is eligible can be deducted. Section 80HHC(1) allows deductions of profits to the extent referred to in sub-section (1B).

In Sections 115J and 115JA, the expression used was profits eligible for deduction under section 80HHC. Section 115JB also uses the expression "profits eligible for deduction". There really can be no difficulty in understanding what this means. Only those profits which are eligible and computed in terms of sub-section (3) or (3A) and quantified in terms of sub-section (1B). The computation whether under sub-section (3) or (3A) are for the purpose of sub-section (1) or (1A). Section 80HHC(1) permits a deduction to the extent or profits referred to in sub-section (1B). The only question is whether the expression in clause (a), (b) or (c) to sub-

section (3) consequent on introduction of section 1B to Section 80 HHC will have a meaning different from the meaning that was originally understood. Until section 115JB was introduced, the whole of the profits computed under Section 80 HHC was eligible for reduction for computing the book profits. Pursuant to section 1B of section 80 HHC, the deduction is available to the extent provided in Section (1B). After 1.4.2005 the deduction of export profits is discontinued. Section 80HHC provides that in computing the total income of the assessee, a deduction is to be made to the extent of profits referred to in sub-section (1B) derived by the assessee from the export of such goods. Sub-Section (1B) provides for deduction in terms set out therein. Sub-section (3) sets out the method of computation of profits. The computation of profits is, therefore, for the purpose of working out the deduction of profits available under Section 80HHC (1B). Earlier it was in terms of sub-section (1). Now Section 80HHC (1) in term refers to section (1B). All the provisions are inter-related and cannot be read *de hors* one and other. If (1B) is not read in (1) then the expression "no deduction shall be allowed in respect of the assessment beginning on the first day of April, 2005 and any subsequent year", shall be rendered otiose.

In so far as section 115JB(2) Explanation 1(iv) is concerned, in computing the book profits the export profits under Section 80HHC had to be reduced. The object of Section 115JB was that companies pay tax not in a manner of total income computed by other companies, but on the book profits which had to be calculated in terms of sub-section 115JB(2). The object of Section 80HHC as originally introduced was to exempt the whole of the export profits. By virtue of Sub-section (1B) introduced w.e.f. 1.4.2001 the deduction is only a percentage of the export profits as allowed therein and no reduction after 1.4.2005. This benefit of reduction was initially not made available to MAT companies, but the benefit was extended from 1.4.1989.

Even if it is accepted that (1B) of Section 80HHC is not a condition and proceed on that footing, nevertheless it is impossible of reading section 80HHC(3) or (3A) independent of section 80HHC(1B). The language is clear. The literal meaning does not in any way defeat the object of the section and/or lead to an absurdity. The object of Section 115JB is to allow even MAT companies to avail of the benefit of deduction. If the argument that MAT companies are entitled to full deduction of export profits were considered it will lead to anomaly, whereby the companies which are paying tax on total income under the normal rules, for them the deduction of export profits will be lesser than what MAT companies are entitled to. Is this a possible view? When section 115J was originally introduced, MAT companies were not entitled to deduction of profits under section 80HHC while working out the book profits. That came to be introduced by Direct Tax Laws (Amendments) Act, 1989 w.e.f. 1.4.1989. A year later. Parliament, therefore, initially had even denied to MAT companies deduction under section 115J. When Section 115JA was introduced w.e.f. 1.4.1997, Section 80HHC benefits were once again not available for MAT companies. The amendment by Finance Act, 1997 to give the benefit was w.e.f. 1.4.1998. Can it now be argued that MAT companies considering section 115JB(2) Explanation 1 (iv) are entitled to be placed in a better position than the other companies entitled to the export deduction under section 80HHC though earlier they constituted one class. No rule of construction nor the language of the section 80HHC read with Section 115JB will permit such construction. If such construction is not possible then both the classes of companies will be entitled to the same deduction. This would contemplate that both would be entitled to deductions of profits in terms of section 80HHC(1B). So read, it would be a harmonious construction. A class of companies covered by Section 80HHC cannot be sub-classified into two classes, when more

so, for intermittent periods Parliament had even denied the benefit of Section 80HHC to MAT companies. What Section 115JB did was to continue the deductions also to the MAT companies. The only difference was that instead of calculating tax at 30% of the book Profits as in the case of Sections 115J, 115JA, it was made 7.5% and from April 1, 2007 it is 10%. The language used in (iii) to Explanation 1 to sub-section (2) of Section 115J or (vii) to Explanation 1 of Section 115JA(2) or (iv) of Explanation 1 of Section 115JB (2) is eligible for deduction.

Considering the literal language there is no absurdity or ambiguity being caused or any mischief sought to be remedied. The language used in section 115JB is deduction available under section 80HHC. It is difficult to conceive of any rational reason as to why the legislature should have thought to give MAT companies additional benefits than the other companies who are paying tax on total income and not the tax based on book profit as calculated under section 115JB. Is it possible to conceive of any degree of fairness and/or justice that MAT companies, who for some periods were denied the benefit of section 80 HHC, because of the introduction of section 115(JB) Explanation 1 (iv) are entitled to have their entire export profits reduced. The object of section 15JB or for that matter section 115J or 115JA was to impose tax on those companies which otherwise considering various exemptions or deductions available under the Act, though making huge profits and paying large dividends were not paying any tax. Therefore, it is not possible to accept the construction, that MAT companies should be treated on a different footing in computing export profits under Section 80HHC, for the purpose of Section 115JB. MAT companies are entitled to the same deduction of export profits under Section 80HHC as any other company involved in export in terms of section 80HHC(1B).

The revenue's appeal was allowed.

## INDIRECT TAX



### Customs/Excise

#### **Section 111 read with 112 of the Customs Act, 1962 – Confiscation of improperly imported goods, etc.**

**Where respondent imported goods free from customs duty availing benefit of Notification No. 48/99-Cus, dated 29-4-1999 providing exemption to manufacturer exporter only, but they had no manufacturing unit at all, confiscation of goods for availing licence fraudulently would be justified**

**Commissioner of Customs (Sea), Chennai vs. Customs Excise and Service Tax Appellate Tribunal, Chennai, April 24, 2009 (Mad.)**

The second respondent had imported four consignment of Copper Scrap and availed the benefit of the Notification No. 48/99 CUS dated 29.4.1999, which permits import of goods free from Duty of Customs. The said notification pertains to an exemption in respect of import against Annual Advance Licence with Actual User Condition. The allegations were that the 2<sup>nd</sup> respondent did not have a manufacturing unit for manufacture of resultant products out of the duty free imported raw materials, even though it declared that its manufacturing units were situated at different places.

*The High Court held that the declaration given by the 2<sup>nd</sup> respondent for availing the Annual Advance Licence with Actual User that they were Manufacturer-Exporter, was a false declaration. Even assuming the 2<sup>nd</sup> respondent had sent the goods to job workers, they would still not be entitled to avail the benefit of the exemption notification since they ought to be a Manufacturer-Exporter, to be eligible for the exemption.*

Clause (o) of Section 111 contemplates confiscation of goods which are exempted from duty subject to a condition, and that condition is not observed by the importer. Occasion for taking action under this clause arises only when the condition is not observed within the period prescribed, if any, or where the period is not so prescribed, within a reasonable period.

The fact in the present case was worse, in the sense that the importer made a false statement for the purpose of securing an advance licence with Actual User Condition. The fact that the time within which he had to discharge his obligation has not come to an end, does not advance the case of the importer. The basis for his discharge of the export obligation is existence of a factory. The basis does not exist, the address given is a false address, so the whole edifice falls. The fact that the importer could affect his export obligation through job workers and the existence of a factory is not a sine quo non, does not advance his case either. The importer claimed he had a factory when he had none. So, whether he could have completed the manufacture otherwise hardly matters. For the purpose of obtaining such licence with Actual User Condition, it is mandatory that the importer should be a Manufacturer-Exporter. The importer made a false declaration of being one.

If the Respondent is not an actual user he would not be entitled to utilise the licence. The licence having been secured by adopting fraudulent method would not confer any right on the importer and as such he cannot be allowed to plead any equity.

The appeal was answered in favour of the Revenue.

#### Sales tax

**Tamilnadu General Sales Tax Act, 1959 – Tax on sale of Wet Grinder - Penalty**

**Wherein sale by dealer, there was sale of new commodity and not different parts thereof, tax should be levied on dealer; however items which were not included in turnover**

**was disclosed in dealer's books of account, no penalty was to be levied**  
**Sree Krishna Electricals vs. State of Tamil Nadu and Another, April 21, 2009 (SC.)**

The appellant-dealer was assessed to tax on the sale of wet grinders. The appellant claimed that he was not selling wet grinder but only parts thereof, the claim was found to be untrue and tax and penalty were imposed.

The Supreme Court held that the authorities had factually adjudicated the issues. The conclusions arrived at by the revenue authorities and the High Court was that in fact what was sold was a complete wet grinder which was a new commodity and not merely parts thereof. This being a factual finding, there was no scope for interference in these appeals so far levy of tax was concerned.

So far as the question of penalty was concerned, the items which were not included in the turnover were found incorporated in the appellant's accounts books and the assessing authorities included these items in the dealers' turnover disallowing the exemption. Therefore, the penalty could not be imposed.

#### OTHER ACTS



#### Banking Laws

**Section 138 of the Negotiable Instrument Act, 1881 – Dishonour of cheque for insufficiency etc. of fund in the account**

**Where notice was issued on the 31<sup>st</sup> day and not within a period of thirty days from date of receipt of intimation from bank, complaint would not be maintainable**  
**Sivakumar vs. Natarajan, May 15, 2009 (SC.)**

On or about 14.08.2003, appellant borrowed Rs. 1,00,000 from the complainant-respondent. The said amount was to be repaid within a period of three months. On or about

20.11.2003 the appellant handed over a cheque dated 27.11.2003. It was presented on 27.11.2003. It was dishonoured with the remarks "insufficient funds" on 2.12.2003. Information thereabout was received by the respondent on 3.12.2003. On 02.01.2004, the respondent issued a legal notice. Thereafter, the respondent filed a complaint petition. The core question which arose for consideration was as to whether the notice dated 2.01.2004 was issued within the stipulated period of thirty days from the date of receipt of intimation of the dishonour of cheque.

The Supreme Court held that both clauses (a) and (b) of the proviso appended to Section 138 employ the term "within a period", whereas clause (a) refers to presentation of the cheque to the bank within a period of six months from the date on which it is drawn. Clause (b) provides for issuance of notice "to the drawer of the cheque within thirty days of the receipt of information".

Indisputably, the notice was issued on the 31<sup>st</sup> day and not within a period of thirty days from the date of receipt of intimation from the bank. If Section 9 of the General Clauses Act, 1897 is not applicable, clause (b) of the proviso appended to Section 138 was required to be complied with by the respondent for the purpose of maintaining a complaint petition against the appellant.

The appeal was allowed.

#### FEMA

**Section 9 read with section 40 of the Foreign Exchange Regulations Act, 1973 – Restrictions on dealing in foreign exchange**

**Retracted confession cannot be basis of conviction**

**Abid Malik vs. Union of India and Another, May 4, 2009 (Del.)**

The revenue's case was that the appellant allegedly stated that a cheque of Rs. 5 lakh was obtained by him at a premium of 12% and that the same had been declared by him as gift. The investigations further revealed that the aforesaid transaction was made only to obtain

benefit under Income-tax Act, 1961 and the transaction was not a gift at all but payment of Rs. 5.60 lakhs was made by the appellant in lieu of the NRE cheque for Rs. 5 lakhs to the credit of one 'N', a Non-resident Indian in contravention of the provisions of section 9(1)(a) of FERA. However, there was no evidence to this effect and the statement made under Section 40 on 04.01.1995 was retracted immediately vide his letter dated 13.01.1995 and it was alleged that the confessional statement recorded by the Enforcement Officer was not voluntary but was under duress.

The High Court held that the retracted confession alone cannot be the basis of conviction. Once a plea is taken by the person alleged to have made the confession that his confession was not voluntary, to remove the doubts and to prove that the confession was not under a threat, coercion or duress, becomes responsibility of the authority concerned and they have to lead evidence of the officer who recorded the confession with a liberty of cross-examination to the person who made the confession and it is only thereafter a finding can be returned as to whether confession was given under duress or not.

Admittedly, in this case no such evidence had been brought on record. Moreover in the present case except for the confessional statement which was immediately retracted, there was no other evidence which might establish that the appellant paid the money to 'N' along with interest to his credit which was the charge against the appellant.

There was no evidence showing that the appellant had returned a sum of Rs. 5 Lakhs alongwith interest by making a payment of Rs. 5.60 Lakhs, the appellant very categorically stated that he had not paid any compensatory payment. There was no

evidence to the contrary. No penal action could be taken against him.

### **Section 57 of the Foreign Exchange Regulations Act, 1973 – Certain offences to be non-cognizable**

**Where petitioner obtained judicial order in his favour from appellate forum for not depositing balance amount of penalty and appeal was still pending before higher appellate forum, petitioner could not be held liable for contravening section 57 in not depositing said balance amount**

#### **Amrik Singh Saluja vs. Union of India and Others, May 5, 2009 (Del.)**

In a search under Section 37 of FERA, huge money was recovered and it was revealed that the appellant was indulging in the acquisition and transfer of foreign exchange as well as receiving and making payments in India in accordance with instructions received from abroad. The Adjudicating Authority held the appellant guilty for violation of provisions of FERA and imposed penalty and further ordered the confiscation. The appellant preferred an appeal before the Appellate Tribunal, on the ground that the appellant had a *prima facie* case. The Tribunal dispensed with the pre-deposit of some amount of penalty. Notwithstanding, the respondent filed a complaint under Section 57 before the Magistrate for the non-deposit of the penalty amount. Subsequently, the Appellate Tribunal dismissed the appeal of the appellant. On appeal, the High Court stayed the recovery of the balance amount of Rs. 4.40 lakhs during pendency of the appeal.

The High Court held that the failure on the part of the person concerned to pay the penalty imposed is the *sine qua non* for conviction under the said Section. Such failure, must exist on the date of the filing of

the complaint. In the present case, there was no failure on the part of the petitioner to pay the penalty imposed, for the reason that the Appellate Tribunal itself had waived the deposit of the balance penalty amount, after taking note of the fact that after the passing of the order of the Adjudicating Authority, the petitioner had paid penalty.

It could not be said that an offence under Section 57 had been committed by the petitioner, so as to make the petitioner liable to the penalty imposed by the said section. In fact, the adjudication order was the subject matter of an appeal and during the pendency of the appeal, the Appellate Tribunal had waived the condition with regard to pre-deposit of the balance penalty amount. After the dismissal of the appeal by the Appellate Tribunal also, the High Court had stayed the recovery of the balance penalty amount. Had the adjudication order attained finality, which it had not in view of the appeal pending before the Tribunal, or had the stay granted by the Appellate Tribunal been vacated by a superior Court/Tribunal, the respondents might have been justified in launching proceedings against the petitioner under section 57. The petitioner could not be liable under the provisions of the said section having obtained a judicial order in his favour from the Appellate Tribunal and his appeal being pending before the Tribunal. The act of the petitioner could not be said to be either deliberate or wilful when the Appellate Tribunal itself had waived the penalty amount.

Therefore, no offence under section 57 had been committed by the petitioner until adjudication of pending appeal before the High Court. The petitioner could not be visited with the penal consequences envisaged by the said section.

# CIRCULARS / NOTIFICATIONS

## DIRECT TAXES



### I. Notification

#### 1. Notification No. 70/2009, dated 22-9-2009

The Central Board of Direct Taxes has through this notification made amendment in the notification of the Government of India, in the Ministry of Finance (Department of Revenue), vide S.O. 1281(E) dated the 27<sup>th</sup> July, 2007, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section(ii), with effect from 27<sup>th</sup> July, 2007 (i.e. the date on which the Scheme came into force).

In the said notification for para 5, the following para has been substituted, namely:-

#### 5. Qualifications of an e-Return Intermediary.

(1) An e-Return Intermediary shall have the following qualifications, namely:-

(a) it must be a public sector company as defined in clause (36A) of section 2 of the Act or any other company in which public are substantially interested within the meaning of clause (18) of section 2 of the Act and any subsidiary of those companies; or

(b) a company incorporated in India, including a bank, having a net worth of rupees one crore or more; or

(c) a firm of Chartered Accountants or Company Secretaries or Advocates, if it has been allotted a permanent account number; or

(d) a Chartered Accountants or Company Secretaries or

Advocates or Tax Return Preparers, if he has been allotted a permanent account number; or

(e) a Drawing or Disbursing Officer (DDO) of a Government Department.

(2) The e-intermediary shall have at least class II digital signature certificate from any of the Certifying authorities authorised to issue such certificates by the Controller of Certifying authorities appointed under Section 17 of the Information Technology Act, 2002 (21 of 2000).

(3) The e-intermediary shall have in place security procedure to the satisfaction of e-Return Administrator to ensure that confidentiality of the assessee's information is properly secured.

(4) The e-intermediary shall have necessary archival, retrieval and security policy for the e>Returns which will be filed through him, as decided by e-Return Administrator from time to time.

(5) The e-intermediary or its Principal Officer must not have been convicted for any professional misconduct, fraud, embezzlement or any criminal offence.

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

## INDIRECT TAXES



### A. EXCISE

#### I. Notification:

1. Notification No. 23/2009 CE (NT) dated 25.09.2009 has amended Notification No. 44/2001 CE (NT) dated

26.06.2001 which provides conditions, safeguards and procedures for removal of excisable goods under rule 19 of the Central Excise Rules, 2002.

After sub-para (ix) and before Explanation in the said notification, the following proviso shall be inserted, namely:-

“Provided that this procedure shall also be available for the supplies made by an Advance authorisation holder to a manufacturer holding another Advance authorisation, if such manufacturer, in turn, supplies the resultant products to an ultimate exporter in terms of para 8.3(c) of the Foreign Trade Policy, and the procedure, safeguards and conditions as prescribed in this notification shall apply mutatis-mutandis.”

### II. Circulars:

1. Circular No. 899/19/2009-CX dated 25.09.2009 - Notification No. 05/2006 CE dated 01.03.2006 stipulates that central excise duty at 8% will be charged on ceramic tiles manufactured in a factory not using electricity for firing the kiln on the condition that “if no credit of the duty paid on the inputs used in or in relation to the manufacture of such ceramic tiles has been taken under rule 3 or rule 13 of the CENVAT Credit Rules, 2004”.

Since above notification debars from taking credit on inputs and not on input services. Further input and input services are separately defined in the CENVAT Credit Rules, 2004, and the term ‘input’ does not include ‘input services’. Therefore, it is clarified that taking of credit on input service would not violate the condition of notification.

2. Circular No. 900/20/2009-CX dated 06.10.2009 has been issued to clarify that duty paid packing material for the purpose of rule 20 of the Central Excise Rules, 2002 can be brought into the export warehouse, but exporter

would not be allowed to claim export benefit like rebate for the duty paid on the said packing material.

## B. CUSTOMS

### I. Notification:

**1. Notification No. 112/2009 Cus. dated 29.09.2009** has exempted materials required for the manufacture of the final goods when imported into India, from whole of the duty of customs leviable thereon under the First Schedule to the Customs Tariff Act, 1975 and from the whole of the additional duty, safeguard duty and anti-dumping duty leviable thereon respectively under sections 3, 8B and 9A of the Customs Tariff Act, except to the extent and subject to such condition specified in the notification itself.

### II. Circular:

**1. Circular No.25/2009-Cus dated 29.09.2009** has been issued to extend the facility of re-export. In case where the goods imported against TPS / DFCE / FMS / FPS / HTPEPS/ SHIS/Agri Infrastructure Incentive scheme under VKGUY found defective or unfit for use, such goods may be permitted to be re-exported by the Commissioner of Customs subject to the conditions specified in the circular itself.

In this case, 98% of the credit amount debited in the above said duty credit scrips shall be generated by the concerned Custom House in the form of a certificate.

The complete text of the above notifications and circulars on Excise and Customs can be referred/ downloaded from the website [www.cbec.gov.in](http://www.cbec.gov.in)

## C. SERVICE TAX

### I. Notifications:

**1. Notification No. 39/2009 ST dated 23.09.2009** has exempted the taxable service specified in clause 105 (zzb) of section 65 of the Finance Act, provided by a person to any other person during the course of manufac-

ture or processing of alcoholic beverages by the service provider, for or on behalf of the service receiver, from so much of value which is equivalent to the value of inputs, excluding capital goods, used for providing the same service, subject to the following conditions, namely:-

- a) that no Cenvat credit has been taken under the provisions of the Cenvat Credit Rules, 2004;
- b) that there is documentary proof specifically indicating the value of such inputs; and
- c) where the service provider also manufactures or processes alcoholic beverages, on his or her own account or in a manner or under an arrangement other than as mentioned aforesaid, he or she shall maintain separate accounts of receipt, production, inventory, despatches of goods as well as financial transactions relating thereto.

Further, it has been clarified that the words or phrase 'input', or as the case may be, 'capital goods' shall have the meaning as is assigned to them under rule 2 of the Cenvat Credit Rules, 2004.

**2. Notification No. 40/2009 ST dated 30.09.2009** has amended Notification No. 17/2009 ST dated 07.07.2009, which exempts certain specified taxable services received by an exporter and used for export of goods. Service received by an exporter and used for export of goods have also been exempted vide this notification subject to fulfilment of conditions specified therein.

"Service provided for transport of export goods through national waterway, inland water and coastal shipping".

### II. Circular:

**1. Circular No. 116/2009-ST dated 15.09.2009** has been issued to clarify the following points:

Issue I – Whether service tax is leviable on construction of canals for Government projects?

Clarification: Since canal system built by the Government or under Government projects, does not falling under commercial activity, the canal system built by the Government will not be chargeable to service tax. However, if the canal system is built by private agencies and is developed as a revenue generating measure, then such construction should be charged to service tax.

Issue II – Whether service tax is leviable on construction of dams, buildings or infrastructure construction etc. through EPC (Engineering Procurement & Construction) mode?

Clarification: This service is covered under Section 65(105) (zzza) of Finance Act, 1994. The said section itself excludes works contract in respect of dams, road, airports, railways, transport terminals, bridges & tunnels executed through EPC mode. Hence works contract in respect of above works even if done through EPC mode are exempt from payment of service tax.

The complete text of the above Service Tax notifications can be referred/downloaded from the website [www.servicetax.gov.in](http://www.servicetax.gov.in)

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

## CORPORATE LAWS



### 1. Introduction of interest rate futures- NBFCs

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

The RBI has issued Circular No. **DNBS.PD.CC.No.161 /3-10.01/ 2009-10** dated 18.09.2009 whereby it has been decided that NBFCs (Non-Banking Financial Companies) may

participate in the designated interest rate futures (IRF) exchanges recognised by SEBI, as clients, subject to RBI / SEBI guidelines in the matter, for the purpose of hedging their underlying exposures. It is also provided in the Circular that NBFCs participating in IRF exchanges may submit the data in this regard half-yearly, in the format enclosed to the Circular, to the Regional office of the Department of Non-Banking Supervision in whose jurisdiction their company is registered, within a period of one month from the close of the half year. Please refer to the above website for further details.

## 2. KYC/AML guidelines for multi level marketing firms

[www.mof.nic.in](http://www.mof.nic.in)

The Financial Intelligence Unit (FIU-IND), Department of Revenue, Ministry of Finance, Government of India has issued Circular No. UBD. CO. BPD. PCB.Cir. No.9/12.05.001/2009-10 dated 16.09.2009 informing banks that they should be careful while accounts are opened by some seven concerns which are listed in the above referred Circular and the banks should ensure that the Know Your Customer / Client (KYC) and Anti Money Laundering (AML) norms are strictly adhered to. This was done in view of these concerns' attempts to raise deposits from public promising high returns by releasing advertisements in the media and on the internet. Also, it is advised that in cases where accounts have already been opened in the names of the marketing agencies, retail traders, investment firms, the banks may undertake quick reviews and wherever large number of cheque books has been issued to such firms, the relative decision may be reviewed considering the fact as to whether the cheque books have been issued to customers on the basis of their express request and after following the internal processes laid down in the matter and whether the number of cheque books is consistent with / matching the profile of the customers as also their nature of business operations. Please refer to the above website for further details.

## 3. Prior approval of RBI for acquisition / transfer of NBFCs

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

The RBI has issued Circular No. DNBS (PD) CC.No. 160/03.10. 001/2009-10 dated 17.09.2009 stating that in terms of the provisions of Section 45-IA(4)(c) of the RBI Act, 1934, a certificate of registration can only be given to a company if the Bank is satisfied, *inter alia*, that the general character of the management or the proposed management of the non-banking financial company shall not be prejudicial to the public interest or the interests of its depositors. It is now clarified that to enable the RBI to verify that the 'fit and proper' character of the management of NBFCs is continuously maintained, any take over/acquisition of shares of a deposit taking NBFC or



merger/amalgamation of a deposit taking NBFC with another entity or any merger/amalgamation of an entity with a deposit taking NBFC that would give the acquirer/another entity control of the deposit taking NBFC, would require prior permission of RBI. Applications in this regard may be submitted to the Regional Office of the Department of Non-Banking Supervision in whose jurisdiction the registered office of the company is located. Please refer to the above website for further details.

#### 4. Payment of Interest on Savings Bank Account on a Daily Product Basis

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

The RBI has issued Circular No. RPCD.CO.RRB.BC.No. 25/03.05.33/2009-10 dated 24.09.2009 whereby interest on savings accounts with banks which hitherto was calculated considering the minimum balance to the credit of the deposit account during the period from the 10<sup>th</sup> to the last day of each calendar month which will now be calculated on a daily product basis with effect from April 1, 2010. Please refer to the above website for further details.

#### 5. Filing of offer documents with SEBI under ICDR Regulations

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

The SEBI has issued Circular No. SEBI/CFD/ICDRR/2/2009/29/09 dtd. 29.09.2009 in relation to the recently issued SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations) which provided in sub-regulations (1) and (4) of regulation 6 and sub-regulation (2) of regulation 10 of the ICDR Regulations that an issuer making a public issue or rights issue (where the aggregate value of specified securities offered is fifty lakh rupees or more) is required, *inter-alia*, to file a draft offer document or an offer document, as the case may be, with the Board at various points of

time. It is now advised to merchant bankers that they may file the draft offer documents or offer documents with a particular office of the SEBI based on the estimated issue size as indicated in the above Circular. Also, the merchant bankers are advised to file five copies of the draft offer documents or offer documents with the office indicated in the above Circular. Please refer to the above website for further details and the locations where the offer documents may be filed.

#### 6. Statement of additional information (SAI) & Scheme Information Document (SID) to be made available on SEBI website

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

The SEBI has issued Circular No. SEBI/IMD/CIR No. 10/178129/09 dated 29.09.2009 informing that presently draft SID is placed on the SEBI website for public comments and with a view to make SEBI website as a central database for SAI and SID, AMCs shall henceforth submit, (a) a soft copy of SAI within 7 days of issuance of this circular, and, (b) soft copy of SIDs along with printed / final copy, two working days prior to the launch of the scheme. The soft copies of these documents shall be submitted to SEBI in PDF format. Also, in continuation with the current practice of uploading the SAI on AMFI website, AMCs shall also upload the soft copy of SID on AMFI website two working days prior to the launch of the scheme. The AMCs shall also submit an undertaking to SEBI while filing the soft copy of these documents certifying that the information contained in the soft copy of SID and SAI (as applicable) to be uploaded on SEBI website is current and relevant and matches exactly with the contents of the hard copy and that AMCs shall be fully responsible to the content of the soft copy of SID and SAI. Please refer to the above website for further details.

#### 7. Prior approval for recommending trading on the Stock Exchange

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

The SEBI has issued Circular No. MRD/DSA/SE/Cir-12/09 dated 07.10.2009 in relation to the 20 recognised stock exchanges in India for which it has been observed that some of the stock exchanges have no trading over the past several years. With the completion of corporatisation and demutualisation of stock exchanges, some of the stock exchanges have generated renewed trading interest and are in the process of resuming trading for reviving the stock exchange and since these stock exchanges have no trading activity for quite some time, the regulatory changes introduced by SEBI in the interim may not have been complied with. A fact that was considered by SEBI was that a stock exchange is required to have adequate and effective trading systems, clearing and settlement system, monitoring and surveillance mechanisms, risk management systems, etc. the resumption of trading activity without basic infrastructure may not be in the interest of investors/trade. Hence, it is now clarified that stock exchanges that have no trading for a period of six months or more shall resume trading only after ensuring that adequate and effective trading systems, clearing and settlement systems, monitoring and surveillance mechanisms, risk management systems are in place and have also complied with all other regulatory requirements stipulated by SEBI from time to time and that the stock exchanges shall resume trading only after obtaining prior approval from SEBI. One may refer to the above website for further details.

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

## DISCIPLINARY CASE

*Summary of a disciplinary case - Council of the Institute of Chartered Accountants of India vs. Shri R.K.Tayal & Anr.<sup>1</sup> (Chartered Accountant Reference No. 3 of 2005) decided on 23.07.2007 by the High Court of Delhi, New Delhi under Section 21 (5) of the Chartered Accountants Act, 1949.*

### Facts of the case:

Shri Thampy Mathews, DGM, Industrial Investment Bank of India, New Delhi (hereinafter referred to as the "Complainant") filed a complaint against Shri R.K.Tayal, Chartered Accountant, M/s. R.K. Tayal & Associates (hereinafter referred to as the "Respondent") under Section 21 of the Chartered Accountants Act, 1949 (hereinafter referred to as the 'Act') to the Institute of Chartered Accountants of India (hereinafter referred to as the 'Institute') alleging, *inter alia*, that the Complainant-bank sanctioned a term loan of Rs.630 lakhs to M/s. Haryana Steel & Alloys Ltd., Sonipat, Haryana (hereinafter referred to as the Company) for its expansion cum modernisation project. As per terms and conditions of sanction, the Company was to bring in 100% of the promoters' contribution (Rs. 270 lakhs) by way of internal accruals and actually bring in atleast 50% of the same. While requesting for disbursement of the sanctioned amount, the Company stated that it had already spent Rs. 147.21 lakhs for the project till that time and in support thereof, the Company submitted a certificate issued by the Respondent-firm stating that the Company has already spent Rs.147.21 lakhs for the project till that time including an amount of Rs.6.61 lakhs paid to the Complainant-bank. Based on the aforesaid certificate of the Respondent-firm, the Complainant-bank disbursed an amount of Rs.315 lakhs in two instalments (Rs.200 lakhs vide letter dated 19.2.1998 and Rs.115 lakhs vide letter dated 23.2.1998) to the Company being 50% of the sanctioned amount and advised it to submit a utilisation certificate. The Company, after vigorous follow up, submitted a certificate dated 26.12.1998 issued by the Respondent-firm certifying the funds utilised by the Company out of the loan of Rs.315 lakhs received from the Complainant's bank. In the said certificate, an amount of Rs.6,61,500/- has also been shown as amount paid to the Complainant's bank for up front fee, while the said amount was received from the funds inducted by the promoters before disbursement of the said loan amount. Further, it was mentioned that an amount of Rs.12,55,117/- and also Rs.7,25,346/- had been paid to the

<sup>1</sup> For full text of the Judgment please see Institute's publication viz. Disciplinary Case Vol.IX, PartI, p. 268 or visit Editorial Board page at [http://www.icai.org/post.html?post\\_id=967&c\\_id=59](http://www.icai.org/post.html?post_id=967&c_id=59)

Complainant-bank for interest on loan of Rs.315 lakhs upto 14.5.1998 and for the period from 15.5.1998 to 30.6.1998. The aforesaid two amounts were however never received by the Complainant-bank. The charges alleged against the Respondent as per the complaint were that (a) the Respondent had not verified the records properly before issuing the aforesaid certificates dated 10.2.1998 and 26.12.1998 and (b) the said certificate did not reflect the end use of the funds.

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 and those produced at the time of hearing, upon recording the evidence and hearing the submissions made by the Complainant, came to the conclusion that the Respondent was guilty of professional misconduct falling within the meaning of Clauses (5), (6), (7) and (8) of Part I of the Second Schedule read with Sections 21 and 22 of the Chartered Accountants Act, 1949. However, the Respondent was not found guilty under Clause (2) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

The Council on consideration of the Report of the Disciplinary Committee, along with the written representation & oral submissions made by the Complainant, accepted the report of Disciplinary Committee and found that the Respondent was guilty of profes-

sional misconduct falling within the meaning of Clauses (5), (6), (7) and (8) of Part I of the Second Schedule read with Sections 21 and 22 of the Chartered Accountants Act, 1949 and not guilty of professional misconduct falling within the meaning of Clause (2) of Part I of the Second Schedule to the Chartered Accountants Act, 1949. The Council decided to recommend to the High Court that the name of the Respondent be removed from the Register of Members for a period of three months. As required under Section 21(5) of the Act, the matter was forwarded to the Delhi High Court with the recommendations of the Council.

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

#### **Decision of the Hon'ble Court:**

The Hon'ble Court observed that the Respondent had been grossly negligent in issuing the certificates dated 10.02.1998 and 26.12.1998 and he was very much aware of the purpose for which the certificate were being issued. Based on these certificates of Respondent, the Complainant-bank had disbursed an amount of Rs. 315 lacs to the Company. As per certificate dated 26.12.1998 a sum of Rs. 6.61 lacs had already been shown as amount paid to the Complainant-bank for up front fee while the said amount was received from funds inducted by the promoters before disbursement of the said amount. Further, it was mentioned that sum of Rs. 12,55,117/- and also Rs.

7,25,348/- had been paid to the Complainant-bank for interest of loan of Rs. 315 lacs but in fact the aforesaid two amounts were never received by the Complainant-bank. So the Respondent did not verify the record properly before issuing the certificates dated 10.02.1998 and 26.12.1998 and these certificates did not reflect the end use of the funds.

The Hon'ble Court also observed that the lack of responsibility displayed by Respondent clearly shows that he had acted in a manner unbecoming of a Chartered Accountant and the Hon'ble Court agreed with the conclusion of the Council recommending the removal of name of Respondent from the register of its members for a period of three months. The Hon'ble Court while examining the issue whether the punishment is justifiable in this case or not found that there has to be some degree of integrity and probity which is expected of a Chartered Accountant who is regularly concerned with financial transactions and on the basis of whose recommendations and certificates, financial institutions such as banks etc. disburse loans or enter into other financial transactions. Under the circumstances, the Court was of the view that the punishment awarded to the Respondent was not unduly harsh.

On overall consideration of the matter, the Hon'ble High Court accepted the finding & recommendation of the Council and ordered that the name of the Respondent be removed from the register of members for a period of three months.

## Revenue recognition from sale of WEGs, and providing installation, commissioning and other related services

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

### A. Facts of the Case

1. A company is engaged in the business of manufacture, erection and commissioning of Wind Electric Generators (WEGs). The company is also engaged in the business of providing sales services for the WEGs besides earning revenue from generation of electricity from its own WEGs.

2. Based on negotiations by the company, the customers agreeing to place orders with the company, issue the following three separate Purchase/Work Orders (a copy each of the formats for these orders have been furnished by the querist for the perusal of the Committee):

- (i) Purchase Order for supply of WEGs.
- (ii) Work Order for civil, electrical and infrastructure work.
- (iii) Order for erection and commissioning of WEGs.

3. The company has been recognising revenue based on the completion of an activity covered in the above-mentioned three Purchase/Work Orders separately. As per the querist, the reasons for taking this view are the following:

- (i) Each activity is an independent activity governed by a separate Purchase/Work Order.
- (ii) Each Purchase/Work Order has a different payment schedule.
- (iii) The taxes, as applicable for each Purchase/Work Order, are different and are deposited by the company on completion of the specific activity of the said Purchase/Work Order.
- (iv) Accounting Standard (AS) 9, 'Revenue Recognition', requires that the amount of revenue arising on a transaction is usually determined by an agreement between the parties involved in

the transaction. The company enters into separate Purchase/Work Orders and hence, complies with the requirement.

- (v) AS 9 requires that the key criterion to recognise revenue from a transaction involving the sale of goods is that the seller has transferred the property to the buyer for a consideration.

4. As per the querist, the accounting policy now suggested by the company for adoption in respect of revenue recognition is as under:

#### "Revenue Recognition

- Revenue comprises sale of WEGs and its spare parts, project income being installation and commissioning of WEGs, income from maintenance services, power generation from own WEGs and interest income. Revenue is recognised to the extent it is probable that the economic benefits will flow to the company and that the revenue can be reliably measured and is expected to be received. Revenue is disclosed net of taxes.
- Sale of WEGs and spare parts are recognised when the significant risks and rewards in respect of ownership of goods have been transferred to the buyer as per the terms of the respective sale orders. Income from project involving installation, commissioning and other incidental works is recognised on completion of the respective work, as per the terms of the work orders.
- Revenue from annual maintenance contracts is recognised on a proportionate basis over the period of the contract on a straight line basis. Income from support services is recognised upon completion of the services.

- Power generation income is recognised on the basis of electricity units generated, net of wheeling and transmission loss.
- Interest income is recognised on a time proportion basis."

5. The querist has informed that the time required for supply of WEGs, completion of civil, electrical and infrastructure works and erection and commissioning normally varies between 4 to 6 months from the date of receipt of purchase order by the company. The period may vary depending on the total capacity of the project and the location of the project. The querist has stated that there are certain situations when part of the activities are completed as at the end of the financial year, e.g., as on March 31, only delivery of WEGs takes place while all other activities, i.e., installation, erection and commissioning gets shifted to the next financial year. Insofar as the company is concerned, major cost of the project is already incurred by the company and supply of WEGs is completed as per supply order and accordingly, as per the querist, it should be possible to fully book the revenue of the same as on 31<sup>st</sup> March. The querist has stated that it has been indicated to the company that if revenue for supply of WEGs is to be booked, a letter be obtained from the customer certifying receipt of WEGs and confirming that risks and rewards in respect of ownership of goods have been transferred to the customer.

6. The querist has further stated that the following background needs to be kept in view with respect to the requirement of obtaining the above-mentioned letter:

- (a) The policy followed by the

company is that after manufacturing the WEGs, these are transferred by the company on a stock transfer basis to a particular site in a particular State and as and when order is received by the company from any customer, the WEGs are allocated to that customer and invoice is raised from that particular site and State in the name of the customer. The WEGs after allocation continue to be in the possession of the company for installation, erection and commissioning. The site is handed over to the customer after commissioning of the WEGs.

- (b) Since the WEGs are taken over by the customer after commissioning along with relevant papers at site, there is reluctance on the part of the customer to give any kind of letter confirming passing of significant risks and rewards in respect of ownership of goods prior to that stage. It is, however, a fact that WEGs are installed at remote sites, where no representative of the customer is present and as such question of obtaining any letter is, therefore, difficult. On the company's part, it is important to recognise revenue as manufactured goods leave the premises and are invoiced in the name of the customer as on 31<sup>st</sup> March.

**B. Query**

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

- (a) Whether the accounting policy for revenue recognition presently suggested to the company is in line with AS 9 or any change is required to be made.
- (b) Whether the company can adopt the policy on revenue recognition independently for all the three orders, without insisting on obtaining a letter from the customers regarding transfer of significant risks and rewards, on account of peculiar nature of the situation.

**C. Points considered by the Committee**

8. The Committee notes that the basic issue raised by the querist relates to whether the accounting policy suggested to the company in respect of recognition of revenue from sale of WEGs and performance of related activities, such as, installation, erection and commissioning in respect thereof is in order. The Committee has, therefore, considered only this issue and has not touched upon any other issue that may be contained in the Facts of the Case, such as, revenue from sale of spare parts, generation of electricity, annual maintenance contract, support services, interest income, etc. Further, the Committee has not examined the accounting for cost of land, path way rights etc. as mentioned in the format for work order for civil, electrical and infrastructural work as the adequate details in respect of the same have not been provided.

9. The Committee notes from the Facts of the Case that the querist has stated that based on negotiations by the company, the customers agreeing to place orders with the company issue three separate purchase/work orders for supply of WEGs and related activities, implying that there are common negotiations for all the three orders. Further, on a perusal of the formats for the said three orders, the Committee notes that the activities performed under the three orders are inter-connected and for all the three orders, commissioning of the WEG is an essential part. From the above, the Committee is of the view that the three separate contracts entered into by the company with its customers are in fact one composite contract which has been broken into three separate agreements.

10. The Committee further notes from the Facts of the Case that the WEGs are manufactured by the company and kept in stock for allocation to the customers upon

receiving an order. Further, as stated by the querist, as far as the company is concerned, the major cost of the project is incurred up to the supply of the WEGs. Accordingly, in the view of the Committee, the contract in the present case basically relates to sale of WEGs.

11. The Committee notes the following paragraphs from AS 9 which provide as below:

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

**“10. Revenue from sales or service transactions should be recognised when the requirements as to performance set out in paragraphs 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.**

**11. In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:**

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

12. The Committee notes from the above that in the instant case, the performance in respect of sale of WEGs is not complete until the commissioning of the WEGs as commissioning is an essential part of all the agreements. The company retains its effective control over the WEGs till the handing over thereof to the customer after commissioning. The Committee is of the view that mere allocation of WEGs to a particular customer/site, or raising of invoice in the name of customer, or delivery of WEGs at the customer's site, do not result in transfer of significant risks and rewards relating to ownership of goods. In this connection, the Committee wishes to point out that the reluctance on the part of the customer to give any kind of letter confirming passing of significant risks and rewards in respect of ownership of goods before commissioning and handing over of the WEGs to the customer, also gives an indication that significant risks and

rewards of ownership of goods do not pass to the customer before commissioning of WEGs. Thus, revenue in the present case should be recognised only on the commissioning of the WEGs. Accordingly, in the view of the Committee, the accounting policy of the company in respect of recognition of revenue from sale of WEGs and performance of various activities, such as, erection, installation, commissioning and other incidental works, on completion of the respective activities as per the terms of the respective purchase/work order is not correct and the same should be rectified on the lines discussed above.

13. As regards obtaining a letter of confirmation from the customer with respect to passing of the significant risks and rewards of ownership, the Committee is of the view that although AS 9 does not contemplate obtaining such a confirmation, the auditor, while gathering audit evidences can consider obtaining such confirmations.

#### **D. Opinion**

14. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 7 above:

- (a) Subject to paragraph 8 above, the accounting policy for revenue recognition presently suggested to the company is not in line with AS 9 and the same should be rectified on the lines discussed in paragraph 12 above.

- (b) No, the company cannot adopt the policy on revenue recognition independently for the three orders as these form part of a single composite contract as discussed in paragraph 9 above. As regards obtaining a letter from the customers regarding passing of significant risks and rewards of ownership, refer paragraph 13 above.

#### **Notes:**

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

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

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

4. Recent opinions of the Committee are available on the website of the Institute at URL: [http://www.icaai.org/category.html?c\\_id=146](http://www.icaai.org/category.html?c_id=146)

# Intellectual Capital Reporting- An Overview

It has become well accepted that a significant portion of the value of an organisation lies in its intangibles. The failure of financial reports to provide adequate information to both existing and prospective investors on all aspects of the organisation particularly the intangible resources obstructing effective investment valuing and decision making has necessitated the need for alternative reporting systems. This article discusses the forces and barriers to the growth of intellectual capital (IC) reporting and provides a brief sketch of the initial intellectual capital reports.



**CA. (Dr.) Shital Jhunjunwala**

*The author is the member of the Institute  
and Assistant Professor,  
Institute of Public Enterprise.  
She can be reached at  
eboard@icai.org*

**V**alue of a firm is based on the markets expectation which in turn depends on the information available to current investors and prospective investors about the firm. The purpose of the annual report is to inform all stakeholders, including the shareholder and the potential stakeholders. For this reason, instead of merely providing the financial condition of the enterprise it should inform what would likely be of interest to the users. Traditional reporting systems provide information on tangible assets but provide nil or limited information on intangible assets like human assets, market assets, organisational capital, relationships with suppliers and customers who are the real wealth creators in an organisation. An understanding of the investment and exploitation of intellectual capital by a company will enable the

investment community to recognise an apt value of the company.

The inadequacy of the existing financial reporting system for capital markets and other stakeholders has led to an incessant search for new ways to measure and report on a company's intellectual capital, resulting in a plethora of new measurement approaches that combine traditional (financial) and intellectual (non-financial) information of the company into one external report.

### Intellectual Capital Statement

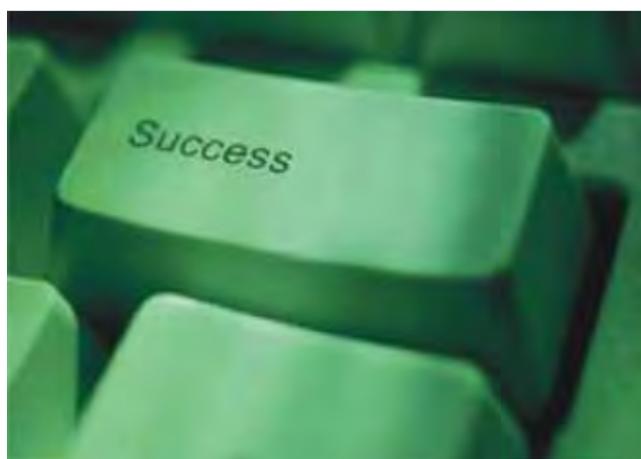
What is an intellectual capital statement? The intellectual capital statement underpins the development of the future value of the company, and consequently its competitiveness in the knowledge economy (DATI 2000). It states the company's ability to acquire and exploit intangible resources for ensuring current performance and its continuous efforts in obtaining, developing and retaining, intangible assets required to ensure sustainability and future growth and success. Its merits lie in expressing the company's strategy for what it must excel at in order to deliver satisfactory products or service (DATI 2001). Intellectual Capital (IC) reporting supports the re-integration of several approaches governing today's companies' management as shown in Figure 1.

### Impetus for Disclosing Intangible Assets

Despite regulators being in the process of establishing mandates on the disclosure of

financial and non-financial information by the companies in their financial statements, companies are voluntarily and frequently reporting more information about their intangibles as they recognise that they will derive economic benefits from an effectively managed disclosure policy.

Primarily, the inclusion of IC statements would result in annual reports describing the value of the company more realistically and displaying all relevant assets from which the company expects to obtain benefits in the coming years. They may enable investors and other relevant stakeholders



It states the company's ability to acquire and exploit intangible resources for ensuring current performance and its continuous efforts in obtaining, developing and retaining, intangible assets required to ensure sustainability and future growth and success.

