



VOLUME 59 | No. 7 | JANUARY 2011 | ₹ 100

SET UP BY AN ACT OF PARLIAMENT

THE CHARTERED ACCOUNTANT JOURNAL

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

VOLUME 59 | No. 7 | JANUARY 2011

THE CHARTERED ACCOUNTANT

₹ 100

Happy &
Prosperous
New year

2011

The Challenge of Financial Inclusion in India

Our economic success and the boom in banking notwithstanding, one of the contemporary critical challenges for India is *financial inclusion* of its population, especially that of underprivileged sections, who remain cut off from not only formal sources of finance but also from basic banking services. Despite persistent policy initiatives and endeavours of the Reserve Bank of India since 2004, and despite *financial inclusion* being a buzzword for almost six years, comprehensive *financial inclusion* still appears far away from reality for us. This is an irony especially in the wake of the fact that one of the major goals of the 11th Five Year Plan is attaining financial inclusion of the most and extending the reach of microfinance to meet credit needs of approximately 80 per cent of the population not directly covered by banks.

Only 44.9 per cent Indian earners had bank account in 2007. Of this, only 38 per cent of paid workers in villages had accounts compared to 62 per cent of those in urban space in 2007. Based on the All India Debt and Investment Survey, the C. Rangarajan Committee on Financial Inclusion observed in its January 2008 report that 111.5 million households had no access to formal credit, 17 million households were indebted to moneylenders, and 45.9 million farmer households in the country out of a total of 89.3 million (or 51 per cent) did not have access to credit, either from institutional or non-institutional sources. India has been ranked poorly, i.e. 50th, below the African countries like Kenya and Morocco, in first-ever index of financial inclusion prepared by Indian Council for Research on International Economic Relations. The number of branches of a bank per one lakh adults in India is just 9.4, as compared to 14.6 in Malaysia. While domestic deposit as share in the GDP is just 54.9 per cent in India compared to 123.9 per cent in Malaysia.

To remedy this bleak situation, the Rangarajan Committee in its January 2008 report mainly mooted a mission called National Rural Financial Inclusion Plan and recommended to establish Financial Inclusion Promotion and Development Fund and Financial Inclusion Technology Fund. It rightly stressed the importance of looking at financial inclusion in a holistic manner and has emphasised on the need to look into insurance and remittance needs of the poor. It set targets to increase financial inclusion in the country across regions and across institutions (banks, rural regional banks etc) and has suggested measures to address both, supply and demand constraints in increasing financial inclusion. The Finance Minister in that year's Budget decided to implement, immediately, two recommendations. The first was to establish a Financial Inclusion Fund with NABARD for meeting the cost of developmental and promotional interventions. The second was to establish a Financial Inclusion Technology Fund to meet the costs of technology adoption. Further, the UID Project, besides other objectives, also aims to bring in major financial inclusion by facilitation opening of the bank accounts by hoi-polloi of Indian society.

Although some major initiatives have been launched in the direction of *financial inclusion*, what is needed is more sustained and sincere efforts on part of our Government as well as our banks. Irrespective of the fact that about 120 million farming families have been brought into the financial system by providing low-interest credits, debt-relief packages and a host of subsidies, banks still have to play an active role in agriculture sector. Indian bankers need to overcome the challenge of finding a low-cost approach to *financial inclusion* sooner than later. A larger spread of the "business correspondent" model of forging

linkages with local communities and a shift from class to mass banking is required for the penetration of the financial services in the rural areas. Particular attention has been paid to certain under-banked states like Bihar, Orissa, Rajasthan, Uttar Pradesh, Chattisgarh, Jharkhand, West Bengal and North-Eastern states in the spirit of new branch authorisation policy of Reserve Bank of India. The Rangarajan committee report says that financial exclusion is most acute in Central, Eastern and North-Eastern regions – having a concentration of 64 per cent of all financially excluded farmer households in the country.