**Figure 1: IC Reporting supports the re-integration of several approaches governing today's companies management.**



Source: [http://www.execupery.com/dokumente/Intellectual\\_Capital\\_Reporting.pdf](http://www.execupery.com/dokumente/Intellectual_Capital_Reporting.pdf)

to assess the firm's future wealth creation capabilities in a better way.

Further, with increased transparency on IC-related information, stakeholders are better equipped to estimate the applicable risk associated with the company, and as a consequence, the firm's cost of capital declines.

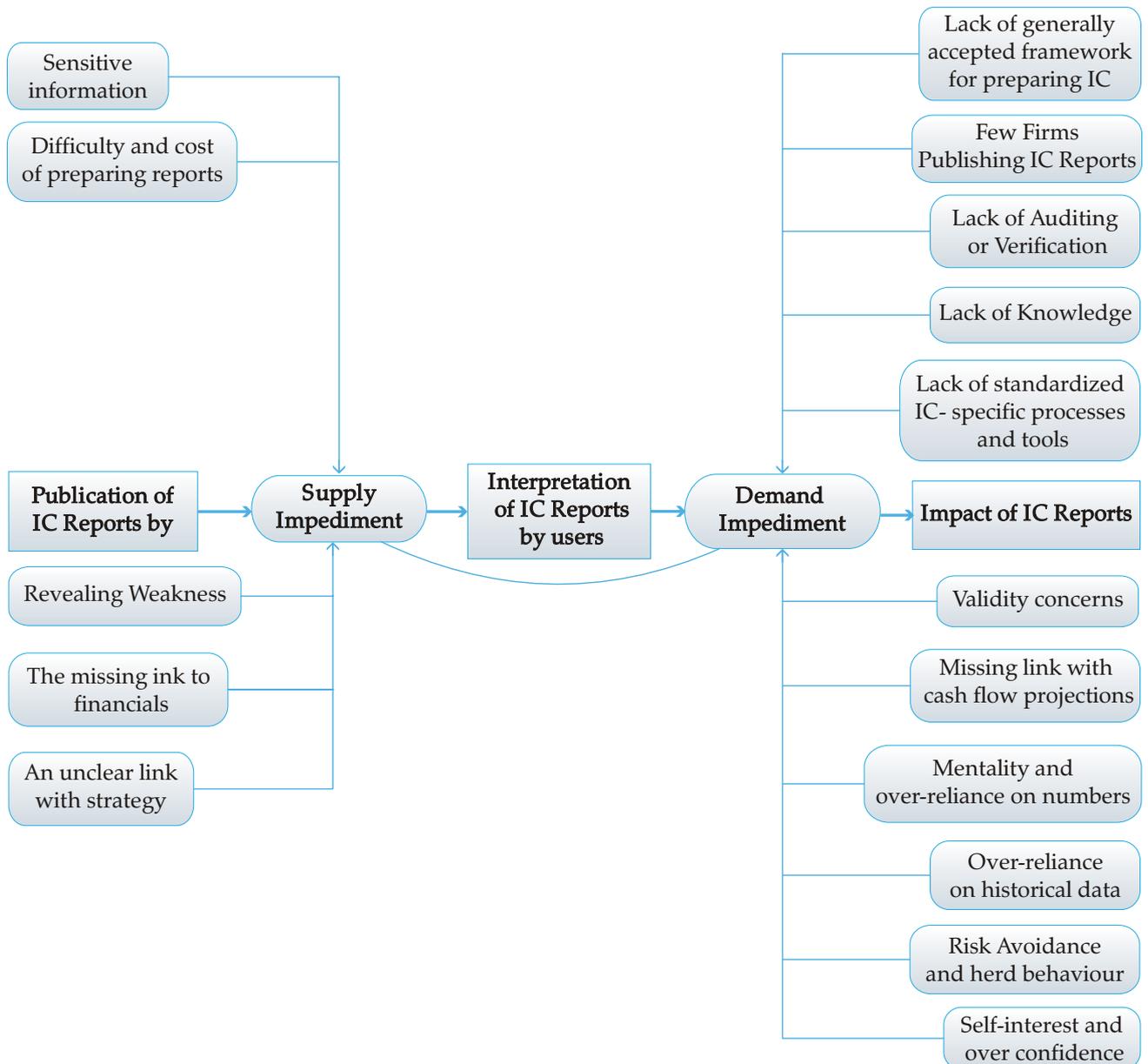
When companies choose not to disclose information regarding the presence of intangibles, it leads to an asymmetry of understanding of the firm between the management and the users of the financial statements. This asymmetry makes the company more vulnerable to insider trading'. (Vergauwen and Alem, 2005)

### Impediment to Disclosing Intangible Assets

Even though it has become well accepted that intangible assets are the value drivers of any organisation and its related information is gaining importance in investment decision making, IC statements are still to come in a big way. The exchange of corporate information can be conceptualised as a market, where the demand side consists mainly of investors and financial analysts and the supply side comprises the firms. According to Jose 'Guimo'n (2005), 'In this market, there are both supply and demand barriers that reduce the impact of IC reports'. Please refer Figure 2.

Given is a list of supply and demand barriers

**Figure 2: Impediments that limit the impact of IC reports in capital markets**



(modified from the one provided by Jose´ Guimo´n) that are often closely connected to each other.

**(1) Supply impediments** (i.e. those related to the way in which firms communicate information on intangibles to capital markets):

1. *Sensitive Information.* An important barrier to IC disclosure is the costs of revealing strategic information to competitors. Since information disclosed in the annual report is public, unveiling sensitive information could wipe out their competitive advantage.
2. *Difficulty and Cost of preparing report:* Sometimes firms perceive preparing IC statements as overburden of reporting in terms of difficulty to prepare them or because they consider the time and cost associated with preparing and publishing IC reports to be too high.
3. *Revealing Weakness:* Disclosure of a firm's poor intellectual capital position may signal the need of the firm's stakeholders to acquire new financing or divert cash flows from current investments or debt repayment. Awareness of a firm's poor intellectual capital standing could spur financial investors to stop future investment funds or the demand for the return of current financing arrangements (Williams, 2001).
4. *The missing link to financials:* The ultimate aim of management is to maximise wealth of the shareholders which is always expressed in financial terms. IC statements fail to provide this financial link between intangibles and wealth creation.
5. *An unclear link with strategy:* One of the prime benefits of IC statements is that they provide the linkage between the firms strategy and present and future performance. IC reports currently published by firms often fail at establishing a clear link between the firm's strategic goals and its intangible resources and activities. The importance of this link is clearly emphasized in the MERITUM (2002) Guidelines.' (Jose´ Guimo´n, 2005)

**2) Demand impediments** (i.e. those related to

financial analysts and users understanding of intangibles):

1. *Lack of a generally accepted framework for preparing IC reports:* The language, formation and indicators contained in IC reports are very heterogeneous across firms. The vast variability in IC reporting by different firms even within the same industry confuses users and makes comparison attempts a futile exercise.
2. *Few Firms Publish IC Reports:* While the number of firms that publish IC reports is on a continuous rise, the absolute numbers are still few and far between. The reports, therefore, cannot be used to set industry standards and comparisons useful for investment decision.
3. *Lack of auditing or verification:* IC report is normally not subject to external auditing or verification, which raises doubts on its authenticity.
4. *Lack of knowledge:* Analysts fail to understand the impact of intangibles on value creation, partly because they have not been trained for it and partly because they lack specific tools to analyse intangibles. They are not used to interpreting IC reports.
5. *Lack of standardised IC-specific processes and tools:* Investment banks, credit rating agencies and other financial institutions rarely provide comprehensive tools and techniques for evaluating IC in their analytical process. While intangibles are perceived as important, they are generally analysed in an intuitive, unstructured way.
6. *Validity concerns:* The validity (are the indicators useful to measure what they try to measure?) of indicators provided by firms in IC reports is also questioned. Further, as disclosures are completely voluntary, firms would tend to publish only the positive data while hiding the information that could have a negative impact.
7. *Missing link with cash flow projections:* Ultimately, the aim of studying these reports is to assess future performance. Thus, IC should help analysts arrive at closer estimates of the firm's future cash flows. IC reports should aim at

persuading analysts to increase their cash flow forecasts or reduce the perceived volatility of such

Primarily, the inclusion of IC statements would result in annual reports describing the value of the company more realistically and displaying all relevant assets from which the company expects to obtain benefits in the coming years.



estimations. However, IC reports rarely establish adequate connections with cash flow projections.

8. *Mentality and over-reliance on numbers:* Analysts consider themselves to be more rational than the rest of people. They have a preference for numbers over qualitative information because quantitative data is considered more real and objective allowing a rational analysis.
9. *Over-reliance on historical data:* Financial analysts frequently argue that there is no better indicator of the quality of a firm's IC than its past financial performance. Good financial results are possible only by appropriately leveraging intangible assets.
10. *Risk avoidance and herd behavior:* To avoid risk, analysts follow the accepted general practices. The lack of reliable and understandable information on intangibles increase the perception of risk. If they follow their employer's standard valuation processes, they cannot be blamed for providing inaccurate estimates. However, if they rely on qualitative information (or on IC indicators), they risk being penalised by their employers.
11. *Self-interest and overconfidence:* Financial analysts and financial institutions generally favour private channels over public channels when it comes to evaluating firms' intangibles and are not interested in information on intangibles published by firms through IC reports because they have already developed alternative channels for gathering such kind of

information. These alternative channels are seen as a competitive advantage over other market participants, in the sense that they can provide a privileged market position. If public IC information and methods for analyzing IC reports improved, financial institutions fear they could eventually lose that privileged position.

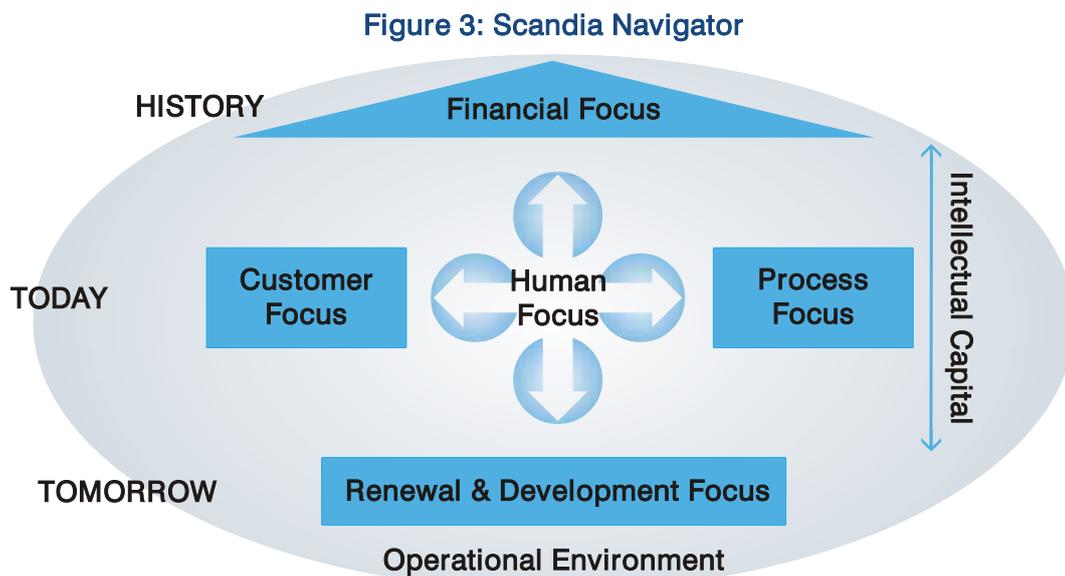
### The Birth of World's First Intellectual Capital Report

The first intellectual capital report was born in 1994. Its 'father' was *Leif Edvinsson* at *Skandia*, and its birth constituted a huge milestone in the field of intellectual capital. (Pablos, 2005)

Leif Edvinsson in May 1995 published the first public Intellectual capital annual report, as a supplement to the financial report for Skandia, the largest insurance and financial company in Scandinavia. Leif Edvinsson, the chief architect behind Skandia's initiative, developed a dynamic and holistic IC reporting model called the Navigator. The Scandia Navigator (Figure 3) tries to measure intangibles and provide a more balanced reporting for the knowledge economy.

At the heart of the model is the idea that the true value of a company's performance lies in its ability to create sustainable value by pursuing a business vision and its resulting strategy. From this strategy one could determine certain success factors that should be maximised. These success factors could thus be grouped into four distinct areas of focus:

**Financial focus** of the Skandia Navigator



Source: [www.valuebasedmanagement.net](http://www.valuebasedmanagement.net)

An important barrier to IC disclosure is the costs of revealing strategic information to competitors. Since information disclosed in the annual report is public, unveiling sensitive information could wipe out their competitive advantage.



captures the financial outcome of our activities. Some like to see it as a receipt. It is here that the long-term goals and also a larger part of the overall conditions for the other perspectives are established. This could be profitability and growth that our shareholder demands from us.

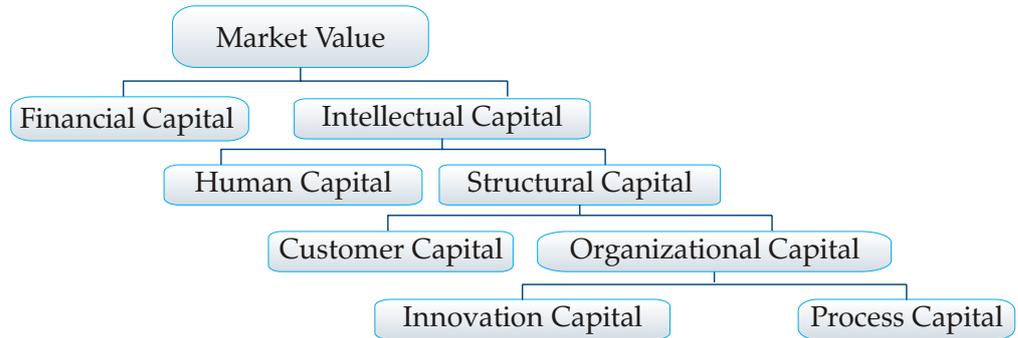
**Customer focus** of the Skandia Navigator (intangibles valuation) gives an indication on how well the organisation fills the needs of its customer *via* services that go from the outside looking in. It is of importance that we define customers' needs.

**Process focus** of the Skandia Navigator (intangibles valuation) captures the actual processes of creating services and products the customers desire. It covers questions like how do we handle our customer support? This focus area is also connected to the internal processes. Are we

working in an efficient way? Are we working in correct manner? Connected to this could be the importance of structural capital.

**Renewal and development** of the Skandia Navigator (intangibles valuation) aims at reassuring the organisations, long-term renewal and in part its sustainability. What steps and actions are we taking now to ensure long-term growth and profitability? What is required to attain and develop the knowledge needed to perceive and satisfy our customer needs?

**Human focus** of the Skandia Navigator (intangibles valuation) is the heart of the organisation and is essential in a value creating organisation. The process of knowledge creation is visualised in this focus area. It is also essential that employees are pleased with their work situation

**Figure 4: The Skandia Market Value Scheme**

Source: Leif Edvinsson & Michael S. Malone, *Intellectual Capital: Realizing your company's true value by finding its Hidden brainpower*, New York: Harper Business, 1997

and conditions; pleased employees lead to pleased customers, improving the company's sales and result.

The Skandia Navigator (intangibles valuation) is collection of critical measurements that all comprise a holistic view of performance and goal achievement. The architecture of the Skandia Navigator is simple yet very sophisticated. Five focus areas or perspectives capture different areas of interest. Each area visualises the value creation process. The Skandia Navigator facilitates a holistic understanding of the organisation and its creation along five focus areas.

The Skandia IC report uses 91 new IC metrics plus 73 traditional metrics to measure these 5 areas. Edvinsson and Malone while suggesting that

relevance and importance may vary for each organisation recommend 112 metrics for a universal IC report which includes direct count, dollar amount, percentage and even survey results.

The value of a company is measured using the Skandia Market Value Scheme (figure 4).

### The First Generation Reports

In and around 1997 most of the pioneer firms published their first intellectual capital report. Mainly they are from Denmark, Sweden, Spain and India. These pioneer firms decided to assume the challenges of building intellectual capital reports without the existence of intellectual capital guidelines. Three big Indian companies published their first intellectual capital report in 1997. These firms are: Balrampur Chini Mills Limited, Reliance Industries Limited and Shree Cement Limited (Pablos, 2005). Principal among the new reporting models is the Intangible Asset Monitor (Sveiby, 1997) and the Intellectual Capital Accounts (Danish Agency for Trade and Industry, 1998). From then on, many firms realised the importance of measuring and reporting intellectual capital but so far just a few firms have built it.

### Notes

1. Intellectual capital and intangible assets have been treated as having the same meaning.
2. Prior to Edvinsson, Kaplan and Norton developed the balance score card in 1992, which is the first known attempt to capture information on intangibles. However, the purpose of a balance scorecard is to enable management in monitoring intangibles, it is not intended for reporting to shareholders.



The Skandia Navigator is collection of critical measurements that all comprise a holistic view of performance and goal achievement. Five focus areas or perspectives capture different areas of interest. Each area visualises the value creation process.

# Fraud Investigation – An Overview



The recent economic downturn and increasing corporate frauds have re-emphasised the importance of financial fraud investigations. The end result of a successful investigation is concise reporting, along with requisite evidence, which would stand up in the court of law. Each Forensic investigation assignment is unique in its own way – in manner of occurrence of the fraudulent activity, nuances involved, location and execution. Financial fraud investigations have a wide connotation. This article provides information and background in relation to various types of fraud investigations.



**CA. Jagdeep Singh Chopra**

*The author is a member of the Institute.*

*He can be reached at  
eboard@icai.org*

**T**he current world scenario of economic downturn and corporate frauds of recent years have renewed interest in financial frauds in various organisations. One of the negative aspects of globalisation and growing economy is 'white collar crimes'. However, the threat of financial fraud has always been there and, as such, there is a need for the management, regulators and law enforcement agencies to deal with these situations more effectively and timely. There is an increasing trend where various businesses are being victimised by serious internal frauds. Fraud by its nature is perpetrated secretly through deception.



**Fraud investigations focus on the unusual accounting irregularities that point towards a trend of criminal financial behaviour. Thus financial fraud investigations require deployment of professionals with expertise in detection and prevention of fraud. This requires the fraud investigators to determine occurrence of a fraud, its perpetrators and the implication of the fraud – monetary loss and damages. Forensic Accountants, besides having expert knowledge of accounting & auditing standards and procedures, should have an understanding of business and financial reporting process.**

### **Audits or Investigations: Mistake or Fraud**

At the outset, it is essential to understand that there are fairly significant differences between an audit and an investigation. Corporate frauds are known to increase during situations similar to the current uncertain economic times world over.

Normally an audit involves inspection of financial statements, accounting procedures and standards and records to make sure that there is “reasonable assurance about whether the financial statements are free from material misstatement” and that they present a “true and fair view in conformity with the accounting principles generally accepted”. In other words, auditors look for errors, and not necessarily for fraud.

Fraud investigation focuses on the unusual accounting irregularities that point towards a trend of criminal financial behaviour. Thus financial fraud investigation requires deployment of professionals with expertise in detection and prevention of fraud. This requires the fraud investigators to determine occurrence of a fraud, its perpetrators and the implication of the fraud – monetary loss and damages.

Certain types of frauds may be due to deliberate inaccuracies in a financial statement that lead to someone benefiting financially.

Usually frauds are detected through a whistle blower or anonymous inputs, or management having suspicions or noticing unusual financial fluctuations. It has been observed that fraud is detected less than 10 percent of the time during the course of audit of financial statements. This is primarily due to the reason that auditors conduct their verification on the basis of sample checking of relevant documents, and look for a “reasonable assurance” and that the statements are free from “material misstatements.” Sample checking is done as it is not practical to verify every transaction during the course of an audit.

During the audit, it needs to be verified whether a company is in compliance with its governance and regulations, and whether the financial statements are accurate within a reasonable degree of materiality. Thus during an audit, the auditor would not be too concerned if an expense is misclassified. However, during a fraud investigation, he would further examine an expense misclassification and reasons behind the same, as it may be intentional. Thus, the outlook while conducting an investigation undergoes a change as compared to an audit.

Public perception is that auditors' job is to detect fraud but in fact the overall purpose of an audit is to ensure the true and fair presentation of financial statements. Auditors try to give full disclosure and transparency in their reports and financial statements audited by them. Present reporting format requires that auditors should report on certain elements of fraud as part of financial audit procedures.

However, a fraud investigation involves a detailed investigation into specific issues along with other processes like gathering evidence, conducting and recording (electronic or manual) interviews of employees and management.

Corporate fraud investigation requires curiosity and tenacity along with the domain knowledge. The work may be time consuming and tedious, but the efforts usually are quite satisfactory. However, there may be instances where during the course of an investigation, considerable efforts put in do not yield commensurate results or findings, and there may be instances where the investigators hit the bull's eye by way of immediate findings in a short period. This in no way should be used as a yard stick in judging the competence or lack of it on part

of the investigators. An investigation involves sifting, collating, verifying and interpreting through mountains of data and information.

Usually, corporate fraud investigators are retained by the corporate or outside counsel; hence they are bound by the lawyer-client confidentiality. As such, in spite of the fact that their findings may point towards an illegal activity, they do not have a say in whether to prosecute a crime or not.

### Forensic Investigations and Dispute Resolution Services

**(A) Dictionary meaning of Forensic Accounting** indicates it to be the specialty practice area of accountancy and refers to assignments that result from actual or anticipated disputes or litigations. "Forensic" means "suitable for use in a court of law," and it is to this result and potential outcome that forensic accountants generally have to work.

**Forensic accountants** are also referred to as forensic auditors or investigative auditors, and are often called to give expert evidence at the eventual trial. Assignments relating to criminal issues arise subsequent to perpetration of fraud and usually involve accounts related issues and assessing the financial statements. By qualification, forensic accountants are Chartered Accountants / Certified Public Accountants or Certified Fraud Examiners.

Thus Forensic Accountants, besides having expert knowledge of accounting & auditing standards and procedures, should have an understanding of business and financial reporting processes. They should be well versed with the investigation techniques, evidence gathering and the related legal procedures involved during the course of their assignment.

According to a study on financial statement fraud conducted by the non-profit Institute for Fraud Prevention (IFP), a consortium of universities for research of the causes of fraud and how to reduce it, internal controls were usually circumvented by a fraud network led by the CEO and assisted by outsiders. The CEO normally includes the CFO in the fraud network. It was further reported that these fraud networks cause extremely large losses that are far greater when the outside audit firm is alleged to have aided the fraud. It was additionally stated that in more than half the cases, an entity other than the organisation where fraud is perpetrated, usually an investment bank, auditing firm, or colluding business partner

were implicated as a party to the crime.

### **(B) Forensic investigations & Dispute services:**

In an era of increased exposure to frauds and related activities, there is a rising trend among professional firms, especially in India, to provide an array of expertise under Forensic Investigations and Dispute Resolution services. It is general trend that all the larger accounting firms as well as many medium-sized and boutique firms have specialist forensic accounting departments, and within this there are further specialisations, as given below.

**Forensic Investigations and Dispute Resolution Services normally involve an expertise in the following areas:**

- Fraud and Financial Investigations
- Corporate Business Intelligence
- Dispute and Litigation Support Services
- Foreign Corrupt Practices Act Consulting
- Anti-Money Laundering
- Analytic and Forensic Technology
- Anti-Counterfeiting Services
- Pre-Employment Background Verification

We would briefly touch upon each of the practice areas stated above, followed by a case study which involves some aspects of a fraud investigation.

### **(C) Fraud and Financial Investigations**

These investigations involve conducting complex



**A majority of corporate fraud cases involve devising accounting schemes with a purpose to deceive stakeholders, auditors and various interested parties with regard to the accurate financial position of the entity. This inaccurate financial data and fictitious performance indicators result in the company artificially depicting good performance resulting in the rise of share price of the corporate. This translates into significant financial losses to investors which has the potential to shatter investor confidence once the correct financials of the company are revealed.**

assignments including those pertaining to financial statement frauds, misappropriation of assets, corruption and bribery, and fraud risk evaluations.

**Fraud Risk Assessment (FRA):** In view of complexity in business transactions, many entities are often at a risk of fraud being perpetrated on them resulting in loss of large sums of money, assets and reputation. It is a well known fact that every organisation is susceptible to fraud risk. There is an increasing trend where the forensic accountants are giving vital inputs for fraud risk reduction by way of conducting FRA assignments at various entities, thereby mitigating the fraud risk for that organisation.

FRA schemes facilitate the management to identify risk areas vulnerable to fraud. FRA exercise then enables the management to incorporate internal controls systems which can deter fraud or help to detect possible fraudulent activity.

**Financial Fraud Investigations:** During the initial phase of discussions and interviews with the management, main issues involved in the investigation are identified and discussed. This always facilitates putting a perspective to the whole investigation. Main ingredients of an investigation are that the findings should be able to stand up in a court of law. Evidence in the form of documents and discreet interviews of employees, customers, associates, competitors and other related parties form an important part of the investigations.

While conducting an investigation into a Financial Statement Fraud, it should be considered that the most common way in which financial statement fraud is carried out is through revenue overstatement. Trends in revenue are compiled and revenue overstatement is thereby detected by analysing these revenue patterns.

A way to overstate revenue without arousing any suspicion would be a constant increase in sales

or profits from period to period. A majority of Corporate Fraud cases involve devising accounting schemes with a purpose to deceive stakeholders, auditors and various interested parties with regard to the accurate financial position of the entity. This inaccurate financial data and fictitious performance indicators result in the company artificially depicting good performance resulting in the rise of share price of the corporate. This translates into significant financial losses to investors which has the potential to shatter investor confidence once the correct financials of the company are revealed.

**Financial frauds and falsification of financial information are usually perpetrated in a combination of following schemes:**

- Incorrect depiction of financial statements,
- Inappropriate revenue recognition including revenue overstatement and fraudulent reporting of fictitious sales,
- Incorrect expense recognition,
- Overstatement of assets and understatement of liabilities,
- Concealment of transactions through off-balance sheet items and entities,
- Misappropriation of assets, fraudulent conduct by senior management and fraud unrelated to financial statements (e.g., corruption),
- Improper ratios pertaining to inventory or accounts receivables, recording of large amounts being written off immediately after closure of the accounting period are indicators for fraudulent manipulation of revenue,
- False accounting entries.

Methodology normally adopted to investigate the financial statement misstatement is briefly discussed below:

- Computerised books of accounts / other relevant records, transaction dumps are extracted and analysed using advanced forensic fraud detection techniques.
- Books of accounts are reviewed for adjusting



Corporate business intelligence primarily involves background verification on potential targets in order to facilitate the client to use the information to make a valued decision for mitigating risks associated with the transaction and form a view regarding the reputation and integrity of a company and the track record of their business performance. The potential target is clearly stated by the client. Evidence in form of documents and discreet interviews of employees, customers, associates, competitors and other related parties form an important part of the investigations.

Forensic Accountants assist law firms and clients to evaluate and build up a credible financial claim, supported by legally admissible evidence. They assist them in conducting the financial analysis of the claim and development of various damage scenarios. It is thus imperative that the issues involved and methodology to be adopted should be discussed and agreed upon with the legal team at the initial stage itself. The process involves in-depth analysis of details collected and preparation of financial claim report with relevant evidence and enclosures.



entries, during the end of accounting period, relating to increase in revenue.

- Sales are checked with relevant support documents, purchase orders, etc, during the year-end, for its genuineness, and analysis of sale returns / debtors written off during subsequent period is done.
- Independent balance confirmations from various parties for accounts receivable, accounts payable and bank balances, where required.
- Existence of various fixed assets and investments, preferably by conducting reasonable physical verification of the same,
- Irregularities in the cash and bank transactions, detrimental to the company,
- Relevant emails, accounting system entries to verify various aspects like sales, agreements, communication, authorisation, etc, are verified.

It may be noted that above mentioned steps are not exhaustive in nature. Each case has its own peculiarities and circumstances, hence requiring specific responses.

**Asset Misappropriation Investigations:** Asset tracing assignment would involve locating assets of a company or individual which have been deliberately kept hidden and are not identifiable. It may so happen that a company or individuals deliberately do not reveal their assets – movable or immovable. This situation often arises during the course of a legal proceeding or other dispute. Experienced professionals use their investigative skills to unearth these assets which might have been kept hidden in a maze of transactions, or in the name of a relative. This involves field visits, interviews and search / study of various documents, whether or not available in public domain.

#### (D) Corporate Business Intelligence

Domestic and international organisations enter into business partnerships with unknown entities

all over the globe, thus making them vulnerable to potential legal and commercial risks. It is thus imperative that due diligence and requisite background investigations be conducted on proposed associates in order to avoid serious legal complications.

Corporate business intelligence primarily involves background verification on potential targets in order to facilitate the client to use the information to make a valued decision for mitigating risks associated with the transaction and form a view regarding the reputation and integrity of a company and the track record of their business performance. The potential target is clearly stated by the client.

The investigators may obtain information available in the public domain, through regulators and statutory authorities, information / interviews of employees and business associates, media search, other data base and Internet search, information from law enforcement agencies and other areas. As required, all or a combination of the sources stated above, are used to conduct such investigations. The process involves comprehensive desktop review and field visits of the investigating team.

Evidence in the form of documents and discreet interviews of employees, customers, associates, competitors and other related parties form an important part of the investigations.

#### (E) Dispute Resolution and Litigation Support Services

Large number of litigations and disputes are bound to arise in an age of rapid globalisation and complex commercial transactions. Experienced legal eagles require inputs on the financial aspect of a legal claim.

The nature of legal dispute might differ. It might involve a financial claim dispute between two parties involved in a buy-sell transaction gone sour, or disagreement in valuation of business venture or a complicated legal issue with financial impact.

Forensic Accountants assist law firms and clients to evaluate and build up a credible financial claim, supported by legally admissible evidence. They assist them in conducting the financial analysis of the claim and development of various damage scenarios. It is thus imperative that the issues involved and methodology to be adopted should be discussed and agreed upon with the legal team at the initial stage itself. The process involves in-depth analysis of details collected and preparation of financial claim report with relevant evidence and enclosures.

On submission of claim in the court of law, forensic accountants provide independent expert witness services to the law firm and client, for appearing in the court / arbitrators for giving evidence in support of the financial claim.

#### **(F) Foreign Corrupt Practices Act (FCPA)**

##### **Services**

US firms seeking to do business in foreign markets must be familiar with the FCPA. In general, the FCPA prohibits corrupt payments to foreign officials by US companies for the purpose of obtaining or keeping business.

US Securities & Exchange Commission investigations in the mid-1970's found that over 400 US companies admitted making questionable or illegal payments in excess of \$300 million to foreign government officials, politicians, and political parties which were in nature of payment of bribes to them in order to secure some type of favourable action by a foreign government / officials. Thereafter, the US Congress enacted the FCPA in an attempt to stop the practice of bribery of foreign officials and to ensure integrity of the American business system.

FCPA rules require US corporations to maintain books and records that accurately and fairly indicate various transactions of the corporation. It further requires these organisations to develop a requisite system of internal accounting controls to identify illegal payments.

Keeping in view FCPA provisions, the US entities having business dealings abroad have to

take appropriate measures to manage FCPA related risks considering the country-specific business and political scenario wherein they have or propose to have business dealings. This would require the US entities to avail professional services to conduct an assessment of the internal control procedures relating to FCPA in the organisation and accounting of relevant transactions. This assessment can be conducted by experienced professionals by undertaking to study the FCPA procedures enunciated at the corporation and by analysing the financial records of the corporation. Interviews of the identified persons would be conducted and recorded. This would facilitate in identifying the FCPA provisions' violations, scope of violations and loopholes in the internal control system of the organisation with regard to FCPA.

#### **(G) Anti-Money Laundering Services**

Anti-money laundering (AML) is a term used to describe internal controls that require banks, financial institutions, intermediates and other regulated institutions to prevent or report money laundering activities.

Money laundering involves concealing or disguising the existence of illegal funds and its source, and illegitimate application of such income in order to provide an apparently perfect legitimate explanation for illicit proceeds. Money laundering activities get initiated by physical placement of cash, thereafter it is followed by separating the illicit money from their criminal origins through a maze of complicated financial transactions.

These processes are then followed by merging the illegal money with the mainstream and providing perfectly legitimate basis for the transactions.

Money laundering also includes the processes by which legitimate funds are transacted through Banks and Financial Institutions to fund illegal activities. It is imperative that these organisations should have robust anti-money laundering regulations and compliance procedures in place. It

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is here that the experienced professionals contribute with their investigative expertise by assessing the existing internal control procedures in these areas. The focus of the investigations is to identify the illegal transactions allegedly pertaining to money laundering and terrorist financing, identify gaps in internal control and areas most vulnerable to fraudulent activities, and thereafter make recommendations for improvement in required areas.

Special software have been developed to analyse and identify suspicious transactions or patterns of transactions that may constitute illegal financial activity. These transactions may include large cash deposits and withdrawals, cheque dealings, electronic transfer of funds, credit card activity and other specific transactions. The banks and financial institutions are required to regularly file various reports to the regulatory authorities. These may be in nature of Currency Transaction Report, Suspicious Activity Report, and other reports generated to monitor customer accounts. These institutions are also required to perform due diligence by maintaining customer profile and account transaction details.

#### **(H) Analytic and Forensic Technology Services**

Global computerisation and enhanced connectivity world wide has provided multitude of opportunities but at the same time has made various organisations vulnerable to sophisticated and varied business threats and challenges. These threats may be due to unauthorised access to information systems of the organisation resulting in revealing the confidential and sensitive official information, modification of data and information illegally accessed, tampering with the e-systems resulting in interruption of business activity of the company.

e-frauds are detected through forensic services by conducting following procedures:

- email and IP address tracing and analysis;
- Forensic analysis of application systems and data;
- Disk imaging, data collection and matching, analysis and reporting;
- Recovery of deleted files, data or passwords;
- restoring of backup tapes;
- Computer penetration testing and related security review;
- Securing and controlling evidence collected as per legal requirements.

Experienced professionals in Analytic & Forensic Technology conduct investigations by collecting, controlling and analysing huge and often complicated data through their proprietary modern technology tools. They search and process complex transactions in order to identify potential illegal activity. Further, by using latest technology, experts can identify and recover information and evidence traces from computer hard drives and backup tapes, including active, deleted, hidden, lost or encrypted files.

Access, securing and collecting evidence should be as per applicable legal requirements. Strict confidentiality with a minimum possible downtime is the essence of these assignments.

#### **(I) Anti Counterfeiting Services**

Anti-counterfeiting services are also known as Brand Protection services. Counterfeit indicates piracy, copying or making fake products. Counterfeiting is a deliberate attempt to deceive the customers by illegally copying and marketing established and branded products. The attempt of the counterfeit is to keep the fake and inferior product very similar to the original branded product in terms of the design, looks, package and technology thus causing a multiple negative impact on the business.

Counterfeiting has become a lucrative business proposal for unscrupulous characters as it is an extremely profitable proposition with minimal risks. It has been found that organised crime syndicates consider counterfeiting as a low risk activity which facilitates them in generating huge funds to support their illegal activities worldwide.

Counterfeiting occurs in various products and industries. It is a regular feature in currency, software, pharmaceuticals, cigarettes, FMCG products, cosmetics, watches, electronic goods, DVDs, works of art and many other products.

Forgery is the process of producing documents with an intention to cheat. There are many instances where currency notes have been forged posing a great law and order threat to the country. Further, Security documents, like stamp papers, have been forged and sold as originals resulting in huge loss of revenue to the government exchequer besides causing damage to the legality of the transactions executed on forged documents.

*Anti-Counterfeiting Services* involve expert detailed investigations. Extensive intelligence gathering mechanisms are required for a

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successful investigation. These involve desktop investigations and field visits.

Desktop investigations are conducted to gather, link and analyse information available in the public domain. The investigators also identify key players involved in the illegal activity of counterfeiting. Due diligence is conducted on the target entities.

Decoy teams are formed with specific purpose of going to the potential target, which may be an individual or a company or any other entity, and inquiring and acquiring the products sold by them. Field investigations involve undercover operations and monitoring of the products and the target entity. The products procured from the target entity are then examined by experts for being fakes and on establishing the illegitimacy of the item, raids are conducted on the target by the legal authorities / police with assistance from the decoy team. However, the whole process has to have the concurrence of the party availing anti-counterfeiting services from the investigators.

Sometimes, instead of carrying out the raids, the investigation findings are utilised to understand the nature and extent of the counterfeit malaise and thereby facilitate formulating appropriate counter strategies.

#### **(J) Pre-Employment Background Verification**

Employers need to make informed decisions when hiring people. An employer's desire to know about their future employees is driven by many factors, primarily being that the employee, when hired, may be in a position to handle sensitive and confidential information of the company. A belief of trust in the employee would be built over a period of time. However, at the initial stage the same is driven by having the comfort that the person employed has disclosed his particulars which are accurate and true. These particulars may pertain to the disclosures made in the potential employee's resume – like initial information, qualifications, past employment history, criminal record (e.g. involvement in any illegal activity,

imprisonment, drug abuse, corruption, etc).

Basically the employer would like to establish the truth of the details submitted by a potential employee, before hiring him. Background investigations can provide an in depth information regarding the history of the subject's past. These investigations give information on the employment history, credit history, educational background, criminal background of the person, his hidden or past assets, financial data, police records, civil history, and other public records as are required.

Normally the main objective of the management is to gather complete information about the skills and behaviors that an applicant will bring to the company.

### **Fraud Investigation – A Case Study**

#### **Introduction:**

As per joint venture and shareholders agreement between a financial institution (say X Co.) having an all India presence and a large enterprise based in west India (say Y Co.), it was stated that there would be equal equity participation between the two parties to form the joint venture company (say XY Co.). XY Co. was incorporated in India, with X Co. and Y Co. being the initial promoters.

Through internal communications and as per the joint venture agreement, the promoters from Y Co. were given the mandate to choose the project site, buy the industrial land at the place so identified and agreed, and thereafter build the factory at the proposed site. The consent of the promoters from X Co. was to be obtained at each stage.

#### **Background of the investigation:**

The concept of a whistleblower came into operation in this particular case, as is prevalent in most such instances. There was an acrimonious exit of a senior management staff (of XY Co.) at the initial stage of the project itself. This disgruntled employee spilled the beans and lodged a formal complaint with X Co, indicating the areas of suspected fraud.

X Co., deputed its representative and legal advisers to look into the matter. Their initial inquiry revealed that an in-depth investigation was required in the issue.

Thereafter, the management of X Co. appointed a firm having expertise in Forensic & Investigation services (FIS) to conduct the investigations primarily into the areas identified mutually. The whole assignment had to be conducted in confidentiality, i.e. not revealing to XY Co. management or Y Co., the nature of findings of the assignment. It was stated to them that a special audit had been ordered by X Co. and that Y Co./XY Co. management and staff were required to cooperate in conduct of the audit. It was further communicated to them that the work assigned may convert into a full fledged investigation, depending on the initial findings.

The terms of appointment, arrived at after consultations between the FIS firm and X Co., required them to initially conduct an investigation into the following areas:

- If the initial investigations required then disk imaging and data collection (including computerised books of accounts / other relevant records) from the XY Co. records would be conducted by the Computer Forensics team. Transaction dumps were to be extracted and advanced forensic fraud detection techniques to be used to analyse the historical data, thereby assisting in detection of anomalies and suspicious transactions. Thereafter, various queries, as thrown up during the investigations, would be run, matched, analysed and reported upon. As required, emails and IP addresses would be traced and analysed, deleted files / data / passwords recovered, etc,
- Verification of background of the promoters from Y Co. and senior employees at XY Co., due diligence of Y Co. and related companies and transactions,
- Scrutiny of capital expenditure incurred till date on the project, e.g. land, plant & machinery, building / factory construction / installation, etc. These expenses to be verified for proper contracts, genuine payments and invoices, consent of joint venture partners, ownership and registration of land purchased and necessary statutory clearances,
- Methodology for verification of books of accounts, cash & bank transactions, expenses

and financial statements, secretarial records would be same as enumerated in part (C) above,

- Detailed and documented inquiry for similar plant & machinery purchased from other suppliers, land purchases in adjacent areas, in order to establish appropriateness of the purchase rate for these transactions,
- Joint venture agreement and relevant records to be verified,
- Physically verify the office / factory locations along with records and assets of the organisation,
- Conduct interviews with staff, management and outside parties, as required for investigation,
- Examine any other area that may come up during the course of the assignment.

#### **Investigation:**

As per the terms of appointment, the investigation firm initiated the process for conducting a preliminary inquiry, in following phases. It may, however, happen that a phase may overlap another and as such no rigidity can be exercised keeping in view the sensitivity of the assignment which may require on the spot decision making.

#### **Phase1**

An initial phase of discussions and interviews were conducted with the management of XY Co. The main thrust of these discussions was to identify the major issues involved and the course of initial investigation. Staff to be interviewed during the course of the assignment and those required to make available the requisite records, were identified.

Thereafter a formal written request was sent to XY Co. to make available various records and they were intimated the dates of visit of the team.

Verification involved scrutiny of various records, relevant to the assignment, as decided in the scope of work initially.

XY Co. was also informed that these were not the exhaustive list of documents required and further records may be required as the audit progressed.

#### **Phase2**

Different teams were allocated to conduct various facets of the investigation.

An overview of the terms and conditions of the joint venture and shareholders agreement was

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conducted by the team leads. This was essential as the transactions conducted by XY Co. should have been within the parameters of these agreements.

**Team 1** comprising experienced professionals in Analytic & Forensic Technology was constituted to conduct investigations by conducting disk imaging, and collecting, controlling and analysing data using their modern technology tools. Their initial role was also to recover all the deleted files, data or passwords and restoring of backup tapes. The team's brief was to search and process complex transactions in order to identify potential illegal activity, and conduct the assignment as per the scope stated in the terms of appointment.

A team, **Team 2**, was deputed to conduct the review of books of accounts, ledgers, cash & bank accounts, investments, financial statements (audited and unaudited), statutory records, joint venture agreement, bank transactions, bank statements and independent confirmations from the banks.

Other specific areas covered included those stated in the scope of work, and falling within the expertise of the team.

Another team, **Team 3**, was formed to visit the office and factory site with an intention to verify the fixed assets installed and physically review the progress of the project. During the course of these visits and verification, interviews of staff was conducted and recorded. Inputs from technical staff / consultants were also obtained where the need arose.

This team was further instructed to conduct roving inquiries from adjacent areas and property agents regarding the purchase price of land, industrialisation of the region and legal / local issues concerning the same, general reputation of the promoters and gather information which may prove to be useful during the course of investigations.

This team was also assigned the task for conducting the review of land records at the office of Registrar (Land) and obtain documents, where possible, supporting the ownership of the land. Prevailing land rates and those existing at the time of land purchase transaction were to be obtained from the registered land surveyors.

**Team 4** was deputed to conduct a Desktop review of the background of the promoters, Y Co., other shareholders, related parties, contractors and main suppliers in order to establish their credibility. Information available on the public domain like RoC records, regulators and statutory authorities, employees and business associates, media search, other data base and Internet search, law enforcement agencies were collected.

Ultimately, the information and findings of various teams were collated and analysed, and a draft report was prepared for initial discussions with the client. Based on the outcome of the discussions, a final report was submitted.

### Conclusion

Reporting is a crucial aspect of any assignment, more so in case of a sensitive work, as described in the preceding sections of the article. The end result of a successful investigation is concise reporting, along with requisite evidence, which would stand up in the court of law.

The scope of the assignment, work done, limitations and restrictions pertaining to the work need to be stated in the relevant portions of the report.

Each Forensic investigation assignment is unique in its own way – in manner of occurrence of the fraudulent activity, nuances involved, location and execution. Thus, approach to each case has to be specific. However, basic aspects of conducting the task would remain almost the same.

# Housing Projects & Recent Special Bench Decision



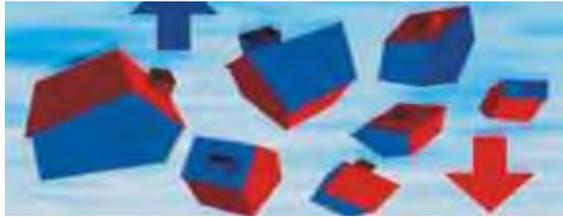
The Special Bench of the Income Tax Appellate Tribunal, Pune recently rendered an important decision in the context of the claim of deduction of profits derived from the execution of housing projects in *Brahma Associates & other cases (22 DTR 1)*. This article discusses the important issues involved in the matter.



**CA. Vardhaman L. Jain**

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

It was way back in 1998 that the Income-tax Act, 1961 first witnessed a provision giving a tax incentive for the development of housing projects in the form of section 80IA(4F) brought in by the Finance Act, 1998 w.e.f. 1.4.1999. The Finance Minister in his speech had observed that housing was a priority area and as such proposed several incentives to encourage house-building activity, which included, *inter alia*, tax holiday for approved housing project. Much water has flown down the river since then until this date where we have the provision in its present form amended substantially last by the Finance Act, 2004 and umpteen issues therefrom being debated and litigated.



One of the major controversies with respect to the provisions was whether housing project as envisaged prior to the amendment made by the Finance Act, 2004 comprised of residential housing units alone or also included commercial establishments.

**Provisions in Brief**

A snapshot summary of the provisions shall be in order at this juncture:

- The deduction is available in the case of an undertaking developing and building housing projects. The amount of deduction is hundred per cent of the profits derived from such housing project.
- The time limit for obtaining approval from the local authority was **31<sup>st</sup> March 2007**.
- The housing project should be **completed within the time** limit given below:

TWOSITUATIONS	TIME-LIMIT FOR COMPLETION
If the local authority has approved the housing project <b>before April 1, 2004</b> .	<b>On or before March 31, 2008</b> .
If the housing project has been approved by the local authority <b>on or after April 1, 2004</b>	<b>Within 4 years</b> from the end of the financial year in which the housing project is approved by local authority

- \* *The date of approval shall be taken as the date on which the **building plan is first approved** by the local authority.*
- \* *The date of completion of the housing project shall be **the date on which the completion certificate is issued by local authority**. This condition has been brought in through the amendment made by the Finance Act, 2004.*
- The project should be on the **plot of land**, having a minimum area of **one acre**. With a view to encourage the redevelopment of slum dwellings, the conditions of minimum plot size of one acre and of time frame for completion have been relaxed in the case of a housing project, carried out in accordance with a scheme framed by the Central Government or a State Government for reconstruction or redevelopment of existing buildings in areas declared to be slum areas (under any law for the time being in force) and such scheme is notified by the Board in this behalf.

- The built-up area of the **shops and other commercial establishments** included in the housing project **shall not exceed 5 per cent of the aggregate built-up area of the housing project or 2000 sq.ft., whichever is less**. This condition has also been brought in through the amendment made by the Finance Act, 2004.
- The maximum **built-up area** of the **residential unit** situated with in the cities of **Mumbai or Delhi** or within 25 km from the municipal limits of these cities should be **1000 sq.ft.** and for **other places**, it should be **1500 sq. ft.**
- The expression “built-up area” has been defined to mean the inner measurements of a residential unit **at the floor level**, including the projections and balconies, as increased by the thickness of the walls but not including the common areas shared with other residential units. This definition has been brought in through an amendment made by the Finance Act, 2004.

**Issues in the Background**

A look at the outcome of assessments of cases where claims u/s 80IB(10) were made brings out one thing in sharp focus, i.e. the Income Tax Department is not viewing the claims charitably. A part of the responsibility for this attitude of the department also lies with the developers’ fraternity, which has endeavoured to liberally interpret the incentive provision to suit its requirements.

One of the major controversies with respect to the provisions was whether housing project as envisaged prior to the amendment made by the Finance Act, 2004 comprised of residential housing units alone or also included commercial establishments. Another question as a sequel to the above controversy was whether a deduction or claim could be made available on a proportionate basis, i.e. w.r.t. the profits of residential housing units. A question further deliberated was whether the amendment made by the Finance Act, 2004 prescribing the built-up area of commercial establishments at 2000 sq. feet or 5% of built-up

area, whichever is less, was applicable with retrospective effect to all the housing projects even in the earlier years.

To answer these questions, a Special Bench of the Tribunal was constituted in Pune. A landmark decision was rendered by the Special Bench on 6<sup>th</sup> April, 2009, on the issue of deduction u/s 80IB(10) in respect of profits from housing projects. The Hon'ble Tribunal, in deciding the issues, gave considerable emphasis to the fact that the tax deduction u/s 80IB(10) was aimed at providing more dwelling units, and considered this as the predominant objective of the incentive provision. However, the Bench observed that commercial use of the area is an integral part of the housing project and merely because a part of the housing project is used for commercial purpose, the character of housing project is not vitiated.

Having concluded that an element of



commercial use is implicit and permissible in a housing project, the Bench next addressed the issue, as to upto what degree and in what measure such a commercial use is permissible. The resolution of this issue was prefaced by an observation by the Special Bench that when a local authority approves the project as a housing project, it is immaterial as to what is the quantum of use of built-up area for commercial purposes. **However, the Bench did not examine the cases w.r.t. their position w.e.f. A.Y. 2005-06.**

The Bench observed that undertakings were building excessive commercial areas because of lacuna in the provision and to check this mischief, the provision regarding limitation on the commercial built-up area in a housing project was introduced as a requirement but this limitation applied w.e.f. 1.4.2005 only.

Having observed thus and having rejected the extreme views canvassed on either side, the

Special Bench observed as under:

1. "We have to draw up some *lakshman rekha* nonetheless so as to ensure that the basic character of the project continues to remain in harmony with the object of the tax incentive i.e. augmenting affordable dwelling units."
2. "No doubt, this is not an easy job in the sense that we do not readily find any objective criterion for the same. The language of the enactment prior to introduction of clause (d) in the section did not provide any area limit on commercial construction in the housing project and, therefore, the problem in providing a clear and easy answer."

Referring to various judicial precedents, the Special Bench has attempted to find a solution as there is no clear legislative guidance. According to the Bench, the true and proper interpretation, which will serve the purpose of the legislature, has to be therefore placed on the provision in question in the light of other material available on record and after taking clue from Clause (d) of Section 80IB(10). The provisions of Clause (d) have been referred to herein earlier. The Special Bench, accordingly, concluded that cases where commercial built-up area did not exceed 10 per cent of the total area, the benefit of the statutory provision could not be denied as such project should be held to be predominantly residential project fully satisfying the description of the term "housing project" as envisaged under the statutory provision prior to A.Y. 2005-06.

The Special Bench then addressed itself to cases where the total built-up commercial area is more than 10 per cent of the total area. It held that in order that the profit from dwelling units segment of the project is eligible for deduction u/s 80IB(10) in such a case, the size of the plot excluding portion under commercial unit must be more than minimum area of one acre and residential units built on such area must satisfy condition of Clause (c) of the provision relating to maximum built up area of the residential unit. The provisions of Clause (c) have been referred to herein earlier.

According to the Special Bench, the above income of the undertakings from project referred to above would be granted exemption under the statutory provision as such incomes satisfy the purpose of the enactment. Save this exception, the other undertakings executing projects with commercial unit of more than 10 per cent of area shall not be entitled to the benefit of exemption as

those undertakings shall have not worked in accordance with the spirit and intendment of the statutory provisions.

While negating the proposition of grant of proportionate deduction, the Special Bench thus carved out an exception in a case where commercial use of built-up area is more than 10 per cent of the total area, but the area of balance residential units is more than one acre. In such a case, the assessee is eligible for deduction in respect of profits of the residential units segment of the project since the residential units segment is being treated on a stand alone basis for eligibility to deduction u/s 80IB(10). The Special Bench held that the eligibility for such deduction can only be for the profits which are in respect of residential unit segment of the overall projects because only that part of the overall project can be said to be Housing Project.

Two issues directly arising from the Special Bench decision are worth considering:

### Issue No 1

The Special Bench was not dealing with the issue of housing project with reference to the A.Y. 20-05-06. In fact, the Special Bench has addressed the issue of commercial construction in a housing project only for the years up to A.Y. 20-04-05. The amendment by way of Clause (d) relating to the extent of shops and other commercial establishment, included in a housing project was brought onto the statute by the Finance Act, 2004 w.e.f 2005-06. Understandably, the projects approved after 1.4.2004, would have to satisfy the built up area cap for shops and other common establishments. However, the position becomes quaint in case of projects which have been approved prior to 1.4.2004 and the extent of commercial construction is beyond 5 per cent of the aggregate built up area or 2000 sq. ft. whichever

is less, and the claim u/s 80IB(10) is made for A.Y. 2005-06 or later years.

The Department is taking a position that the claim shall be examined with reference to the law in force in the assessment year unless otherwise provided expressly or by necessary implication. Reliance is sought to be placed on the decision of the Supreme Court in *Reliance Jute Industries vs. CIT 120 ITR 921*, for the proposition that there is no vested right possessed by the assessee.

However, it needs to be noted that the present factual matrix is different from the one available on the case of *Reliance Jute*. A housing project typically extending beyond one year may be sanctioned in either of the years prior to 1.4.2004 and may continue beyond 1.4.2004. The profits of such projects may be offered on a year on year basis including some years prior to assessment year 05-06 and some years later. Resultantly, the claim of section 80IB(10) would be made for all the years. Going by the Department's stand, the housing project which shall be entitled to the claims in the years upto A.Y. 2004-05, shall become ineligible for A.Y. 2005-06 and later years.

The cap on the built up area on shops and commercial establishments shall apply only for the projects approved after 1.4.2004. Obviously then, the very plans approved by the local authority prior to 1.4.2004, which are otherwise compliant with the provisions prevalent at that time, cannot be said to become non-compliant after 1.4.2004. A project commenced prior to 1.4.2004 as per compliant plans approved cannot be said to be eligible for the assessment years upto A.Y. 2004-05 and ineligible thereafter.

There is a definite vested rights possessed by the assessee with reference to such a project and the provision granting relief shall have to be read in a manner as was available at the time when relief was granted and the subsequent amendment shall

not affect the claim for such a relief. Reliance for this proposition is placed on the Supreme Court decisions in *CIT vs. Shah Sadiq & Sons (166 ITR 102)* and the Madras High Court decision in *CIT vs. S.S.C. Shoes Ltd. (259 ITR 674)*.

Expecting the assessee to be compliant in subsequent



**While negating the proposition of grant of proportionate deduction, the Special Bench thus carved out an exception in a case where commercial use of built-up area is more than 10 per cent of the total area, but the area of balance residential units is more than one acre.**

years under the amended position with reference to a project which is already underway and which is compliant with the then prevailing provisions, is expecting an impossibility. In fact, it would be asking the assessee to do the impossible which cannot be the intent of any statute. [*CIT vs. Shapoorji Pallonji Mistry 44 ITR 891(SC); ACIT vs. Jindal Irrigation Systems Ltd. 56 ITT 164 (Hyd)*]

## Issue No.2

The Special Bench case has not negated the question of proportionate deduction in observing that it is not relevant as to what is the portion of profits which can be said to be attributable to residential units.

Question No. 2 for consideration before the Special Bench was that in the event that the deduction u/s 80IB(10) is admissible in case of a housing project comprising residential units and commercial establishment, whether a proportionate deduction should be allowed, considering the facts of a particular case. In Para 124, the Special Bench has held: "once, therefore we hold that the project in question is a housing project entire profits of the housing project are deductible entirely u/s 80IB(10). The question of proportionate deduction therefore, is not at all relevant in this context."

The issue of grant of proportionate deduction would have been before the Special Bench only if the answer to Question no. 1 was in the negative. Based on its decision on connotation of "housing project", the Special Bench has rightly considered irrelevant the issue of proportionate deduction attributable to residential units once the housing project is accepted to as comprising of residential units and commercial establishments. In fact, the Special Bench has accepted the principle of proportionate deduction by carving out an exception on the issue dealt with by it. This is also clear from reading of Para 130(b) which reads as under:

"(b) The deduction under section 80IB(10) is available in respect of profits of housing project as a whole, and, as such, it is not relevant as to what is the portion of profits which can be said to be attributable to residential units. This is subject to the rider that in case commercial use of built up area in a project is more than 10 per cent and, for this reason the project cannot be said to be a predominantly housing project, but, in terms

of observations made in paragraph 115 above, the assessee is entitled to deduction in respect of residential unit segment of the overall project on fulfillment of necessary conditions, the entitlement of incentive deduction will be confined to only the profits to the residential segment of the overall project".

The principle of pro-rata deductions has been upheld in *Arun Excello's case (108 TTJ 71)*. It is significant to note that even the Bangalore Bench in *Brigade Enterprises (119 TTJ 269)* has held that deduction should be computed unit wise. The Hon'ble Tribunal in *Laukik Developers (108 TTJ 364)* has also held that proportionate deduction can be allowed when the building project is first eligible to claim exemption u/s 80IB(10) by fulfilling the conditions precedent for its application.

In fact, the Calcutta Tribunal in *Bengal Ambuja Housing Development Limited vs. DCIT (ITA Nos. 1595 & 1735/ Kol/2005 dated 24.03.2006)* has allowed the claim of pro-rata income on qualifying units by observing that the provision laid down in Section 80IB(10) does not speak regarding the denial of deduction in the case of profits from a housing complex containing both the smaller and larger residential units.

It is to be noted that this decision of the Tribunal has been confirmed by the Calcutta High Court by its order dated 5.1.2007. The dismissal of the appeal by the High Court merges with the Tribunal decision and for all purposes it is the decision of the High Court. Reliance for this proposition can be placed on the High Court decisions in *Nirma Industries Ltd. vs. DCIT 283 ITR 402 (Guj)* and *Smt. Tej Kumari vs. CIT 247 ITR 210 (Patna) (FB)*.

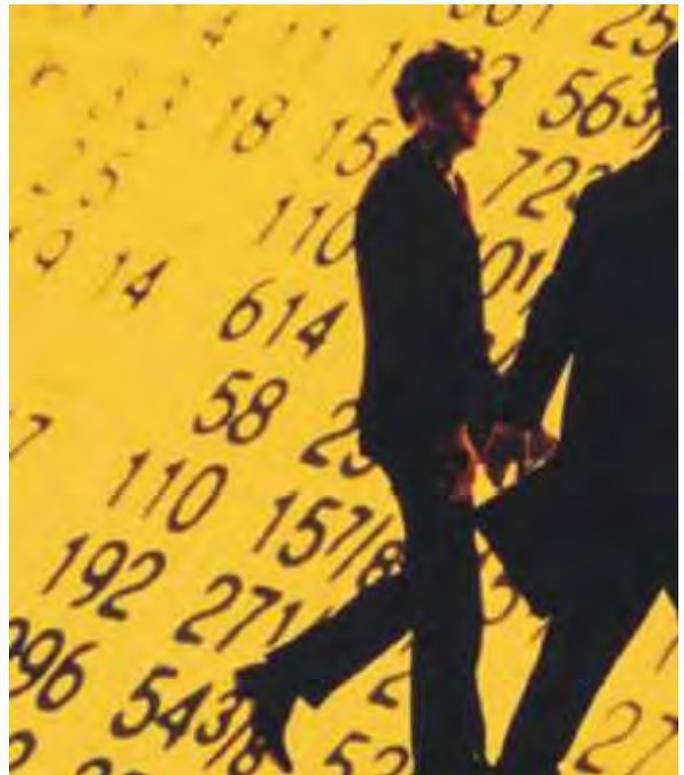
The Calcutta High Court decision is the solitary decision of the High Court on the issue and is a binding precedent on all the lower courts in the country including at Pune. Reliance for this proposition can be placed on the *Maharashtra State Warehousing Corporation Limited vs. DCIT 122 TTJ 865 (Pune)*.

## Epilogue

The Special Bench decision has, for the time being, laid at rest a major controversy on the subject. It cannot be said that the last word has been said on the subject. Besides, a host of other issues shall make the subject of claims u/s 80IB(10) a raging controversy for quite some time to come. ■

# Special Provisions for Taxation of Co-operative/Other Banks

The advent of section 80P(4) w.e.f. assessment year 2007-08 has closed the doors for co-operative banks for claiming the benefit of deduction under section 80P(2)(a)(i) from its total income. Since profits of co-operative banks have become taxable after withdrawal of 80P deduction, there have been various amendments in the Income-tax Act, 1961 to bring co-operative banks at par with other commercial banks. In this article, an attempt has been made to understand the provisions applicable *vis-à-vis* a co-operative bank in a post 80P(4) scenario.



**CA. Darshan Jain**

*The author is a member of the Institute.*

*He can be reached at  
drj@icai.org*

**T**he advent of section 80P(4) w.e.f. assessment year 2007-08 has closed the doors for co-operative banks for claiming the benefit of deduction u/s. 80P(2)(a)(i) from its total income. All the disputes in respect of income from banking business have now ended and every co-operative bank shall now be entitled to be assessed as a normal banking company. There are various special provisions in the Income-tax Act, 1961 applicable to commercial banks, which are now even of interest to co-operative banks that are now devoid of benefits of deduction under section 80P(2)(a)(i). There are various special and typical provisions applicable only to assessment of banks. Such provisions require exercise of extra caution as they are typical and one does not use them generally in case of other assessees.

The Department, therefore, has come out with a checklist on deductions for assessment of bank, vide its Instruction No. 17/2008 dt 26/11/2008 (F. No. 228/3/3008 – ITA- III). A major thrust in the checklist is given to provisions relating to the allowance of provisions of bad and doubtful

debts, depreciation on investments, interest element in cum-interest investments and other provisions made on prudential basis.

Since profits of co-operative banks have become taxable after withdrawal of 80P deduction, there have been various amendments in the Act to bring co-operative banks at par with other commercial banks.

### Amendment to Section 80P

The clause (4) inserted in section 80P has taken away the benefits of the erstwhile deduction available to a co-operative society engaged in carrying on the business of banking or providing credit facilities to its members. The new clause 4 inserted by the Finance Act, 2006 with effect from 01.04.2007 reads as under:

*"[4) The provisions of this section shall not apply in relation to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.]"*

The intention of the provision could be derived more appropriately from the relevant para no. 166 of the budget speech which stated that "Co-operative banks, like any other bank, are lending institutions and should pay tax on their profits. Primary Agricultural Credit Societies (PACS) and Primary Co-operative Agricultural and Rural Development Banks (PCARDB) stand on a special footing and will continue to be exempt under section 80P of the Income-tax Act. However, I propose to exclude all other co-operative banks from the scope of that section." Accordingly, section 80P is to be amended to give effect to the above proposal. It is also proposed to amend section 2(24) to provide that profits and gains of business of banking (including providing credit facilities) carried on by a co-operative society with its members shall be included in the definition of 'income' (with effect from 1<sup>st</sup> April, 2007)."

Now that no deduction is available to a co-operative bank under section 80P(2)(a)(i) all the controversies in respect of banking income have finally come to rest and the plethora of decisions of

various courts including the apex court in *CIT vs. Karnataka State Co-operative Apex Bank (2001) 169 CTR (SC) 486 : (2001) 251 ITR 194 (SC)* and *Mehsana District Central Co-operative Bank Ltd. vs. ITO (2001) 170 CTR (SC)* have now become inapplicable in the light of the new law and all income, be it from member or otherwise, has henceforth been made taxable under the Act.

### Deductions Available to Co-operative Banks / Banks

Co-operative banks, unlike other commercial banks, are subjected to dual control from both RBI as well as from state co-operative department. The accounting treatment for a co-operative bank is, therefore, a result of guidelines from both the controlling authorities. Ordinarily a deduction is not available to an assessee unless specifically provided under the Act. This is irrespective of the accounting treatment provided by the assessee in its books of account. But at the same time it is well settled that the deduction expressly mentioned under the Act are not exhaustive and profit is to be derived according to ordinary commercial principles.

The various special deductions available to a co-operative bank are as under:

**(a) Claim for Bad Debts:** The risk of bad debts is one of the most significant risks in financial sector and is an inherent feature of the credit system. The only loss available as deduction under the Act is in respect of bad debts, which is covered under section 36(1)(vii). The co-operative sector is already suffering from heaps of NPAs and rising bad debts. An assessee engaged in the business of money lending/banking can claim bad debts in respect of loans and advances given in the ordinary course of its business. A debt is created by a bank/financial institution immediately on disbursement of a credit facility. Recovery of the principal and interest thereon is a subsequent event. If the loan is proved to be bad, based on certain criterion, the financial sector is mandated to make provision in the books.

**Section 35DDA of the Act provides that where an assessee incurs any expenditure by way of payment of any sum to an employee at the time of his retirement in accordance with any scheme of voluntary retirement, one fifth of the amount so paid shall be deducted in computing the profit and gains of the business and the balance shall be deducted in equal installments for each of the four immediately succeeding years. Therefore, only one-fifth of such expenditure should be claimed in each of the five years.**

The claim for bad debts is available to all assesseees under section 36(1)(vii) subject to satisfaction of certain conditions specified under section 36(2) of the Act. Accordingly, the deduction on account of bad debts which are written off as irrecoverable in the accounts of a bank is also admissible. However, as co-operative banks are also eligible for a deduction as regards provision for bad and doubtful debts under section 36(1)(vii) w.e.f. 01.04.2007, the deduction under section 36(1)(vii) on actual write off of bad debt is restricted to the write off in excess of the provision for bad and doubtful debts made under section 36(1)(vii).

Further, the deduction for bad debts would be allowable subject to satisfaction of requirement of provisions of section 36(2)(v). Thus, if a bank makes a provision for bad and doubtful debts (in relation to urban or rural advances), clause (v) of section 36(2) obliges the bank to debit that part of the debt to be written off to the Provision for Bad and Doubtful Debt Account made under clause (vii) as otherwise it cannot claim or avail deduction under clause (vii). The deduction for both bad debts and provision for bad and doubtful debts, no doubt is independent of each other. The only connection between these two sections is that the same amount cannot be allowed as deduction twice merely because they overlap in some areas.

The scope of proviso to section 36(1)(vii) was duly explained by the Madras High Court in *CIT vs. City Union Bank Ltd.* (2007) 213 CTR (Mad) 113: (2007) 291 ITR 144 (Mad). The Court observed as under:

*"According to us, the scope of the proviso to clause (vii) of section 36(1) of the Act is only to deny deduction to the extent of bad debt written off in the books with respect to which provision is made under clause (vii) of the Act. To make it clear, if the bad debt written off relates to debts other than for which the provision is made under clause (vii), such debts will fall squarely under the main part of clause (vii) which is entitled to deduction and in respect of that part of the debt with reference to which a provision is made under clause (vii), the proviso will operate to limit the deduction to the extent of the difference between that part of the debt written off in the*

**The claim for bad debts is available to all assesseees under section 36(1)(vii) subject to satisfaction of certain conditions specified under section 36(2) of the Act. Accordingly, the deduction on account of bad debts which are written off as irrecoverable in the accounts of a bank is also admissible. However, as co-operative banks are also eligible for a deduction as regards provision for bad and doubtful debts under section 36(1)(vii) w.e.f. 01.04.2007, the deduction under section 36(1)(vii) on actual write off of bad debt is restricted to the write off in excess of the provision for bad and doubtful debts made under section 36(1)(vii).**



*previous year and the credit balance in the provision for bad and doubtful debts account made under clause (vii)".*

The scope of the proviso to clause (vii) of section 36(1) is, therefore, only to deny the deduction to the extent of bad debt written off in the books with respect to which provision was made under clause (vii). If the bad debt written off relates to debts other than for which the provision is made under clause (vii), such debts will fall squarely under the main part of clause (vii) which is entitled to deduction and in respect of that part of the debt with reference to which a provision is made under clause (vii), the proviso will operate to limit the deduction to the extent of the difference between that part of debt written off in the previous year and the credit balance in the provision for bad and doubtful debts account made under clause (vii). The same view was also upheld in *South Indian Bank Ltd. vs. Commissioner of Income Tax* (2003) 183 CTR (Ker) 21 : (2003) 262 ITR 579 (Ker).

Thus, it is evident that both the clauses of sections 36(1), (vii) and (vii) are separate, distinct and independent. It is always open for the assessee to claim benefit of the provision which enables him a larger benefit. However, under no circumstances it should lead to double deduction of the same debt. This view is also upheld in case of *CIT vs. Bank of Rajasthan Ltd.* (2002) 255 ITR 599 (Raj.).

As stated earlier, the proviso to section 36(1)(vii) limits the claim for bad debt only to such amount written off as bad as it exceeds the credit balance available in the provision for bad and doubtful debt

(for short referred as "PBDD") account created under section 36(2)(viiia) of the Act. There were considerable number of litigations i.r.o of the credit balance in the PBDD account. Whether the opening balance of the provision as on April 1 or the closing balance as on March 31 (after current year's provision) should be considered for determining the value of allowable bad debts. The CBDT, taking note of the decision of the Mumbai Tribunal in the *Oman International Bank SAOG vs. DCIT* (2005 92 ITD 76) and other judgments on the issue, has resolved the matter and have instructed the Assessing Officer (AO) that the credit balance for this purpose will be the opening credit balance in the PBDD Account i.e., the balance brought forward as on 1<sup>st</sup> April of the relevant accounting year.

The claim for deduction of bad debt can be best understood by way of an example:

Sr.No.	Particulars	Amount
1.	Provision for Bad & Doubtful Debts [Already allowed under 36(1)(viiia) in preceding years]	1,50,000
2.	Total Bad Debts identified for the C.Y. - Corresponding to Op - Bal of PBDD Rs. 50000 - In excess of corresponding PBDD Rs. 200000	2,50,000
3.	Provision for Bad & Doubtful Debts [Allowable as per section 36(1)(viiia)]	3,00,000
4.	Transfer Bad Debt to P&L Account	2,00,000
5.	Transfer PBDD to P&L Account	3,00,000
6.	Balance in PBDD Account Carried Over	4,00,000

The claim for deduction of bad debts, more often than not, is disallowed by AO on the ground

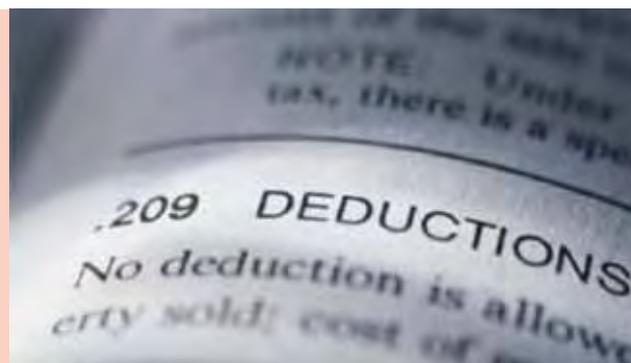
that the bad debt written off is not credited to debtor account but is simply credited to reserve or some contra account. In a similar matter before the Amritsar Bench of ITAT in the case of *Deputy Commissioner of Income Tax vs. The J&K Bank Ltd.* (2006) 104 TTJ (ASR) 593 it was held that "there is no requirement under the law that amounts must be written off by crediting the account of respective debtors."

**(b) Reserve/Provisions for Bad and Doubtful Debts:** The phrase Bad and Doubtful debt had been interpreted way back by the Calcutta HC in the case of *Hong Kong and Shanghai Banking Corporation vs. Commissioner of Income Tax* (1955) 28 ITR 199 (CAL). The two words "bad" and "doubtful" are always applied adjectively to the same class of debts, meaning debts of which the chance of recovery is nil or slender.

Estimation of doubtful debts to be bad is not an impossible notion and if bad debts could be held to be irrecoverable, wholly or in part, and doubtful debts could be held to be bad, one cannot see why doubtful debts cannot be held to be irrecoverable. However, unlike the allowance to Bad Debts which is available to all the assesseees, deduction on account of provision for bad and doubtful debts is available only to the financial sector due to the specific permission granted (from assessment year 1980-81 onwards) to make provision for doubtful debts, *vide* section 36(1)(viiia).

Section 36(2)(viiia)(a) of the Act grants deduction i.r.o. Provision for Bad and Doubtful Debts made by certain financial institutions. The said deduction is available as deduction to a Co-operative Bank w.e.f. 01.04.2007, subject to certain ceilings based on percentage of total income and of the advances made by the rural branches of the bank. The deduction on account of PBDD is allowable to the following extent, irrespective of the actual provision made in books of account:

It is evident that both the clauses of sections 36(1), (vii) and (viiia) are separate, distinct and independent. It is always open for the assessee to claim benefit of the provision which enables him a larger benefit. However, under no circumstances it should lead to double deduction of the same debt. This view is also upheld in case of *CIT vs. Bank of Rajasthan Ltd.* (2002) 255 ITR 599 (Raj.).



Sr.	Criteria	Ceiling
1.	Total Income (computed before making any deduction under this clause and Chapter VI-A but after adjusting brought forward losses)	7.5% of GTI before allowance u/s 36(1)(viiia)
2.	Aggregate Average Advances by Rural Branches of Bank computed as prescribed u/r 6ABA	10% of such Advances

For working out the aggregate average advances by rural branches of a bank, the assessee should list down the branch(es) and categorise 'rural branches' as per the definition in Explanation (ia) below section 36(1)(viiia). Accordingly all branches of a bank, which are situated in a place which has a population of less or equal to 10000 according to the last preceding census can be categorised as rural branches. It is advisable that a chart of such Rural Branches should be prepared in the following format to comply with the provisions of the both sections 36(1)(viiia) and rule 6ABA.

Sr. No.	Name of Branch	Population as per last census on 1 <sup>st</sup> April	Average Advances (Σ Monthly Advances/No. of months)
1.	A	<=10000	X
2.	B	<=10000	X
3.	N	<=10000	X
		<b>Total</b>	{Sum Above}– Aggregate average advances by rural branches

The PBDD can, therefore, be divided into two parts viz. Provision for Rural Advances (Specific) and Provision for Other Advances (General). The total deduction for provision for bad and

doubtful debts, however, is restricted to the amount of such provision actually created in the books of the assessee in the relevant year or the amount calculated as per limits provided hereinabove, whichever is less. The allowable deduction can be best explained by way of an example:

Sr.	Particulars	Amount
1.	Aggregate Average Advances by Rural Branches	10,00,000
2.	Gross Total Income before deduction u/s 36(1)(viiia)	5,00,000
3.	Provision for Rural Advances @ 10% of (1) above	1,00,000
4.	Provision for Other Advances @ 5% of (2) above	25,000
5.	Total Allowable Provision u/s 36(1)(viiia) [(3)+(4)]	1,25,000

**(c) Deduction for Special Reserve:** A special deduction is now available to specified financial institutions including co-operative banks in respect of a special reserve created and maintained out of profit derived from the business of providing long-term finance (Repayment period 5 Years) for industrial, agricultural, infrastructural development or for purchase/construction of residential houses.

The maximum amount of yearly deduction under this clause is limited to an amount of 20% of profits (before making any deduction under this clause and Chapter VI-A) derived from the business of providing such long-term finance or the amount transferred to such special reserve, whichever is less.

However, the deduction under this clause is available so long as the aggregate of the amounts credited to the special reserve account from time to time, do not exceed 200% of the paid up share capital and general reserve of the bank.



For working out the aggregate average advances by rural branches of a bank, the assessee should list down the branch(es) and categorise 'rural branches' as per the definition in Explanation (ia) below section 36(1)(viia). Accordingly, all branches of a bank, which are situated in a place which has a population of less or equal to 10000 according to the last preceding census, can be categorised as rural branches.



The conditions for special reserves should be rigidly applied and the assessee bank has to create the reserve by debit to the Profit & Loss account only.

In case if any amount is withdrawn from the special reserve or the assessee bank ceases to maintain such reserve account, the whole of amount so withdrawn or written off shall be chargeable to tax under section 41(4A) in the year of such withdrawal or such write off.

**(d) Depreciation on Investments:** As per the extant RBI guidelines dated 1<sup>st</sup> July, 2009, the investment portfolio of the banks is required to be classified under three categories viz. Held to Maturity (HTM), Held for Trading (HFT) and Available for Sale (AFS). The valuation of each kind of investment is to be done in the following manner.

Sr. Classification of Investment	Valuation Norms
1. HTM	These are carried at <u>acquisition cost</u> unless the cost is more than the face value, in which case the premium should be amortised over the period remaining to maturity. The premium is required to be amortised over the period remaining to maturity. This apart, any permanent diminution in value <u>shall FV shall go on to reduce cost of the investment.</u>
2. AFS	The individual scrips in the Available for Sale category will be <u>marked to market</u> at quarterly or at more frequent intervals. These investments are considered to form stock-in-trade of a bank and therefore are to be valued at cost or NRV, whichever is less. Fall in value below cost, therefore, is

### 3. HFT

to be provided immediately, however any net appreciation in value is ignored and not recognised as income on the basis of conservatism.

The individual scrips in the Held for Trading category will be marked to market at monthly or at more frequent intervals and provided for as in the case of those in the Available for Sale category.

The Master Circular of RBI on Investment by Primary (Urban) Co-operative Banks requires a co-operative bank to debit the provision required on account of depreciation in the "Available for Sale" and "Held for Trading" category in any year to the Profit & Loss Account and an equivalent amount (net of tax benefit, if any) should be transferred from the Investment Fluctuation Reserve to the Profit & Loss Account.

Further, in respect of securities included in any of the three categories where interest/principal is in arrears, the banks should not reckon income on the securities and should also make appropriate provisions for the depreciation in the value of the investment. The banks should not set-off the depreciation requirement in respect of these non-performing securities against the appreciation in respect of other performing securities.

Depreciation in value of investments held by bank is allowable as business deduction at various appellate levels. The Bombay HC in case of *Commissioner of Income Tax vs. Bank of Baroda* (2003) 262 ITR 334 (Bom) has held that: "Depreciation in value of investments held by bank was allowable as deduction more so when the loss was debited to P&L A/c which was reflected as a provision for liability in the balance sheet and the shares and securities were valued at cost on the asset aside."

The CBDT has also, in its Instruction No. 17/2008 and Circular No. 599, dated 24<sup>th</sup> April, 1991, taken a

It could be appreciated that the issue of penal interest to RBI is still a hanging pendulum and one needs to wait for the apex court to decide the issue and resolve the conflicting opinions in this regard. In the humble opinion of the author the payment of penal interest, mostly, is driven by commercial compulsion rather than malafide intentions of the assessee bank. Hence, such penal interest levied for not complying with liquidity ratio remains compensatory in nature and may be allowable as business expenditure.



view to allow depreciation on securities in accordance with the extant RBI guidelines and securities to be treated as stock-in-trade and not investments.

The Investment Fluctuation Reserve (IFR) maintained by banks as per the extant RBI Guidelines in order to guard against market risks as a percentage of the investment portfolio in HFT & AFS Category by 31<sup>st</sup> March, is however, not allowable as deduction under the Income-tax Act, 1961.

**(e) Voluntary Retirement:** Section 35DDA of the Act provides that where an assessee incurs any expenditure by way of payment of, any sum to an employee at the time of his retirement in accordance with any scheme of voluntary retirement, one-fifth of the amount so paid shall be deducted

in computing the profit and gains of the business and the balance shall be deducted in equal installments for each of the four immediately succeeding years. Therefore, only one-fifth of such expenditure should be claimed in each of the five years.

**(f) Interest paid for not meeting liquidity requirement:** The issue of deduction of interest paid to RBI on account of failure to meet liquidity requirement prescribed under section 24 of the Banking Regulation Act, 1949 has been discussed before various appellate authorities and there are divergent views in respect of allowance of such "penal interest" paid to RBI by banks. The three different views of the various appellate authorities are summarised as under:

Sr.No.	Appellate Authority/Case	View
1.	ITAT, Cochin Bench <i>Deputy Commissioner of Income Tax vs. Dhanalakshmi Bank Ltd.</i> (2002) 76 TTJ (Coch) 439	Penal interest paid by assessee-bank to RBI for non-maintenance of Cash Reserve Ratio (CRR) and/or Statutory Liquidity Ratio (SLR) could not be considered as having been incurred for any infraction of law and, therefore, deduction thereof could not be disallowed.
2.	High Court of Kerala <i>Commissioner of Income Tax vs. Catholic Syrian Bank Ltd. &amp; Ors.</i> (2003) 183 CTR (Ker) 1 : (2004) 265 ITR 177 (Ker)	From the provisions of the two enactments i.e. the RBI Act and the Banking Regulation Act, it would appear that sections 42 and 24 respectively contain the provisions of compensatory nature as well as penal interest; if the payment of penal interest relates to first default of non-compliance of those provisions such payment cannot be treated as penalty for infraction of law and cannot be disallowed in the hands of assessee-bank; but the payment for the second default under the aforesaid provisions, has to be treated as penalty for infraction of law and accordingly liable to be disallowed.
3.	High Court of Karnataka <i>CIT vs. Syndicate Bank</i> (2003) 180 CTR (Kar) 1	Penal interest paid by the assessee-bank for non-compliance of the provisions of section 24 of the Banking Regulation Act, 1949, cannot be allowed as a permissible item of business expenditure, same being in the nature of a penalty for contravention of a statutory provision. The Court relied on the Supreme Court decision in <i>Maddi Venkataraman &amp; Co. (P) Ltd. vs. CIT</i> (1998) 144 CTR (SC) 214 : (1998) 229 ITR 534 (SC).

In view of above, it could be appreciated that the issue of penal interest to RBI is still a hanging pendulum and one needs to wait for the apex court to decide the issue and resolve the conflicting opinions in this regard. In the humble opinion of the author, the payment of penal interest, mostly, is driven by commercial compulsion rather than *malafide* intentions of the assessee bank. Hence, such penal interest levied for not complying with liquidity ratio remains compensatory in nature and may be allowable as business expenditure.

**(g) Interest on Sticky Loans:** This is another area of major controversy in case of assessment of banks. There has been divergence of judicial opinion in respect of taxation of such interest on such non-performing advances. The controversy, though, is set to rest by the decision of apex court in *UCO Bank vs. CIT* (1999) 237 ITR 889 (SC). The Court observed that the interest income pertaining to doubtful loans as not real income in the year in which it accrues, but only when it is realised. This is also consistent with AS-9 on *Revenue Recognition*, issued by ICAI and the IRAC norms issued by RBI from time to time in this regard.

Interest on sticky loans are normally very difficult to recover; taxing such income on accrual basis reduces the liquidity of the bank without any actual generation of income. The Finance Act, 1991, therefore, has introduced section 43D with a view of improving the viability of banks, public financial institutions, so as to provide that interest on sticky loans shall be charged to tax only in the year in which the interest is actually received or is credited to the "Profit & Loss Account", whichever is earlier. However, it is to be noted that the said section 43D is not applicable to co-operative banks. However, in the humble opinion of the author, banks following Cash System for interest on sticky loans on a consistent basis, may continue to do so in view of

the judgment in *UCO Bank vs. CIT* (supra) and analogy drawn from Circular No. 491 dated 30/06/1984.

In order to settle any dispute that could arise in future, the said provisions of section 43D should also be extended to co-operative banks and other such financial institutions.

**(h) Broken period interest:** The issue of tax treatment of broken period interest on securities has also been a subject matter of litigation before various appellate authorities. Interest on fixed income bearing securities generally accrues regularly but is paid / fall due only on specified dates, for example 31<sup>st</sup> March or 31<sup>st</sup> September etc., and therefore, the buyer of such security has to pay interest to the seller i.r.o. the period from previous date of interest payment to the date of sale. This interest for broken period is revenue receipt for the seller and revenue expenditure for the buyer. However, the revenue has vehemently contended that the interest for broken period go out to increase the cost of the investment and is not allowable as deduction from interest income.

#### Example of BPI:

1.	5.0 per cent GOI Loan, 2015, at Face Value	10,00,000
2.	Half Yearly interest payable on 12 <sup>th</sup> May and 12 <sup>th</sup> Nov., every year by RBI on SGL	50,000 for each half year to the bank whose name appear as holders in the PDO/SGL Account
3.	Date of Purchase of Security	1 <sup>st</sup> Jan
4.	Period for which interest accrued but not due (BPI)	13 <sup>th</sup> Nov to 31 <sup>st</sup> Dec (i.e. 49 days)
5.	Amount Payable – Rs. 10,13,462	Towards FV - Rs. 10,00,000 Towards BPI for 49 days - Rs. 13,462 (Approx).

**A special deduction is now available to specified financial institutions including co-operative banks in respect of a special reserve created and maintained out of profit derived from the business of providing long term finance (repayment period 5 Years) for industrial, agricultural, infrastructural development or for purchase / construction of residential houses.**



The BPI of Rs. 13,462 is normally claimed as deduction and the entire interest of Rs. 50,000 received on due date is offered as revenue income.

This enables only the net interest attributable to the purchaser being offered as income.

The situation has also aggravated by conflicting judgments by courts in this regard. The different views in respect of such BPI are as under:

Sr.	Appellate Authority/Case	View
1.	Supreme Court in case of <i>Vijaya Bank Ltd. vs. CIT</i> (1991 187 ITR 541)	“Amount spent on purchase of securities being capital outlay cannot be set off against interest income. Accordingly, the issue was decided in favour of Revenue and the deduction for such broken period interest was disallowed.
2.	Bombay High Court <i>American Express International Banking Corporation vs. CIT</i> (2002 258 ITR 601)	It was held only after analysis of <i>Vijaya Bank</i> case (supra) that once the broken period interest received by assessee-bank on Government securities was charged to tax as business income under section 28, deduction for payment made for broken period interest at the time of purchase of these securities could not be denied when the assessee's method of accounting does not result in loss of tax/revenue for the Department. The court dissented from the decision of the SC on the ground that it was rendered u/s 18 of the Act, which was no longer extant. Accordingly the issue was decided in favour of the assessee and BPI was held allowable as deduction.

3. High Court of Rajasthan *Commissioner of Income Tax vs. The Bank of Rajasthan Ltd.* (2008) 218 Ctr (Raj) 417

The court decided the issue in favour of the department upholding the findings of the apex court in *Vijaya Bank's* case and dissented from the *American Express* case, both referred hereinabove. The court observed that amount paid by bank towards broken period interest on securities purchased by assessee is not an allowable deduction.

The CBDT, has also, in the present instruction on assessment of bank, indicated that where an assessee bank purchases securities under capital account at a price inclusive of any accrued interest (i.e. at cum-interest price), the entire purchase consideration is in the nature of capital outlay. Therefore, any interest element included in the purchase consideration is not allowable as expenditure against income accruing on those securities. In would be worth noting that the said observation of CBDT is contrary to its own circular No. 599, dated 24/04/1991 issued in the past. In fact, the said circular was withdrawn only because of the findings of the apex court in favour of the revenue.

Sound policy requires such interest for the broken period to be reduced from the cost of investment, being capital receipt and only the balance, i.e. pertaining to the period post acquisition, should be made taxable as revenue income.



**Conclusion**

Financial institutions and banks, definitely, are into a different genre of business and deserve to be treated specially. The Act has also recognised the need to treat them distinctly, by framing separate provisions for its assessment. Its taxation being typical in nature requires meticulous study of the specific provisions applicable to the banking industry. More so, applicability of such provisions to co-operative banks being relatively new, there is a need for exercise of more caution while finalising tax returns of the co-operative banks.

# Financial Modelling: An Opportunity for CAs



Identifying the right area for change and improvement is of paramount importance for the overall success of a business organisation. It becomes especially relevant when one's business operates in extremely challenging macro and micro economic indicators. Financial Modelling is nothing but a mathematical mapping of business strategies of your financial statements. Managers would be enabled to run the simulation in a computer environment and immediately see the impact of their change, without risking costly setbacks of real world trials and errors. Organisations simply cannot afford to try out new strategies in reality and correct mistakes, once they've occurred. The stakes are too high. Thus emerges the utility of this technique across financial planning, risk management and business process mapping. This article presents a basic understanding on this relatively uncharted territory.



**CA. Anurag Singal**

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

**T**he post-liberalisation era saw Indian companies becoming increasingly integrated with the global economy by establishing operations overseas, increasing the export/import intensity, entering into global sourcing/marketing alliance, raising funds from overseas market, etc. In the recent past, India Inc. has had to cope with uncertainty of a magnitude like never before. Global markets are today in a state of turmoil and the domestic markets having accordingly followed suit, even within India, companies can no longer afford to assume fixed capacity utilisation and a ready-market scenario. Key indicators of economic prosperity, be it the GDP Growth Rate or the "The Index of Industrial Production" (IIP) numbers, had witnessed a significant downside as a consequence of the global financial crisis. In the same breadth, forex fluctuations have adversely impacted the overseas borrowings of our leading companies. This is a clear sign of discord between expectations and reality in the changed scenario. Without the companies adopting concrete pre-emptive and reactive measures, the gloom could kill a business before it hits its stride.

**“Let our advance worrying become advance thinking and planning” - Winston Churchill.**

In times when the demand-supply equation may not really be conducive to business operations or may undergo erratic swings, corporate needs to have a dynamic mechanism to gauge the likely impact of the market turbulence on their fortunes and thus arises the need for financial modelling.

Among the various possible uses of the same, generating the revenue and expense forecasts is of paramount importance. In conjunction with the proposed capital expenditure plans and debt servicing obligations of the company, this could be a source of crucial insights for decision-making and foresee the possible scenarios of profitability and liquidity.

### Financial Modelling: Applications



The exercise would then act as a baseline for management’s adoption of contingency measures:

- Sprucing up their marketing efforts to streamline revenues or adopting cost-rationalisation initiatives
- Scaling down of capex plans (or alternatively prioritizing between various projects) determine how much investment capital is required and thus scout for additional funding (if required)
- Undertaking production cuts, as deemed to be appropriate, to prevent inventory build up beyond tolerable limits

While the measures as outlined above could vary according to the unique business dynamics of the various segments of the company, it goes without saying that the exercise of creating a sound financial model would go a long way in helping

management cope with uncertainty and focus on the value-creation process for stake-holders.

Companies require robust financial models to help them in analysing the complexities of the geographies where they operate, consider multiple currencies in their projections, evaluate varying capacity as well as capacity utilisations combinations to find out the optimal capacity under varying industry demand-supply scenarios and a host of similar cases.

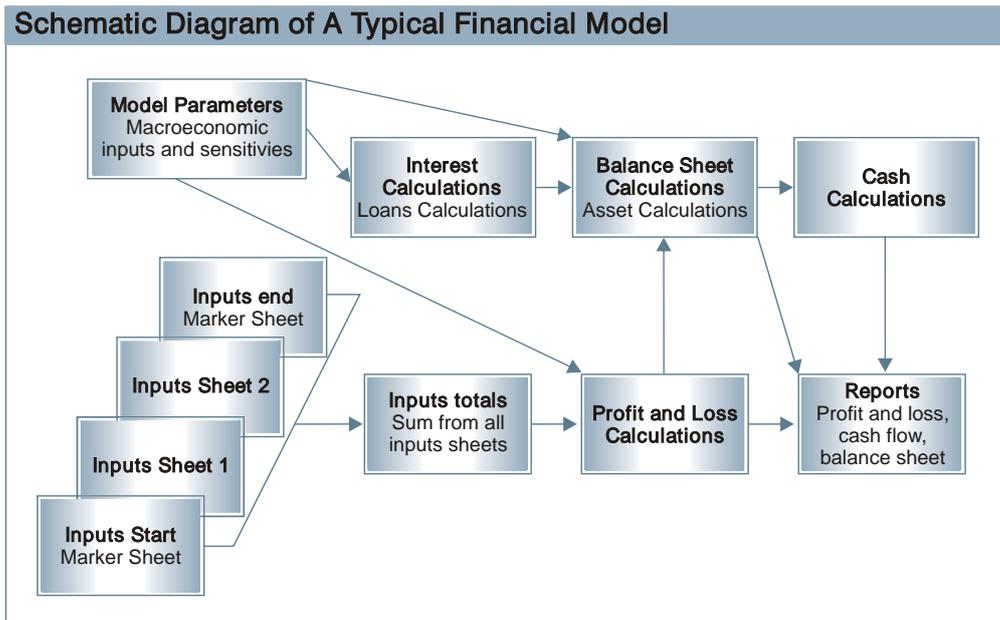
### Concept

The Oxford Dictionary defines the word *model* as a simplified mathematical description of a business/process. Model is a representation of reality. In other words, financial modelling is the task of building an abstract representation of a financial decision making situation. A mathematical model is designed to represent the anticipated performance of a financial asset or a portfolio of a business, a project, or any other form of financial investment.

A typical financial model would enable simulation of cost and revenue relations to support business decisions. It is prepared whenever any organisation is considering project finance, bidding for a project, evaluating acquisition target, carrying out periodic financial planning, conducting capital structure studies, etc.

### Preparing a Spreadsheet Model

Building reliable and thorough models needn’t be a painful process – as long as one sticks to the basic principles. Before one starts to build a financial model, it is essential to plan the design and structure of the model. The planning stage of the model is very important. This is particularly true with a large, complex model that has a number of separate worksheets. One needs to have a clear understanding of the aims and objectives of the model so that the model can be designed in strict conformity with the same. The objective could either be to generate a profit & loss account, balance sheet and cash flows statement or to compute the price to be paid for the target or to compute the target requisite sales volume for achieving a desired profit level. The model should clearly be able to forecast the pattern of cash flows for the company in the near future and enable its executive management to fully understand the cash implications and subtleties of the timing of payments and receipts with its attendant impact on liquidity.