The Chartered Accountants, micro-finance institutions, self-help groups and NGOs can play a pivotal role. Prime Minister Dr. Manmohan Singh rightly pointed out during the Diamond Jubilee celebrations of the ICAI that CAs of the country can promote *financial inclusion* by creating awareness about microfinance, financial products, money management and other initiatives of the Government like NABARD, and encouraging public to join formal financial systems. Technology can be a tool in providing access to banking products in remote areas.

The focus of *financial inclusion* presently is confined to ensuring a bare minimum access to a savings bank account without frills, to all. But a current or savings account can not be regarded as an indicator of financial inclusion. In UK access to banking, affordable credits and free face-to-face money advice has been identified as priority. We can have comparable wider perspectives. *Financial inclusion*, accepted globally as an explicit strategy for fostering economic growth, is a compulsion rather than a need. Financial inclusion is a must for inclusive growth of the nation.

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SUBSCRIPTION RATES

Inland subscribers :	₹ 1,000 per annum
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EDITORIAL SUPPORT, DESIGN, ADVERTISEMENT & MARKETING SPENTA MULTIMEDIA

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Printed and published by Vijay Kapur on behalf of The Institute of Chartered Accountants of India (ICAI)

Editor — CA. Amarjit Chopra

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

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TOTAL CIRCULATION: 2,05,666

Total No. of Pages: 148 including Covers

Cover image: www.dreamstime.com

Inside images and graphics: www.dreamstime.com



VOLUME 59 | No. 7 | JANUARY 2011 | ₹100

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Dear All,

Let us take this opportunity to wish everybody a very delightful and blissful New Year. Let happiness, satisfaction and joy always be an integral part of your life.

In 2011, to begin with, let us take this opportunity to make our wish-list public: Let our Institute grow to newer heights and spread its wings to all corners of the world. Let our profession touch towering altitudes of success while helping our society and country, and fulfil all their expectations. Let members of our profession reach and touch lives of common people and make their lives better while carrying out their social responsibility.

Here, I would like to recall what Natalie Goldberg, an American author, had said somewhere: *Trust in what you love, continue to do it, and it will take you where you need to go.* This is the message we would like to send across to all connected with the accountancy profession. Let us enjoy our work with all our heart.

Now, let us get updated with the developments and opportunities that we have tried to create for our Institute, profession and members at large in particular, and for our society and country in general.

ICAI Commended

Shri Pranab Mukherjee, Hon'ble Finance Minister of India, while inaugurating the 42nd Regional Conference of SIRC at Kochi applauded the role of ICAI. He complemented the Institute *'for its initiatives to work with financial institutions in streamlining and fine-tuning the financial reporting, auditing and accounting architecture of India'*. He, however, suggested, *'The accountants as information intermediaries between managers and shareholders need to identify and recognise losses at an early stage, thereby mitigating asymmetry in information.'* He also cautioned that *'we need to regulate better and at the same time ensure that regulation does not degenerate into obsessive control.'*

Hon'ble Governor of Bihar Shri Devanand Konwar inaugurated a two-day national conference of Chartered Accountants in Guwahati. He categorically recognised our disciplinary mechanism and opined that our

disciplinary mechanism is the best one among those in other institutions. He especially appreciated the fact that the names of members held guilty of professional misconduct had been publicly displayed by us.

Hon'ble Governor of Orissa Shri Murlidhar C. Bhandare while addressing the 301st meeting of our Council in Puri, said: *'What is most satisfying is the significant contribution that Indian Chartered Accountants have made in growth of Indian economy in the era of liberalisation and globalisation...the Institute has performed its role very well.* He, then, sincerely expected our *'Institute can help the Government in designing suitable mechanism for monitoring the use of the funds made available for public expenditure.'* He was all praise for the ICAI as 'partner in nation-building' in particular and chartered accountancy profession in general.

Hon'ble Governor of Uttar Pradesh Shri B. L. Joshi also complemented the Institute for its effective disciplinary mechanism while inaugurating the Conference on Management of fiscal and Natural Wealth organised by Lucknow Branch of the Institute.

We are thankful to these dignitaries for their commendations of our Institute and profession. We assure them that we would continue to serve our society to the best of our capabilities.