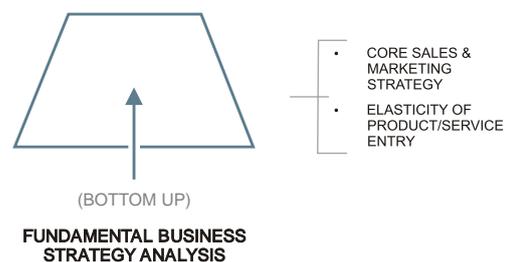


The core five elements of a financial model are:

- **Revenue:** The channels from which your business generates revenue and how much from each stream
- **Cost of Goods (COGS):** The cost of selling your product or service
- **Operational Expenditures (OPEX):** How much your business spends in order to sustain the scale of its day to day operations
- **Income Statement:** How much net profits or losses your business will incur during a period of time
- **Cash Flow:** How much cash your business generates and uses during a given time period
- **Capital Expenditures (CAPEX):** Money spent acquiring or upgrading physical assets i.e. Property
- **Balance Sheet:** Summary of a company’s assets, liabilities and share holders equity at a given time period
- **Working Capital:** How well a company manages its current assets vs. current liabilities

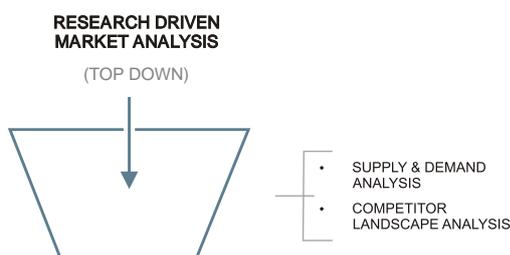
In this approach, the company tries to assess its share of the pie and accordingly builds up its costs and revenue on a broad level. This is done by estimating the overall market potential for its product/service offering and then determining where it stands on the competitive landscape. In other words, the forecasts for are initially developed at the brand, category or division level, and then allocated down to the lower levels. The overall expectations so determined percolate down to the value chain as specific targets for individual business units (profit centres). You can then plan and forecast sales and inventory requirements accordingly.

## 2. Bottom Up Approach



## Approaches to Financial Modelling

### 1. Top-Down Approach



On the other hand, in the bottom-up approach, individual activities and projects of a company become the focal point for planning action and operational managers have the freedom and flexibility to chart out their roadmap for the planning horizon. These individual figures are then aggregated to arrive at projected performance numbers for the company as a whole.

## Steps Involved in Preparing a Model

### Step 1

A good financial model is simply a translation of business plan wording into numbers. Since this model becomes the financial roadmap of the company, all endeavor should be to capture the complexities of the business and generate streamlined and accurate data flows. The first step is to gather information on key parameters affecting the business which could be broadly as follows: *Understand as to what are the cost and revenue drivers for the company and what are the macro and micro economic indicators which could have a bearing on the same.*

For a petrochemical company in India, revenues, in terms of Gross Refining Margins (GRM) would vary substantially in line with international crude prices and the administered petroleum prices. Similarly the EBITDA (Earnings before Interest, Tax, Depreciation and Amortization) margins for a company in the aluminium space would vary proportionately with the international/domestic prices of Aluminium Ingots, Bauxite and Electricity. Factors such as Inflation could have a more evident bearing on the fortunes of FMCG or Consumer Durables companies because their business model is based on tapping the surplus liquidity in the hands of an individual customer. All forecasts are assumptions (some of the major ones would be price, sales growth and cost of goods sold). The trick is to be reasonable and defensible while making them.

### Step 2

For internal analysis business, understand the Cost Behavior Pattern in terms of whether it is committed or variable. For example, a company which goes into branding the goods sourced from Contract Manufacturers or engages labour force on contract basis would have lesser a burden of fixed overheads as compared to a company with in-house manufacturing facilities and a substantial number of people permanently on its payroll. An assumption made today that online advertisements would drive a company's business revenues to US \$ 10 million by year 2014 would be solely impacted by the variable factor called *Click-Through-Rates*. If the same is 0.1 per cent, therefore a website, which receives 100,000 page visits, would probably convert roughly 100 potential sales leads per ad campaign.

### Step 3

Model the relations among parameters. They are usually linear relations, e.g. manufacturing 1

shirt, priced at Rs. 250 would require 2 meters of cloth purchased @ Rs. 50 per metre and entail an overhead expense of Rs. 75, but in some cases one may observe non-linear relations as well. In either case, establishing the relationship in an integrated manufacturing is not an easy task and one has to rely on past data and subject it to different statistical tests.

### Step 4

Models ought to be dynamic. Nothing ever works the way you thought and reasonable models provide flexibility to adjust to reality. Incorporate sensitivity analysis into the model in order to answer *What if* questions. For example, what if the selling price of shirt falls down to Rs. 205 in the above example or the raw material costs go down to Rs. 40 per meter. The user must have the flexibility to vary each model parameter, one at a time or even more than one simultaneously and observe change in outcome (profit, break-even level) and also calculate Model Elasticity (per cent change in profit/per cent change in parameter).

Make the structure as flexible as possible so that one can change an individual module later on without changing the rest of the model. For example, the key output of the production module which is being taken to other sheets can be summarised at one place within the production module. Thus, if required at a later stage, one can introduce the capacity expansion in the production module without having to change the rest of the model.

### Step 5

Since each model parameter could vary in a given range, the model should also have a Scenario Analysis feature where the user is able to generate outcomes under the Best, Worst, and Most-Likely cases. This would help one to evaluate risk under alternative scenarios by measuring effects of possible parameter changes. Thus, the up-side and down-side risks of adopting a particular strategy would be clearly foreseeable

Scenarios are feasible combinations of parameters:

- Best case – Highest sales prices + lowest costs (*only one possibility*)
- Worst case – Lowest sales prices + highest costs (*only one possibility*)
- Most-likely case – Most likely combination of prices and costs

A typical profit planning model for a gaming company would be as follows:

	A	B	C	D
1	<b>Profit planning model</b>			
2	<b>Input data</b>		Sales price per ticket	\$ 7.00
3	Ballpark seating capacity per game	4,000	Variable cost per ticket	\$ 2.00
4	Home games per season	54	Committed facility costs per season	\$ 450,000
5	Average percentage seats sold per game	85%	Target profit	\$ 400,000
6				
7	<b>Breakeven analysis</b>		<b>Planned profit analysis</b>	
8	Committed costs (D4)	\$ 450,000	Planned sales volume in units (B3*B4*B5)	183,600
9	Divided by contribution margin per ticket (D2-D3)	\$ 5.00	Sales revenues (D2*D6)	\$ 1,285,200
10	<b>Breakeven volume in units (B8/B9)</b>	<b>90,000</b>	Less variable costs (D3*D6)	367,200
11	<b>Target profit analysis</b>		Contribution margin (D9-D10)	918,000
12	Committed costs (D4)	\$ 450,000	Less committed costs (D4)	450,000
13	Plus target profit (D5)	400,000	<b>Operating profit (loss) (D11-D12)</b>	<b>\$ 468,000</b>
14	Target total contribution margin (B12+B13)	\$ 850,000		
15	Divided by contribution margin per unit (D2-D3)	\$ 5.00		
16	<b>Target volume in units (B14/B15)</b>	<b>170,000</b>		
17				

## Guidelines to Enhance the Utility of the Model

### 1. Modular Structures

Set up modular structure so that it is easy to build the model initially and also to maintain and update it later in view of the changed business realities. For example, the entire model can be broken into various modules such as production volume, sales value, working capital, tax computation, depreciation computation, etc. For each element of the financial model one would need to deal with the implications for profit and loss, cash flow and balance sheet. It could be done with greater ease and accuracy with a series of four-line or five-line schedules that will form the heart of the integrated model. This calculates the opening and closing balance of an "account" and the movements in and out.

Taking a debtor account, for example, the schedule above provides the values needed to ensure that an integrated model can be produced. The model preparer would need one of these

schedules for every category of asset, debtor, creditor and all other balance-sheet entries. For example, a separate segment for the company's Fixed Assets Block (Gross and Block) would typically incorporate the impact of capex/disposal of assets planned to be incurred during the future year. Similar calculations could be made for calculation for Deferred Taxes Calculation. Details of the same can then flow into the integrated model.

### 2. Integrity Check

To ensure that the balance sheet stays in balance and to provide an integrity check, one should calculate all of the lines in the balance sheet and then check that it does balance. Although it is often difficult to operationalise this tenet, it's still advisable to resist the temptation to put a "fix" into a formula. If the balance sheet doesn't balance, find the problem and solve it. Double-entry bookkeeping has survived as the basis for all accounting because of the rigour it imposes. The simple method, when used in an integrated financial

### Sample schedule for Debtors Account

	Period 1	Period 2	Financial Report Affected
Opening Balance	300	320	
Additions (Credit Sales)	90	80	via P&L Account
Payments Received	(70)	(85)	Actual cash Flow in the period
Closing Balance	320	315	Balance Sheet
Working Capital Movements	-20	5	Used in Cash Flow Statement

model, will allow one to produce a balancing balance sheet, instilling confidence in it among users. Set up cell logic (for example, the maximum and minimum limits of debt-equity ratios, the maximum capacity utilisation, funding constraints, etc.) of the modules so as to minimise errors when building the model and make it easier to find and correct errors.

### 3. Control Checks

Use as many control checks (for example, total assets = total liabilities, sum of product mix = 100 %, opening stock + production/purchases - sales - closing stock = 0, etc.) as possible to ensure that there is no conceivable error in the model. Also, they should be built in such a way that they automatically flash whenever an error occurs in the model. It would also be a good idea to familiarise oneself with the advanced features of Excel and frequently using them, for example, the data validation feature avoids the accidental selection of incorrect value for an input cell.

### 4. Documentation

Ensure the model has adequate documentation so that it can be easily modified later. The documentation would help in understanding the design and structure of the model and would be particularly useful when the model is required to be operated by a person other than the person who has developed it. Every financial model would have multiple worksheets and calculations. To help users understand the model, one can put a schematic diagram on the front sheet of the model for describing the various sheets and indicating how they interact with each other. One can also use hyperlinks to the relevant modules, thereby making the first sheet as a navigational tool, helping users to find their way around.

### 5. Pre-launch Testing

We wouldn't be expected to buy software that hasn't been through the rigours of alpha and beta testing before going on sale, but many spreadsheet models receive little more than a cursory inspection.

However, it must be noted that the review and test phase of a financial model is the most critical part of the entire model making process, but is often the most neglected one. In this stage, a cell by cell detailed review of the model is undertaken so as to check the mathematical accuracy and logical integrity of the model. To test a model is to root out errors and inconsistencies and to increase confidence in the reliability of results produced by the model.

The level of testing would be a function of the

risk associated with the errors. If a financial model is developed to make investment decisions involving a sizeable chunk of the company's funds, one has to ensure that it should be tested exhaustively. If you are borrowing on the strength of the model, the lender is likely to insist on a full independent review. But if it's for an internal departmental budget, testing could justifiably be less extensive. Varying input values and observing the impact on outputs is also a useful technique for spotting errors. One may also consider taking the help of independent experts for carrying out the testing of the model.

There are software available that are designed to help in the review process, but there's no substitute for checking both the numerical and formulaic content of the model. To achieve the highest level of comfort, an independent and experienced person should check each unique formula in the model. This may not be as onerous as it sounds: a well-constructed model will contain only a small percentage of formulas that are not copied across or down. At least check that formulas are copied across rows correctly and perform some sense-checking of the numerical output of the model.

### Possible Pitfalls

One should refrain from committing the following mistakes while preparing the model:

- Presenting financials without having the ability to discuss detail if asked. While the figures generated by a model are seldom reality because it is literally impossible to capture the intricacies of real-life business processes. Its logical framework should ideally demonstrate that the preparer fully understands the intricacies of the business. The model should not suffer from a failure to understand industry comparables and know the dynamics of gross profit margins, expense levels as a per cent of revenue and operating margins.
- Revenue growth always takes a longer period and is often more difficult than predicted. One must understand the sales qualification and challenges before adopting overly optimistic assumptions and it's always prudent to view projected growth trends with a sense of skepticism before adopting them into the model.
- Often, people assume that the sales would increase by 20 per cent and the operating profit margin would improve by 2 per cent without

giving sufficient thought about how the same would be achieved.

- It should not happen that the revenue plan is created solely to match the expectations of the top management or meet stakeholders requirements (lenders, credit rating agencies, etc) or to simply project that everything is going to be hunky-dory and thus attempt to stretch stock market valuations beyond their realistic levels. It had been observed in the past that the stock prices of software companies take a severe beating if their actual financial numbers are not in tune with their publicly announced revenue guidance.
- It is recommended that one should give sufficient attention to the underlying factors so that the sales and profits figures can be supported by explicitly stated underlying assumptions and calculations. Another advantage is that it forces the person to question the validity of the inputs and, thus, ensures that a well-developed model is not producing garbage results due to garbage inputs being used in line with GIGO (Garbage in Garbage Out) principle.
- Competition in a free market is a reality and rather than living in a state of denial, while taking assumptions and as such, it is advisable for the company to account for competition, anticipate their strategies and perceive the likely impact on prices.

### Role of Chartered Accountants

In India, organisations, especially the SMEs do not often have the necessary skill sets in conceptualising and developing modelling solutions that can facilitate an accurate evaluation of critical complex business decisions. Their financial models are often not based on best practices and a comprehensive, independent review of the financial model by experts is seldom done. Similarly, with the passage of time and with the changes in environment, the dynamics of the business may have undergone change and the data flows need to be appropriately synchronised.

The pre-requisite is to demonstrate an understanding of the world as a set of related systems which any entity has. A comprehensive knowledge on the client's business dynamics and their relation inter-se is warranted. Besides, hands-on experience in MS-Excel and conversance with the various in-built functions is advantageous as the job entails an extensive use of complex logical arguments embedded in closely-linked spreadsheets.

With the introduction of the Limited Liability

Partnership Act, Chartered Accountant firms could collaborate with firms possessing the technical know-how and capabilities and take up Modelling assignments for SMEs on a turnkey basis. Members in practice, with demonstrated capabilities in their conventional audit and accounting assignments would be ideally suited to interact with the clients, understand the revenue and cost processes with an endeavor to make an exhaustive list of factors affecting the topline and bottomline of the business and communicate it to the technical partners. They would also be highly solicited when it comes to understanding the impact on a particular business transaction on the various components of the company's financial statements. For example, charging Depreciation of a particular amount in a year would have a material impact in terms of the Profit & Loss Accounts and the Balance Sheet but the same would be immaterial from a Cash Flow perspective (expect for the tax shield). Again, it is often possible for Chartered Accountants to prepare self-sufficient models in MS Excel alone and work independently without having to liaise with technical firms.

These models often seek to capture not only the likely impact of business parameters like revenue and cost drivers but also generate the projected financial statements (Profit & Loss Account, Balance Sheet and Cash Flow Statements) after ensuring compliance to the stipulations mandated by the different accounting conventions, namely the Indian GAAP, US GAAP and International Financial Reporting Standards (IFRS).

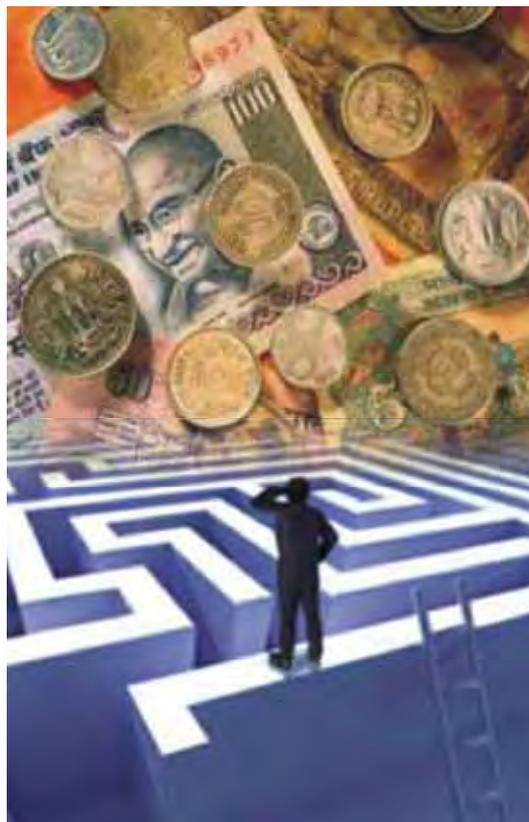
Thus it becomes imperative that we gear ourselves to harness this opportunity and prove our mettle as we have done in a vast array of non-conventional fields.

### Conclusion

With the passage of time and with the change in the business environment, it may be essential to amend the model so that it does not outlive its utility. While smaller to medium changes may be carried out in the same model and its use may be continued, one may need to scrap the old one and build a new model from scratch if the extent of changes requires making substantial amendment to the model. Therefore, financial modelling is an art and expertise in this area could be achieved through constant practice and commitment in professional rendering services to clients.

# ‘Employee’ – A Confusing Term under Employee Provident Fund Act, 1952

In Provident Fund (PF) laws the definition of “employee” has always remained focal and it bamboozles employers because there are many holes in the argument as to who would be an employee under the provision of this law for being extended the benefits of the scheme. The judiciary, rather our Apex court has laid down several guiding factors in this regard but unfortunately the authorities of PF Department just ignore them and resort to pressing an employer. They would argue, implement and enforce that every employee in the organisation is susceptible to PF membership. In this article, the author has tried to critically and analytically examine the various facets of this vexed question. He has also tried to read between the lines to arrive at a correct legal position of “employee” as dictated by the particular facts and circumstances of the case.



**Mr. S.M. Jain**

*The author is Vice-President (Personnel) with the Rajasthan Textile Mills.*

*He can be reached at [journal@icai.org](mailto:journal@icai.org)*

**T**he industries of today are passing through a recessionary period and many of them are struggling for survival. At the start of year 2008, very few entrepreneurs would have predicted that they were poised to enter perhaps the most difficult 12 months period and likewise at the beginning of year 2009 even fewer would have predicted any recovery. We believe that worst is now behind us. Still it is imperative for an industry/company to cut its manufacturing cost if it has to remain viable and economic in this period of crisis. The industries need to be cost cut-oriented. In the cost component, the labour cost is probably the most and in labour cost much is spent on implementing beneficial legislations like PF and ESI, etc.

Present time would be termed as a transition period of labour laws in our country. Very often in the name of reforms we have been amending



The number of persons to be considered to have been employed by an establishment for the purpose of PF Act has to be determined by taking into account the general requirements of the establishment for its regular work.

labour laws all indiscriminately and recklessly bringing about a cauldron of confusion. We sometimes have very harsh amendments. In EPF laws there are frequent amendments and changes which involve more biting than an employer can eschew. The practical difficulties of executing such amended provisions after change can only be felt at the point of implementation. In spite of all this whenever there arises a vexed question of labour law requiring interpretation, it is our apex court which comes to our rescue and we are handed over a conceptually clear concept of such a defiant issue.

That being an aspect there are difficulties even in interpreting correctly a particular concept/concept of employment. The definition and import of this word has to be read with para 26 of the Employees Provident Fund Scheme, 1952 whose sub-para 1 (a) is important. It has been held by the apex court as back as in the year 1971 between *Regional Provident Fund Commissioner, Andhra Pradesh vs. T.S. Hariharan* 1971 (22) FLR 260 that the number of persons to be considered to have been employed by an establishment for the purpose of EPF Act has to be determined by taking into account the general requirements of the establishment for its regular work which should also have a commercial nexus with its general financial capacity and stability. Now considering the language of Section 1(3)(d) of the Act it would appear that the employment of a few persons on account of some emergency or for a short period necessitated by some abnormal contingency which is not the regular feature of the business of the establishment and which does not reflect its business prosperity or its financial capacity and stability from which it could be reasonably concluded that the establishment would in the normal way bear the burden of contribution towards the Provident Fund under the Act, would not be covered by this definition. The court felt that the word "employment" must, therefore, be construed as employment in the regular course of the business of the establishment. Such employ-

ment obviously would not include employment of a few persons for a short period on account of some pressing necessity or some temporary emergency beyond the control of the company. This would naturally require determination of the question in each case on its particular facts. The crucial point which is stressed in this case law is that the financial capacity of the establishment to bear the burden must, therefore, have some *semblance* of a reasonably long term stability. In other words the employment of requisite number of persons must be dictated by the normal regular requirement of the establishment having regard to its financial capacity and stability. It would, therefore, be concluded that the number of persons to be considered to have been employed by an establishment for the purpose of this Act has to be determined by taking into account the general requirements of the establishment for its regular work. It has also been held in the case *Laxmi Restaurant & Anrs. vs. RPFCDelhi* 1975 LLN(2) 213 that for being an employee the person must have been employed regularly in the course of business. This would necessarily exclude casual workers who are employed occasionally on temporary work for less than 240 days a year.

The hon'ble Supreme Court in the case *ESIC vs. Premier Clay Products* (1995) SCC (L&S) 162 SC (21) held that the hiring of some casual coolies for loading and unloading of goods which was of sporadic nature and which coolies were available for work to others and who in fact as the very day worked for several others, such coolies cannot even be called casual workmen and, therefore, they would not be employees under Section 2(9) of the ESI Act, 1948. This observation by the apex court about ESI Act is a supportive thesis for determining as to who would be an employee under EPF Act.

Similarly, the Punjab & Haryana High Court in the case of *Employees State Insurance Corporation vs. Surya Printmac Industries, Faridabad* 2000 LLR 110 held that engagement of labours for loading and unloading job on contract basis would not attract

employment. This employment was for a specific job unconnected with the establishment and, therefore, such workers were not even casual workmen. In view of this, the holding of the Madhya Pradesh High Court in the case of *Orient Paper Mills vs. Regional Provident Fund Commissioner*

& anrs. 2006 LLR 177 that the person who were sitting inside the trucks and who had brought the bamboos for the manufacture of paper and who unload the bamboo from the trucks could be brought under the ambit and sweep of the definition of the employees under EPF Act, is not and would not be a good law. It appears that the court carried the concept of beneficial legislation too far. It is correct that the definition of the employee under the provisions of Employees Provident Fund & Misc. Provisions Act, 1952 is an independent one and comprehensive enough and could not be borrowed from the other enactment relating to labour laws such as Minimum Wages Act, 1949; Workmen Compensation Act, 1923; Industrial Disputes Act, 1947; M.P. Industrial Relation Act, 1960 and Indian Factories Act, 1948, even then it cannot be extended too far as to include all casual labourers.

Even after a catena of case laws the confusion still persists. However, there is valid classification in the statute itself with regard to the employees who can get the benefit of the scheme. So the definition of the employee would be *vis-à-vis* the benefit of the scheme. Viewed so, *bidi* workers, part time workers, *khadi* workers making *khadi* at their homes, liaison officer, accountant working at home, medical officers, cine workers, paid sons of employer, paid members of co-operative societies, employees of club attached to the factory, persons appointed after voluntary retirement, employees of cycle stand, home workers engaged through contractors, personal drivers of managers, sales persons in regional offices, drivers and conductors of buses on hire with school would be employees. This enumeration is only illustrative and not exhaustive.

Similarly, and negatively directors of a factory or establishment or a working partner or partners of a firm, domestic servants, managing partners,



**It was held that if an authority wanted to contend that employees not directly employed by an employer should also be treated as employees of that employer, the burden of proof lies on the authority to establish the said fact.**

contractors, trainees/apprentices, employees of other firms, motor mechanics in Petrol Pumps would not be employees. This enumeration is also just for an example. Now a question is usually debated as to on whom lies the burden of proof about this. In *Karachi Bakery Hyderabad vs. RPFC Hyderabad 1991 (62) FLR 627* it was argued on behalf of the Regional Provident Fund Commissioner that the burden of proof to prove the employees in question were not employees of the company, lies on the company but this argument was overruled and it was held that if an authority wanted to contend that employees not directly employed by an employer should also be treated as employees of that employer, the burden of proof lies on the authority to establish the said fact.

A dispassionate study of the legal position on this vexed question would reveal that yardsticks are still not crystal clear. In this context, it would be very enlightening to know about the recent pronouncement of Employees Provident Fund Appellate Tribunal in the case of *M/s ARCO Transport Company vs. APFC Nashik, ATA 348 (9) 2005* in which it was observed that the door delivery employees/boys would not be treated as "employees" for the purpose of the EPF Act. In this case the cases of *Provident Fund Inspector vs. T.S. Hariharan 1971 (1) LLJ 416*, *Laxmi Restaurants vs. RPFC 1975 LIC 1186*, *ESIC vs. Premier Clay Products 1995 SCC (L&S) 162* and *ESIC vs. Survey Printmac Industries Faridabad 2000 LLR 110* were mentioned. So far ascertaining as to who is an "employee" under the Act in the given facts and circumstances, we shall have to read between the lines as is warranted by the particular situations.

It is unfortunate that Provident Fund Authorities usually violate with immunity the legal aspects as regard "wages" and "employees" while administering the provisions of EPF law. ■

# Electronic Payments and E-Banking in India: An Overview

Information technology is considered to be the key driver for the changes taking place around the world. The transformation from the traditional banking to e-banking has been a 'leap' change. The evolution of e-banking started with the use of Automated Teller Machines (ATMs) and since then has grown with the introduction of telephone banking (tele-banking), direct bill payment, electronic fund transfer and the revolutionary online banking. The advent of e-commerce has changed the way people shop. No other technology since the invention of electricity has brought about such a gargantuan transformation in our lives. This article provides an overview of the various electronic payments facilities available for availing any service or utility.



**CA. Lavanya Gupta**

*The author is a member of  
the Institute. She can be reached at  
lavanya.gupta@icai.org*

**A**n electronic payment is any kind of non-cash payment that doesn't involve a paper cheque. Methods of electronic payments include credit cards, debit cards and the electronic fund transfer (EFT) network. Electronic funds transfer refers to the computer-based systems used to perform financial transactions electronically. The EFT system comprises direct deposit, direct debit and electronic cheque (e-cheque). The term is used for a number of different concepts:

- Cardholder-initiated transactions, where a cardholder makes use of a payment card
- Direct deposit payroll payments for a business to its employees, possibly via a payroll services company

- Direct debit payments from customer to business, where the transaction is initiated by the business with customer permission
- Electronic bill payment in online banking, which may be delivered by EFT or paper cheque
- Transactions involving stored value of electronic money, possibly in a private currency. Digital gold currency (or DGC) is a form of electronic money based on ounces of gold. eg. gold money, e-bullion, e-liberty dollar.
- Wire transfer via an international banking network (generally carries a higher fee) (eg. FX global transfer and Western Union)



**EFT payments are easy and convenient and eliminate the need of going to banks physically which results in reduced administrative cost.**

## Benefits

### Benefits of EFT

The benefits of e-payment system cannot be overemphasised. Few such benefits are as follows:

- EFT payments are safer than cheques and eliminate the plethora of cases annually lodged for forged, counterfeit, and altered cheques. Further, it eliminates the problem of lost or stolen cheques completely.
- EFT payments are faster than cheques, with funds available on the date the payment is due. E-payments eliminate the need to obtain and deposit your pay cheque or encash your pay cheque each pay day.
- EFT payments are easy and convenient and eliminate the need of going to banks physically which results in reduced administrative cost.

### Benefits of Credit Cards

A credit card from VISA, MasterCard, or any other network allows its user to pay for purchases or services by borrowing from the credit card company. This borrowed amount can be repaid to the credit card company in lump sum within the deadline generally without any interest or by making monthly payments towards the amount borrowed along with the interest. That means, you have the option to not to repay the whole borrowed amount in full at one go. Here are some of other benefits:

- Convenience– Purchase products or services whenever and wherever you want, without ready cash or cheque book and paying for

them at a later date.

- Credit Card Float– A float is the time lag between the date on which you buy an item and charged for that, and the date in which full payment is due in order to avoid interest charges. You can really use this to your advantage if you are smart. Many times you will get an extra 30 days to pay off the balance before interest kicks in.
- Credit Card Rewards– Many credit card companies offer rewards that you will not get by using cash, cheques, or a debit card. Credit card reward programme include cash back, airline rewards, and other merchandise programme. These rewards can be a nice addition that comes in handy at times.
- Withdraw cash whenever, wherever you are, through ATMs and other withdrawal centres.
- Transact money of more than one currency, from one country to another. You may find it difficult to write an American cheque while visiting Italy but not so when you use a credit card.
- Monthly Budget– Having a credit card can help you budget your monthly bills. You'll have your monthly credit card statement that itemizes your transactions each month and you will know exactly what you have spent. If you are disciplined, this works well.

### Benefits of eCommerce

eCommerce is the essential pathway to implement globalisation and having the following benefits:

- Expanded Geographical Reach, Customer Base
- Increased Visibility through Search Engine Marketing
- Provides Customers valuable information about your business
- Available 24/7/365
- Builds Customer Loyalty
- Reduction of Marketing and Advertising

Costs as well as production cost by replacing paper based business operations

- Payments of goods and services can be made immediately without waiting for cheques to get cleared
- Collection of Customer Data and better information collection and retrieval system
- Can lead to automated customisation of products online by the customers themselves

### Concerns about Electronic Payment

The main drawbacks to electronic payments are concerns over privacy and the possibility of identity theft. Fortunately, there are many safeguards available to protect your sensitive and personal information from falling into the wrong hands.

You can defend yourself against identity theft by using virus protection software and a firewall on your computer. You should also make sure that you send your credit card information over a secure server (Mostly using SSL technology). Your Internet browser will notify you when a server is secure by showing a lock or key icon. In addition, the URL on a secure site is usually designated by the prefix "https" instead of "http" Retailers do their part by using data encryption (through payment gateway services), which codes your information in such a way that only the key holder can decode it.

Privacy concerns aside, some people simply dislike making electronic payments. They find the set up too time-consuming and don't want more logons and passwords to remember. Others simply prefer the familiarity of writing cheques and dropping envelopes in the mail. Regardless of these concerns, electronic payment is likely to continue to rise in popularity.

### Methods and Types of Electronic Payment

For all the methods of electronic payment, there are three main types of transactions:

1. Business-to-business payment:



RTGS, NEFT OR SWIFT

2. one-time customer-to-vendor payment
  - By credit card physically at merchant location
  - Online credit card payment
  - Mail order/secure order form system
  - Alternative online payment options
3. Recurring customer-to-vendor payment bill pay by regularly scheduled direct debit from your bank account or an automatic charge to your credit card. This type of payment plan is commonly offered by car insurance companies, phone companies and loan management companies.

Let us now discuss each of these methods in detail:

**RTGS - Real Time Gross Settlement** is a comprehensively secured online settlement solution, set up, operated and maintained by Reserve Bank of India to enable funds settlement across banks in the country on real time basis to minimise costs and maximize benefits, increase velocity of funds-flow both inter-city and inter bank, reduce credit risk, increase transparency of payments and better liquidity management.

In RTGS system, inter-bank payment instructions are processed and settled transaction by transaction and continuously (online) throughout the day. Its main benefit is to provide liquidity to the beneficiary in no time on the date of transaction itself. All customers maintaining SB/CD/CC/OD accounts are eligible for remittance of fund through RTGS. Minimum amount to be transferred through this mode is Rs.1 lakh and there is no maximum limit for fund transfers under this system. There is a meagre transaction charge of Rs. 25 per transaction for utilising this service.

**NEFT- National Electronic Fund Transfer Settlement System** is a system where transmission, processing is done for a set of transactions

The main drawbacks to electronic payments are concerns over privacy and the possibility of identity theft. Fortunately, there are many safeguards available to protect your sensitive and personal information from falling into the wrong hands.



In RTGS system, inter-bank payment instructions are processed and settled transaction by transaction and continuously (online) through out the day. Its main benefit is to provide liquidity to the beneficiary in no time on the date of transaction itself.

at a particular point of time and the settlement takes place on a pre-fixed interval of time or at the end of the day. This facility is available to all customers/account holders of banks having netbanking facilities. There is no minimum or maximum limit for fund transfer under this system.

### International Remittances

- SWIFT: A SWIFT message is a highly secure and efficient method of fund transfer. The sending bank has an arrangement with the receiving bank so that funds can be transferred by mentioning just the SWIFT codes of the bank and branch, the account number of the beneficiary and the amount to be transferred. Charges are also nominal around Rs.150 per transaction.
- ONLINE REMITTANCE SERVICE eg. remit2india
- WIRE TRANSFERS eg. Western Union

### Credit Card Payment – Physically at Merchant Location

This is known as “Brick and Mortar” card authorisation which works as under:

- A customer selects item(s) to purchase, brings them to a cashier, and hands the credit card to the merchant for making payment.
- The merchant swipes the card and transfers transaction information to a point-of-sale terminal.
- The point-of-sale terminal routes information to the processor via a dial-up connection, (the point-of-sale terminal takes the place of the payment gateway in the offline world).
- The processor sends information to the issuing bank of the customer’s credit card.
- The issuing bank sends the transaction result (authorisation or decline) to the processor.
- The processor routes the transaction result to the point-of-sale terminal.

- The point-of-sale terminal shows the merchant whether the transaction was approved or declined.
- The merchant tells the customer the outcome of the transaction. If approved, the merchant takes the customer sign on the credit card receipt and gives the item(s) as well as second copy of the credit card receipt to the customer.

### Online Credit Card Payments

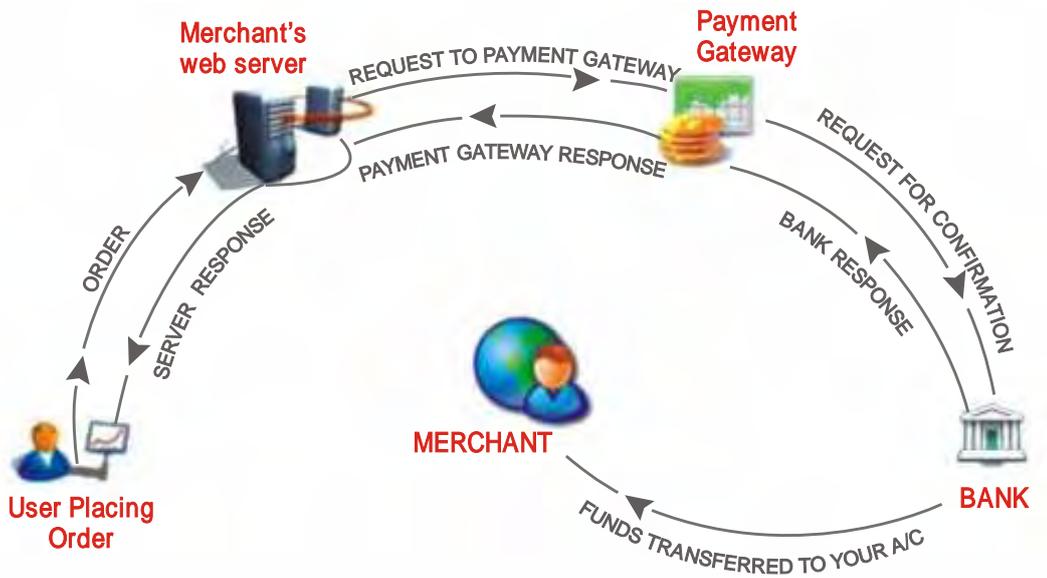
This requires multiple components. Between a paying customer and your bank account, three layers exist:

**Payment Gateway**—This is the code that will transmit a customer's order to and from an internet merchant account provider. The payment gateway provides you the ability to accept customer billing information (credit card number, credit card type, expiration date, and payment amount) and the necessary validation steps that must be followed before the credit card is actually billed. Payment gateways encrypt sensitive information, such as credit card numbers to ensure that information passes securely between the customer and the merchant.

**Internet Merchant Account**—A Merchant Account is an account with a financial institution or bank, which enables you to accept credit card payments from your clients. The payment gateway actually transmits the billing information to the internet merchant account provider. Many banks have their own payment gateway product integrated with the merchant account. Unfortunately, most local banks do not provide Internet merchant account capability.

**Website** - Regardless of which merchant provider and gateway service you choose, your website will need to integrate with your service providers. Most providers include detailed web integration instructions.

The process works as under:



The following table shows a comparative analysis of various major payment gateway services available in India.

**Comparison of Online Payment Gateways in India**

GATEWAY PRODUCT SERVICE PROVIDER/ PLAN	ONE TIME SET UP FEE / INTEGRATION CHARGES	TRANSACTION COST		MAINTENANCE COST
		CREDIT CARD	NET BANKING	
CC AVENUE				
ECONOMY ACCOUNT	7500	7%	4%	1200 P.A
PREMIUM ACCOUNT	25000	5%	4%	2400 P.A
PRIVILEGE ACCOUNT	40000	3.75%	3.75%	3600 P.A
DIRECPAY				
TIMES OF MONEY GROUP				
CAT A	25000	3.50%	3%	1200 P.A
CAT B	15000	4.50%	3.50%	2400 P.A
CAT C	7500	5%	4%	2400 P.A
ABC PAYMENTS				
I	10000	7%		NIL
II	16000	6%		NIL
III	28000	5%		NIL
			WEEKLY PAYOUTS	
EBS				
REGULAR	12000	5%		2400 P.A
SILVER	18000	4%		2400 P.A
GOLD	24000	3.75%		2400 P.A
PLATINUM	30000	3.25%		2400 P.A
AXIS BANK	30000-50000	3-3.5%		10000-30000 P.A
ICICI PAYSEAL	30000	3.50%		10000 P.A
HDFC BANK	20000	2.75%		10000 P.A
TRANSECUTE	The website says it is not giving new accounts in India now.			

PAYPAL	FREE	3.4% OR 3.9% +.30 US \$ PER TRANSACTION  WITHDRAWAL TO BANK ACCOUNT: Withdrawal of Rs. 7000 No Fee Withdrawal of less than Rs. 7000 Rs. 50 Fee Withdrawal may take 8 Working Days  WITHDRAWAL BY PAYPAL CHEQUE IS ALSO POSSIBLE ALTHOUGH IT IS EXPENSIVE AND TIME CONSUMING		
EAZY2PAY	10000 15000 20000 25000	5% 4.50% 4% 4%		WEEKLY PAYOUTS

\* Please note that each product differs with respect to credit cards supported and banks supported which might be referred to in their respective websites  
 \* Source: Quotation proposals received from service providers/ websites/ startupdunia.com-2009.  
 \*Applicable taxes extra

Please note that apart from the above there are other lesser known service providers as well as a plethora of payment gateway implementation service providers who are either resellers of the gateway products or provide web integration services for established gateway providers. It is not possible to include all of them in the study.

Transactions conducted over the Internet are totally different from face-to-face transactions where a signature is required to authorize the purchase. This makes online transactions prone to credit card fraud. Fraud protection should be one of your primary considerations when choosing a payment gateway and an internet merchant account provider.

**What You Should Know About Fraud**

Credit card fraud can be a significant problem for customers, merchants, and credit card issuers. Liability for fraudulent transactions belongs to the credit card issuer for a card-present, in-store transaction, but shifts to the merchant for “card not present” transactions, including transactions conducted online. This means that the merchant does not receive payment for a fraudulent online transaction. Fortunately, there are steps you can take to significantly limit your risk as an online merchant. The following important fraud prevention steps should be adhered to:

- 1.Choose a payment services provider that is well-established and credible. Your provider should also have in-depth experience and a strong track record in transaction security.
- 2.Make sure your payment gateway provider

offers real-time credit card authorisation results. This ensures that the credit card has not been reported as lost or stolen and that it is a valid card number.

- 3.One of the simplest ways to reduce the risk of a fraudulent transaction is to use Address Verification Service (AVS). This matches the card holder billing address on file with the billing address submitted to ensure that the card holder is the card owner.
- 4.Use Card Security Codes, known as CVV2 for Visa, CVVC for MasterCard, and CID for American Express. For Visa and MasterCard, the code is a three-digit number that appears at the end of the account number on the back of the card. The code is not printed on any receipts and provides additional assurance that the actual card is in possession of the person submitting the transaction. As a merchant, you can ask for this code on your online order form. Even if you do not use this for processing, simply asking for it acts as a strong deterrent against fraud.
- 5.Watch for multiple orders for easily resold items such as electronic goods purchased on the same credit card.
- 6.Develop a negative card and shipping address list and cross-check transactions against it. Many perpetrators will go back to the same merchant again and again to make fraudulent transactions.
- 7.Security Standards Compliance: No matter what e-commerce technology or technologies you use, be sure you comply with

security standards. Credit card companies will hold an Internet merchant responsible for fraud if it happens. So get to know the requirements of the Payment Card Industry (PCI) Data Security Standard and follow them. Non-compliance is heavily penalised.

8. Even if one has chosen the perfect e-commerce host, it is still certain that technical problems will arise and having a host that provides 24/7 customer support will be of great difference from having an otherwise perfect host that does not.

### Mail Order

Mail order is the term used when you buy goods through means other than physical purchasing by picking them up in a store. The goods are usually delivered via a postal service. The home shopping catalogues/ websites which act as catalogues exist today and have thousands of items you can choose from. Once you have posted or telephoned your order all you have to do is wait for it to arrive by mail. Most shopping services use their own delivery vans or a postal service and payment is required on delivery.

### Secure Order Forms

An order form is a simple page on your site that the customer fills in with their details and the details of the goods they want to buy. There is no automation and the fields in the forms are sent to you as an e-mail and do not use a PSP. This is a very basic method of taking orders through your online catalogue and can be very labour intensive.

A slightly more advanced option is available by using a shopping cart software product as most carts have the ability to either store credit card numbers securely so you can view them over the Internet or send them securely over e-mail using a secure server.

### Alternative Payment Options

Other ways of taking payments online can work as a first step to enabling payments on your website or allowing payments from customers without credit cards.

- **Person-to-person** – an entry-level payment solution where consumers set up an account using their bank account details which is then debited by eligible merchants.
- **Mobile commerce** – allows a sale that has been

conducted over the Internet to be confirmed by sending an SMS to the customer's mobile phone.

- **Pre-paid cash card** – these cards can be "charged up" and then used at participating websites and high street stores. Useful for small transaction amounts where the credit card transaction charges might make the sale.

### Bill Pay Services

Bill pay services can be availed by registering for online bill payment facilities provided by various banks in tie up with various utility companies such as phone and mobile bills, insurance premiums, electricity bills, water bills, municipal dues, etc. Payments can be made by just clicking and confirming the pending bills at the bank's netbanking website and a debit would be initiated in customer's account and a payment reference number shall be generated for the customer's record. There is absolutely no need for queuing up at collection centres or writing cheques. Sometimes the banks also come up with lucrative discount offers for customers using netbanking to pay their bills. Some banks also give the facility of using credit cards to pay these bills online.

Some companies also provide IVR (Interactive Voice Response) Services for bill payments where you can just dial the numbers from your land-line/mobile phone and confirm bill payments.

### Conclusion

To conclude, the advent of the Internet has provided great and endless opportunities for the people all over the world and the importance of the Internet in the world of business and banking has grown astoundingly. This is why most businesses today, from colossal corporations to petite family-owned enterprises, have embraced the Internet to avoid being edged out by their competitors. This is just logical as failing to adapt to the changes brought by the Internet will be suicidal for any business. However, it has been hounded by negative issues like identity theft and hacking frauds which is the reason why there are still some people who are wary of using net based services such as electronic payment. But, to address this concern, our IT brainchild have developed and implemented various security measures. It is inevitable to espouse the same and resort to the Internet which opens the door to the world. ■

# Regional Trade Agreements: Road Ahead For Agricultural Sector



The Doha round of negotiations may see work on two “simultaneous tracks”: One on modalities in Agriculture and Non-Agricultural Market Access (NAMA), and another for starting the scheduling exercise for both these areas. In the present recessionary scenario, the developed countries would focus on the tariff liberalisation for industrial goods while the developing countries would focus on market access for agricultural goods. Nowadays, cross-border trade liberalisation of food products and agricultural products are forming part of Regional Trade Agreements (RTAs). The cross-border trade liberalisation for agricultural sector through RTAs may force a country to change its domestic policies; the national policies on preferential rules of origin are important for country's domestic policies. Read on to have an overview of the concept.



**CA. Rajay Kumar Aggarwal**

*The author is a member of the Institute.*

*He can be reached at  
eboard@icai.org*

**A**s per World Trade Organisation (WTO), 421 Regional Trade Agreements (RTAs) have been notified and 230 agreements were in force till December 2008. The Free Trade Agreements (FTAs) and Partial Scope Agreements (PSAs) accounted for more than 90 per cent and the Custom Unions (CUs) accounted for less than 10 per cent. In a Free Trade Agreement, member countries eliminate or liberalise tariff and non-tariff barriers among member countries, while each member is free to have different criteria for non-members.

Regional Trade Agreements (RTAs) are economic arrangements in which member countries offer more favorable market access to each other only by reducing tariffs and trade restrictions / barriers. The non-member countries are not entitled to the favourable market access. RTAs now may cover agriculture products, services, investments, intellectual property, technical barriers to trade, dispute settlement, supra-national institutional arrangements, etc. Free Trade Agreements (FTA), Custom Unions

(CU), and Economic Integration Agreements (EIA) are examples of different RTAs.

The majority of trade is being carried out through the channel of Regional Trade Agreements. India is also aggressively negotiating Regional Trade Agreements with a number of countries, custom unions or trade blocs. Regional Trade Agreements are likely to become deeper in the form of Economic Integration Agreement (EIA) covering goods, services and investments. Preferential Rules of Origin are contained in all the Regional Trade Agreements to ensure that preferential tariffs are confined to members, trade deflection is prevented and trade creation is encouraged.

### Rules of Origin

Origin is the “economic” nationality of goods traded in commerce. It is necessary to determine the nationality and tariff classification of goods in order to be able to determine the duties and equivalent charges or any customs restrictions or

goods being imported to save the domestic market.

So, non-preferential origin merely confers an “economic” nationality on goods and does not confer any benefit on them. Non-preferential origin is obtained either by the goods being “wholly obtained” in one country or, when two or more countries are involved in the manufacture of a product, origin is obtained in the country where the last substantially, economically justified working or processing is carried out. Non-preferential origin is used, for example, in determining whether or not goods are subject to anti-dumping measures or quantitative restrictions and for statistical purposes. It can also be used to determine origin in the context of the “origin marking” of goods.

Preferential origin is conferred on goods from particular countries when they have fulfilled certain criteria. Preferential origin criteria generally demand that goods undergo more working or processing than is required to obtain non-preferential origin. However, wholly obtained

**India with arable land of 184 million hectares, produces annually 90 million tons of milk (highest in the world), 150 million tons of fruits & vegetables (second largest), 485 million livestock (largest), 204 million tons food grain (third largest), 6.3 million tons fish (3<sup>rd</sup> largest) 489 million poultry and 45,200 million eggs. The globalization provides opportunities for our farm sector to cater to the global demand for agro food products. So, the food sector is an important sector for India in terms of cross-border business and in terms of domestic market.**



obligations applicable to them. No product shall be deemed to be a produce or manufacture of either party unless the conditions specified in these rules are complied with in relation to such products to the satisfaction of the authority issuing the certificate of origin.

There are two kinds of origin, non-preferential and preferential and the customs treatment of goods at importation is determined by the origin they have. The preferential rules simply allow a determination of whether a good is originating in a Regional Trade Agreement / Free Trade Agreement member or not; we have not to determine the “official” originating country if the goods are not being originated from the partner country. The non-preferential rules of origin allow a determination of the “official” originating country when this is not the country of export; with this determination, we apply restrictions in one or other form over the

goods can also benefit from preferential origin status. Preferential origin confers certain benefits on goods traded between countries that have agreed such an arrangement, usually entry at a reduced rate or free of duty.

For the purpose of this agreement, goods wholly obtained or produced in the territory of a party shall be treated as originating goods of that party. The following shall be considered as wholly produced or obtained in a party:

- a) Raw or mineral products extracted from its soil, water, seabed, or beneath the seabed;
- b) Agriculture, vegetable and forestry products harvested or produced there;
- c) An animal born and raised there;
- d) Products obtained from animals referred to in clause (c) above;
- e) Products obtained from hunting, trapping, fishing or aquaculture conducted there;

- f) Products of sea fishing and other marine goods taken from outside its territory / territorial waters and Exclusive Economic Zone (EEZ) by vessels registered with a party and flying its flag;
- g) Products processed and / or made on board factory ships registered with a party and flying its flag exclusively from products referred to in paragraph (f) above;
- h) Articles collected there which can no longer perform their original purpose nor are capable of being restored or repaired and are fit only for disposal or recovery of parts or raw materials;
- i) Waste and scrap resulting from manufacturing operations conducted there;
- j) Products taken from the seabed, ocean floor or subsoil thereof beyond the limits of national jurisdiction, provided it has the exclusive rights to exploit that sea bed, ocean floor or subsoil thereof, in accordance with the provisions of the United Nations Convention on the Law of the Sea;
- k) Goods produced there exclusively from the products referred to in clause (a) to (j) above.

Subject to the provisions of Insufficient Operations and Accumulation that the final process of manufacturing is performed within the territory of the exporting party, products would be considered as originating if:

- (a) (i) The total value of the materials, parts or produce originating from countries other than the parties or of undetermined origin used in the manufacture of the product does not exceed 60 per cent of the FOB value of the product so produced or obtained; and,
  - (ii) The product so produced or obtained is classified in a heading, at the four digit level, of the Harmonised System different from those in which all the non-originating materials used in its manufacture are classified; or
- (b) The product satisfies the Product Specific Rules of Origin.

### Road Ahead for RTAs and Rules of Origin

The Agreement on Agriculture (AoA) was signed in Uruguay Round of trade negotiations with the framework of continuous trade liberalisation. AoA has three main pillars in the form of Domestic Support, Market Access, and Export Subsidies. In Hong Kong declarations, 2005 the ministers made the conditional declaration of elimination of export subsidies by 2013 subject to the completion of the modalities. These modalities are still under DOHA Round negotiations.

WTO Director-General Pascal Lamy, in presenting to the General Council his vision for the WTO for the next four years, said on 29<sup>th</sup> April 2009: "...let me mention two areas which are part of our current mandate and which, in my view, deserve more of our attention: *Regional Trade Agreements and Rules of Origin.*

*"On RTAs, it is difficult to see why such deep concessions and commitments are undertaken today in the context of preferential agreements, without any consequences in the multilateral context. We all know this is a complex issue and there are differences between RTAs aiming at deep regional integration and other free trade agreements. But, if we are serious about the prevalence of the Most-Favoured-Nation principle, we should collectively think about some way of gradually "multilateralising" concessions made in free trade agreements. Food for thought for Article XXIV negotiators.*

*"On Rules of Origin, the proliferation of different regimes – regional, bilateral or even unilateral – needs, in my view, to be addressed head-on, in order to simplify the lives of trade and economic operators.*

*These two examples – RTAs and Rules of Origin – show that the WTO's current agenda is anything but old-fashioned. A lot of what we do today was already on the agenda of the Uruguay Round, even in the Tokyo Round to be more precise! But the fact is that they remain as relevant, if not more so, for economic operators today..."<sup>1</sup>*

**We have to attract tertiary industry for food products to make the vertical integration of food chain and to make more value addition to agricultural products. India's economic growth is on fast track upward trend and has a large number of middle class people. So, India is a good destination for processed, ready to eat food products or tertiary industry food products. More investments may be attracted in this sector with the help of RTAs.**



<sup>1</sup> www.wto.org

Government of India is making good efforts in activating food processing sector by making the changes on macro level in a broad way. The government is trying hard to attract a large amount of private investment and foreign direct investment (FDI) in food processing sector through Food Parks. Through APMC Act, the farmers may sell their produce directly to retailers, food processors, etc.



### Road Ahead for WTO Negotiations

WTO Director-General Mr. Pascal Lamy suggested to the WTO members at the General Council (GC) that for the Doha Round, they could work on two “simultaneous tracks”: One on modalities in agriculture and NAMA and another for starting the scheduling exercise for both these areas. Setting individual tariffs in cross-border trade is known as scheduling and the formulas underlying tariff and subsidy cuts are known as modalities. In the present recessionary scenario, the developed countries would focus on the tariff liberalisation for industrial goods; the developing countries would focus on market access for agricultural goods. Through the mechanism of scheduling, the developed countries may press for sectoral negotiations, which means moving towards a zero or very low tariff regime in selected industry sectors.

The agricultural sector is sensitive for all the countries because of their domestic compulsions in the form of food security, the presence of large agriculture labour, and / or net food importing status. The agricultural sector may see the negotiations on modalities and the scheduling of individual tariffs pertaining to this agricultural sector. The negotiations may see a narrow gap in Bound Tariff Rates and Applied Tariff Rates for India; the Applied Tariff Rates are higher for agricultural sector in comparison to non-agricultural sector. So, the agricultural sector is going to have higher tariff structure in general compared to non-agricultural sector. Nowadays, liberalisation in cross border trade of food products and agricultural products are forming part of RTAs as FTAs or EIAs. The opening up of cross-border trade for agriculture sector through RTAs may force a country to change its domestic policies; the national policies on preferential rules of origin are important for country's domestic policies.

### Product Coverage in Agreement on Agriculture

As per Product Coverage given in Article 2 of Agreement on Agriculture of WTO, “This Agreement applies to the products listed in Annex 1 of this agreement, hereinafter referred to as agricultural products.” Annex 1 covers HS Chapters 1 to 24 less fish and fish products, plus some other products given in different HS Code and HS Headings. The Agricultural products and food products are given mainly in HS Chapters 1 to 24 on the weblink [http://www.wto.org/english/docs\\_e/legal\\_e/14-ag.doc](http://www.wto.org/english/docs_e/legal_e/14-ag.doc). So, food products are part of Agreement on Agriculture.

### Importance of Agricultural Sector for India

The food prices have recently gone up globally even as the food product is an important sector for all countries. For the welfare of its population and strategic planning, the food security is vital for related country. To stabilize the food prices in domestic market, some developing countries have restricted the free export of a few agriculture primary produce and some countries including developed countries have reduced import duty for a few required primary agriculture produce. As per Euro monitor 2003, the global sales of food, including food sold through food service establishments, were estimated at about US \$ 4.0 trillion in 2002 and approximately 90% of the food products are consumed within the producing country itself and only near about 10% of the food produce is traded cross-border.

The food product in India is one of the fastest growing sectors in growth prospects. The government is giving a higher priority, with a number of changes in laws, fiscal relief and incentives to encourage commercialisation and value addition to agricultural produce and for minimizing pre / post harvest wastage, generating employment fair market competition and export growth. The

private funds are being attracted to the food sector in the form of organised retail sector; fair competition in food retailing sector will attract more funds in tertiary industry of food products.

The annual foodgrain production increased from 51 million tons in the early fifties to 209 million tons in the new millennium. The share of agricultural and allied sectors in Gross Domestic Product (at 1999 – 2000 prices) for the year 2006 – 07(AE) stands at 18.50 % approximately and about 60% of the total workforce is engaged in agricultural sector in India.<sup>2</sup> India with arable land of 184 million hectares, annually produces 90 million tons of milk (highest in the world), 150 million tons of fruits & vegetables (second largest), 485 million livestock (largest), 204 million tons foodgrain (third largest), 6.3 million tons fish (3<sup>rd</sup> largest) 489 million poultry and 45,200 million eggs.<sup>3</sup> The globalisation provides opportunities for our farm sector to cater to the global demand for agro-food products. So, the food sector is an important sector for India in terms of cross-border

and so the fair level playing field for domestic food sector will open the door for better price addition and in turn better prices to the farmers. In India about 7% value addition is done in food processing as against about 23% in China and about 45% in Philippines.<sup>5</sup> India's agricultural production base is quite strong but at the same time wastage of agricultural produce is massive. Processing level is very low i.e. around 2% for fruit & vegetables, 26% for marine, 6% for poultry and 20% for buffalo meat, as against 60-70% in developed countries. The share of India's export of processed food in global trade is only 1.5%.<sup>6</sup>

### Food Sector in Developing Countries

The food sector may be divided into three types of products / industry — a) primary products / industry, b) secondary products / industry, and c) tertiary products / industry. The primary industry or products may be defined as products on farm gates like fruits, grains, milk, honey, flowers, vegetables, fish, etc. The secondary industry or



**The success of regional trade agreement, in terms of net-trade creation and welfare, would depend to a large extent on its rules of origin. The margin of preference attracts the business community to comply with the Preferential Rules of Origin. If the margin of preference is not large enough to offset administrative burden of complying with the rules, the exporters may choose to forgo the preferential rates offered under Regional Trade Agreements.**

business and in terms of domestic market.

In 2004-05, total area under fruit and vegetable cultivation had been 11.72 million hectares and total production had been 150.73 million tons. India produces about 10.23% of the world's total fruits and is second largest fruit producer.<sup>4</sup> India produces about 14.45% of the world's total vegetables and is second largest vegetable producer. India is the largest producer of mangoes and bananas in the world. India produces about 65% of world's mango production and about 11% of world's banana production. As such, agriculture and allied sector is very important for India. The farmer is the end recipient of prices in food sector

products may be defined as intermediate products like sugar, milk powder, fruits peel, be-headed/frozen fish, frozen meat, grains flour, etc. The tertiary industry may be defined as ready to eat products like bakery, winery, chocolates, packed fruit juice, flavored milk, ice cream, sweets etc.

The developing countries have advantage in primary and secondary industry of food products. The developed countries have advantage in tertiary industry of food products because of capital, technology and Intellectual Property Rights (IPR) involved. The tertiary industry in food products will come to India because of its vast market, its fast economic growth, and availability

<sup>2</sup> Agricultural Statistics at a glance, 2006; Department of agricultural and co-operation, Ministry of Agriculture, Government of India.

<sup>3</sup> Annual Report, Ministry of Food Processing Industries, Government of India. 2006 – 2007, Page – 7.

<sup>4</sup> National Horticulture Board, Government of India. [www.nhb.gov.in](http://www.nhb.gov.in)

<sup>5</sup> India: Agribusiness and Commercial Agriculture Assessment, Final Report, Volume – I, Asian Development Bank, May 2004. Page – 10.

<sup>6</sup> Annual Report, Ministry of Food Processing Industries, Government of India. 2006 – 2007, Page – 7.

of cheaper labour force, variety and quantity of agricultural / horticultural produce, laws related with IPR, food safety laws and competition laws. The tertiary industry of food products will help in more value addition to our agricultural produce. A large quantum of tertiary food products are coming from neighboring countries with lower quality and imitation products for domestic consumption in India.

We have to attract tertiary industry for food products to make the vertical integration of food chain and to make more value addition to agricultural products. India's economic growth is on fast track upward trend and has a large number of middle class people. So, India is a good destination for processed, ready to eat food products or tertiary industry food products. More investments may be attracted in this sector with the help of RTAs.

### Road Ahead for Food Processing Sector

Government of India is also making good efforts in activating this sector by making the changes on macro level in a broad way. Government of India is trying hard to attract a large amount of private investment and foreign direct investment (FDI) in food processing sector through Food Parks. Through APMC Act, the farmers may sell their produce directly to retailers, food processors, etc. The agricultural sector may be divided in three focus areas namely a) Agriculture Services, b) Production of primary agricultural produces, and c) Food Processing. Hundred per cent FDI is allowed in Agriculture Services and Food Processing. Though FDI is not allowed in India for producing the primary agricultural products, the domestic / multinational / foreign companies may enter into contract/agreements of contract farming with domestic farmers for primary agricultural products in India. The Food Safety and Standard Act, 2006 has been enacted for laying down science-based standards for food articles and to regulate their manufacturing, storage, distribution, sale and import besides ensuring availability of safe and wholesome food for human consumption and related matters. For making Indian retail market competitive, the government is making the Competition Act, 2002 applicable after making few amendments.

The success of regional trade agreement, in terms of net-trade creation and welfare, would depend to a large extent on its rules of origin. The margin of preference attracts the business commu-

nity to comply with the Preferential Rules of Origin. If the margin of preference is not large enough to offset administrative burden of complying with the rules, the exporters may choose to forgo the preferential rates offered under Regional Trade Agreements.

### Conclusion

India has a large work force dependent on agricultural and allied activities. Various ministries of Government of India and Government departments are working hard for the betterment of agricultural sector. India has separate ministry for Food Processing sector reflecting the importance of Food Processing for India. India has vast market for processed food products because of emerging economy and large number of middle class families. Like other countries in general, India also has higher tariff rates for agriculture products compared to non-agriculture products. Food products are forming part of deeper integrated RTAs; Preferential Rules of Origin are integral part of RTAs in general. Regarding Product specific rules of origin for Agricultural Products, the following may be suggested:

- a) India is good in producing basic agricultural produces. India produces a large variety of agriculture products and it has large head counts and wide coastal area. So, we should serve our farmers and growers of primary products by better placing wholly obtained condition in Product Specific Rules of Origin for primary agriculture products.
- b) Our Food Processing Ministry is trying to make food processing industry attractive and efficient. To save and encourage our domestic industry in this sector we should have condition like "domestic value addition" and wholly obtained primary agricultural product condition in Product Specific Rules of Origin.
- c) To make the more value additions in primary and intermediate agricultural products, the two stages processing for the finish or ready to eat products or tertiary industry may be adopted. By facilitating more value addition in domestic agri-processing industry, this industrial sector may be made a revenue earner for larger section of our agriculture-based society. Our domestic tertiary industry will be forced to streamline their supply chain and to make more value addition for getting the economy of scale. ■

# The Global Demand for Enterprise Risk Managers and the Emergence of the Risk Intelligent Entity



Implementation of the Enterprise Risk Management (ERM) in a company can improve the results, eliminate the risk, help prepare to face the possible problems and seize the opportunity. It is a global demand now for all corporations. Especially audit committees of the corporations need to be educated about the principles of the ERM, and only then they can effectively evaluate the risk management procedures. Risk management consultants can advise and assist in implementing an effective ERM strategy.

**CA. Deepak Wadhawan**

*The author is a member of the Institute.*

*He can be reached at  
dwadhawan@icai.org*

## Background

For a decade, legislation in various countries requires listed entities to have a risk management framework within them. By 2003, over 50 countries, including India, implemented legislation in the form of governance codes, viz. Clause 49 of the listing agreement. Hence, the initial phase defining the requirement and role of risk managers has been well established. After the global financial meltdown of 2008, affected governments and regulators, mainly in the developed world, have got their tax payers to write down roughly \$ 3 trillion in return that their economies get spared of a collapse in payment systems and credit flows that would probably have caused a depression. Tax payer money comes with strings attached in the form of a heavy dose of regulatory and compliance requirements. The coming years would hence see the

next phase where risk management should become established as part of the management of entities covering the methods and processes used by them to identify, evaluate, manage and monitor risks within their businesses. Hence, risk managers should be in great demand and one of the important sources of this talent pool would be India.

Formal risk management is an outcome of corporate disasters and it has gained greater prominence through legislation and its inclusion in rating agencies' credit assessments. Apart from being a matter of compliance, it also offers competitive advantage to entities practicing it by enabling them to manage not just their capital but their entire business, more effectively. As elsewhere, in India also, a structured approach to managing risks started in early 2000s as a compliance activity of Clause 49 of the listing agreement. But now many organisations including the Navratna PSUs are going in for full-blown ERM systems engaging consultants to draw up policy and practice document, defining the organisation structure for the risk management department, etc., which is then to be implemented by management.

**Advantages of the ERM**

Proper implementation of ERM initiative within a company can improve performance and produce results from risk elimination, to preparation for possible problems, to preparedness for seizing opportunity. Coordination of efforts concerning risk management will also improve general communication within the organisation, help in defining company's strategy, align resources, and drive performance. These early movers who have set up ERM systems, started off with a well-defined organisation chart and in this particular case set up the Risk council in the late 1990s. There is a recognition for the role of risk management consultants for advice and assistance in implementing an effective ERM strategy. As a result, risk management consulting is on the growth path over the past three to four years, and in the coming years large consulting revenue is expected to accrue even in the Indian market.

Given this background of the growing importance of ERM within India and its increasing adoption by various types of industries, it is felt that the product life cycle of ERM and the need for

consulting services will be similar to the way ERP consulting services has grown over the last decade both internationally and domestically. While the ERP market in India was slow in the first decade, the subsequent growth took many of us by surprise. There is a growing global demand for ERM professionals who can understand business requirements and actualise the risk management systems to meet company's needs. These industries range from manufacturing to banking to asset management and to any firm that is exposed to the vagaries of risk. As mentioned earlier, the fallout of the global 2008 financial crisis would boost the requirement of ERM and ERM professionals.

**ERM Certification**

ERM positions are available at all levels of an entity, be it the back office or the middle levels, or, the senior levels. To occupy these positions, ERM professionals not only need to possess strong

**Proper implementation of ERM initiative within a company can improve performance and produce results from risk elimination, to preparation for possible problems, to preparedness for seizing opportunity.**



functional skills, but they must also possess strong personal, interpersonal and business skills in order to play a value-added role in the organisation. Towards this end, ERM certification would help in filling the gap. For ERM professionals, certification can help provide a clear, motivating path for career growth, as well as equip them with a set of credentials that will be recognised and with the current trend should over the time be accepted globally. Certification also provides them with membership in a community of peers that share the same skills and background, values and standards within the profession.

At the outset, let us understand the definition of ERM.

1. As the word enterprise connotes, ERM is a continuous activity across the entity.
2. This activity is undertaken at all levels, all functions, all processes including in strategy formulation.
3. The activity is to identify events which could impact the objectives, assess the risks, address

the risks appropriately, so that risk is contained within the risk appetite of the Board.

4. By undertaking this activity, the management would be in a position to give a reasonable assurance to the Board that the Business objectives will be met.

### Audit Committee and the ERM

The role and participation of the directors, especially those on the Audit committee, are a key to a successful ERM. For example, one of the fundamental concepts is the risk appetite of the Board wherein against significant risks the Board is required to express their risk appetite. This is a starting point. In other words, the Board is part of an ERM system, both as a user of assurance and also as a provider of key inputs.

Hence, the Audit committee needs to be aware of the process of risk management in their respective organisation, and have the ability to evaluate how effective the organisation is in managing its risks. As a result, they need sufficient knowledge and skills of this integrated practice of risk management. ERM calls upon organisations to manage their risks on an enterprise-wide basis, rather than by function or organisational unit. Audit committee directors should understand the ERM principles, framework and process in an integrated way so that they will be able to exercise their role in overseeing risk management procedures, including the review and monitoring of key risk policies, risk authorities, and risk tolerances. They will also be able to explore the methods for evaluating risk management's infrastructure, including personnel competencies, technologies and communications, and ensure that the risk information they receive provides them with appropriate top-down enterprise view of risks.

To perform their role effectively, Audit committee directors need to understand some references of ERM framework and methodology, e.g. the existing widely-known COSO ERM framework.

### ISO 31000 and the ERM

Time may be right to know and understand a

new international standard of risk management called ISO 31000 (still in its draft version), which is being developed to bring a much more integrated perspective, and yet allow high degree of flexibility to the organisation. ISO 31000 suggests eleven principles as the foundation of its framework and process for managing risks across the organisation. Although they are not expected to become a risk management practitioner on their own, Audit committee's full understanding and knowledge of the whole principles, framework, and its process are very crucial. Through ERM process, Audit committee can present deeper risk insights before the Board by identifying events that might create risk opportunities as well as risk threats to accomplishing organisation's objectives. As a result, the Board can be better informed about areas requiring greater attention and governance oversight, which in turn strengthens their ability to protect and enhance stakeholder's value.

### Phases of the ERM Implementation

Getting Audit committee participation is a challenge in India. This will be the first significant risk the Risk Manager will face. One of the important constituents of any enterprise wide roll out whether ERP is the VISIBILITY and POSITIONING it has within the organisation. In the case of ERM, fortunately it has been on Audit committee agenda. The challenge is the understanding of ERM, the benefits that it can bring and the active participation by the directors.

The usual way ERM has come up is in phases. In the first phase, the Board of Directors constitute a committee as per clause 49 where key risks are discussed and a system to obtain risk data gets introduced. But this may not by itself give business value.

Here we can take a real case of an export oriented textile mill as follows:

1. Around 5 years ago, a risk committee of the Board was constituted.
2. Key risks areas such as export sale price points, import prices of oil & lubricants, electricity generating costs, cotton prices, interest costs,

**ERM certification would help in filling the gap. For ERM professionals, certification can help provide a clear, motivating path for career growth, as well as equip them with a set of credentials that will be recognized and with the current trend should over time be accepted globally.**



- FE rates, HR issues, etc. were discussed.
3. The risk data was tracked religiously at every meeting. Soon it was found that there was a disconnect as there was no significant change in the risk profile of the entity.
  4. So after a couple of years a steering committee on risk was set up under the CFO, with senior managers from projects, legal & secretarial, materials management, operations, marketing, etc. as its members.
  5. There was a good cross-functional participation. The steering committee discussed significant risks, but soon discussions on operational problems took precedence as people started taking advantage of the cross-functional presence to resolve outstanding issues. So the Risk committee moved in substance to that of a PPC committee where day-to-day problems were discussed and solutions were found. This served everyone's purpose.
  6. Also discussions on risk did not move down to process teams. Nor was risk documentation as risk registers maintained apart from a 4-page note listing the risks and regular minutes of meetings.
  7. Now, around two years ago as the textile industry was not part of the then economic boom and not doing well, finding other sources of revenue became a hot topic of discussion. The bankers were pushing for a newish product viz. FE derivatives. These were hotly debated at the Board and Audit committee level but not at the two Risk committees. Consultations with the FE experts and bankers took place on continuous basis. Eventually a well considered decision was taken to use FE derivatives.
  8. As we all know Indian companies have lost heavily in this area. Some put a collective loss in the range of Rs. 20 to Rs. 40 thousand crore. The entity in question lost half its paid up share capital in these two years.
  9. Is this a simple case of business risk going bad? What more could have been done. There were two Risk committees and a collective transparent & well studied decision. It is unfortunate that the foreign currency chose to behave out of trend for the first time in two decades and that also in a radical way.
  10. If you look at this objectively, this is speculation and the management were collectively caught

in the greed/fear cycle. Also by being a collector of risk data the Risk committee was only ornamental as it did not execute the remaining steps, viz periodically reviewing the residual exposure and bringing it within the risk exposure as per the risk appetite. This is the end-to-end process of managing risks and when done by all across the enterprise it is ERM.

11. The Risk committee should have defined the risk appetite of all the significant risks and got periodic assurance on whether the FE derivative risk was within their defined risk appetite. Not doing this step made their management action as speculative grade.
12. The second aspect that management had missed out was the finer points of the business environment. Uncertainty has moved to instability. Since the past couple of years, every six to nine months, the global and local environment is oscillating for most industry segments as if the current has changed from DC to AC. One of the unique aspects of the financial meltdown is not fraudulent corporates, which also happened in the late 1990s (Asian crisis) and again in early 2000s (precursor to SOX), but the speed of collapse. This has made the impact of the risk catastrophic and has moved the crisis from corporate disasters to country disasters. Being an export unit tracking all type of commodity prices over three decades, thereby experts on global & local environment, the entity should have had a sophisticated view of the unstable global environment and its possible local impact.

### Globalisation and Other Challenges

In this global age, instability in business environment is permanent characteristic. Some risks which start off as low in impact take no time to assume catastrophic implications with the turn of a few events. Mergers and acquisitions are also now a constant. The entities of the future will be risk managing entities.

Any management system when it gains importance is measured regularly for its maturity in the organisation. Just as the IT industry has its CMM level and the BPO industry has its PCMM, the emerging risk managed entities will be measuring themselves against their risk maturity



**Audit committee directors should understand the ERM principles, framework and process in an integrated way so that they will be able exercise their role in overseeing risk management procedures, including the review and monitoring of key risk policies, risk authorities, and risk tolerances.**

employees, rating agencies, government may start asking entities, as to how risk-matured they are.

Since the time business started, those individuals who knew which risks and opportunities to take created growth entities. These risk intelligent individuals have existed in all ages and across all human endeavour and history has chronicled them as leaders and super achievers. Just being smart in managing commodity risks, treasury risks, customer risks, etc., by itself will not be sufficient anymore as these address only one part of the business objectives. Times have changed and the measuring unit has moved from individuals and given way to processes, entities, community, nations, geographies.

### Conclusion

Being smart in managing entity objectives as a whole is what will bring sustainable business success. Hence, enterprise risk managers are a new breed of risk managers who help ensure that risks across an entity are being managed within the risk appetite of the Board. While these individuals may have specific risk domain expertise, their real value would be in seeing that risks are managed across the enterprise. With an overall unstable environment where risks can change their intensity and move up or down the probability and impact scale not in megacycles but in teracycles. Welcome to seizing and converting opportunities in the future!

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### » Government to Tweak Tax Code

The government may increase sops to low-income tax payers in the proposed Direct Tax Code (DTC). The details of the new tax system, which is scheduled to be implemented from April 1, 2011, have been put on the finance ministry's website to get reactions from general public, professionals and industries. The government will also look into objections raised by the industry, regarding new proposed minimum alternate tax (MAT) to be levied on the basis of assets of a company instead of profit. In a recent interaction with the industry captains and tax professionals, Finance Minister Pranab Mukherjee said the government would implement the new tax system only after a comprehensive review of the proposals in the light of suggestions put forwarded by all stakeholders. He said the government has identified seven critical areas in the DTC for further examinations after interactions with stakeholders. The areas are concept of MAT based on gross assets, shift from EEE (exempt-exempt-exempt) to EET (exempt-exempt-tax) system, Double Taxation Avoidance Agreement (DTAA), General Anti-Avoidance Rule (GAAR) and issues relating to effective management control and taxation of foreign companies in India.

**Source:** <http://www.business-standard.com/india/news>

### » SEBI Declares System Audits

The Securities Exchange Board of India (SEBI) stated recently that system audits of mutual funds in India must be conducted by CISA/CISM-certified (or equivalent) auditors. Mandatory audits of systems and processes will bring transparency in the complex workings of mutual funds, prove integrity of the transactions and build confidence among the stakeholders. These systems audits will be conducted once every two years. A systems audit report and compliance status will be presented before the trustees of the mutual fund. The systems audit report/findings, along with trustee comments, are to be communicated to SEBI.

**Source:** <http://economictimes.indiatimes.com/news/>

### » Audit of National Rural Employment Guarantee Scheme

The social audit of the National Rural Employment Guarantee Scheme (NREGS) is continuing in full swing. Said to be the biggest social audit programme in India, spanning over 381 panchayats, covering more than a thousand villages in the Bhilwara district of Rajasthan, the social audit began on September 30. More than 2,000 people are participating in this process. India is the first country to perform this kind of an exercise at such a massive level. About 136 teams of social auditors have been pressed into service. They are visiting the villages to take account of the implementation of Rural Employment Guarantee Act. In each of these panchayats, a detailed account of NREGA work will be taken and audit conducted.

**Source:** <http://www.hindustantimes.com>

### » Transfer Pricing Rules Help Income-tax Department

Transfer pricing (TP) rules that were put in place by the government in the 2001-02 Budget has helped the country's direct tax regime to earn an additional Rs. 15,000 crore to date, according to figures available with the Income-tax department. Ever since the first assessment under the TP rules were made in 2003-04, the revenue realised through it has been on the ascent, rising at a rate of 20-25% every year. It is also expected to go up this fiscal, in view of the new Dispute Resolution Panel of collegium of commissioners, which will look into all the TP assessments. The collegium of Commissioners, comprising three Commissioners, are appointed to pass a decision on the demands made by the TP officer. This order is binding on the I-T department. This system eliminates delay in realising the tax demand, and therefore, the department expects the tax via TP rules to increase substantially this year.

**Source:** <http://www.financialexpress.com>

### » Tax Mop-up Gives Hope to Govt. to Meet Budget Target

The government is optimistic of meeting the Budgeted Tax target which amounts to around Rs. 3.70 lakh crore, as the direct tax collection crossed Rs. 1.50 lakh crore (primarily personal income tax and corporate tax) mark in the first half of the fiscal. If the amount (Rs. 1.54 lakh crore) accounts for 40% of the total collection, then the government can hope for collecting nearly Rs. 2.25 lakh crore in the next half of this fiscal which will sum the total to Rs. 3.79 lakh crore.

**Source:** <http://profit.ndtv.com/Home.aspx>

### » Survey Shows Small Business Lending Holds Steady; Accountants Play Key Role in Lending Decisions

Some small and medium-sized enterprises (SMEs) may have access to more credit down the road, but will have to pass more rigorous tests to demonstrate their creditworthiness, according to the findings of a global survey of banks conducted by *The Banker* magazine in association with the International Federation of Accountants (IFAC). The survey results also confirmed the critical role that accountants play in providing information that influences lender decision making. "Accountants have a long-standing history as the trusted advisors for SMEs. To continue to fulfill this role, accountants should be proactive in advising their SME clients about lending options and requirements," states IFAC Chief Executive Officer Ian Ball. "The survey results provide useful information to assist both accountants and SMEs." The survey showed that lenders also highly value audited financial statements. Two-thirds of the respondents indicated that their lending policies require some form of assurance on the entity's financial statements from an external accountant, and audited financial statements are preferred by most respondents. In addition, another 60 per cent of respondents said that accountant involvement in an SME's business would significantly and positively influence their lending decisions.

**Source:** <http://www.ifac.org/>

### » IAASB Releases New Tools to Support Clarity ISA Implementation

To promote awareness and understanding of the newly clarified International Standards on Auditing (ISAs), the International Auditing and Assurance Standards Board (IAASB) has released a series of "ISA Modules" focusing on some of the new and more significantly revised ISAs. Developed by IAASB staff, each of these modules combines short video presentations and accompanying slides that explain the key principles of, and major changes in, individual ISAs, including the implications for audits of small- and medium-sized entities (SMEs). "Promoting the adoption and successful implementation of ISAs is one of the IAASB's most important goals. These new tools will help us to move closer to that goal by providing support to those responsible for adopting and implementing the clarified ISAs, trainers, and auditors in applying them in practice," explains Arnold Schilder, Chairman of the IAASB. This new resource includes modules that provide an introduction to, and an overview of, the clarified ISAs, including ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, and audit documentation and SME audit considerations. Additional modules cover ISAs that address related parties, auditing accounting estimates, including fair value estimates, communication with those charged with governance, and communicating deficiencies in internal control.

**Source:** <http://www.ifac.org/>

### » IFRS Returns to the Front Burner in US

Leading the charge to convert the world to International Financial Reporting Standards, David Tweedie says many of the problems opponents cite are being addressed and resolved. His assertion was part of the debate over whether US companies should be forced to use international accounting standards that took a new life last month when the Securities and Exchange Commission assured investors, companies, and accountants that the convergence project is still active. Once the SEC announced it hadn't lost sight of the project, criticism of International Financial Reporting Standards bubbled up again, with opponents making the same arguments they did when the SEC released the IFRS roadmap in 2007. The main criticisms: training U.S. accountants and auditors by the proposed 2014 deadline would be impossible; the SEC would cede its regulatory power to a global regulator; the standard-setter that wrote the rules — the International Accounting Standards Board — would buckle under political pressure; and compared with US generally accepted accounting principles, IFRS is weak and would therefore invite accounting abuse.

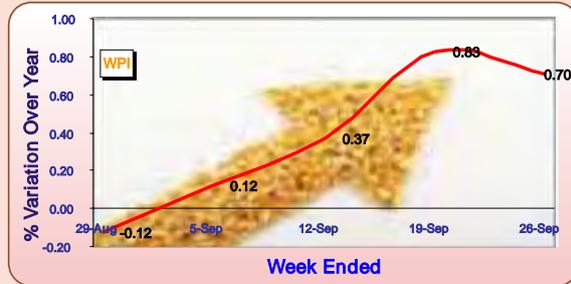
**Source:** <http://www.cfo.com/>

### » Salary Prospects Better in Accounting: Report:

Salaries in the developed world are expected to remain flat or decline in 2010, but prospects for some positions, including in the field of accounting, are better than others, according to Robert Half International, an international staffing firm. According to Robert Half's 2010 Salary Guides, starting salaries in accounting, IT, finance and administrative fields will not increase next year, but hiring trends within those fields indicate that job seekers may do well to narrow their search on specific positions, including tax accounting and information security. In accounting and finance, positions that help companies save money and boost profitability, such as tax accountants, compliance directors, credit managers and senior financial analysts are more promising than others.

**Source:** <http://www.wbjournal.com/>

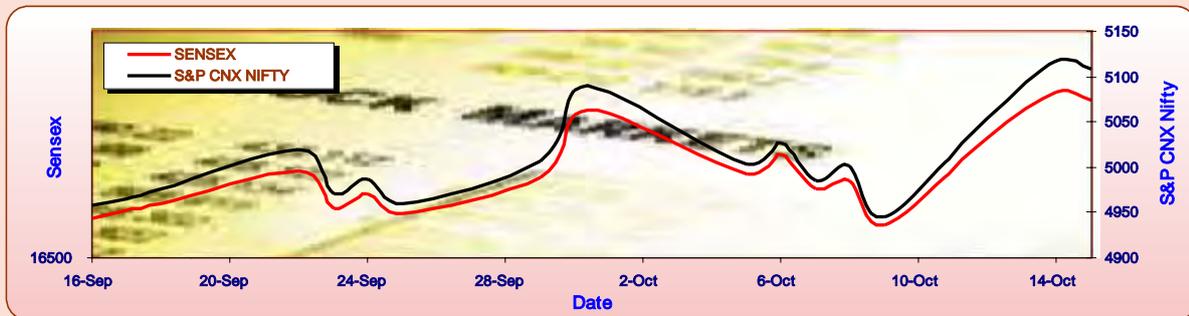
# Economic Indicators



Indian Rupee vs. Major Foreign Currencies (September 16, 2009 to October 15, 2009)



## Stock Markets



## Selected Indicators

Item	Unit/Base	2008		2009				
		Oct. 3	Aug. 28	Sep. 4	Sep. 11	Sep. 18	Sep. 25	Oct. 2
Cash Reserve Ratio	per cent	9.00	5.00	5.00	5.00	5.00	5.00	5.00
Bank Rate	Per cent per annum	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Prime Lending Rate	Per cent per annum	13.75-14.00	11.00-12.00	11.00-12.00	11.00-12.00	11.00-12.00	11.00-12.00	11.00-12.00
Deposit Rate	Per cent per annum	8.75-10.50	6.50-7.75	6.50-7.75	6.50-7.75	6.50-7.75	6.50-7.75	6.50-7.75
Call Money Rate (Low/High)	Per cent per annum	9.00/17.50	1.00/3.30	1.75/3.30	1.50/3.47	1.75/4.00	1.50/4.25	2.15/4.30

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

# ACCOUNTANT'S BROWSER

## “PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE”

Index of some useful articles taken from Periodicals/Newspapers received during September–October 2009 for the reference of Faculty/Students & Members of the Institute.

### 1. ACCOUNTING

Disclosed Values of Option-Based Compensation – Incompetence, Deliberate Underreporting or the Use of Expected Option Life? by Ken L. Bechmann & Toke K. Hjortshoj. *European Accounting Review*, Vol. 18/3, 2009, pp. 475-513.

Farm Accounting in India: Needs an Accounting Standard by Padmanava Mohapatra. *Indian Journal of Accounting*.

Value Relevance of Conservative & Non-Conservative Accounting Information by Dimitrios V. Kousenidis etc. *The International Journal of Accounting*, Vol. 44, 2009, pp. 219-238.

### 2. AUDITING

Are Fully Independent Audit Committees Really Necessary? by Scott N. Bronson etc. *J. Account. Public Policy*, Vol. 28, 2009, pp. 265-280.

Audit Reform Revived by Nick Huber. *Accountancy*, September 2009, pp. 29-31.

The Effectiveness of the Auditor's Going-Concern Evaluation as an External Governance Mechanism: Evidence From Loan Defaults by Alnoor Bhimani, etc. *The International Journal of Accounting*, Vol. 44, 2009, pp. 239-255.

FTSE 100 Auditors Survey: Holding Firm During the Recession? by Liz Fisher. *Accountancy*, September 2009, pp. 25-28.

### 3. ECONOMICS

Blueprint For a Fairer & More Stable Global Economy by Arjun Jayadev. *Eco. & Pol. Weekly*, September 5, 2009, pp. 26-30.

Changing Higher Education Scenario in India by Neeraj Hatekar.

*Eco. & Pol. Weekly*, September 19, 2009, pp. 22-23.

China & India: Idiosyncratic Paths to High Growth by Kaushik Basu. *Eco. & Pol. Weekly*, September 19, 2009, pp. 43-56.

Creating Value in an Economic Crisis by Bill Clinton. *Harvard Business Review*, September 2009, pp. 70-71.

Different Approach to Financial Regulation by Avinash Persaud. *Eco. & Pol. Weekly*, September 5, 2009, pp. 34-34.

Economy & Voting in the 15<sup>th</sup> Lok Sabha Elections by K.C. Suri. *Eco. & Pol. Weekly*, September 26, 2009, pp. 64-70.

Effective Role of CRM in Banking Sector by S. Chandrakala. *Banking Finance*, September 2009, pp. 5-8.

Special Report on the World Economy by Simon Cox. *The Economist*, October 3, 2009, pp. 1-28.

### 4. INVESTMENT

Management Forecast Characteristics: Effects on Venture Capital Investment Screening Judgments by Damon M. Fleming. *Behavioral Research in Accounting*, Vol. 21/2, 2009, pp. 13-36.

The Role of Shareholder Derivative Actions in Corporate Governance by Vatsal Gaur. *Company Law Journal*, Vol. 3, 2009, pp. 166-173.

The Securities & Exchange Board of India (Aid for Legal Proceedings) Guidelines, 2009. *Corporate Law Adviser*, September (2<sup>nd</sup>) 2009, pp. 285-287.

### 5. LAW

Addressing Legality of Assignment of Non-Performing Assets: A Critical Analysis of Kotak Mahindra Case by Harshita Mathur.

*Company Law Journal*. Vol. 3, 2009, pp. 151-157.

Is the Board of Directors the Weakest Link in the Corporate Chain? by P.T. Rangamani. *Chartered Secretary*, September 2009, pp. 1201-1205.

Limited Liability Partnerships – Meaning, Advantages & Disadvantages by Sanjiv Agarwal. *Consolidated Commercial Digest*, 01.09.2009, pp. 6-10.

### 6. MANAGEMENT

Guidelines on Corporate Governance for the Insurance Sector. *SEBI & Corporate Laws*, September 21-27, 2009, pp. 426-442.

Workplace Relations: When Valuable New Staff Leave After a Short Period it Could Come Down to Poor Induction Practices. *In the black*, October 2009, pp. 60-61.

### 7. TAXATION & FINANCE

Constitutional Validity of Section 50C of Income Tax Act by R. Santhanam. *CTR*, September 24, 2009, pp. 81-86.

Taxation of Import of Services in India & Levy of Service Tax by N. Vijay Kumar. *Service Tax Today*, September 25 to Oct 1, 2009, pp. 57-61.

Survey & Scrutiny Assessment by N.M. Ranka. *CTR*, September 24, 2009, pp. 90-101.

Computation of Income from Employment & House Property As Per Direct Taxes Code Bill by C.S. Padmanabhan. *CTR*, October 1st 2009, pp. 14-19.

Radical Changes in Direct Tax Law by T.C.A. Ramanujam & T.C.A. Sangeetha. *Consolidated Commercial Digest*, 01.10.2009, pp. 206-213.

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



**Career Ascent**  
Mid Career Campus

**Special Campus**  
Placement Programme

**Corporate Conclave**  
In Pursuit of Excellence

**ICAI Awards**  
Excellence in Financial Reporting

**ICAI's Award 2009**  
Corporate CA Achievers Acclaim

### Introduction

Committee for Members in Industry (CMII) of ICAI is pleased to announce the conduct of comprehensive three days Corporate Forum event at Mumbai in January 2010<sup>1</sup>. Corporate Forum is a unique programme in which four concurrent events i.e Career Ascent, Corporate Conclave, Special Campus Placement Programme and ICAI Awards will be organised. ICAI Awards for Excellence in Financial Reporting for the year 2008-2009, an initiative of the Research Committee of ICAI, will also be given away to the winning organisations in this programme.

Creation of Employment Opportunities, Enhancing Knowledge and Skill Sets and Recognition of the Exemplary work of Members in Industry are the primary goals of the CMII of ICAI. Keeping this in mind, the ICAI will be organising the Corporate Forum consisting of all these activities concurrently.

### CAREER ASCENT - MID CAREER CAMPUS

29 | 30 | 31 January, 2010, Goregaon Sports Club, Mumbai

#### OBJECTIVE

As a measure to develop employment opportunities for Chartered Accountants, CMII of ICAI has been successfully organising 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.

Career Ascent provides Chartered Accountants who have one year or more of industry experience and passed CA Final Examination on or before November 2008 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.

#### MEET THE COMPLETE BUSINESS PROFESSIONALS: CHARTERED ACCOUNTANTS

Chartered Accountants are considered as complete business solution providers in this dynamic business world. They are thoroughly trained practically in all avenues of finance and accounting, auditing, management and information technology. They can undertake responsibilities ranging from carrying out feasibility study, raising financial resources, compliance with regulatory framework, capital structure 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.

#### CAREER ASCENT – A Great Advantage for Corporates

If you are looking for complete and experienced 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 one 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.

Possible care would be taken to maintain the confidentiality of the candidates during the entire process.

#### ELIGIBILITY of Candidates for Career Ascent

Chartered Accountants who have more than one year of industry experience and passed C.A. final Examination on or before November 2008 are eligible to take part in Career Ascent.

#### PARTICIPATION FEES for Career Ascent

Day of the Career Ascent	For Organisations other than Firms of CAs	For Firms of CAs
Day 1	Rs. 3,00,000/- + Service Tax @ 10.3%	Rs. 2,50,000/- + Service Tax @ 10.3%
Day 2	Rs. 2,50,000/- + Service Tax @ 10.3%	Rs. 2,00,000/- + Service Tax @ 10.3%
Day 3	Rs. 2,00,000/- + Service Tax @ 10.3%	Firms with more than 10 partners: Rs. 1,00,000/- + Service Tax @ 10.3% Firms with less than 10 partners: Rs. 50,000/- + Service Tax @ 10.3%

For detailed Guidelines for the Participating Organisations as well as for the Candidates (i.e. experienced CAs), Payment Terms, please visit [www.cmii.icai.org](http://www.cmii.icai.org) or the ICAI's Corporate Forum Portlet on the home page of [www.icai.org](http://www.icai.org). For details contact:

CA. B. C. Jain Chairman, WIRC of ICAI  
Mob: +91 98211 17813

Email: [bhalawat@vsnl.com](mailto:bhalawat@vsnl.com)

Dr. T. Paramasivan — Secretary, CMII

Tel : +91 (11) 30110450/491

Email : [tparamasivan@icai.in](mailto:tparamasivan@icai.in)  
[placements@icai.org](mailto:placements@icai.org)

Mrs. S. Kapoor — Senior Assistant Director, ICAI

Tel : +91 (22) 39802921

Email : [kapoor@icai.org](mailto:kapoor@icai.org)



<sup>1</sup> Complete details of various events will be hosted in the websites of the Institute [www.icai.org](http://www.icai.org), [www.cmii.icai.org](http://www.cmii.icai.org) and also covered in the forthcoming issues of the Chartered Accountant Journal.

## SPECIAL CAMPUS PLACEMENT PROGRAMME

29 | 30 | 31 January, 2010, Goregaon Sports Club, Mumbai

## OBJECTIVE

As a measure to develop employment opportunities for Chartered Accountants who had undergone the special course at NIFM, Faridabad ([www.nifm.ac.in](http://www.nifm.ac.in)), L.N. Mittal Institute of Information Technology, Jaipur and IIM Indore ([www.iimdr.ac.in](http://www.iimdr.ac.in)), the Committee for Members in Industry of ICAI is organising Special Placement Programmes for them, wherein prospective employers and candidates interact and explore the possibility of taking up employment careers in various organisations.

## About SPECIAL CAMPUS PLACEMENT PROGRAMME

If you are looking for a complete business solution provider with contemporary communication and behavioural skills, then end your search by taking part in the next ICAI Special Campus Placement Programme for Chartered Accountants undergone 3 months Residential Programme on Professional Skills Development at National Institute of Financial Management (NIFM), Faridabad, L. N. Mittal Institute of Information Technology, Jaipur as well as at Indian Institute of Management, Indore.

## ELIGIBILITY to Participate in the Special Campus Placement Programme

The Special Campus Placement Programme is for Chartered Accountants who had undergone the three months residential programme organized by the Institute and administered by the NIFM, Faridabad, L.N. Mittal Institute of Information Technology, Jaipur as well as IIM, Indore and would be completing the articleship training latest by 28<sup>th</sup> February, 2010.