International Initiatives

International Conference in New Delhi: We are glad to share that Hon'ble Finance Minister Shri Pranab Mukherjee has kindly consented to inaugurate the International Conference at Vigyan Bhawan in January 2011. The programme structure as it stands includes speakers from New Zealand, Australia, UK, Japan, Bangladesh, Nepal, Pakistan, Sri Lanka, Australia, IASB, IAASB, IFAC, ICAI Chapters abroad and regulators from C&AG and CGA. The Guests of Honour for the inaugural session are Hon'ble Shri K. Rahman Khan, Deputy Chairman of Rajya Sabha and Hon'ble Shri Salman Khurshid, Minister of State (Independent Charge) for Corporate Affairs and Minority Affairs.



Shri R. Bandyopadhyay, Secretary, Ministry of Corporate Affairs, will grace the occasion as the special guest during the Inaugural Session. We are sure that our members will actively participate, get benefited from the Conference and eventually make this event a grand success.

SAFA—Regional Standard Setters Conference in India & Other Events in Nepal:

It is a matter of satisfaction for us that the ICAI successfully hosted the SAFA's *Regional Standard Setters Conference* in New Delhi focusing on IFRS, its future direction and its implication for the SAARC Region. It was inaugurated by Hon'ble Rajya Sabha Deputy Chairman Shri K. Rahman Khan, who highly appreciated our role as standard-setter and our steps taken in the recent past in this regard. The Conference also witnessed the crucial presence of IASB Chairman Sir David Tweedie and IASB Board Member Mr. Prabhakar Kalavacherla. The event had participation from almost all SAFA member bodies. From India itself, there were almost 100 delegates, particularly from our members in industry. The undersigned made it clear to the IASB Chair that we were only converging our Standards, not adopting, in the interest of the present condition of our nation. After this event, the undersigned along with some Central Council colleagues visited Kathmandu to attend a 350-delegate SAFA Summit on *Sustainable Development in SAARC Region* hosted

by the Institute of Chartered Accountants of Nepal (ICAN). It was inaugurated by Dr. Ram Baran Yadav, Hon'ble President of Nepal. On the sidelines, we had a meeting with the office bearers of the ICAN, who requested us to start a course on DISA and IFRS in Nepal and asked us for help on other professional matters. We promised all possible help and support to them.

Interaction with Trade Officials of Various Embassies in India: In order to develop means to foster bilateral cooperation and to explore areas whereby ICAI can collaborate with similar placed organisations/institutions for positioning brand Indian CA globally, we recently organised an interaction with the trade officials of 15 embassies in India. Representatives from USA, Colombia, Mauritius, Iraq, Israel, Italy, Kenya, Malawi, Maldives, Paraguay, Tunisia, United Arab Emirates, Congo, Bangladesh and Kyrgyz Republic, actively interacted and touched upon the areas where the ICAI can help in promoting the mandate of providing "One Stop" information on the socio-economic legal and regulatory environment.

Initiatives with Government

India Corporate Week, New Delhi: The undersigned along with the Vice-President CA. G. Ramaswamy, few Central Council colleagues and officers of the Institute attended the inaugural function of *India Corporate Week* recently, organised by the Ministry of Corporate Affairs. Hon'ble Prime Minister of India Dr. Manmohan Singh was the Chief Guest. The function was presided over by Hon'ble Minister for Corporate Affairs Shri Salman Khurshid. As part of this *Week*, the ICAI along with MCA organised a large number of half-day seminars on the same theme, *Sustainable Business*, at various branches across the nation under the aegis of Corporate Laws & Corporate Governance Committee.

Meeting of Central Statutory Auditors of Public-Sector Banks: The RBI organised meetings recently of Central statutory auditors of public-sector banks on regional basis. The one organised in Delhi was addressed by the under-signed. Such a pragmatic step shall definitely lead to better coordination between auditors and regulators.

Meeting with Member Secretary of Planning Commission: The undersigned along with the ICAI Secretary recently met Ms. Sudha Pillai, Member Secretary, Planning Commission. We expressed our willingness to be a part of every scheme being introduced by central and/or state governments by introduction of scheme of maintenance of accounts and internal/statutory audits by chartered accountants across the nation. For the purpose, we also offered a multipurpose panel which is prepared by the Institute on an annual basis.