## PARTICIPATION FEES for Special Campus Placement Programme

Day of the Special Campus	For Organisations other than Firms of CAs	For Firms of CAs
Day 1	Rs. 50,000/- + Service Tax @ 10.3%	Rs. 50,000/- + Service Tax @ 10.3%
Day 2	Rs. 40,000/- + Service Tax @ 10.3%	Rs. 40,000/- + Service Tax @ 10.3%
Day 3	Rs. 30,000/- + Service Tax @ 10.3%	Rs. 20,000/- + Service Tax @ 10.3%

For Detailed Guidelines for the Participating Organisations as well as for the Candidates (i.e. CAs who have undergone the three months residential programme on professional skills and communication development course), Payment Terms, please visit [www.cmii.icai.org](http://www.cmii.icai.org) or the ICAI's Corporate Forum Portlet on the home page of [www.icai.org](http://www.icai.org).

For details contact:

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 Tel : +91 (11) 30110450/491  
 Email : [tparamasivan@icai.in](mailto:tparamasivan@icai.in); [placements@icai.org](mailto:placements@icai.org)  
 Mrs. S. Kapoor — Senior Assistant Director, ICAI  
 Tel : +91 (22) 39802921  
 Email : [kapoor@icai.org](mailto:kapoor@icai.org)

## CORPORATE CONCLAVE - IN PURSUIT OF EXCELLENCE

29 | 30 | 31 January, 2010, Hotel JW Marriott, Juhu, Mumbai

An opportunity to enrich knowledge and enhance skill set. Three full day Conclave on Information Systems Audit and IFRSs.

1. Conclave on Information Systems Audit Professionals: Organised jointly by Information Systems Audit and Control Association (ISACA), Committee for Members In Industry and Committee on Information Technology of ICAI
2. All India Mega Women Conference organised by Committee for Members in Industry jointly with Women Steering Group of ICAI
3. Conclave on IFRSs: Organised by Committee for Members In Industry jointly with Accounting Standards Board of ICAI

Participation Fees	Members of ICAI	Non -Members of ICAI
Two days conclave for Information Systems Audit	Rs. 5,000/-	Rs. 7,000/-
All India Mega Women Conference	Rs. 2,500/-	Rs. 3,500/-
One day conclave for IFRSs	Rs. 2,500/-	Rs. 3,500/-

The Package would includes: Course materials, 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. Priya Bhansali — Convenor, WSG of ICAI  
 Tel : +91 (11) 30110490 Email: [wsg@icai.org](mailto:wsg@icai.org)  
 CA. B. C. Jain Chairman, WIRC of ICAI  
 Mob: +91 98211 17813 Email: [bhalawat@vsnl.com](mailto:bhalawat@vsnl.com)  
 Dr. T. Paramasivan — Secretary, CMII  
 Tel : +91 (11) 30110450/491  
 Email : [tparamasivan@icai.in](mailto:tparamasivan@icai.in), [placements@icai.org](mailto:placements@icai.org)  
 Mrs. S. Kapoor — Senior Assistant Director, ICAI  
 Tel : +91 (22) 39802921  
 Email : [kapoor@icai.org](mailto:kapoor@icai.org)

*INSPIRING TODAY, FOR TOMORROW*  
 All India Mega Conference of Women Steering Group of ICAI

Coinciding with the ICAI's Corporate Forum, Women Steering Group of ICAI is organising an All India Mega Conference on the theme "Inspiring Today, For Tomorrow" on 30<sup>th</sup> January, 2009 to emphasise the importance of women obtaining the CA credential and highlighting the flexibility and various career paths of the accounting profession. Session topics will focus on the importance of networking and mentoring. Professionals with an array of expertise in public accounting, private industry, and academia will take part in discussion forums and give presentations focusing on the development of strong leadership skills.

The theme "Inspiring Today, For Tomorrow" emphasises the opportunities the profession provides, and confirms the Institute's commitment to attracting female talents to a profession vital to the world's economy. The Conference will focus on teaching women life-coping strategies to manage stress, conduct career planning, as well as develop positive relationships and mental health awareness. In addition to bringing together women of all lifestyles to develop a network of communication, the Conference proposes to increase the awareness of the resources available to women, demonstrate support for issues of concern and enhance awareness of how women can improve their quality of life.

The All India Conference will serve as the flagship event for the Women Steering Group. WSG is holding this Conference for the first time in the Diamond Jubilee Year of ICAI which will draw participation from all over the country. The Conference will offer a wide variety of session formats, including panel sessions, special symposia, as well as various opportunities to networking.

*Complete details for the said event shall be hosted on the website shortly.*

**ICAI AWARDS FOR EXCELLENCE IN FINANCIAL REPORTING**  
31 January 2010, Goregoan Sports Club, Mumbai

With a view to promote better standards in the preparation and presentation of information in the financial statements, Research Committee of the Institute of Chartered Accountants of India has been holding the annual competition for the 'ICAI Awards for Excellence in Financial Reporting'. The Awards are given in seven categories of business and other entities.

Gold Shield and Silver Shield is awarded in each category for the best entry and the next best entry, respectively. Apart from the aforesaid awards, a Hall of Fame is also awarded for the entry that has been awarded the first prize in that category continuously in the last five years and Plaques will be also awarded for the Annual Reports that are following better financial reporting practices amongst the remaining enterprises that would be participating in the Competition. For complete details of the Award and the Competition (last date of which was 15<sup>th</sup> October 2009), please visit [http://www.icai.org/resource\\_file/16823icai\\_awards\\_efr.pdf](http://www.icai.org/resource_file/16823icai_awards_efr.pdf)

**ICAI's AWARD 2009 - CORPORATE CA ACHIEVERS ACCLAIM**  
31 January, 2010, Goregaon Sports Club, Mumbai

*"The Highest Recognition for a man is to be honoured by his alma mater"*

These Corporate CA Achievers Acclaim Awards of ICAI 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.
- To acknowledge contribution in ICAI Activities.

**AWARDS CATEGORIES**

Awards/Cate-gories	CA Business Achiever	CFO	CA Professional Achiever	Awards/Cate-gories	CA Business Achiever	CFO	CA Professional Achiever
a.	CA Business Achiever – Financial Services	Manufacturing	Manufacturing	f.		Media & Entertainment Enterprises	Media & Entertainment Enterprises
b.	CA Business Achiever – Corporate	Auto & Ancillary Sector	Auto & Ancillary Sector	g.		Telecom Sector	Telecom Sector
c.	CA Business Achiever – SME	Financial Sector	Financial Sector	h.		FMCG Sector	FMCG Sector
d.	CA Business Achiever – Others	Service Sector	Service Sector	i.		Infrastructure & Construction	Infrastructure & Construction
e.		Information Technology - IT & ITES Sector	Information Technology - IT & ITES Sector	j.		Healthcare Sector	Healthcare Sector
				k.		Engineering & Capital Goods Sector	Engineering & Capital Goods Sector
				l.		Public Sector	Public Sector
				m.		Others	Others
				n.		Woman	Woman

**AWARDEES FOR 2007**

S. No.	Name and Category	Designation/Organisation
1.	CA Nilesh Shah, CA. Professional Manager - Private Sector (1 <sup>st</sup> Rank)	Deputy Managing Director Chief Investment Officer, ICICI Prudential Mutual Fund
2.	CA. D. Prasad, CA. Professional Manager - Private Sector (2 <sup>nd</sup> Rank)	Head of Finance & Accounts, Essar Oil Ltd.
3.	CA. S. K. Gupta, CA. Professional Manager - Private Sector (3 <sup>rd</sup> Rank)	Chief Financial Officer, DLF Ltd.
4.	CA. Raman Roy, CA. Business Leader - SME (1 <sup>st</sup> Rank)	Chairman, Quattro BPO Solutions Pvt. Ltd.
5.	CA. Raman Deep Singh Bawa, CA. Business Leader - SME (2 <sup>nd</sup> Rank)	Group Chief Financial Officer, Network 18 Media & Investments Limited
6.	CA. Dinesh Nandwana, CA. Business Leader - SME (3 <sup>rd</sup> Rank)	Chairman and Managing Director, Vakrangee Softwares Limited
7.	CA. Pooja Gupta, CA. Young Leader - Female (1 <sup>st</sup> Rank)	Senior Financial Consultant, Standard Chartered Bank
8.	CA. Vishakha Mulye, CA. Young Leader - Female (2 <sup>nd</sup> Rank)	Executive Director, ICICI Lombard General Insurance Company Ltd.
9.	CA. Neetu Kashiramka, CA. Young Leader - Female (3 <sup>rd</sup> Rank)	Chief Finance Officer, Jyothy Laboratories Ltd.
10.	CA. M. Ramadoss, CA. Professional Manager - Public/Government Sector (1 <sup>st</sup> Rank)	Chairman-cum-Managing Director, The Oriental Insurance Company Limited
11.	CA. S. K. Garg, CA. Business Leader - CA. Professional Manager - Public/Government Sector (2 <sup>nd</sup> Rank)	CMD, N.H.P.C. Ltd.
12.	CA. C. Ramulu, CA. Professional Manager - Public/Government Sector (3 <sup>rd</sup> Rank)	Director - Finance, Hindustan Petroleum Corporation Ltd.

## AWARDEES FOR 2007

13.	CA. Nitin Agrawal, CA. Young Leader - Male (1 <sup>st</sup> Rank)	Manager (Finance & Accounts) L & T Ltd.
14.	CA. Upendra Gupta, CA. Young Leader - Male (2 <sup>nd</sup> Rank)	Sr. Manager (Finance) Dabur India Ltd.
15.	CA. Asheesh Awasthy, CA. Young Leader - Male (3 <sup>rd</sup> Rank)	Head of Finance and India Centre of Excellence, Google India Pvt. Ltd.
16.	CA. R. Seshasayee, Lifetime Achievement Award	Managing Director, Ashok Leyland Ltd.
17.	CA. Ramesh D. Chandak, CA. Business Leader - Corporate (1 <sup>st</sup> Rank)	Chief Executive Officer & Managing Director, KEC International Limited
18.	CA. Nirmal Jain, CA. Business Leader - Corporate (2 <sup>nd</sup> Rank)	Chairman & Managing Director, India Infoline Ltd.
19.	CA. Deepak Ghaisas Keshav, CA. Business Leader - Corporate (3 <sup>rd</sup> Rank)	Vice Chairman & Director, I-Flex Solution Limited

## AWARDEES FOR 2008

S. No.	Name and Category	Designation/Organisation
1.	CA. Akhil Gupta CA. Business Achiever -Corporate	Dy. Group CEO & MD, Bharti Group
2.	CA. Motilal Oswal CA. Business Achiever - Financial Services	Chairman & Managing Director, Motilal Oswal Financial Services Ltd.
3.	CA. K. Ullas Kamath CA. Business Achiever-SME	Dy. MD Jyothy Laboratories Limited
4.	CA. Adesh Gupta CFO - Manufacturing	Whole Time Director & CFO Aditya Birla NOVO Limited
5.	CA. Keki Mistry, CFO-Financial Sector	Vice Chairman and MD HDFC Ltd.
6.	CA. A. K. Singhal, CFO - Public sector	Director (Finance) NTPC Limited
7.	CA. V. Balakrishnan, CFO (Information Technology, Media, Communication and Entertainment)	CFO Infosys Technologies Limited
8.	CA. Irawati Dani, CFO-Women	Director (Finance) Western Coalfields Limited
9.	CA. Bharat Banka, CA Professional Achiever-Finance Sector	MD & CEO Aditya Birla Capital Advisors, also President and Head, Group Corporate Finance, Aditya Birla Group

## CATEGORY CRITERIA

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

I CA Business Achiever

This Category is for CEOs/Directors (or individuals holding equivalent positions in their organisation) in the following sub-categories:

## A) Financial Services

All Enterprises in Financial Sector (including NBFCs, 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 CFOs, Business Vertical Heads, Chief Risk Officers, Chief Treasury Officers 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.

## Sub-categories

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

- (i) Manufacturing (including Processing, Mining, Plantations, Oil and Gas enterprises, etc.).
- (ii) Auto & Ancillary Sector.
- (iii) Financial Sector (including Banking, Financial Institutions, Insurance, NBFCs, Mutual Funds, etc.)
- (iv) Service Sector (including Hotels, Consultancy, Transport, Stock Exchanges, R & D, Private Hospitals, etc.)
- (v) Information Technology – IT & ITES Sector
- (vi) Media and Entertainment Enterprise
- (vii) Telecom Sector
- (viii) FMCG Sector
- (ix) Infrastructure and Construction (including Power Generation and Supply, Port Trusts, Metro, Roads, Real Estates, etc.)
- (x) Healthcare Sector
- (xi) Engineering and Capital Goods Sector
- (xii) Public Sector (including Government Organisations, Regulators, etc.)
- (xiii) Others (Section 25 companies, Educational Institutions, NGOs, Charitable Hospitals, etc.)
- (xiv) Woman (This is an additional category for woman open for all the sectors given above. A woman CFO/ Professional Achiever can also apply/be considered in any of the above categories.)

## EVALUATION PARAMETERS

The Steering Committee will finalise the parameters for evaluation. An illustrative list of parameters to be considered for each category is 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.

## JURY FOR 2007

S. No.	Name of the Member	Designation/Organisation (as on the date of Jury meet)
1.	CA. N. D. Gupta	Past President, ICAI, Chairman of the Jury
2.	Mr. Sajjan Jindal	Sr. Vice President, ASSOCHAM
3.	Mr. Dheeraj Kumar	CMD & Actor, Producer & Director, Creative Eye Limited
4.	Mr. Vijay J. Darda	Chairman, Managing Director & Editor-in-Chief, Lokmat Times
5.	Mr. Keki M. Mistry	Vice-Chairman & Managing Director, HDFC Ltd.
6.	Dr. Rakesh Sinha	Leading Surgeon, Beams Specialty Hospital



## JURY FOR 2008

S. No.	Name	Designation/Organisation (as on the date of Jury meet)
1.	Shri Suresh Prabhu	Former Union Minister for Power, Heavy Industry & Public Enterprise & MP (Lok Sabha) Chairman of the Jury Panel
2.	Mr. Vimal Gandhi	President, ITAT
3.	CA. N. P. Sarda	Past President of ICAI – Vice Chairman of the Jury Panel
4.	CA. Uttam Prakash Agarwal	Vice-President – ICAI
5.	Mr. T. S. Vijayan	Chairman, LIC
6.	Mr. K. V. Kamath	MD & CEO, ICICI Bank
7.	Mr. Venugopal Nandlal Dhoot	Chairman & Managing Director, Videocon Industries Ltd.
8.	Shri S. K. Roongta	Chairman, Steel Authority of India Limited
9.	Mr. Ramesh Chandak	Chief Executive Officer & Managing Director, KEC International Limited
10.	Mr. T. V. Mohandas Pai	Member of the Board and Director, Human Resources Infosys Technologies Ltd.
11.	Mr. Venkat Chary	Chairman and Director, MCX
12.	Mr. Kishore Biyani	Managing Director, Pantaloons
13.	Mr. M. Ramadoss	Chairman-cum-Managing Director, The Oriental Insurance Company Limited
14.	Mr R. Ramaseshan	MD & CEO, National Commodity & Derivatives Exchange Ltd.
15.	Mr. D. D. Rathi	Whole-time Director & CFO Grasim Industries Limited

## JURY FOR 2009

Eminent personalities from different fields are being invited to act as Jury for the awards.

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

Applications can be made by –

1. Chartered Accountant himself
2. Employer
3. Any other member of ICAI
4. Others, which the Nomination Committee may deem fit. For Nomination requirements, Guidelines and Form kindly visit [www.icai.org](http://www.icai.org) and [www.cmii.icai.org](http://www.cmii.icai.org)

For details contact:

CA. B. C. Jain Chairman, WIRC of ICAI

Mob: +91 98211 17813

Email: [bhalawat@vsnl.com](mailto:bhalawat@vsnl.com)

Dr. T. Paramasivan Secretary, CMII,

Tel : +91 (11) 30110450/491,

Email : [tparamasivan@icai.in](mailto:tparamasivan@icai.in),

[placements@icai.org](mailto:placements@icai.org)

Mrs. S. Kapoor Sr. Assistant Director, ICAI

Tel : +91 (22) 39802921

Email : [kapoor@icai.org](mailto:kapoor@icai.org)



CPE

# 20

HRS

## Auditors Training Programme on Finacle CBS

**Organized by: Committee on Information Technology, ICAI**

Location	Hosted by	Course Dates	Last date for form receipt at CIT, Delhi	Venue
Pune	Pune Branch of WIRC of ICAI	January 20-24, 2010	January 5, 2010	C2 (Classroom 2), B1 (Building No.-1), Infosys, Hinjewadi Phase 1, Pune
Chennai	SIRC of ICAI	December 18-22, 2009	December 4, 2009	ICAI, Chennai

The Committee on Information Technology is going to organize a **NON Residential** training programme on “Auditors Training Programme on Finacle CBS” in association with M/s. Infosys Technologies at Pune and Chennai at the above-mentioned dates. This course aims to provide hands-on training on the basic use of Finacle CBS (Version 7) and an introduction to the use of its Audit & Control features. Delegates have to make their own lodging and boarding arrangements. Registration is on *First-Cum-First-Serve* basis for 25 delegates on receipt of application with Fee of **Rs. 25,000/- (Rupees Twenty Five Thousand only)** per delegate payable by DD/ Pay-Order/ Online (<http://icai.org/ccm.html?progid=48> ) drawn in favour of “The Secretary, ICAI” payable at Delhi and has to be sent to “The Secretary, Committee on Information Technology, The Institute of Chartered Accountants of India, ICAI Bhawan, Plot No. 52-54, Vishwas Nagar, Shahdara, Delhi – 110 032. 20 CPE Hours. Further details, pre-requisites and course schedule are available at [www.icai.org](http://www.icai.org). Please contact: [cit@icai.in](mailto:cit@icai.in)/Ph. 011-30210619/621 for further details and assistance, if any.

# IFRS

eLearning Course

- ⊙ On-Demand Training - At your Doorstep
- ⊙ Be Informed, Up-to-Date & Empowered
- ⊙ Well Structured Standardised Training pan India
- ⊙ Course Fee: Rs. 5,000/-, 9 Months Access
- ⊙ CPE Hours: 20
- ⊙ Register online through Online Payment Portal at <http://www.icai.org/ccm.html>
- ⊙ Further Details/ Support: eLearning Portal: <http://elearn.icai.org>  
e-Mail: [elearn@icai.in](mailto:elearn@icai.in)  
Phone: 011-30210621

### 3<sup>rd</sup> Women Conference on “WOMEN - TAKING THE LEAD”

#### THE CONFERENCE EVENT

Women Steering Group of the Institute of Chartered Accountants of India is organising its 3<sup>rd</sup> Women's Conference on “WOMEN- TAKING THE LEAD” which is being hosted by SIRC of ICAI on 21<sup>st</sup> November, 2009 in Chennai.

This shall be a day long conference that seeks to empower, motivate, and inspire women to live up to your full potential and make their dreams come true. It is our passion in this Conference to rally women leaders, community leaders, visionaries and women from all walks of life in the nation to share perspectives, experience transformation and cultivate lasting legacies.

#### CONFERENCE DETAILS

**Date & Day:** 21<sup>st</sup> November, 2009, Saturday.

**Venue:** P. Brahmaya Memorial Hall, 'ICAI Bhawan', No. 122, Mahatma Gandhi Road, Nungambakkam, Chennai – 600 034

#### REGISTRATION INFORMATION

**Conference registration:** Registration will begin from 1<sup>st</sup> November, 2009 to 18<sup>th</sup> November 2009 between 10.00 hours and 17.30 hours at **SIRC of ICAI, 'ICAI Bhawan', No. 122, Mahatma Gandhi Road, Nungambakkam, Chennai – 600 034.**

**All timing are according to Indian Standard Time (IST).**

**PARTICIPATION:** Total number of seats is limited to 100. Entry is only through registration. Registration shall be on first come basis.

**Complete details are available at [www.icai.org](http://www.icai.org)**

#### CONFERENCE FEE

For Women Chartered Accountants	Rs. 500
For Women Chartered Accountant Students	Rs. 350
For Women Non Members	Rs. 550

#### PAYMENT OPTIONS

Cheque/Demand Draft drawn in favour of “SIRC of ICAI” payable at Chennai.

#### CONTACT DETAILS

CA. Priya Bhansali	<a href="mailto:priya@bhansali.in">priya@bhansali.in</a>	9442635213
CA. S. Rajeshwari	<a href="mailto:rajesh@pkfindia.in">rajesh@pkfindia.in</a>	9841024530
CA. Ruchika Bachchani	<a href="mailto:ruchika.bachchani@icai.in">ruchika.bachchani@icai.in</a>	011-30110403
CA. Shalini Jindal	<a href="mailto:wsg@icai.in">wsg@icai.in</a>	011-30110490

## New Publications From the Committee on Information Technology

### Data Analysis for Auditors – Practical Case studies on using CAATs

The Committee on Information Technology has issued “Data Analysis for Auditors - Practical Case studies on using CAATs”



- Identifying Exceptions & irregularities
- Profiling Data
- Working with Multiple files
- Sampling
- Field Manipulation
- Importing Various Data File formats
- Working with Application Softwares
- Application of CAATs to General Insurance, Banks, Retail Sector, Utility Services
- Computer IT Security and IDEA
- Fraud Investigation Using IDEA
- Documentation of CAATs
- Continuous Auditing using IDEA

This publication can be obtained from the Sales Counters of the Institute at Regional Offices/ Head Office. It can also be obtained through post by sending a DD for the publication cost plus courier charges as indicated below in favour of “The Secretary, ICAI” payable at New Delhi to “The Postal Sales Department, The Institute of Chartered Accountants of India, A-94/4, Sector 58, Noida – 201 301, Uttar Pradesh”.

**Price:** Rs. 400/-, **Courier Charges** within Delhi & NCR Rs. 10/- and Rest of India Rs. 20/-.

#### Salient Features:

- Introduction
- Regulatory Drivers for the Use of CAATs Worldwide
- Stages in use of CAATs
- Examining Data & Isolating specific items

### XBRL– A Primer

The Committee on Information Technology has issued “XBRL- A Primer”



- XBRL and Financial Reporting.
- An Introduction to Taxonomies
- Opportunities for Chartered Accountants

This publication can be obtained from the Sales Counters of the Institute at Regional Offices/ Head Office. It can also be obtained through post by sending a DD for the publication cost plus courier charges as indicated below in favour of “The Secretary, ICAI” payable at New Delhi to “The Postal Sales Department, The Institute of Chartered Accountants of India, A-94/4, Sector 58, Noida – 201 301, Uttar Pradesh”.

This Book also contains a Companion CD.

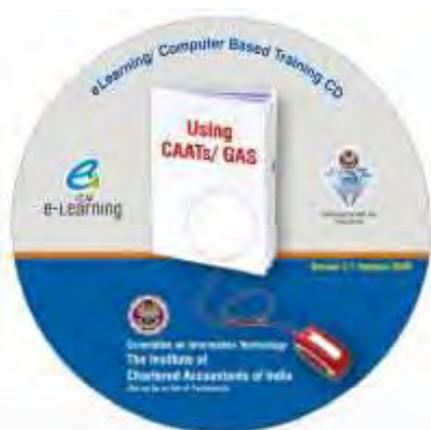
**Price:** Rs. 120/-, **Courier Charges** within Delhi & NCR Rs. 10/- & Rest of India Rs. 20/-

#### Salient Features:

- Introduction to XBRL.
- XBRL: Regulatory Perspectives.

### Using CAATs/GAS eLearning CD

The Committee on Information Technology has great pleasure in making available the eLearning CD on Using CAATs/GAS – revised version with voice explanations/support, training videos and updated software for training and development on using Computer Assisted Auditing Techniques/ General Audit Software.



#### Salient Features

- On Demand Training at Your Doorsteps
- Hands-on Training on (HOT) on Using CAAT/GAS

- Working copies of two CAAT/GAS Tools for Practice
- Lessons on Importing Files for Analysis, Selecting/Extracting required Records, Detecting Gaps & Duplicates, Aging Analysis, Pivot Table Reports, Benford/Digital Analysis for Fraud Detection and Sampling
- Training Videos and Self Assessment
- 6 CPE Hours under unstructured Learning

This publication can be obtained from the Sales Counters of the Institute at Regional Offices/ Head Office. It can also be obtained through post by sending a DD for the publication cost plus postal/ courier charges as indicated below in favour of "The Secretary, ICAI" payable at New Delhi to "The Postal Sales Department, The Institute of Chartered Accountants of India, A-94/4, Sector 58, Noida – 201 301, Uttar Pradesh".

**eLearning CD Price:** Rs. 100/-. Courier Charges: Within Delhi & NCR Rs. 6/- & Rest of India Rs. 15/-. Registered Parcel within India: Rs. 25 & Unregistered Parcel within India Rs. 10/-.

## Single window help desk for Chartered Accountants in Service/Industry relating to Membership in ICAI



**A**s part of its quality service to the Chartered Accountants in Service/Industry, The Committee for Members in Industry of ICAI has started a single window help desk for the Chartered Accountants with respect to all services related to their membership in ICAI. These services would cover appropriate assistance on the following:

1. Enrolment as members of ICAI
2. Restoration of Membership of ICAI
3. Enrolment as Fellow Member of ICAI



The above services would be co-ordinated by the CMII Secretariat through the respective Regional Offices of ICAI. Members who are in Service/Industry and desirous of availing this service may send their requests to [cmii@icai.org](mailto:cmii@icai.org).

It may be specifically noted that **Form-2** for Enrolment as Members of ICAI and **Form-9** for Restoration of membership of ICAI and **Form – 3** for Enrolment as Fellow Member of ICAI should be first sent to the respective Regional Offices of the ICAI. Accordingly this **Centralized ICAI Membership Assistance Services for Chartered Accountants in Service/Industry** is available to those Chartered Accountants who would like to get the assistance from the CMII Secretariat after filling the relevant forms at the concerned Regional Offices of the Institute.

Committee for Members in Industry

## FORM FOR INTIMATING THE ICAI ABOUT ENGAGEMENTS ACCEPTED (after submission of multipurpose empanelment application form for the year 2009-10)



MEF No.:

Name of the applicant:

Place of Head Office:

Firm Regn. No./MRN:

Unique Code No.:

1. Association of the concern/any partner/proprietor with Public Sector Banks as Concurrent / internal / income and expenditure or revenue auditor/ stock auditor/ auditor of borrowers accounts etc. (**other than as Statutory Bank Branch Auditors and Central Statutory Auditors**).

Name of the Bank	Name of the Branch	Name of the partner/ proprietor	Nature of assignment	Term of engagement	Date on which accepted

2. Details of loan availed (for amounts exceeding Rs.1,000) from Public Sector Banks (including outstandings in respect of credit cards)/any guarantee given in respect of any loan etc.

Name of the Bank	Name of the Branch	Name of the partner/ proprietor	*Amount of loan/outstanding/ Guarantee	Term of Loan availed outstanding/guarantee

\* Please fill-up the amount of loan/outstanding against credit card/guarantee given as on the date of furnishing this information. **No further information is required** on account of any change in this amount at a later date. However, details of further loan/outstanding against credit card/guarantee given should be sent to the Institute, if any.

3. Details of acceptance of position as Director on the Board of Public Sector Banks.

Name of the Bank	Name of the partner/proprietor	Date of Appointment	Term of Appointment	Date on which appointment accepted

The above details should be provided in respect of those engagements which have been accepted after submission of Multipurpose Empanelment Form to the Institute. All details received upto **30<sup>th</sup> November, 2009** would be compiled and submitted to RBI for their consideration.

The above information should be sent by e-mail at [mefpdc@icai.in](mailto:mefpdc@icai.in) with a copy by Speed Post /Courier at the below mentioned address:

The Director,  
Professional Development Directorate,  
'ICAI Bhawan', The Institute of Chartered Accountants of India,  
PO Box 7100, Indraprastha Marg, New Delhi- 110002  
(Details should be given separately for each Bank)

## Invitation for Expression of Interest for Authoring Publications

The Committee for Members in Industry (CMII) invites Expression of Interest from members of the Institute and other experts who are interested in developing / preparing basic drafts of the publications on topics relevant to the Members of ICAI serving in Industry. The intending authors of the CMII publications are expected to have appropriate level of practical experience in the relevant area along with the knowledge of various aspects of industry.

The CMII intends to bring out publications as a self-learning booklet in the form of handbooks with proper mix of theory and practical case studies.

**Apart from getting recognition, amongst the CA fraternity for their contribution in authoring the publication, the authors of the accepted publication materials will get :**

1. Their names printed in the Publications
2. Honorarium and reimbursement of incidental expenses as per the prevailing policy of the Institute. (This will depend upon the size, time and efforts to be required to prepare such publication materials).

### Procedure

**The intending authors are required to send a formal proposal with the following details:**

- Brief profile of the author
- Specific experience and expertise in the relevant topic for which they offer themselves to write the background materials which will enable the CMII Secretariat for allotting the preparation of material for them
- Proposed coverage of the Publication (in about 2000 - 3000 words)
- Sources of primary and secondary data based on which the Publication material will be written
- Time frame within which they can submit the publication material.

**The proposal should be sent to:**

The Secretary,  
Committee for Members in Industry,  
The Institute of Chartered Accountants of India,  
Post Box No. 7100,  
Indraprastha Marg,  
New Delhi - 110 002.

**Sending proposals by email at [cmii@icai.org](mailto:cmii@icai.org) is preferred.**

**Indicative topics on which CMII would like to bring out publications are given below:**

1. Evaluating and Improving Governance in Organizations
2. Handbook for the Professional Accountants in Business
3. Study of Governance in the Public Sector
4. E-Business and the Accountant
5. Handbook for Information Security Governance
6. Rebuilding Public Confidence in Financial Reporting
7. Implementing the Accounting Standards: Technical and Managerial Issues in various Industries
8. Cost and Financial Management
9. Business Management
10. Others\*



\*For detailed information on the topics including guidelines for Authors for preparing the basic drafts of publications, please visit [http://www.icai.org/resource\\_file/17182Indicative\\_topics\\_publications.pdf](http://www.icai.org/resource_file/17182Indicative_topics_publications.pdf)

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



Dear CA *Parivar*,

As you are aware, the recent torrential rains and flash floods in Karnataka and Andhra Pradesh have left a trail of death and destruction. The devastating September 30-October 2 floods, termed worst in 100 years in the two states, have killed about 300 people and rendered about 20 lakh people homeless in 20 districts. Besides, these have destroyed crops, cattle and property worth Rs. 16,500 crore in Karnataka and Rs . 12,500 crore in Andhra Pradesh.

It has been one of the worst calamities and our unfortunate brothers, sisters and children, who have become victims of this catastrophe, are in dire need of helping hand to begin their lives afresh from scratch. The sheer scale of the calamity has dwarfed all efforts to offer relief and succour to the needy and there is an urgent need to provide more relief to the suffering millions. It is at such times that the bond of oneness that makes us a nation should show itself.

ICAI and accounting profession have always risen to such occasions of national calamities. In keeping with this novel tradition, I, on behalf of ICAI, earnestly appeal to all colleagues, firms of chartered accountants and students to generously contribute their share for the cause of the hapless flood victims, which would go a long way in repaying our debt to the society at large.

We would be grateful to receive your contribution, by way of demand draft/cheque drawn in favour of 'The Secretary, ICAI (Southern India Flood Relief Account)' payable at New Delhi and send it at ICAI Bhawan, Indraprastha Marg, New Delhi-110002.

Your timely support will help reduce the suffering of millions of flood victims. Let's come forward to their aid, in line with our tradition.

-CA. Uttam Prakash Agarwal  
President, ICAI



## NON-RECEIPT OF JOURNAL

This is for the information of members/subscribers who fail to receive *The Chartered Accountant journal* despatched to them either due to unintimated change of address or postal problems. The membership/subscriber numbers of the members/subscribers whose journals have been returned undelivered are regularly hosted on the website of the Institute for the information of members/subscribers.

Please inform the respective regions immediately after you change the address to ensure regular and timely delivery of journals to you. Other queries and complaints in this regard can also be sent to [journal@icai.org](mailto:journal@icai.org)

## CPE Study Circle for members in Industry of ICAI

ICAI has developed the norms for CPE Study Circles for Members in Industry, which cater exclusively for the members in service. These CPE Study Circles are being contemplated to help Members in industry to achieve the objectives of maintaining their core competencies and exchange professional knowledge amongst the members apart from fostering and developing fellowship.

The Committee has started registering CPE Study Circles for Members otherwise than in practice. The following CPE Study Circles for Members otherwise than in practice have been formed so far:

Sr. No.	Name Of the CPE Study Circle	Location
1	Reay Road CPE Study Circle	Mumbai
2	Nungambakkam CPE Study Circle	Nungambakkam
3	Electronic City, Bangalore CPE Study Circle	Bangalore
4	Vittal Mallya Road, CPE Study Circle	Bangalore
5	WCS-IT PARK-PUNE CPE Study Circle	Pune
6	North Delhi Hudson Line CPE Study Circle.	Delhi
7	Cenotaph CPE Study Circle	Chennnai
8	Perungudi CPE Study Circle.	Chennai
9	Urja CPE Study Circle	Noida
10	Barakhamba Road CPE Study Circle	New Delhi
11	Surat (Hazira) CPE Study Circle	Surat (Hazira)
12	Gulmohar Road, Mumbai CPE Study Circle	Mumbai
13	Power Transmission CPE Study Circle	Mumbai

14	Bangalore Outer Ring Road ITES Industry CPE Study Circle	Bangalore
15	Dairy Circle, CPE Study Circle	Bangalore
16	Lodhi Road CPE Study Circle	New Delhi
17	Pharma Sector CPE Study Circle	Noida
18	Udyog Vihar CPE Study Circle	Gurgaon
19	Sriperumbudur CPE Study Circle	Tamil Nadu

We request the members serving in industry to come forward to form CPE study circle in their esteemed organization/locality. Norms for CPE Study Circle for Members in Industry can be viewed at [http://www.icai.org/resource\\_file/15888announ180409.pdf](http://www.icai.org/resource_file/15888announ180409.pdf), the said norms were also published at page numbers 1992-1995 of the May 2009 issue of the Journal.

Helpline for forming CPE Study Circle for Members in Industry:

Email: [cmii\\_events@icai.in](mailto:cmii_events@icai.in), Telephone: 011-30110549

Committee for Members in Industry



### CORRIGENDUM

Please refer to the advertisements relating to ICAI Job portal published in CA Journals previous issues. The hyperlink of the portal may be read as <http://Jobs4CAs.icai.org> instead of [www.Jobs4CAs.icai.org](http://www.Jobs4CAs.icai.org).

## Help Line Desk

Do you have any query about NOVEMBER, 2009 examination?



This is to inform you that a Help Line Desk has become functional from 16<sup>th</sup> October and will remain functional till 15<sup>th</sup> November, 2009 for 24 hours on all days (inclusive of holidays and Sundays) to attend to any query relating to the ensuing Chartered Accountant Examinations to be held from 5<sup>th</sup> to 20<sup>th</sup> November, 2009. The contact details of the Help Line Desk are as follows:

Phone Nos.: (0120) 3054851, 3054852, 3054853  
Fax: (0120) 3054843

Students having any query with regard to their appearance in the ensuing examination are welcome to contact the Help Line Desk on the above telephone numbers. The query could be non-receipt of Admit Card or any other matter related thereto. Students who have not received their admit cards can download it from website [www.icai.nic.in](http://www.icai.nic.in)

Further, separate e-mail IDs have been created to cater to the needs of the students. The student can contact at:

[pce\\_examhelpline@icai.in](mailto:pce_examhelpline@icai.in) for Professional Competence Examination

[ipce\\_examhelpline@icai.in](mailto:ipce_examhelpline@icai.in) for Integrated Professional Competence examination/Accounting Technician Examination

[pe2\\_examhelpline@icai.in](mailto:pe2_examhelpline@icai.in) for Professional Education Examination – II

[final\\_examhelpline@icai.in](mailto:final_examhelpline@icai.in) for Final Examination

Students who have not received their Admit Cards or could not download the same from the website and desirous of getting information regarding appearance in the examinations may utilise this facility for prompt response from 'help-line desk' of Examination Department of ICAI.

Additional Secretary (Exams)



## 'Women Empowerment' – Request to Contribute Articles



This is to inform all women Chartered Accountants and other women professionals that the January 2010 issue of *The Chartered Accountant* journal will focus on the theme 'Women Empowerment'. Therefore, we solicit your contributions, by way of articles, highlighting the prime role, importance and achievements of women in different walks of life and professional expectations from them. These women-oriented articles may also focus on women's interaction with various professions including the accountant's profession, role of gender, demand of contemporary times, society, media and politics, or, any other topic of your choice. Last date for submission of articles for the January 2010 issue is November 25, 2009.

The article of about 3000 words each, along with an executive summary of about 100 words each,

passport size photograph of the author and ICAI's email-id of the author may be sent at [journal@icai.org](mailto:journal@icai.org)/[eboard@icai.org](mailto:eboard@icai.org). The articles should be the original work of the author and a self-declaration about the originality of the article should also be submitted along with the article.



## High Court of Delhi directs to accord exemption to ICAI-ARF under Section 10(23)(c)(iv) of the Income-tax Act, 1961



The Institute of Chartered Accountants of India (ICAI) set up Accounting Research Foundation (ICAI-ARF) by registering it as a Company under Section 25 of the Companies Act, 1956. Director General of Income Tax (Exemptions) Delhi vide order dated 28.12.2007 dismissed the Application dated 18.12.2006 of ICAI-ARF for grant of exemption under Section 10(23)(c)(iv) of the Income-Tax Act, 1961 for assessment year 2007-08 onwards, as a fund or institution established for charitable purposes. Aggrieved by the said order, ICAI-ARF filed Writ Petition No. 3032/2008 in the High Court of Delhi in March, 2008. The Division Bench of Hon'ble High Court comprising Hon'ble Justice A.K. Sikri and Justice Valmiki J. Mehta by order dated 28.08.2009 has allowed the aforesaid Writ Petition and set aside the order dated 28.12.2007 passed by Director General Income Tax (Exemptions) Delhi. A full text of the said order is on the Website [www.icaai.org](http://www.icaai.org) and [www.icaiarf.org](http://www.icaiarf.org). The gist of the important observations of the Court are as under :-

- Definition of 'Charitable Purpose' as per Section 2(15) of the Income-tax Act, 1961 is as under :-  
"Charitable purpose includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility."  
The vision of the ICAI-ARF is to establish it as a co-research body with facilities to undertake research in the areas of accounting, auditing, capital markets, fiscal policies and other related disciplines and to develop quality pronouncements, documents, research papers on these subjects. There is not even an iota of doubt that ICAI-ARF is involved in education and thus meets the description of 'Charitable Institution'.
- The projects of Municipal Corporation of Delhi (MCD), Kolkata Municipal Corporation (KMC), Strengthening Rural Decentralisation (SRD) of West Bengal carried out by ICAI-ARF arose out of decision of the Govt. of India and State Government to implement accrual based accounting reform in the Government. Merely because some remuneration was taken by ICAI-ARF for undertaking these projects would not alter the character of these projects which remain research and consultancy work. Most of the amount received for those projects was spent on the project and surplus, if any, is used for advancement of objectives of ICAI-ARF. For arriving at this conclusion, the Hon'ble Court relied upon its earlier judgement in *ACIT vs. Hamdard Dawakhana (1986) 157ITR639 (Del)* and Madras High Court Judgement in *CIT vs. K.S. Venkatasubbiah Reddiar (1996) 221 ITR 18 (Mad)*, which interpreted the true meaning of the terms 'Charitable Purpose' and 'business' and the relevant paragraphs of the said decisions are given in paras 18 and 19 of this judgement.
- The amended definition of 'charitable purpose' would not alter the above position because the essential character of ICAI-ARF cannot be converted into the one which carries on an activity of trade, commerce or business or activity of rendering any service relating to trade, commerce and business.
- The status of ICAI-ARF which is granted by the Govt. itself is the recognition of the fact that the ICAI-ARF is essentially established for the purpose of education and/or for advancement of any other project of general public utility.

## Non receipt of policy certificate of "CABF Group Term Insurance Scheme"



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Committee on Information Technology  
The Institute of Chartered Accountants of India  
ICAI Bhawan, Plot No. 52-54, Vishwas Nagar  
Shahadara, Delhi – 110 032, India

e-Mail: [cit@icaai.org](mailto:cit@icaai.org), [elearn@icaai.org](mailto:elearn@icaai.org)  
Web: <http://cit.icaai.org> | [www.icaai.org](http://www.icaai.org)  
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# Standard on Auditing (SA) 220 (Revised)

## Quality Control for an Audit of Financial Statements

Your comments on these Exposure Drafts should reach us by December 30, 2009. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

Secretary, Auditing and Assurance Standards Board  
The Institute of Chartered Accountants of India  
ICAI Bhawan, A -94/4, Sector-58,  
NOIDA, Uttar Pradesh – 201 301.

Comments can also be e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

Proposed Standard on Auditing (SA) 220 (Revised), "Quality Control for an Audit of Financial Statements" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"<sup>1</sup>, which sets out the authority of SAs and proposed SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"<sup>2</sup>.

### Introduction

#### Scope of this SA

1. This Standard on Auditing (SA) deals with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. It also addresses, where applicable, the responsibilities of the engagement quality control reviewer. This SA is to be read in conjunction with relevant ethical requirements.

#### System of Quality Control and Role of Engagement Teams

2. Quality control systems, policies and procedures are the responsibility of the audit firm. Under SQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

- (a) The firm and its personnel comply with professional standards and regulatory and legal requirements; and
- (b) The reports issued by the firm or engagement partners are appropriate in the circumstances<sup>3</sup>.

This SA is premised on the basis that the firm is subject to SQC 1. (Ref: Para. A1)

3. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

4. Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise. (Ref: Para. A2)

#### Effective Date

5. This SA is effective for audits of financial statements for periods beginning on or after .....

#### Objective

6. The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- (a) The audit complies with professional standards and regulatory and legal requirements; and
- (b) The auditor's report issued is appropriate in the circumstances.

#### Definitions

7. For purposes of the SAs, the following terms have the meanings attributed below:

- (a) Engagement partner – the partner or other person in the firm who is a member of the Institute of Chartered Accountants of India and is in full time practice and is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
- (b) Engagement quality control review – a process designed to

provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.

- (c) Engagement quality control reviewer – a partner, other person<sup>4</sup> in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report. However, in case the review is done by a team of individuals, such team should be headed by a member of the Institute.
- (d) Engagement team – all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.
- (e) Firm – a sole practitioner/proprietor, partnership, or any such entity of professional accountants, as may be permitted by law.
- (f) Inspection – in relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.
- (g) Listed entity – an entity whose shares, stock or debt are quoted

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> The Exposure Draft of SA 200 (Revised) has been published in the September, 2009 issue of the Journal. The last date for sending the comments on the same is October 30, 2009.

<sup>3</sup> Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", paragraph 10.

<sup>4</sup> Such other person should be a member of the Institute of Chartered Accountants of India.

or listed on a recognized stock exchange, or are traded under the regulations of a recognized stock exchange or other equivalent body.

- (h) Monitoring – a process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.
- (i) Network firm – an entity under common control, ownership or management with the firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as being part of the firm nationally or internationally<sup>5</sup>.
- (j) Partner – any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (K) Personnel – partners and staff.
- (l) Professional standards – Engagement Standards, as defined in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", issued by the Institute of Chartered Accountants of India and relevant ethical requirements as contained in the Code of Ethics issued by the Institute.
- (m) Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise the Code of Ethics of the Institute of Chartered Accountants of India related to an audit of financial statements.
- (n) Staff – professionals, other than partners, including any experts which the firm employs.
- (o) Suitably qualified external person – an individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner or an employee<sup>6</sup> (with appropriate experience) of another firm.

## Requirements

### *Leadership Responsibilities for Quality on Audits*

8. The engagement partner shall

take responsibility for the overall quality on each audit engagement to which that partner is assigned. (Ref: Para. A3)

### *Relevant Ethical Requirements*

9. Throughout the audit engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team. (Ref: Para. A4)

10. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action.

### *Independence*

11. The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:

- (a) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
- (b) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- (c) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action. (Ref: Para. A5-A6)

### *Acceptance and Continuance of Client Relationships and Audit Engagements*

12. The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that

conclusions reached in this regard are appropriate. (Ref: Para. A7-A8)

13. If the engagement partner obtains information that would have caused the firm to decline the audit engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. (Ref: Para. A8)

### *Assignment of Engagement Teams*

14. The engagement partner shall be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to:

- (a) Perform the audit engagement in accordance with professional standards and regulatory and legal requirements; and
- (b) Enable an auditor's report that is appropriate in the circumstances to be issued. (Ref: Para. A9-A11)

### *Engagement Performance*

#### *Direction, Supervision and Performance*

15. The engagement partner shall take responsibility for:

- (a) The direction, supervision and performance of the audit engagement in compliance with professional standards and regulatory and legal requirements; and (Ref: Para. A12-A14, A19)
- (b) The auditor's report being appropriate in the circumstances.

### *Reviews*

16. The engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. (Ref: Para. A15-A16, A19)

17. On or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: Para. A17-A19)

### *Consultation*

18. The engagement partner shall:

- (a) Take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters;
- (b) Be satisfied that members of the engagement team have under-

<sup>5</sup> Paragraph 12 (l) of the ISQC 1 (Redrafted) defines the 'Network' as follows:-

Network – A larger structure:

(i) That is aimed at co-operation, and

(ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

<sup>6</sup> Such employee should be a member of the Institute of Chartered Accountants of India.

taken appropriate consultation during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm;

- (c) Be satisfied that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted; and
- (d) Determine that conclusions resulting from such consultations have been implemented. (Ref: Para. A20-A21)

#### *Engagement Quality Control Review*

19. For audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:

- (a) Determine that an engagement quality control reviewer has been appointed;
- (b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- (c) Not date the auditor's report until the completion of the engagement quality control review. (Ref: Para. A22-A24)

20. The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation shall involve:

- (a) Discussion of significant matters with the engagement partner;
- (b) Review of the financial statements and the proposed auditor's report;
- (c) Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached; and
- (d) Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate. (Ref: Para. A25-A26, A28-A30)

21. For audits of financial statements of listed entities, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

- (a) The engagement team's evaluation of the firm's independence in relation to the audit engagement;
- (b) Whether appropriate consultation

has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and

- (c) Whether audit documentation selected for review reflects the work performed in relation to the significant judgments made and supports the conclusions reached. (Ref: Para. A27-A30)

#### *Differences of Opinion*

22. If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

#### *Monitoring*

23. An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the audit engagement. (Ref: Para A31-A33)

#### *Documentation*

24. The auditor shall document:

- (a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- (b) Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
- (c) Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
- (d) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement. (Ref: Para. A34)

25. The engagement quality control reviewer shall document, for the audit engagement reviewed, that:

- (a) The procedures required by the firm's policies on engagement quality control review have been performed;
- (b) The engagement quality control review has been completed on or before the date of the auditor's report; and

- (c) The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

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#### *Application and Other Explanatory Material*

##### *System of Quality Control and Role of Engagement Teams* (Ref: Para. 2)

A1. SQC 1 deals with the firm's responsibilities to establish and maintain its system of quality control for audit engagements. The system of quality control includes policies and procedures that address each of the following elements:

- Leadership responsibilities for quality within the firm;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement performance; and
- Monitoring.

##### *Reliance on the Firm's System of Quality Control* (Ref: Para. 4)

A2. Unless information provided by the firm or other parties suggest otherwise, the engagement team may rely on the firm's system of quality control in relation to, for example:

- Competence of personnel through their recruitment and formal training.
- Independence through the accumulation and communication of relevant independence information.
- Maintenance of client relationships through acceptance and continuance systems.
- Adherence to regulatory and legal requirements through the monitoring process.

##### *Leadership Responsibilities for Quality on Audits* (Ref: Para. 8)

A3. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

- (a) The importance to audit quality of:
- (i) Performing work that complies with professional standards and regulatory and legal requirements;
  - (ii) Complying with the firm's quality control policies and procedures as applicable;
  - (iii) Issuing auditor's reports that are appropriate in the circumstances; and
  - (iv) The engagement team's ability to raise concerns

without fear of reprisals; and  
(b) The fact that quality is essential in performing audit engagements.

*Relevant Ethical Requirements Compliance with Relevant Ethical Requirements* (Ref: Para. 9)

A4. The Code of Ethics issued by the Institute of Chartered Accountants of India establishes the fundamental principles of professional ethics, which include:

- (a) Integrity;
- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behaviour.

*Threats to Independence* (Ref: Para. 11(c))

A5. The engagement partner may identify a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level. In that case, as required by paragraph 11(c), the engagement partner reports to the relevant person(s) within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is legally permitted.

A6. In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), statutory measures may provide safeguards for the independence of auditors of certain entities. However, such auditors or audit firms carrying out audits on behalf of the statutory auditor may, depending on the terms of the applicable legal or regulatory framework, need to adapt their approach in order to promote compliance with the spirit of paragraph 11. This may include, where the auditor's applicable law or regulation does not permit withdrawal of the auditor from the engagement, disclosure through a public report, of circumstances that have arisen that would, have otherwise lead the auditor to withdraw.

*Acceptance and Continuance of Client Relationships and Audit Engagements* (Ref: Para. 12)

A7. SQC 1 requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client<sup>7</sup>. Information such as the following

assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity of the principal owners, key management and those charged with governance of the entity;
- Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- Whether the firm and the engagement team can comply with relevant ethical requirements; and
- Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

A8. In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and audit engagements as set out in paragraphs 12, 13 and A7 may not be relevant. Nonetheless, information gathered as a result of the process described may be valuable to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

*Assignment of Engagement Teams* (Ref: Para. 14)

A9. An engagement team also includes a member using expertise in a specialised area of accounting or auditing, whether engaged or employed by the firm, if any, who performs audit procedures on the engagement.

A10. When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's:

- Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- Understanding of professional standards and regulatory and legal requirements.
- Technical expertise, including expertise with relevant information technology and specialized

- areas of accounting or auditing.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- Understanding of the firm's quality control policies and procedures.

A11. In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), additional appropriate competence may include skills that are necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such competence may include an understanding of the applicable reporting arrangements, including reporting to the legislature or other governing body or in the public interest. The wider scope of certain entities audit may include, for example, some aspects of performance auditing or a comprehensive assessment of compliance with legislative authorities and preventing and detecting fraud and corruption.

*Engagement Performance Direction, Supervision and Performance* (Ref: Para. 15(a))

A12. Direction of the engagement team involves informing the members of the engagement team of matters such as:

- Their responsibilities, including the need to comply with relevant ethical requirements, and to plan and perform an audit with professional skepticism as required by SA 200<sup>8</sup>.
- Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.
- The objectives of the work to be performed.
- The nature of the entity's business.
- Risk-related issues.
- Problems that may arise.
- The detailed approach to the performance of the engagement.

Discussion among members of the engagement team allows less experienced team members to raise questions with more experienced team members so that appropriate communication can occur within the engagement team.

A13. Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

A14. Supervision includes matters such as:

<sup>7</sup> SQC 1, paragraph 28.

<sup>8</sup> Exposure Draft of revised SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" has been published in the September, 2009 issue of the Journal. The last date for sending the comments on the same is October 30, 2009.

- Tracking the progress of the audit engagement.
- Considering the competence and capabilities of individual members of the engagement team, including whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the audit engagement.
- Addressing significant matters arising during the audit engagement, considering their significance and modifying the planned approach appropriately.
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.

*Reviews*

Review Responsibilities (Ref: Para. 16)

A15. Under SQC 1, the firm's review responsibility policies and procedures are determined on the basis that work of less experienced team members is reviewed by more experienced team members<sup>9</sup>.

A16. A review consists of consideration whether, for example:

- The work has been performed in accordance with professional standards and regulatory and legal requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the auditor's report; and
- The objectives of the engagement procedures have been achieved.

*The Engagement Partner's Review of Work Performed* (Ref: Para. 17)

A17. Timely reviews of the following by the engagement partner at appropriate stages during the engagement allow significant matters to be resolved on a timely basis to the engagement partner's satisfaction on or before the date of the auditor's report:

- Critical areas of judgment, especially those relating to

difficult or contentious matters identified during the course of the engagement;

- Significant risks; and
- Other areas the engagement partner considers important.

The engagement partner need not review all audit documentation, but may do so. However, as required by SA 230 (Revised), the partner documents the extent and timing of the reviews<sup>10</sup>.

A18. An engagement partner taking over an audit during the engagement may apply the review procedures as described in paragraphs A17 to review the work performed to the date of a change in order to assume the responsibilities of an engagement partner.

*Considerations Relevant Where a Member of the Engagement Team with Expertise in a Specialised Area of Accounting or Auditing Is Used* (Ref: Para. 15-17)

A19. Where a member of the engagement team with expertise in a specialized area of accounting or auditing is used, direction, supervision and review of that engagement team member's work may include matters such as:

- Agreeing with that member the nature, scope and objectives of that member's work; and the respective roles of, and the nature, timing and extent of communication between that member and other members of the engagement team.
- Evaluating the adequacy of that member's work including the relevance and reasonableness of that member's findings or conclusions and their consistency with other audit evidence.

*Consultation* (Ref: Para. 18)

A20. Effective consultation on significant technical, ethical, and other matters within the firm or, where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience.

A21. It may be appropriate for the engagement team to consult outside the firm, for example, where the firm lacks appropriate internal resources. They may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organisations that

provide relevant quality control services.

*Engagement Quality Control Review*

*Completion of the Engagement Quality Control Review before Dating of the Auditor's Report* (Ref: Para. 19(c))

A22. SA 700 (Revised) requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements<sup>11</sup>. In cases of an audit of financial statements of listed entities or when an engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

A23. Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

A24. Completion of the engagement quality control review means the completion by the engagement quality control reviewer of the requirements in paragraphs 20-21, and where applicable, compliance with paragraph 22. Documentation of the engagement quality control review may be completed after the date of the auditor's report as part of the assembly of the final audit file. SA 230 (Revised) establishes requirements and provides guidance in this regard<sup>12</sup>.

*Nature, Extent and Timing of Engagement Quality Control Review* (Ref: Para. 20)

A25. Remaining alert for changes in circumstances allows the engagement partner to identify situations in which an engagement quality control review is necessary, even though at the start of the engagement, such a review was not required.

A26. The extent of the engagement quality control review may depend, among other things, on the complexity of the audit engagement, whether the entity is a listed entity, and the risk that the auditor's report might not be appropriate in the circumstances. The performance of an engagement quality control review does not reduce the responsibilities of the engagement partner for the

<sup>9</sup> SQC 1, paragraph 50.

<sup>10</sup> SA 230 (Revised), "Audit Documentation", paragraph 9(c).

<sup>11</sup> Exposure Draft of SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", paragraph 41. The same has been published in the June, 2009 issue of the Journal.

<sup>12</sup> SA 230 (Revised), paragraphs 14-16 and A21-A24.

audit engagement and its performance.

*Engagement Quality Control Review of Listed Entities* (Ref: Para. 21)

A27. Other matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review of a listed entity include:

- Significant risks identified during the engagement in accordance with SA 315<sup>13</sup>, and the responses to those risks in accordance with SA 330<sup>14</sup>, including the engagement team's assessment of, and response to, the risk of fraud in accordance with SA 240 (Revised)<sup>15</sup>.
- Judgments made, particularly with respect to materiality and significant risks.
- The significance and disposition of corrected and uncorrected misstatements identified during the audit.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

These other matters, depending on the circumstances, may also be applicable for engagement quality control reviews for audits of financial statements of other entities.

A28. In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), in addition to the audits of financial statements of listed entities, an engagement quality control review is required for audit engagements that meet the criteria established by the firm that subjects engagements to an engagement quality control review. In some cases, none of the firm's audit engagements may meet the criteria that would subject them to such a review.

A29. In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General), may act in a role equivalent to that of engagement partner with overall responsibility for certain entities audits. In such

circumstances, where applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.

A30. Listed entities as referred to in paragraphs 21 and A27 are not common in the certain entities. However, there may be other entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Examples include state owned corporations and public utilities. Ongoing transformations within the certain entities may also give rise to new types of significant entities. There are no fixed objective criteria on which the determination of significance is based. Nonetheless, certain entities auditors evaluate which entities may be of sufficient significance to warrant performance of an engagement quality control review.

*Monitoring* (Ref: Para. 23)

A31. SQC 1 requires the firm to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control is relevant, adequate and operating effectively<sup>16</sup>.

A32. In considering deficiencies that may affect the audit engagement, the engagement partner may have regard to measures the firm took to rectify the situation that the engagement partner considers are sufficient in the context of that audit.

A33. A deficiency in the firm's system of quality control does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and regulatory and legal requirements, or that the auditor's report was not appropriate.

*Documentation*

*Documentation of Consultations* (Ref: Para. 24(d))

A34. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

- The issue on which consultation was sought; and
- The results of the consultation,

including any decisions taken, the basis for those decisions and how they were implemented.

*Material Modifications vis-à-vis ISA 220, Quality Control for an Audit of Financial Statements*

*Deletions*

1. Paragraph A5 of the Application Section of ISA 220 which provides that the definition of 'firm', 'network' and 'network firm' in the relevant ethical requirements may differ from those set out in this ISA, has been deleted, since this paragraph is not relevant in the Indian context.

2. Paragraphs A7, A9, A12, A30 and A31 of the Application Section of ISA 220 dealt with the application of the requirements of ISA 220 to the audits of public sector entities. Since as mentioned in the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services", the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

Further, it is also possible that these requirements may also exist in case of non public sector entities pursuant to a requirement under the statute. Accordingly, the spirit of erstwhile paragraphs A7, A9, A12, A30 and A31 has, accordingly, been made more generic in its application.

3. Paragraph A29 of the Application Section of ISA 220 dealt with the application of the requirements of ISA 220 to the audits of small 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 small entities has been deleted.

Further, it is also possible that these requirements may also exist in case of larger entities pursuant to a requirement under the statute. Accordingly, the spirit of erstwhile paragraph A29 has, accordingly, been made more generic in its application.

<sup>13</sup> SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment".

<sup>14</sup> SA 330, "The Auditor's Responses to Assessed Risks".

<sup>15</sup> SA 240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements".

<sup>16</sup> SQC 1, Paragraph 86.

# Standard on Auditing (SA) 501 (Revised)

## Audit Evidence — Specific Considerations for Selected Items

Your comments on these Exposure Drafts should reach us by December 30, 2009. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

Secretary, Auditing and Assurance Standards Board

The Institute of Chartered Accountants of India

ICAI Bhawan, A-94/4, Sector-58,

NOIDA,

Uttar Pradesh – 201 301.

Comments can also be e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

Proposed Standard on Auditing (SA) 501 (Revised), "Audit Evidence—Specific Considerations for Selected Items" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services<sup>1</sup>," which sets out the authority of SAs and proposed SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"<sup>2</sup>.

### Introduction

#### Scope of this SA

1. This Standard on Auditing (SA) deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with SA 330,<sup>3</sup> SA 500 (Revised)<sup>4</sup> and other relevant SAs, with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial statements.

#### 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 obtain sufficient appropriate audit evidence regarding the:

- Existence and condition of inventory;
- Completeness of litigation and claims involving the entity; and
- Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

### Requirements

#### Inventory

4. When inventory is material to the

financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

- Attendance at physical inventory counting, unless impracticable, to: (Ref: Para. A1-A3)
  - Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting; (Ref: Para. A4)
  - Observe the performance of management's count procedures; (Ref: Para. A5)
  - Inspect the inventory; and (Ref: Para. A6)
  - Perform test counts; and (Ref: Para. A7-A8)
- Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

5. If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures required by paragraph 4, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the

financial statements are properly recorded. (Ref: Para. A9-A11)

6. If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.

7. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with Proposed SA 705<sup>5</sup>. (Ref: Para. A12-A14)

8. When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. (Ref: Para. A15)

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> The Exposure Draft of SA 200 (Revised) has been published in the September, 2009 issue of the Journal. The last date for sending the comments on the same is October 30, 2009.

<sup>3</sup> SA 330, "The Auditor's Responses to Assessed Risks".

<sup>4</sup> SA 500 (Revised), "Audit Evidence".

<sup>5</sup> Proposed SA 705, "Modifications to the Opinion in the Independent Auditor's Report". The Exposure Draft of SA 705 has been published in the June, 2009 issue of the Journal.

(b) Perform inspection or other audit procedures appropriate in the circumstances. (Ref: Para. A16)

#### *Litigation and Claims*

9. The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including: (Ref: Para. A17-A19)

(a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;

(b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and

(c) Reviewing legal expense accounts. (Ref: Para. A20)

10. If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry, prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor. If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures. (Ref: Para. A21-A25)

11. If:

(a) management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding; and

(b) the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, the auditor shall modify the opinion in the auditor's report in accordance with Proposed SA 705.

#### *Written Representations*

12. The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

#### *Segment Information*

13. The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by: (Ref: Para. A26)

(a) Obtaining an understanding of the methods used by management in determining segment information, and: (Ref: Para. A27)

(i) Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and

(ii) Where appropriate, testing the application of such methods; and

(b) Performing analytical procedures or other audit procedures appropriate in the circumstances.

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#### *Application and Other Explanatory Material*

##### *Inventory*

##### *Attendance at Physical Inventory Counting* (Ref: Para. 4(a))

A1. Management ordinarily establishes procedures under which inventory is physically counted at least once a year to serve as a basis for the preparation of the financial statements and, if applicable, to ascertain the reliability of the entity's perpetual inventory system.

A2. Attendance at physical inventory counting involves:

- Inspecting the inventory to ascertain its existence and evaluate its condition, and performing test counts;
- Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and

- Obtaining audit evidence as to the reliability of management's count procedures.

These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.

A3. Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs 4-8 of this SA) include, for example:

- The risks of material misstatement related to inventory.
- The nature of the internal control related to inventory.
- Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- The timing of physical inventory counting.
- Whether the entity maintains a perpetual inventory system.
- The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate. Proposed SA 600 (Revised)<sup>6</sup> deals with the involvement of other auditors and accordingly may be relevant if such involvement is with regards to attendance of physical inventory counting at a remote location.
- Whether the assistance of an auditor's expert is needed. Proposed SA 620 (Revised)<sup>7</sup> deals with the use of an auditor's expert to assist the auditor to obtain sufficient appropriate audit evidence.

##### *Evaluate Management's Instructions and Procedures* (Ref: Para. 4(a)(i))

A4. Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example:

- The application of appropriate control activities, for example, collection of used physical inventory count records, accounting for unused physical inventory count records, and count and recount procedures.

<sup>6</sup> Currently SA 600 (AAS 10), "Using the Work of Another Auditor" is in force. The Standard is being revised in the light of the corresponding International Standard on Auditing (ISA) 600 (Revised and Redrafted), "Special Considerations — Audits of Group Financial Statements (Including the Work of the Component Auditors)".

<sup>7</sup> The Exposure Draft of proposed Revised Standard on Auditing (SA) 620, "Using the Work of an Auditor's Expert", has been published elsewhere in this issue of the Journal. The last date for sending the comments on the same is December 30, 2009.

- The accurate identification of the stage of completion of work in progress, of slow moving, obsolete or damaged items and of inventory owned by a third party, for example, on consignment.
- The procedures used to estimate physical quantities, where applicable, such as may be needed in estimating the physical quantity of a coal pile.
- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cut off date.

*Observe the Performance of Management's Count Procedures* (Ref: Para. 4(a)(ii))

A5. Observing the performance of management's count procedures, for example those relating to control over the movement of inventory before, during and after the count, assists the auditor in obtaining audit evidence that management's instructions and count procedures are adequately designed and implemented. In addition, the auditor may obtain copies of cut off information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date.

*Inspect the Inventory* (Ref: Para. 4(a)(iii))

A6. Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership), and in identifying, for example, obsolete, damaged or ageing inventory.

*Perform Test Counts* (Ref: Para. 4(a)(iv))

A7. Performing test counts, for example by tracing items selected from management's count records to the physical inventory and tracing items selected from the physical inventory to management's count records, provides audit evidence about the completeness and the accuracy of those records.

A8. In addition to recording the auditor's test counts, obtaining copies of management's completed physical inventory count records assists the auditor in performing subsequent audit procedures to determine whether the entity's final inventory records accurately reflect actual inventory count results.

*Physical Inventory Counting Conducted Other than At the Date of the Financial Statements* (Ref: Para. 5)

A9. For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes. SA 330 establishes requirements and provides guidance on substantive procedures performed at an interim date<sup>8</sup>.

A10. Where a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity's perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively.

A11. Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:

- Whether the perpetual inventory records are properly adjusted.
- Reliability of the entity's perpetual inventory records.
- Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

*Attendance at Physical Inventory Counting Is Impracticable* (Ref: Para. 7)

A12. In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example,

where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in Proposed SA 200 (Revised),<sup>9</sup> the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

A13. In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

A14. In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 (Revised) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation<sup>10</sup>.

*Inventory under the Custody and Control of a Third Party Confirmation* (Ref: Para. 8(a))

A15. Proposed SA 505 (Revised)<sup>11</sup> establishes requirements and provides guidance for performing external confirmation procedures.

*Other Audit Procedures* (Ref: Para. 8(b))

A16. Depending on the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
- Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that

<sup>8</sup> SA 330, paragraphs 23-24.

<sup>9</sup> SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", paragraph A48 of the Exposure Draft of SA 200 (Revised).

<sup>10</sup> Proposed SA 705, paragraph 13 of the Exposure Draft of SA 705.

<sup>11</sup> The Exposure Draft of Proposed Revised Standard on Auditing (SA) 505, "External Confirmations" has been published elsewhere in this issue of the Journal. The last date for sending the comments on the same is December 30, 2009.

inventory is properly counted and adequately safeguarded.

- Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.
- Requesting confirmation from other parties when inventory has been pledged as collateral.

#### *Litigation and Claims*

##### *Completeness of Litigations and Claims* (Ref: Para. 9)

A17. Litigation and claims involving the entity may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements.

A18. In addition to the procedures identified in paragraph 9, other relevant procedures include, for example, using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the entity and its environment to assist the auditor to become aware of litigation and claims involving the entity.

A19. Audit evidence obtained for purposes of identifying litigation and claims that may give rise to a risk of material misstatement also may provide audit evidence regarding other relevant considerations, such as valuation or measurement, regarding litigation and claims. SA 540 (Revised)<sup>12</sup> establishes requirements and provides guidance relevant to the auditor's consideration of litigation and claims requiring accounting estimates or related disclosures in the financial statements.

##### *Reviewing Legal Expense Accounts* (Ref: Para. 9(c))

A20. Depending on the circumstances, the auditor may judge it appropriate to examine related source documents, such as invoices for legal expenses, as part of the auditor's review of legal expense accounts.

##### *Communication with the Entity's External Legal Counsel* (Ref: Para. 10-11)

A21. Direct communication with the entity's external legal counsel assists the auditor in obtaining sufficient appropriate audit evidence as to whether potentially material litigation and claims are known and management's estimates of the financial implications, including costs, are reasonable.

A22. In some cases, the auditor may seek direct communication with the

entity's external legal counsel through a letter of general inquiry. For this purpose, a letter of general inquiry requests the entity's external legal counsel to inform the auditor of any litigation and claims that the counsel is aware of, together with an assessment of the outcome of the litigation and claims, and an estimate of the financial implications, including costs involved.

A23. If it is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general inquiry, for example if the professional body to which the external legal counsel belongs prohibits response to such a letter, the auditor may seek direct communication through a letter of specific inquiry. For this purpose, a letter of specific inquiry includes:

- (a) A list of litigation and claims;
- (b) Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved; and
- (c) A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect.

A24. In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, where:

- The auditor determines that the matter is a significant risk.
- The matter is complex.
- There is disagreement between management and the entity's external legal counsel. Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

A25. In accordance with Proposed SA 700 (Revised)<sup>13</sup>, the auditor is required to date the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements. Audit evidence

about the status of litigation and claims up to the date of the auditor's report may be obtained by inquiry of management, including in-house legal counsel, responsible for dealing with the relevant matters. In some instances, the auditor may need to obtain updated information from the entity's external legal counsel.

##### *Segment Information* (Ref: Para. 13)

A26. Depending on the applicable financial reporting framework, the entity may be required or permitted to disclose segment information in the financial statements. The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements taken as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a stand alone basis.

##### *Understanding of the Methods Used by Management* (Ref: Para. 13(a))

A27. Depending on the circumstances, example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

- Sales, transfers and charges between segments, and elimination of inter-segment amounts.
- Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
- The allocation of assets and costs among segments.
- Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

##### *Material Modifications vis-à-vis ISA 501, "Audit Evidence — Specific Considerations for Selected Items"*

The Revised SA 501, "Audit Evidence—Specific Considerations for Selected Items" does not contain any material modifications vis-à-vis ISA 501.

<sup>12</sup> SA 540 (Revised), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures".

<sup>13</sup> Proposed SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", paragraph 41 of the Exposure Draft of SA 700 (Revised). The same is published in the June, 2009 issue of the Journal.

# Standard on Auditing (SA) 520 (Revised) Analytical Procedures

Your comments on these Exposure Drafts should reach us by December 30, 2009. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

Secretary, Auditing and Assurance Standards Board  
The Institute of Chartered Accountants of India  
ICAI Bhawan, A -94/4, Sector-58,  
NOIDA, Uttar Pradesh – 201 301.

Comments can also be e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

Proposed Standard on Auditing (SA) 520 (Revised), "Analytical Procedures" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"<sup>1</sup>, which sets out the authority of SAs and proposed SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"<sup>2</sup>.

## Introduction

### Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"), and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements. The use of analytical procedures as risk assessment procedures is dealt with in SA 315<sup>3</sup>. SA 330 includes requirements and guidance regarding the nature, timing and extent of audit procedures in response to assessed risks; these audit procedures may include substantive analytical procedures<sup>4</sup>.

### Effective Date

2. This SA is effective for audits of financial statements for periods beginning on or after .....

## Objectives

3. The objectives of the auditor are:  
(a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and  
(b) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

## Definition

4. For the purposes of the SAs, the term "analytical procedures" means

evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. The auditor's choice of procedures, methods and level of application is a matter of professional judgement. (Ref: Para. A1-A3)

## Requirements

### Substantive Analytical Procedures

5. When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330<sup>5</sup>, the auditor shall: (Ref: Para. A4-A5)

- (a) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions; (Ref: Para. A6-A11)
- (b) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation; (Ref: Para. A12-A14)

- (c) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and (Ref: Para. A15)
- (d) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph 7. (Ref: Para. A16)

### Analytical Procedures that Assist When Forming an Overall Conclusion

6. The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity. (Ref: Para. A17-A19)

### Investigating Results of Analytical Procedures

7. If analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

- (a) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> The Exposure Draft of SA 200 (Revised) has been published in the September, 2009 issue of the Journal. The last date for sending the comments on the same is October 30, 2009.

<sup>3</sup> SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", paragraphs 6 and A6a-A8a. Paragraphs A6a and A8a to be inserted in SA 315 when the final revised SA 520 will come into force.

<sup>4</sup> SA 330, "The Auditor's Responses to Assessed Risks", paragraphs 6 and 20.

<sup>5</sup> SA 330, paragraph 20.

(b) Performing other audit procedures as necessary in the circumstances. (Ref: Para. A20- A21)

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#### Application and Other Explanatory Material

*Nature of Analytical Procedures* (Ref: Para. 4)

A1. Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
- Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

A2. Analytical procedures also include consideration of relationships, for example:

- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
- Between financial information and relevant non-financial information, such as payroll costs to number of employees.

A3. Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

*Substantive Analytical Procedures* (Ref: Para. 5)

A4. The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.

A5. The auditor may inquire of management as to the availability and reliability of information needed to

apply substantive analytical procedures, and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is properly prepared.

*Suitability of Particular Analytical Procedures for Given Assertions* (Ref: Para. 5(a))

A6. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

A7. In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

A8. Different types of analytical procedures provide different levels of assurance. Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified. In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence, but may provide useful corroboration if used in combination with other audit procedures.

A9. The determination of the suitability of particular substantive analytical procedures is influenced by the nature of the assertion and the auditor's assessment of the risk of material misstatement. For example, if controls over sales order processing are weak, the auditor may place more reliance on tests of details rather than on substantive analytical procedures for assertions related to receivables.

A10. Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion. For example, when obtaining audit evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers' accounts in addition to performing tests of details on subsequent cash receipts to determine the collectability of the receivables.

*Considerations Specific to Public Sector Entities*

A11. The relationships between individual financial statement items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities; for example, in many public sector entities there may be little direct relationship between revenue and expenditure. In addition, because expenditure on the acquisition of assets may not be capitalised, there may be no relationship between expenditures on, for example, inventories and fixed assets and the amount of those assets reported in the financial statements. Also, industry data or statistics for comparative purposes may not be available in the public sector. However, other relationships may be relevant, for example, variations in the cost per kilometer of road construction or the number of vehicles acquired compared with vehicles retired.

*The Reliability of the Data* (Ref: Para. 5(b))

A12. The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:

- (a) Source of the information available. For example, information may be more reliable when it is obtained from independent

- sources outside the entity;<sup>6</sup>
- (b) Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products;
- (c) Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and
- (d) Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

A13. The auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing substantive analytical procedures in response to assessed risks. When such controls are effective, the auditor generally has greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The operating effectiveness of controls over non-financial information may often be tested in conjunction with other tests of controls. For example, in establishing controls over the processing of sales invoices, an entity may include controls over the recording of unit sales. In these circumstances, the auditor may test the operating effectiveness of controls over the recording of unit sales in conjunction with tests of the operating effectiveness of controls over the processing of sales invoices. Alternatively, the auditor may consider whether the information was subjected to audit testing. SA 500 (Revised) establishes requirements and provides guidance in determining the audit procedures to be performed on the information to be used for substantive analytical procedures<sup>7</sup>.

A14. The matters discussed in paragraphs A12(a)-A12(d) are relevant irrespective of whether the auditor performs substantive analytical procedures on the entity's period end financial statements, or at

an interim date and plans to perform substantive analytical procedures for the remaining period. SA 330 establishes requirements and provides guidance on substantive procedures performed at an interim date<sup>8</sup>.

*Evaluation of Whether the Expectation Is Sufficiently Precise* (Ref: Para. 5(c))

A15. Matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include:

- The accuracy with which the expected results of substantive analytical procedures can be predicted. For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.
- The degree to which information can be disaggregated. For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole.
- The availability of the information, both financial and non-financial. For example, the auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information as discussed in paragraphs A12-A13 above.

*Amount of Difference of Recorded Amounts from Expected Values that Is Acceptable* (Ref: Para. 5(d))

A16. The auditor's determination of the amount of difference from the expectation that can be accepted

without further investigation is influenced by materiality<sup>9</sup> and the consistency with the desired level of assurance, taking account of the possibility that a misstatement, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated. SA 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of risk<sup>10</sup>. Accordingly, as the assessed risk increases, the amount of difference considered acceptable without investigation decreases in order to achieve the desired level of persuasive evidence<sup>11</sup>.

*Analytical Procedures that Assist When Forming an Overall Conclusion* (Ref: Para. 6)

A17. The conclusions drawn from the results of analytical procedures designed and performed in accordance with paragraph 6 are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements. This assists the auditor to draw reasonable conclusions on which to base the auditor's opinion.

A18. The results of such analytical procedures may identify a previously unrecognised risk of material misstatement. In such circumstances, SA 315 requires the auditor to revise the auditor's assessment of the risks of material misstatement and modify the further planned audit procedures accordingly<sup>12</sup>.

A19. The analytical procedures performed in accordance with paragraph 6 may be similar to those that would be used as risk assessment procedures.

*Investigating Results of Analytical Procedures* (Ref: Para. 7)

A20. Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

A21. The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the

<sup>6</sup> SA 500 (Revised), "Audit Evidence", paragraph A31.

<sup>7</sup> SA 500 (Revised), paragraph 10.

<sup>8</sup> SA 330, paragraphs 23-24.

<sup>9</sup> SA 320 (Revised), "Materiality in Planning and Performing an Audit", paragraph A13.

<sup>10</sup> SA 330, paragraph 7(b).

<sup>11</sup> SA 330, paragraph A19.

<sup>12</sup> SA 315, paragraph 30.

explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

### Material Modifications *vis-à-vis* ISA 520, "Analytical Procedures"

The Revised SA 520, "Analytical Procedures" does not contain any material modifications *vis-à-vis* ISA 520.

### Appendix: Analytical procedures

#### Trends:

Analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years.

#### Reasonableness:

Tests are made by reviewing the relationship of certain account balances to other balances for reasonableness of amounts. Examples of accounts that may be reasonably tested are:

1. Interest expense against interest bearing obligations;
2. Sales discounts and commissions against sales volume; and
3. Rental revenues based on occupancy of premises.

#### Ratios:

Analysis by computation of ratios includes the study of relationships between financial statement amounts. Common ratios are used for the following:

1. Elements of income or loss as a percentage of sales;
2. Gross profit;
3. Accounts receivable;
4. Inventory;
5. Profitability, leverage, and liquidity.

Once analytical procedures are used, results may turn up unfavourable. If that is the case, the auditor is required to apply additional procedures, and make further inquiry of management, which should then be corroborated with other evidential matter. Accounting schedules and or analyses for the explanations of the fluctuations should be completed to satisfy the auditor or accountant as to whether the differences are a likely misstatement. Documentation of those

procedures performed should be made to support the conclusions reached.

Analytical Procedures is one of financial audit skill which help an auditor understand the client's business and changes in the business, to identify potential risk areas and to plan other audit procedures.

Analytical Procedures include comparison of financial information (data in financial statement) with:

1. Prior periods
2. Budgets
3. Forecasts
4. Similar industries and so on.

It also includes consideration of predictable relationships, such as:

1. Gross profit to sales,
2. Payroll costs to employees,
3. Financial information and non-financial information, for examples the CEO's reports and the industry news.

Sources of information about the client include:

1. Interim financial information
2. Budgets
3. Management accounts
4. Non-Financial information
5. Bank and cash records
6. VAT returns
7. Board minutes
8. Discussion or correspondence with the client at the year-end.

### Limited Revisions Consequential to issuance of the Exposure Draft of SA 520 (Revised), "Analytical Procedures"

The Proposed changes to SA 315 have been shown in Track Changed mode

### SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment"

#### Analytical Procedures

A6a. Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks.<sup>2</sup> Analytical procedures performed as

risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.

A7. Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

A8. However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist.

Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.

~~SA 520, "Analytical Procedures"~~<sup>3</sup> ~~establishes requirements and provides guidance on the use of analytical procedures.~~ Considerations Specific to Smaller Entities

A8a. Some smaller entities may not have interim or monthly financial information that can be used for purposes of analytical procedures. In these circumstances, although the auditor may be able to perform limited analytical procedures for purposes of planning the audit or obtain some information through inquiry, the auditor may need to plan to perform analytical procedures to identify and assess the risks of material misstatement when an early draft of the entity's financial statements is available.

[When the consequential limited revisions are included in SA 315, paragraph A6a will become paragraph A7 and the SA will be renumbered accordingly.]

\* Proposed SA 520, "Analytical Procedures," paragraphs A1-A3 describes the nature of analytical procedures.

# Standard on Auditing (SA) 505 (Revised)

## External Confirmations

Your comments on these Exposure Drafts should reach us by December 30, 2009. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

Secretary, Auditing and Assurance Standards Board  
The Institute of Chartered Accountants of India  
ICAI Bhawan, A-94/4, Sector-58,  
NOIDA, Uttar Pradesh – 201 301.

Comments can also be e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

Proposed Standard on Auditing (SA) 505 (Revised), "External Confirmations" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"<sup>1</sup>, which sets out the authority of SAs and proposed SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"<sup>2</sup>.

### Introduction

#### Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's use of external confirmation procedures to obtain audit evidence in accordance with the requirements of SA 330<sup>3</sup> and SA 500 (Revised)<sup>4</sup>. It does not address inquiries regarding litigation and claims. SA 501 (Revised)<sup>5</sup> deals with obtaining sufficient appropriate audit evidence from such inquiries.

#### External Confirmation Procedures to Obtain Audit Evidence

2. SA 500 (Revised) indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained<sup>6</sup>. That SA also includes the following generalisations applicable to audit evidence<sup>7</sup>:

- Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This SA is intended to assist the auditor in designing and performing external confirmations procedures to obtain relevant and reliable audit evidence.

3. Other SAs recognise the importance of external confirmations as audit evidence, for example:

- SA 330 discusses the auditor's responsibility to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level, and to design and perform further audit procedures whose nature, timing and extent are based on, and are responsive to, the assessed risks of material misstatement at the assertion level<sup>8</sup>. In addition, SA 330 requires that, irrespective of the assessed risks of material misstatement, the auditor designs and performs substantive procedures for each material class of transactions, account balance, and disclosure. The auditor is also

required to consider whether external confirmation procedures are to be performed as substantive audit procedures<sup>9</sup>.

- SA 330 requires that the auditor obtain more persuasive audit evidence the higher the auditor's assessment of risk<sup>10</sup>. To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. SA 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error<sup>11</sup>.
- SA 240 (Revised) indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement, whether due to fraud at the assertion level<sup>12</sup>.

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> The Exposure Draft of SA 200 (Revised) has been published in the September, 2009 issue of the Journal. The last date for sending the comments on the same is October 30, 2009.

<sup>3</sup> SA 330, "The Auditor's Responses to Assessed Risks".

<sup>4</sup> SA 500 (Revised), "Audit Evidence".

<sup>5</sup> SA 501 (Revised), "Audit Evidence — Specific Considerations for Selected Items". The Exposure Draft of the same has been published elsewhere in this issue of the Journal. The last date for sending the comments on the same is December 30, 2009.

<sup>6</sup> SA 500 (Revised), paragraph A5.

<sup>7</sup> SA 500 (Revised), paragraph A31.

<sup>8</sup> SA 330, paragraphs 5-6.

<sup>9</sup> SA 330, Paragraphs 20 and 20a. Paragraph 20a to be inserted in SA 330 when the final Revised SA 505 will come into force.

<sup>10</sup> SA 330, paragraph 7(b).

<sup>11</sup> SA 330, paragraph A49.

<sup>12</sup> SA 240 (Revised), "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", paragraph A37.

- SA 500 (Revised) indicates that corroborating information obtained from a source independent of the entity, such as external confirmations, may increase the assurance the auditor obtains from evidence existing within the accounting records or from the representations made by the management<sup>13</sup>.

#### Effective Date

4. This SA is effective for audit of financial statements for period beginning on or after .....

#### Objective

5. The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

#### Definitions

6. For purposes of the SAs, the following terms have the meanings attributed below:

- External confirmation* – Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
- Positive confirmation request* – A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.
- Negative confirmation request* – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
- Non-response* – A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
- Exception* – A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

#### Requirements

##### External Confirmation Procedures

7. When using external confirmation procedures, the auditor shall

maintain control over external confirmation requests, including:

- Determining the information to be confirmed or requested; (Ref: Para. A1)
- Selecting the appropriate confirming party; (Ref: Para. A2)
- Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and (Ref: Para. A3-A6)
- Sending the requests, including follow-up requests when applicable, to the confirming party. (Ref: Para. A7)

##### Management's Refusal to Allow the Auditor to Send a Confirmation Request

8. If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness; (Ref: Para. A8)
- Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and (Ref: Para. A9)
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence. (Ref: Para. A10)

9. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260 (Revised)<sup>14</sup>. The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705<sup>15</sup>.

##### Results of the External Confirmation Procedures

##### Reliability of Responses to Confirmation Requests

10. If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor

shall obtain further audit evidence to resolve those doubts. (Ref: Para. A11-A16)

11. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures. (Ref: Para. A17)

##### Non-responses

12. In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence. (Ref: Para A18-A19)

##### When a Response to a Positive Confirmation Request is Necessary to Obtain Sufficient Appropriate Audit Evidence

13. If the auditor has determined that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires. If the auditor does not obtain such confirmation, the auditor shall determine the implications for the audit and the auditor's opinion in accordance with SA 705. (Ref: Para A20)

##### Exceptions

14. The auditor shall investigate exceptions to determine whether or not they are indicative of misstatements. (Ref: Para. A21-A22)

##### Negative Confirmations

15. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present: (Ref: Para. A23)

- The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
- The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;

<sup>13</sup> SA 500 (Revised), paragraph A8.

<sup>14</sup> SA 260 (Revised), "Communication with those Charged with Governance", paragraph 12.

<sup>15</sup> SA 705, "Modifications to the Opinion in the Independent Auditor's Report". The Exposure Draft of the same has been published in the June, 2009 issue of the Journal.

- (c) A very low exception rate is expected; and
- (d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

#### *Evaluating the Evidence Obtained*

16. The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether performing further audit procedures is necessary. (Ref: Para. A24-A25)

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### Application and Other Explanatory Material

#### *External Confirmation Procedures*

*Determining the Information to be Confirmed or Requested* (Ref: Para. 7(a))

A1. External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a "side agreement".

*Selecting the Appropriate Confirming Party* (Ref: Para. 7(b))

A2. Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.

*Designing Confirmation Requests* (Ref: Para. 7(c))

A3. The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.

A4. Factors to consider when designing confirmation requests include:

- The assertions being addressed.
- Specific identified risks of material misstatement, including fraud risks.

- The layout and presentation of the confirmation request.
- Prior experience on the audit or similar engagements.
- The method of communication (for example, in paper form, or by electronic or other medium).
- Management's authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.
- The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

A5. A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the confirming parties.

A6. Determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out.

*Follow-up on Confirmation Requests* (Ref: Para. 7(d))

A7. The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

#### *Management's Refusal to Allow the Auditor to send a Confirmation Request*

*Reasonableness of Management's Refusal* (Ref: Para. 8(a))

A8. A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

*Implications for the Assessment of Risks of Material Misstatement* (Ref: Para. 8(b))

A9. The auditor may conclude from the evaluation in paragraph 8(b) that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures in accordance with SA 315<sup>16</sup>. For example, if management's request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with SA 240 (Revised)<sup>17</sup>.

*Alternative Audit Procedures* (Ref: Para. 8(c))

A10. The alternative audit procedures performed may be similar to those appropriate for a non-response as set out in paragraphs A18-A19 of this SA. Such procedures also would take account of the results of the auditor's evaluation in paragraph 8(b) of this SA.

#### *Results of the External Confirmation Procedures*

*Reliability of Responses to Confirmation Requests* (Ref: Para. 10)

A11. SA 500 (Revised) indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability<sup>18</sup>. All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other

<sup>16</sup> SA 315, paragraph 30.

<sup>17</sup> SA 240 (Revised), paragraph 24.

<sup>18</sup> SA 500 (Revised), paragraph A31.

medium. Factors that may indicate doubts about the reliability of a response include that it:

- Was received by the auditor indirectly; or
- Appeared not to come from the originally intended confirming party.

A12. Responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect. A process used by the auditor and the respondent that creates a secure environment for responses received electronically may mitigate these risks. If the auditor is satisfied that such a process is secure and properly controlled, the reliability of the related responses is enhanced. An electronic confirmation process might incorporate various techniques for validating the identity of a sender of information in electronic form, for example, through the use of encryption, electronic digital signatures, and procedures to verify website authenticity.

A13. If a confirming party uses a third party to co-ordinate and provide responses to confirmation requests, the auditor may perform procedures to address the risks that:

- (a) The response may not be from the proper source;
- (b) A respondent may not be authorised to respond; and
- (c) The integrity of the transmission may have been compromised.

A14. The auditor is required by SA 500 (Revised) to determine whether to modify or add procedures to resolve doubts over the reliability of information to be used as audit evidence<sup>19</sup>. The auditor may choose to verify the source and contents of a response to a confirmation request by contacting the confirming party. For example, when a confirming party responds by electronic mail, the auditor may telephone the confirming party to determine whether the confirming party did, in fact, send the response. When a response has been returned to the auditor indirectly (for example, because the confirming party incorrectly addressed it to the entity

rather than to the auditor), the auditor may request the confirming party to respond in writing directly to the auditor.

A15. On its own, an oral response to a confirmation request does not meet the definition of an external confirmation because it is not a direct written response to the auditor. However, upon obtaining an oral response to a confirmation request, the auditor may, depending on the circumstances, request the confirming party to respond in writing directly to the auditor. If no such response is received, in accordance with paragraph 12, the auditor seeks other audit evidence to support the information in the oral response.

A16. A response to a confirmation request may contain restrictive language regarding its use. Such restrictions do not necessarily invalidate the reliability of the response as audit evidence.

*Unreliable Responses* (Ref: Para. 11)

A17. When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with SA 315<sup>20</sup>. For example, an unreliable response may indicate a fraud risk factor that requires evaluation in accordance with SA 240 (Revised)<sup>21</sup>.

*Non-responses* (Ref: Para.12)

A18. Examples of alternative audit procedures the auditor may perform include:

- For accounts receivable balances – examining specific subsequent cash receipts, shipping documentation, and sales near the period-end.
- For accounts payable balances – examining subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.

A19. The nature and extent of alternative audit procedures are affected by the account and assertion in question. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to

revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with SA 315<sup>22</sup>. For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation in accordance with SA 240 (Revised)<sup>23</sup>.

*When a Response to a Positive Confirmation Request is Necessary to Obtain Sufficient Appropriate Audit Evidence* (Ref: Para. 13)

A20. In certain circumstances, the auditor may identify an assessed risk of material misstatement at the assertion level for which a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. Such circumstances may include where:

- The information available to corroborate management's assertion(s) is only available outside the entity.
- Specific fraud risk factors, such as the risk of management override of controls, or the risk of collusion which can involve employee(s) and/or management, prevent the auditor from relying on evidence from the entity.

*Exceptions* (Ref: Para. 14)

A21. Exceptions noted in responses to confirmation requests may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required by SA 240 (Revised) to evaluate whether such misstatement is indicative of fraud<sup>24</sup>. Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also may indicate a deficiency, or deficiencies, in the entity's internal control over financial reporting.

A22. Some exceptions do not represent misstatements. For example, the auditor may conclude that differences in responses to confirmation requests are due to timing, measurement, or clerical errors in the external confirmation procedures.

<sup>19</sup> SA 500 (Revised), paragraph 11.

<sup>20</sup> SA 315, paragraph 30.

<sup>21</sup> SA 240 (Revised), paragraph 24.

<sup>22</sup> SA 315 (Revised), paragraph 30.

<sup>23</sup> SA 240 (Revised), paragraph 24.

<sup>24</sup> SA 240 (Revised), paragraph 35.

**Negative Confirmations** (Ref: Para. 15) A23. The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favour, and less likely to respond otherwise. For example, holders of bank deposit accounts may be more likely to respond if they believe that the balance in their account is understated in the confirmation request, but may be less likely to respond when they believe the balance is overstated. Therefore, sending negative confirmation requests to holders of bank deposit accounts may be a useful procedure in considering whether such balances may be understated, but is unlikely to be effective if the auditor is seeking evidence regarding over-statement.

**Evaluating the Evidence Obtained** (Ref: Para. 16)

A24. When evaluating the results of individual external confirmation requests, the auditor may categorise such results as follows:

- (a) A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request, or providing requested information without exception;
- (b) A response deemed unreliable;
- (c) A non-response; or
- (d) A response indicating an exception.

A25. The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether performing further audit procedures is necessary, as required by SA 330<sup>25</sup>.

**Material Modifications *vis-à-vis* ISA 505, "External Confirmations"**

The Revised SA 505, "External Confirmations" does not contain any material modifications *vis-à-vis* ISA 505.

**Limited Revisions Consequential to issuance of the Exposure Draft of SA 505 (Revised), "External Confirmations"**

The Proposed changes to SA 330 have been shown in Track Changed mode.

**SA 330, "The Auditor's Responses to Assessed Risks"**

20a. The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures. (Ref: Para. A47a-A47d)

[When the consequential limited revisions are included in SA 330, paragraph 20a will become paragraph 21 and the SA will be renumbered accordingly.]

Considering Whether External Confirmation Procedures are to be Performed

A47a. External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no "side agreement" exists that may be relevant to an entity's revenue cut-off assertion. Other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include:

- Bank balances and other information relevant to banking relationships.
- Accounts receivable balances and terms.
- Inventories held by third parties at bonded warehouses for processing or on consignment.
- Property title deeds held by lawyers or financiers for safe custody or as security.

- Investments held for safekeeping by third parties, or purchased from stock-brokers but not delivered at the balance sheet date.
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms.

A47b. Although external confirmations may provide relevant audit evidence relating to certain assertions, there are some assertions for which external confirmations provide less relevant audit evidence. For example, external confirmations provide less relevant audit evidence relating to the recoverability of accounts receivable balances, than they do of their existence.

A47c. The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for information relevant to other financial statement assertions. Such considerations may influence the auditor's decision about whether to perform external confirmation procedures.

A47d. Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

- The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- The ability or willingness of the intended confirming party to respond – for example, the confirming party:
  - May not accept responsibility for responding to a confirmation request;
  - May consider responding too costly or time consuming;
  - May have concerns about the potential legal liability resulting from responding;
  - May account for transactions in different currencies; or

<sup>25</sup> SA 330, paragraphs 27-28.

- May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

- The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

*Substantive Procedures Responsive to Significant Risks* (Ref: Para. 22)

A49. Paragraph 22 of this SA requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a risk that management is inflating sales by improperly recognising revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmations ~~procedures~~ not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmations ~~procedures~~ with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms. ~~Substantive procedures related to significant risks are most often designed to obtain audit evidence with high reliability.~~

[When the consequential limited revisions are included in SA 330, paragraph A47a will become paragraph A48 and the SA will be renumbered accordingly.]



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# Standard on Auditing (SA) 620 (Revised)

## Using the Work of an Auditor's Expert

Your comments on these Exposure Drafts should reach us by December 30, 2009. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

Secretary, Auditing and Assurance Standards Board  
The Institute of Chartered Accountants of India  
ICAI Bhawan, A -94/4, Sector-58,  
NOIDA, Uttar Pradesh – 201 301.

Comments can also be e-mailed at: [aasb@icai.org](mailto:aasb@icai.org)

Proposed Standard on Auditing (SA) 620 (Revised), "Using the Work of an Auditor's Expert" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services<sup>1</sup>," which sets out the authority of SAs and proposed SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"<sup>2</sup>.

### Introduction

#### Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibilities regarding the use of an individual or organisation's work in a field of expertise other than accounting or auditing, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.

2. This SA does not deal with:

- (a) Situations where the engagement team includes a member with expertise in specialised area of accounting or auditing, which is dealt with in Proposed SA 220 (Revised)<sup>3</sup>; or
- (b) The auditor's use of the work of an individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements (a management's expert), which is dealt with in SA 500 (Revised)<sup>4</sup>.

#### The Auditor's Responsibility for the Audit Opinion

3. The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. Nonetheless, if the auditor using the work of an auditor's expert, having followed this SA, concludes that the work of that expert is adequate for the auditor's purposes,

the auditor may accept that expert's findings or conclusions in the expert's field as appropriate audit evidence.

#### Effective Date

4. This SA is effective for audits of financial statements for periods beginning on or after .....

### Objectives

5. The objectives of the auditor are:

- (a) To determine whether to use the work of an auditor's expert; and
- (b) If using the work of an auditor's expert, to determine whether that work is adequate for the auditor's purposes.

### Definitions

6. For purposes of the SAs, the following terms have the meanings attributed below:

- (a) Auditor's expert – An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's expert may be either an auditor's internal expert (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm), or an auditor's external expert. (Ref: Para. A1-A3)
- (b) Expertise – Skills, knowledge and experience in a particular field.
- (c) Management's expert – An

individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

### Requirements

#### Determining the Need for an Auditor's Expert

7. If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert. (Ref: Para. A4-A9)

#### Nature, Timing and Extent of Audit Procedures

8. The nature, timing and extent of the auditor's procedures with respect to the requirements in paragraphs 9-13 of this SA will vary depending on the circumstances. In determining the nature, timing and extent of those procedures, the auditor shall consider matters including: (Ref: Para. A10)

- (a) The nature of the matter to which that expert's work relates;
- (b) The risks of material misstatement in the matter to which that expert's work relates;
- (c) The significance of that expert's work in the context of the audit;
- (d) The auditor's knowledge of and experience with previous work performed by that expert; and
- (e) Whether that expert is subject to

<sup>1</sup> Published in the July, 2007 issue of the Journal.

<sup>2</sup> The Exposure Draft of SA 200 (Revised) has been published in the September, 2009 issue of the Journal. The last date for sending the comments on the same is October 30, 2009.

<sup>3</sup> Proposed Standard on Auditing (SA) 220 (Revised), "Quality Control for an Audit of Financial Statements", paragraph A19. The Exposure Draft of the same has been published elsewhere in this issue of the Journal. The last date for sending the comments on the same is December 30, 2009.

<sup>4</sup> SA 500 (Revised), "Audit Evidence", paragraphs A34-A48.

the auditor's firm's quality control policies and procedures. (Ref: Para. A11-A13)

#### *The Competence, Capabilities and Objectivity of the Auditor's Expert*

9. The auditor shall evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity. (Ref: Para. A14-A20)

#### *Obtaining an Understanding of the Field of Expertise of the Auditor's Expert*

10. The auditor shall obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor to: (Ref: Para. A21-A22)

- (a) Determine the nature, scope and objectives of that expert's work for the auditor's purposes; and
- (b) Evaluate the adequacy of that work for the auditor's purposes.

#### *Agreement with the Auditor's Expert*

11. The auditor shall agree, in writing when appropriate, on the following matters with the auditor's expert: (Ref: Para. A23-A26)

- (a) The nature, scope and objectives of that expert's work; (Ref: Para. A27)
- (b) The respective roles and responsibilities of the auditor and that expert; (Ref: Para. A28-A29)
- (c) The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and (Ref: Para. A30)
- (d) The need for the auditor's expert to observe confidentiality requirements. (Ref: Para. A31)

#### *Evaluating the Adequacy of the Auditor's Expert's Work*

12. The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including: (Ref: Para. A32)

- (a) The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence; (Ref: Para. A33-A34)
- (b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and (Ref: Para. A35-A37)

(c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data. (Ref: Para. A38-A39)

13. If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall: (Ref: Para. A40)

- (a) Agree with that expert on the nature and extent of further work to be performed by that expert; or
- (b) Perform further audit procedures appropriate to the circumstances.

#### *Reference to the Auditor's Expert in the Auditor's Report*

14. The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the audit opinion. (Ref: Para. A41)

15. If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion. (Ref: Para. A42)

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### **Application and Other Explanatory Material**

#### *Definitions*

*Auditor's Expert* (Ref: Para. 6(a))

A1. Expertise in a field other than accounting or auditing may include expertise in relation to such matters as:

- The valuation of complex financial instruments, land and buildings, plant and machinery, jewellery, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired.
- The actuarial calculation of liabilities associated with insurance contracts or employee benefit plans.
- The estimation of oil and gas reserves.
- The valuation of environmental liabilities, and site clean-up costs.
- The interpretation of contracts, laws and regulations.
- The analysis of complex or

unusual tax compliance issues.

A2. In many cases, distinguishing between expertise in accounting or auditing, and expertise in another field, will be straightforward, even where this involves a specialised area of accounting or auditing. For example, an individual with expertise in applying methods of accounting for deferred income tax can often be easily distinguished from an expert in taxation law. The former is not an expert for the purposes of this SA as this constitutes accounting expertise; the latter is an expert for the purposes of this SA as this constitutes legal expertise. Similar distinctions may also be able to be made in other areas, for example, between expertise in methods of accounting for financial instruments, and expertise in complex modelling for the purpose of valuing financial instruments. In some cases, however, particularly those involving an emerging area of accounting or auditing expertise, distinguishing between specialised areas of accounting or auditing, and expertise in another field, will be a matter of professional judgment. Applicable professional rules and standards regarding education and competency requirements for accountants and auditors may assist the auditor in exercising that judgment.

A3. It is necessary to apply judgment when considering how the requirements of this SA are affected by the fact that an auditor's expert may be either an individual or an organisation. For example, when evaluating the competence, capabilities and objectivity of an auditor's expert, it may be that the expert is an organisation the auditor has previously used, but the auditor has no prior experience of the individual expert assigned by the organisation for the particular engagement; or it may be the reverse, that is, the auditor may be familiar with the work of an individual expert but not with the organisation that expert has joined. In either case, both the personal attributes of the individual and the managerial attributes of the organisation (such as systems of quality control the organisation implements) may be relevant to the auditor's evaluation.

#### *Determining the Need for an Auditor's Expert* (Ref: Para. 7)

A4. An auditor's expert may be needed to assist the auditor in one or more of the following:

- Obtaining an understanding of the entity and its environment, including its internal control.

- Identifying and assessing the risks of material misstatement.
- Determining and implementing overall responses to assessed risks at the financial statement level.
- Designing and performing further audit procedures to respond to assessed risks at the assertion level, comprising tests of controls or substantive procedures.
- Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements.

A5. The risks of material misstatement may increase when expertise in a field other than accounting is needed for management to prepare the financial statements, for example, because this may indicate some complexity, or because management may not possess knowledge of the field of expertise. If in preparing the financial statements management does not possess the necessary expertise, a management's expert may be used in addressing those risks. Relevant controls, including controls that relate to the work of a management's expert, if any, may also reduce the risks of material misstatement.

A6. If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required to be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the audit engagement<sup>5</sup>. Further, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the engagement<sup>6</sup>. The auditor's determination of whether to use the work of an auditor's expert, and if so when and to what extent, assists the auditor in meeting these requirements. As the audit progresses, or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's expert.

A7. An auditor who is not an expert in a relevant field other than accounting

or auditing may nevertheless be able to obtain a sufficient understanding of that field to perform the audit without an auditor's expert. This understanding may be obtained through, for example:

- Experience in auditing entities that require such expertise in the preparation of their financial statements.
- Education or professional development in the particular field. This may include formal courses, or discussion with individuals possessing expertise in the relevant field for the purpose of enhancing the auditor's own capacity to deal with matters in that field. Such discussion differs from consultation with an auditor's expert regarding a specific set of circumstances encountered on the engagement where that expert is given all the relevant facts that will enable the expert to provide informed advice about the particular matter<sup>7</sup>.
- Discussion with auditors who have performed similar engagements.

A8. In other cases, however, the auditor may determine that it is necessary, or may choose, to use an auditor's expert to assist in obtaining sufficient appropriate audit evidence. Considerations when deciding whether to use an auditor's expert may include:

- Whether management has used a management's expert in preparing the financial statements (see paragraph A9).
- The nature and significance of the matter, including its complexity.
- The risks of material misstatement in the matter.
- The expected nature of procedures to respond to identified risks, including the auditor's knowledge of and experience with the work of experts in relation to such matters; and the availability of alternative sources of audit evidence.

A9. When management has used a management's expert in preparing the financial statements, the auditor's decision on whether to use an auditor's expert may also be influenced by such factors as:

- The nature, scope and objectives of the management's expert's work.

- Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
- The extent to which management can exercise control or influence over the work of the management's expert.
- The management's expert's competence and capabilities.
- Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
- Any controls within the entity over the management's expert's work.

SA 500 (Revised)<sup>8</sup> includes requirements and guidance regarding the effect of the competence, capabilities and objectivity of management's experts on the reliability of audit evidence.

*Nature, Timing and Extent of Audit Procedures* (Ref: Para. 8)

A10. The nature, timing and extent of audit procedures with respect to the requirements in paragraphs 9-13 of this SA will vary depending on the circumstances. For example, the following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

- The work of the auditor's expert relates to a significant matter that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor's expert, and has no prior knowledge of that expert's competence, capabilities and objectivity.
- The auditor's expert is performing procedures that are integral to the audit, rather than being consulted to provide advice on an individual matter.
- The expert is an auditor's external expert and is not, therefore, subject to the firm's quality control policies and procedures.

*The Auditor's Firm's Quality Control Policies and Procedures* (Ref: Para. 8(e))

A11. An auditor's internal expert may be a partner or staff, including temporary staff, of the auditor's firm, and therefore subject to the quality control policies and procedures of that firm in accordance with SQC 1<sup>9</sup>. Alternatively, an auditor's internal

<sup>5</sup> Proposed SA 220 (Revised), paragraph 14 of the Exposure Draft.

<sup>6</sup> SA 300 (Revised), "Planning an Audit of Financial Statements", paragraph 7(e).

<sup>7</sup> Proposed SA 220 (Revised), paragraph A20 of the Exposure Draft.

<sup>8</sup> SA 500 (Revised), paragraphs 8, and A34-A48.

expert may be a partner or staff, including temporary staff, of a network firm, which may share common quality control policies and procedures with the auditor's firm.

A12. An auditor's external expert is not a member of the engagement team and is not subject to quality control policies and procedures in accordance with SQC 1<sup>10</sup>. In some jurisdictions, however, law or regulation may require that an auditor's external expert be treated as a member of the engagement team, and may therefore be subject to relevant ethical and other professional requirements, including those relating to independence, as determined by that law or regulation<sup>11</sup>.

A13. Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise<sup>12</sup>. The extent of that reliance will vary with the circumstances, and may affect the nature, timing and extent of the auditor's procedures with respect to such matters as:

- Competence and capabilities, through recruitment and training programmes.
- Objectivity. Auditor's internal experts are subject to relevant ethical requirements, including those pertaining to independence.
- The auditor's evaluation of the adequacy of the auditor's expert's work. For example, the firm's training programmes may provide auditor's internal experts with an appropriate understanding of the interrelationship of their expertise with the audit process. Reliance on such training and other firm processes, such as protocols for scoping the work of auditor's internal experts, may affect the nature, timing and extent of the auditor's procedures to evaluate the adequacy of the auditor's expert's work.
- Adherence to regulatory and legal requirements, through monitoring processes.
- Agreement with the auditor's expert.

Such reliance does not reduce the auditor's responsibility to meet the requirements of this SA.

*The Competence, Capabilities and Objectivity of the Auditor's Expert* (Ref: Para. 9)

A14. The competence, capabilities and objectivity of an auditor's expert are factors that significantly affect whether the work of the auditor's expert will be adequate for the auditor's purposes. Competence relates to the nature and level of expertise of the auditor's expert. Capability relates to the ability of the auditor's expert to exercise that competence in the circumstances of the engagement. Factors that influence capability may include, for example, geographic location, and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business judgment of the auditor's expert.

A15. Information regarding the competence, capabilities and objectivity of an auditor's expert may come from a variety of sources, such as:

- Personal experience with previous work of that expert.
- Discussions with that expert.
- Discussions with other auditors or others who are familiar with that expert's work.
- Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
- Published papers or books written by that expert.
- The auditor's firm's quality control policies and procedures (see paragraphs A11-A13)

A16. Matters relevant to evaluating the competence, capabilities and objectivity of the auditor's expert include whether that expert's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards

of a licensing body, or requirements imposed by law or regulation.

A17. Other matters that may be relevant include:

- The relevance of the auditor's expert's competence to the matter for which that expert's work will be used, including any areas of speciality within that expert's field. For example, a particular actuary may specialise in property and casualty insurance, but have limited expertise regarding pension calculations.
- The auditor's expert's competence with respect to relevant accounting and auditing requirements, for example, knowledge of assumptions and methods, including models where applicable, that are consistent with the applicable financial reporting framework.
- Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities and objectivity of the auditor's expert as the audit progresses.

A18. A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may eliminate or reduce such threats, and may be created by external structures (for example, the auditor's expert's profession, legislation or regulation), or by the auditor's expert's work environment (for example, quality control policies and procedures). There may also be safeguards specific to the audit engagement.

A19. The evaluation of the significance of threats to objectivity and of whether there is a need for safeguards may depend upon the role of the auditor's expert and the significance of the expert's work in the context of the audit. There may be some circumstances in which safeguards cannot reduce threats to an acceptable level, for example, if a proposed auditor's expert is an individual who

<sup>9</sup> SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements", paragraph 12(e).

<sup>10</sup> SQC 1, paragraph 12(e).

<sup>11</sup> Relevant ethical requirements ordinarily comprise the Code of Ethics of the Institute of Chartered Accountants of India related to an audit of financial statements.

<sup>12</sup> Proposed SA 220 (Revised), paragraph 4 of the Exposure Draft.

has played a significant role in preparing the information that is being audited, that is, if the auditor's expert is a management's expert.

A20. When evaluating the objectivity of an auditor's external expert, it may be relevant to:

- (a) Inquire of the entity about any known interests or relationships that the entity has with the auditor's external expert that may affect that expert's objectivity.
- (b) Discuss with that expert any applicable safeguards, including any professional requirements that apply to that expert; and evaluate whether the safeguards are adequate to reduce threats to an acceptable level. Interests and relationships that may be relevant to discuss with the auditor's expert include:
  - Financial interests.
  - Business and personal relationships.
  - Provision of other services by the expert, including by the organisation in the case of an external expert that is an organisation.
  - In some cases, it may also be appropriate for the auditor to obtain a written representation from the auditor's external expert about any interests or relationships with the entity of which that expert is aware.

*Obtaining an Understanding of the Field of Expertise of the Auditor's Expert* (Ref: Para. 10)

A21. The auditor may obtain an understanding of the auditor's expert's field of expertise through the means described in paragraph A7, or through discussion with that expert.

A22. Aspects of the auditor's expert's field relevant to the auditor's understanding may include:

- Whether that expert's field has areas of specialty within it that are relevant to the audit (see paragraph A17).
- Whether any professional or other standards, and regulatory or legal requirements apply.
- What assumptions and methods, including models where applicable, are used by the auditor's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.
- The nature of internal and external data or information the auditor's expert uses.

*Agreement with the Auditor's Expert* (Ref: Para. 11)

A23. The nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert regardless of whether the expert is an auditor's external expert or an auditor's internal expert.

A24. The matters noted in paragraph 8 may affect the level of detail and formality of the agreement between the auditor and the auditor's expert, including whether it is appropriate that the agreement be in writing. For example, the following factors may suggest the need for more a detailed agreement than would otherwise be the case, or for the agreement to be set out in writing:

- The auditor's expert will have access to sensitive or confidential entity information.
- The respective roles or responsibilities of the auditor and the auditor's expert are different from those normally expected.
- Multi-jurisdictional legal or regulatory requirements apply.
- The matter to which the auditor's expert's work relates is highly complex.
- The auditor has not previously used work performed by that expert.
- The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

A25. The agreement between the auditor and an auditor's external expert is often in the form of an engagement letter. The Appendix lists matters that the auditor may consider for inclusion in such an engagement letter, or in any other form of agreement with an auditor's external expert.

A26. When there is no written agreement between the auditor and the auditor's expert, evidence of the agreement may be included in, for example:

- Planning memoranda, or related working papers such as the audit programme.
- The policies and procedures of the auditor's firm. In the case of an auditor's internal expert, the established policies and proce-

dures to which that expert is subject may include particular policies and procedures in relation to that expert's work. The extent of documentation in the auditor's working papers depends on the nature of such policies and procedures. For example, no documentation may be required in the auditor's working papers if the auditor's firm has detailed protocols covering the circumstances in which the work of such an expert is used.

*Nature, Scope and Objectives of Work* (Ref: Para. 11(a))

A27. It may often be relevant when agreeing on the nature, scope and objectives of the auditor's expert's work to include discussion of any relevant technical performance standards or other professional or industry requirements that the expert will follow.

*Respective Roles and Responsibilities* (Ref: Para. 11(b))

A28. Agreement on the respective roles and responsibilities of the auditor and the auditor's expert may include:

- Whether the auditor or the auditor's expert will perform detailed testing of source data.
- Consent for the auditor to discuss the auditor's expert's findings or conclusions with the entity and others, and to include details of that expert's findings or conclusions in a modified auditor's report, if necessary (see paragraph A42).
- Any agreement to inform the auditor's expert of the auditor's conclusions concerning that expert's work.

*Working Papers*

A29. Agreement on the respective roles and responsibilities of the auditor and the auditor's expert may also include agreement about access to, and retention of, each other's working papers. When the auditor's expert is a member of the engagement team, that expert's working papers form part of the audit documentation. Subject to any agreement to the contrary, auditor's external experts' working papers are their own and do not form part of the audit documentation.

*Communication* (Ref: Para. 11(c))

A30. Effective two-way communication facilitates the proper integration of the nature, timing and extent of the auditor's expert's procedures with other work on the audit, and appropriate modification of the auditor's expert's objectives during the course

of the audit. For example, when the work of the auditor's expert relates to the auditor's conclusions regarding a significant risk, both a formal written report at the conclusion of that expert's work, and oral reports as the work progresses, may be appropriate. Identification of specific partners or staff who will liaise with the auditor's expert, and procedures for communication between that expert and the entity, assists timely and effective communication, particularly on larger engagements.

*Confidentiality* (Ref: Para. 11(d))

A31. It is necessary for the confidentiality provisions of relevant ethical requirements that apply to the auditor also to apply to the auditor's expert. Additional requirements may be imposed by law or regulation. The entity may also have requested that specific confidentiality provisions be agreed with auditor's external experts.

*Evaluating the Adequacy of the Auditor's Expert's Work* (Ref: Para. 12)

A32. The auditor's evaluation of the auditor's expert's competence, capabilities and objectivity, the auditor's familiarity with the auditor's expert's field of expertise, and the nature of the work performed by the auditor's expert affect the nature, timing and extent of audit procedures to evaluate the adequacy of that expert's work for the auditor's purposes.

*The Findings and Conclusions of the Auditor's Expert* (Ref: Para. 12(a))

A33. Specific procedures to evaluate the adequacy of the auditor's expert's work for the auditor's purposes may include:

- Inquiries of the auditor's expert.
- Reviewing the auditor's expert's working papers and reports.
- Corroborative procedures, such as:
  - Observing the auditor's expert's work;
  - Examining published data, such as statistical reports from reputable, authoritative sources;
  - Confirming relevant matters with third parties;
  - Performing detailed analytical procedures; and
  - Re-performing calculations.
- Discussion with another expert with relevant expertise when, for example, the findings or conclu-

sions of the auditor's expert are not consistent with other audit evidence.

- Discussing the auditor's expert's report with management.

A34. Relevant factors when evaluating the relevance and reasonableness of the findings or conclusions of the auditor's expert, whether in a report or other form, may include whether they are:

- Presented in a manner that is consistent with any standards of the auditor's expert's profession or industry;
- Clearly expressed, including reference to the objectives agreed with the auditor, the scope of the work performed and standards applied;
- Based on an appropriate period and take into account subsequent events, where relevant;
- Subject to any reservation, limitation or restriction on use, and if so, whether this has implications for the auditor; and
- Based on appropriate consideration of errors or deviations encountered by the auditor's expert.

*Assumptions, Methods and Source Data*

*Assumptions and Methods* (Ref: Para. 12(b))

A35. When the auditor's expert's work is to evaluate underlying assumptions and methods, including models where applicable, used by management in developing an accounting estimate, the auditor's procedures are likely to be primarily directed to evaluating whether the auditor's expert has adequately reviewed those assumptions and methods. When the auditor's expert's work is to develop an auditor's point estimate or an auditor's range for comparison with management's point estimate, the auditor's procedures may be primarily directed to evaluating the assumptions and methods, including models where appropriate, used by the auditor's expert.

A36. SA 540 (Revised)<sup>13</sup> discusses the assumptions and methods used by management in making accounting estimates, including the use in some cases of highly specialised, entity-developed models. Although that discussion is written in the context of the auditor obtaining sufficient appropriate audit evidence regarding management's assumptions and

methods, it may also assist the auditor when evaluating an auditor's expert's assumptions and methods.

A37. When an auditor's expert's work involves the use of significant assumptions and methods, factors relevant to the auditor's evaluation of those assumptions and methods include whether they are:

- Generally accepted within the auditor's expert's field;
- Consistent with the requirements of the applicable financial reporting framework;
- Dependent on the use of specialised models; and
- Consistent with those of management, and if not, the reason for, and effects of, the differences.

*Source Data Used by the Auditor's Expert* (Ref: Para. 12(c))

A38. When an auditor's expert's work involves the use of source data that is significant to that expert's work, procedures such as the following may be used to test that data:

- Verifying the origin of the data, including obtaining an understanding of, and where applicable testing, the internal controls over the data and, where relevant, its transmission to the expert.
- Reviewing the data for completeness and internal consistency.

A39. In many cases, the auditor may test source data. However, in other cases, when the nature of the source data used by an auditor's expert is highly technical in relation to the expert's field, that expert may test the source data. If the auditor's expert has tested the source data, inquiry of that expert by the auditor, or supervision or review of that expert's tests may be an appropriate way for the auditor to evaluate that data's relevance, completeness, and accuracy.

*Inadequate Work* (Ref: Para. 13)

A40. If the auditor concludes that the work of the auditor's expert is not adequate for the auditor's purposes and the auditor cannot resolve the matter through the additional audit procedures required by paragraph 13, which may involve further work being performed by both the expert and the auditor, or include employing or engaging another expert, it may be necessary to express a modified opinion in the auditor's report in accordance with SA 705 because the auditor has not obtained sufficient appropriate audit evidence<sup>14</sup>.

<sup>13</sup> SA 540 (Revised), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", paragraphs 8, 13 and 15.

*Reference to the Auditor's Expert in the Auditor's Report* (Ref: Para. 14-15)

A41. In some cases, law or regulation may require a reference to the work of an auditor's expert, for example, for the purposes of transparency in the public sector.

A42. It may be appropriate in some circumstances to refer to the auditor's expert in an auditor's report containing a modified opinion, to explain the nature of the modification. In such circumstances, the auditor may need the permission of the auditor's expert before making such a reference.

*Material Modifications vis-a-vis ISA 620, "Using the Work of an Auditor's Expert"*

The Revised SA 620, "Using the Work of an Auditor's Expert" does not contain any material modifications vis-à-vis ISA 620.

*Appendix*  
(Ref: Para. A25)

*Considerations for Agreement between the Auditor and an Auditor's External Expert*

This Appendix lists matters that the auditor may consider for inclusion in any agreement with an auditor's external expert. The following list is illustrative and is not exhaustive; it is intended only to be a guide that may be used in conjunction with the considerations outlined in this SA. Whether to include particular matters in the agreement depends on the circumstances of the engagement. The list may also be of assistance in considering the matters to be included in an agreement with an auditor's internal expert.

*Nature, Scope and Objectives of the Auditor's External Expert's Work*

- The nature and scope of the procedures to be performed by the auditor's external expert.
- The objectives of the auditor's external expert's work in the context of materiality and risk considerations concerning the matter to which the auditor's external expert's work relates, and, when relevant, the applicable financial reporting framework.
- Any relevant technical performance standards or other professional or industry requirements the auditor's external expert will follow.

- The assumptions and methods, including models where applicable, the auditor's external expert will use, and their authority.
- The effective date of, or when applicable the testing period for, the subject matter of the auditor's external expert's work, and requirements regarding subsequent events.

*The Respective Roles and Responsibilities of the Auditor and the Auditor's External Expert*

- Relevant auditing and accounting standards, and relevant regulatory or legal requirements.
- The auditor's external expert's consent to the auditor's intended use of that expert's report, including any reference to it, or disclosure of it, to others, for example reference to it in a modified auditor's report, if necessary, or disclosure of it to management or an audit committee.
- The nature and extent of the auditor's review of the auditor's external expert's work.
- Whether the auditor or the auditor's external expert will test source data.
- The auditor's external expert's access to the entity's records, files, personnel and to experts engaged by the entity.
- Procedures for communication between the auditor's external expert and the entity.
- The auditor's and the auditor's external expert's access to each other's working papers.
- Ownership and control of working papers during and after the engagement, including any file retention requirements.
- The auditor's external expert's responsibility to perform work with due skill and care.
- The auditor's external expert's competence and capability to perform the work.
- The expectation that the auditor's external expert will use all knowledge that expert has that is relevant to the audit or, if not, will inform the auditor.
- Any restriction on the auditor's external expert's association with the auditor's report.
- Any agreement to inform the auditor's external expert of the auditor's conclusions concerning

that expert's work.

*Communications and Reporting*

- Methods and frequency of communications, including:
  - How the auditor's external expert's findings or conclusions will be reported (written report, oral report, ongoing input to the engagement team, etc.).
  - Identification of specific persons within the engagement team who will liaise with the auditor's external expert.
- When the auditor's external expert will complete the work and report findings or conclusions to the auditor.
- The auditor's external expert's responsibility to communicate promptly any potential delay in completing the work, and any potential reservation or limitation on that expert's findings or conclusions.
- The auditor's external expert's responsibility to communicate promptly instances in which the entity restricts that expert's access to records, files, personnel or experts engaged by the entity.
- The auditor's external expert's responsibility to communicate to the auditor all information that expert believes may be relevant to the audit, including any changes in circumstances previously communicated.
- The auditor's external expert's responsibility to communicate circumstances that may create threats to that expert's objectivity, and any relevant safeguards that may eliminate or reduce such threats to an acceptable level.

*Confidentiality*

- The need for the auditor's expert to observe confidentiality requirements, including:
  - The confidentiality provisions of relevant ethical requirements that apply to the auditor.
  - Additional requirements that may be imposed by law or regulation, if any.
  - Specific confidentiality provisions requested by the entity, if any

<sup>14</sup> Proposed SA 705, "Modifications to the Opinion in the Independent Auditor's Report", paragraph 6(b). The Exposure Draft of SA 705 has been published in the June, 2009 issue of the Journal. The last date for sending the comments on the same was July 31, 2009.

## HEALTH TIPS

**Nidra the barometer of equilibrium amongst Body, Mind and Soul:**

- “Having good health is very different from only being not sick.” barometer of good health is **quantity and quality** of the sleep you have.
- In response to a question “Bhagwan, is it better to sleep or to keep awake.” Lord Mahavir said “**Sleeping is good. So is keeping awake good.**” Questioned once again “Bhagwan, how could both be same. One must be better than other.” Bhagwan replied smilingly “For a sinner it is better that he sleeps. For a good man it is better if he keeps awake. A sinner benefits the world by sleeping. A good person benefits it by keeping awake.

*Contributed by CA R. S. Agrawal, Mumbai  
He can be reached at  
rsagrawal@icai.org*

**Yoga Nidra - An open secret of divine yogic self healing technique:****Yoga Nidra, Steps Involved and Healing Benefits**

Yoga nidra is a **state of conscious deep sleep**. During the practice of yoga nidra, one appears to be sleeping, but the consciousness is functioning at the deeper level of awareness. Normally when we sleep, we lose track of ourselves and cannot utilize the capacity of mind.

Classical yogic texts explain that there are 72000 nadis (bioplasmic pathways) in the human pranic framework acting as medium and base for the physical body. Yoga nidra is a technique that helps **to harmonize the pranic flows throughout the whole human structure by rotating awareness through different parts of the body.**

**Points to remember when doing yoga nidra:**

- Relax, but don't sleep;
- Be aware, don't concentrate;
- Maintain the attitude of a witness, don't get lost in the mental reverie;
- Don't move the body;
- Keep **your eyes closed throughout the practice;**
- Don't try to intellectualize the process of yoga nidra.

**Steps to yoga nidra in very brief:**

1. **Preparation:** Lie down in Shavasana facing upside->loose cloth->keep the feet and legs a little apart->arms beside your body->palms facing up->adjust your body comfortably->**vow not to sleep;**
2. **Sinking the body:** Look at the space in front of eyes->imagine the space surrounds to body->imagine your body is immersed in that space->simultaneously be aware of your body... it **feels very light->as light as a leaf... falling from a tree... your body is sinking... sinking... sinking into depth like a falling leaf->be aware of this feeling;**
3. **Rhythmical breathe awareness:** Become aware of your breathing (a) .....**at the naval->as you breathe in count 1 mentally->as you breathe out count 2 mentally (imagining rhythmical pulling in and pushing out air from naval part) ->like**

count up to 20; (b) then become aware of **area of chest->repeat the process of awareness and breathing counting upto 20 as you did in navel area;** (c) then become aware of breathing **at the nose-> repeat the same process;**

4. **Sankalp:** Repeat your Sankalp (goal) or Resolution, at least 3 times, over and over again with heart feeling **not with lips.**
5. **Visualization-body awareness:** Imagining that you are viewing your body from outside as it looks in a large mirror->see your whole body in the order of ->feet, knees, thighs, abdomen, chest, arms, hands, each finger, nose, eyes, eyebrow centre, whole face and your whole body->rotate awareness at different parts of the body->continue for few seconds.
6. **Physic centre-awareness rotation:** You now have to discover physic centres (chakra) in your body. **Feel sensation, starting from Muladhara to Sahasrara, at each point of each chakra.** Now repeat the process in reverse i.e. downwards in turn through Sahasrara. This is 1 complete round of chakra rotation.

Do few rounds or more if time permits. Chant **“AUM” at each point mentally only to feel vibration.**

7. **Physic centre-visualization:** Now you try to visualize, to the best of your ability, the symbol of each chakra **starting from Muladhara to Sahasrara.**  
Now repeat the process in reverse i.e. downwards in turn through Sahasrara. This is 1 complete round. Take few rounds and also spend few seconds on each centre.
8. **Eyebrow centre awareness:** Now fix your attention at the eyebrow centre->**feel blood pulse at that point->synchronize mantra “AUM” with pulse beat mentally like ticking of a clock->continue for few seconds->feel “AUM” is emanating outwards in all directions->feel your being and whole universe is enveloped in “AUM”->feel your expansion->continue for few seconds;**

9. **Sankalp:** Repeat your goal over and over again for a minute;

10. **End:** Become aware of your breath...and your whole body->become aware of outer sense perception->feel that you are lying on the floor->feel the places of physical contacts->hear outside sounds->slowly move your body->stretch your muscles->and get up. This is the end of yoga nidra.

**Summarized healing benefits:**

- Relaxes the **whole physio-psychological system;**
- Rejuvenates the **body and mind;**
- Removes and prevents psychosomatic diseases like high **BP, diabetes, asthma, rheumatism, neurasthenia, allergies** etc;
- **Reduces sleep requirement;**
- **Induces sleep** in insomnia;
- Brings **deeper perception of mind, inner intelligence,** joy contentment etc;
- Removes **psychological blocks,** fears, phobias, conflicts etc. especially which are **unresponsive to routine psychotherapy;**
- **Enhances learning process;**
- Restructures and reforms whole personality from within;
- Can **make corporate more efficient** by enhancing their creativity, receptivity of knowledge and problem solving skills;
- **Manages diseases of all kinds including cancer;**
- **Beneficial in both acute and chronic conditions like hypertension, heart diseases and arthritis;**
- **Stimulates the pituitary gland;**
- **In pregnancy creates the most favourable conditions for intra uterine growth;**
- Opens door for meditation and prepares **mind for spiritual evolution;**

Yoga nidra will **take about 25 to 45 minutes** for the practice. **Everyone can practice.** Even beginners who are stiff.

**Disclaimer:**

The above information have been taken from the reliable sources (Swami Satyanand Saraswati), still the author is not liable for any loss or damage that may be caused directly or indirectly by the above information. A physician is always recommended for any remedy.

# Significance of Water in Vastu Shastra



**Kashyap Nitin Pathak**

*The author is a Vastu expert.*

He can be reached at [kash3001@rediffmail.com](mailto:kash3001@rediffmail.com)



**O**ne of the five elements which make the *panch mahabhoot* is *jal* (water). Water is an element which has two different energies and two different roles to play in human life. The fundamental character of this element is to have a cooling effect. The second character is exactly opposite—i.e. to generate heat. Flowing water is capable of generating energy (heat) by rolling the turbines. This is an amazing quality of water. Our body and the Earth both comprise up to 70% of this element. Water is ruled by the planet Moon. Though moon is a satellite of the Earth but in Indian astrology it has the significance of a planet. The influence of moon can be felt when the moon is waxing or increasing in light and size. People usually become more emotional when the moon is approaching its full moon days. Injuries caused on a full moon day also tend to profuse bleeding.

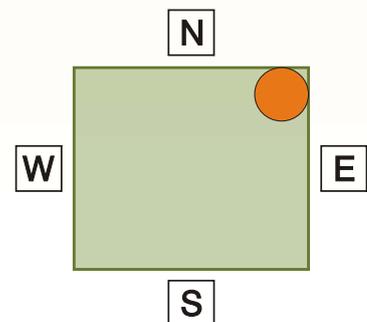
## Drinking Water

Water, which is going to be consumed in the form of drinking or cooking should ideally be in the North East or *Eshanya* direction. Water kept in this direction will be exposed to sunlight in the morning and moonlight in the night. Thus, it will have both energies absorbed. Of course the water

storage for drinking, whether a pot or a utensil, should be kept closed. A copper pot is the best suited for drinking water storage as it balances the metal (*dhatu*) in your body. Storage of water in a wrong direction will have a lot of health issues in the house as this is the water which you intake. Correcting the position will bring improvement in blood pressure, cough cold, blood circulation and kidney disorders.

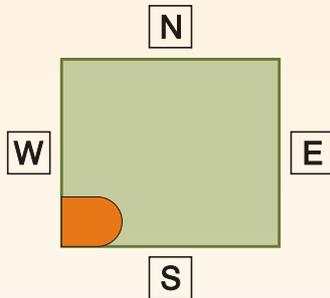
## Early morning practice

Before going to bed, fill a glass of water preferably in a copper utensil and keep it in the East or North East direction. In the morning after cleaning your mouth, drink this water. Follow this practice like a religion. I am a witness to very old skin diseases, allergies, intestinal disorders, liver and kidney issues, irregular bowel movements being cured without any medication by following this simple practice.



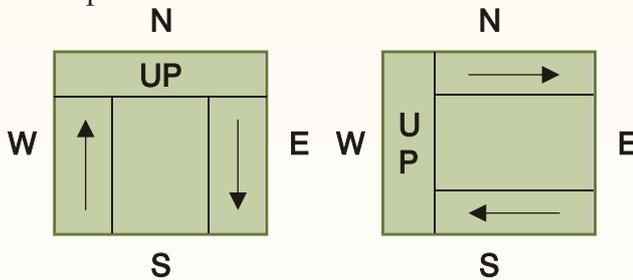
**Sewerage Water**

Bathing and other excretion water should be kept and discharged in the South West or *Nairutya* direction of the house. The latrine can be in this direction. However, the bathroom is better to be in the East because it keeps the premise fungus free and healthy. The bathroom should never be located in North East. The Indian sages used to worship and offer salutation to the Sun after having a bath, that is also the reason for the bathroom to be in the East direction.



**Stair case**

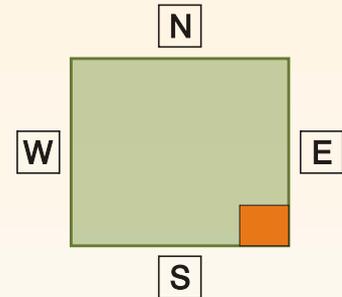
Stair case in the house should be only in the North or West direction. That is to say, when one is climbing the steps he should be going towards the North or West. If the staircases are in a circular motion then they should turn towards the right only. The number of steps should be in even numbers as far as possible. Stair case within the house should



never be made of metal. The space below the staircase should be kept empty; it can be used to store items not used frequently. The position of a temple below the staircase is extremely bad. In such houses there is absence of spiritualism and health concerns bother the entire family.

**Centrally cooling Unit**

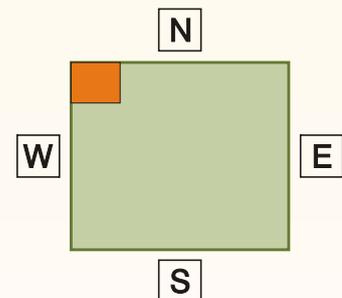
The Air conditioning equipment in your house, especially in case of big size halls, should be kept in the South East direction. The result of such a placement is that these equipment last long without giving any trouble and they will also consume lower electricity.



**Place for hoarding grains**

If the foodgrains stored in the house are solely for the consumption of the family then the correct placement would be the North West direction.

Hoarding foodgrains in this direction will ensure that the family never falls short of food and that it remains in good condition without any spoilage.



**CLASSIFIEDS**

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# THIS MONTH FOR YOU

(based on Tarot Card reading)



**Puja Mathur**  
The contributor is  
Tarot Card reader.  
She can be reached at  
pujatarot@yahoo.com

*LIFE MESSAGE: "It will come to pass". Something has not just come together yet.*

## ARIES

You are distracted by your past. Avoid long journeys. Work which has been started in the past will face some problems.



**TAURUS** *LIFE MESSAGE: Be cautious with your resources and take only smart risks.*



Long-awaited investments will be fruitful this month. Try to be disciplined in your diet and follow your doctor's instructions. Motivate yourself for work. Receive blessings from elders while starting any new work or project.

*LIFE MESSAGE: Reciprocate opportunities with safety and understanding.*

## GEMINI

This is a resourceful month for you. You will join a new venture with lot of support of people. Enjoy abundance of love. Take care of your resources with your inner beauty to enhance your work.



**CANCER** *LIFE MESSAGE: Beware of friendly sinners*



If you have approached for new job opportunities, business or relationship you are going to get a positive response. Forgive your past mistakes and enhance your creativity. There is a possibility of a new birth or a new opportunity.

*LIFE MESSAGE: Get started with a reunion.*

## LEO

All the year round you have been working on your own. But now work in unity. Don't spoil your good relations; this may affect your career. Don't take any hasty decisions regarding your future.



**VIRGO** *LIFE MESSAGE: God has bestowed a lot on you; make an attempt to acknowledge it.*



There is stress related to your work and partnership. Have patience for decision-making. You will inherit ancestral wealth or property. You will be very happy. This month you will get a favourable reply regarding a property issue.

*LIFE MESSAGE: Be patient and keep faith in your choice*

## LIBRA

Right now you are not feeling stable. Create stability in your work and relationships. You will come across a lady aged between 25 and 30 years who will support you financially and emotionally.



**SCORPIO** *LIFE MESSAGE: You are going to experience your true essence.*



You are going to do some encouraging work which will enhance your creativity. You will work with your true sense and will enjoy it. Give your hundred per cent to your work as you have done in the past. Wear or use turquoise blue colour for the entire month.

*LIFE MESSAGE: Surrender your creativity to God.*

## SAGITTARIUS

If you have started a new venture or work where many people are involved, they will appreciate you and you will get good rewards. This work will bring you in the limelight and fetch you good monetary gains. You will buy a magnificent property.



**CAPRICORN** *LIFE MESSAGE: Don't be in the past; move forward in life*



This month is not appropriate for financial gains. You are juggling with two things at a time. Be cautious while making unknown choices. Focus on your health. Wear a lot of white colour.

*LIFE MESSAGE: Avoid doing mistakes.*

## AQUARIUS

The earlier decision regarding your work will not prove fruitful and you have to wait for the appropriate time.



**PISCES** *LIFE MESSAGE: Listen to your inner voice before starting a new venture.*



You have to balance with your work and family. This rough phase will go and the outcome will be very good. In the future you are going to feel abundance of money. Changes will be adventurous for job.

"DISCLAIMER: The views expressed or implied in this feature are those of the author and not of the ICAI, which will not be responsible for any action taken on the basis of this feature."

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# CROSS

## WORD 041

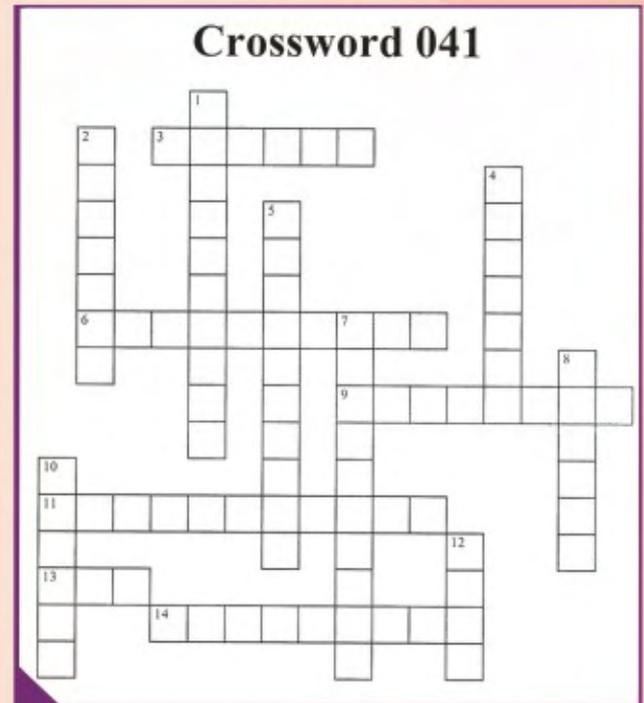
**ACROSS**

3. 'Ultra Vires' means 'beyond \_\_\_\_\_'. (6)
6. At the recently concluded Campus Placement Programme of the ICAI, highest number of job offers were made at this centre under the 'Smaller Centres' category. (10)
9. \_\_\_\_\_ is the converse of a merger or acquisition. (8)
11. Whether interest on borrowed capital will be treated as capital or revenue depends on \_\_\_\_\_ of loans raised. (11)
13. \_\_\_\_\_ has decided to outsource the technical scrutiny of the balance sheet filed with them under the Companies Act, 1956 to the professionals.
14. ICAI International Delegation has recently visited \_\_\_\_\_. (9)

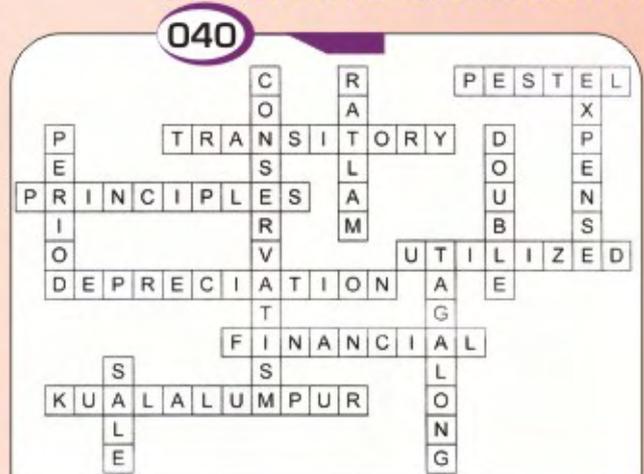
**DOWN**

1. The comparison, analysis and interpretation of a similar item of financial statements relating to two accounting periods is called \_\_\_\_\_ analysis. (10)
2. Section 77A (1) of the Companies Act, 1956 provides for power of a company to \_\_\_\_\_ its shares or other securities. (3,4)
4. According to section 2(24), \_\_\_\_\_ means 'An individual who has the management of the whole or substantially the whole of the affairs of a company'. (7)
5. ICAI's e-Governance project. (10)
7. Section 260 empowers the Directors to appoint \_\_\_\_\_ Directors if the power is given to them by the Article of Association. (10)
8. A company is an artificial \_\_\_\_\_ created by law. (6)
10. \_\_\_\_\_ is the minimum number of members, which must be present in the meeting to make the meeting a valid one. (6)
12. Goods and Service Tax to be implemented from 2010 will be the \_\_\_\_\_ GST which will have a Federal part and a State part. (4)

Note: Members can claim one hour CPE Credit - Unstructured Learning through self-declaration for attempting above Crossword.



## SOLUTION Crossword



Please

**1** After 40 years of wondering why he didn't look like his younger sister or brother, the man finally got up the nerve to ask his mother if he was adopted.  
 "Yes, you were son," his mother said as she started to cry softly.  
 "But it didn't work out and they brought you back."

**2**  
 "What do you do for a living?"  
 "I pack parachutes."  
 "That's not an easy job. How do you manage it?"  
 "Very well, I think. No one has ever complained about my work."