ICAI to Play Crucial Role in Audit of Accounts of Political Parties: We wish to inform with pride that the Election Commission of India is in process of examining if the Accounting Standards and Auditing and Assurance Standards adopted by us could be made applicable to the accounts and audits of political parties. In this regard, the undersigned attended a meeting convened by the Election Commission of India recently in New Delhi. It was decided to entrust the ICAI with the responsibility of looking at various formats of accounts of political parties and advise in the matter accordingly.

Development in IFRS Convergence: As the date of convergence with IFRS is drawing close, there is considerable activity on the part of the ICAI at the Ministry of Corporate Affairs to complete the remaining tasks by 2010. In this regard, the Council of the ICAI recently approved revised Schedule XIV to the Companies Act, 1956 which proposes to lay down the indicative lives of various assets for companies which will be required to follow the Indian Accounting Standards converged with IFRS. The revised Schedule XIV will be considered by the National Advisory Committee on Accounting Standards at its next meeting and thereafter will be sent to the Ministry of Corporate Affairs for its notification. The Council, at its last meeting, also finalised certain clarifications on the Roadmap for Convergence issued earlier by the Ministry of Corporate Affairs. These clarifications will be sent to the Ministry for issuance. It may also be mentioned that nearly all Accounting Standards which will come into effect from April 1, 2011, have been finalised by the NACAS and the Ministry of Corporate Affairs is also in the process of finalising the same for their notification and it is expected

that these will be brought in the public domain at a very early date.

Meeting of GASAB at C&AG: The undersigned recently attended a meeting of the Government Accounting Standards Advisory Board (GASAB) in the office of the Comptroller and Auditor General of India, New Delhi. The undersigned suggested that the role of preparing the Accounting Standards equivalent to IPSAS may be given to ICAI and the GASAB might undertake the responsibility of approving the same. The idea was welcomed by the GASAB Chairman and endorsed by the RBI nominee. In the context of the pending final decisions, however, it was decided to include ICAI representation in every technical group constituted to prepare the Standards.

ICAI submits First Interim Report on Direct Taxes Code Bill, 2010: It is satisfying to note that we have recently submitted the first interim report on the Direct Taxes Code Bill, 2010 to the Standing Committee on Finance. Suggestions of various members of Direct Taxes Committee and sub-groups on Direct Taxes Code Bill, 2010 were considered before preparing the the Final Report on the Bill.

ICAI Nomination for Pre-Budget Meeting under Ministry of Finance: It was a matter of pride for the profession that we had received a letter from the Ministry of Finance to nominate our representatives to participate in the pre-budget meeting to be convened by the Department of Revenue with various trade and industry associations in New Delhi. CA. Sanjay Kumar Agarwal, member, Direct Taxes Committee was authorised to attend the aforesaid meeting, who presented our suggestions on Direct Taxes outlining the gist of the recommendations on pre-budget and focusing on its core issues.

Presentation on Pre-Budget Memorandum, 2011 in Ministry of Finance: This is to inform our professional colleagues that the Indirect Taxes Committee of the Institute has recently submitted the Pre-Budget Memorandum, 2011 containing the suggestions related to indirect taxes to the Ministry of Finance. Subsequently, in response to an invitation by the Ministry to make a presentation outlining the gist of recommendations in Pre-Budget Memorandum, 2011, our Central Council colleague Indirect Taxes Committee Chairperson CA. Bhavna

Doshi along with CA. Smita Mishra, Secretary to the Committee, presented our suggestions on Indirect Taxes.

Position Paper on Direct Taxes Issue Arising from IFRS Convergence Ready:

It is satisfying to inform that the draft position paper with regard to Direct Taxes issues arising from convergence of Indian Accounting Standards (ASs) with International Financial Reporting Standards (IFRSs) has been prepared by a sub-group constituted under the conensorship of our Central Council colleague and Direct Taxes Committee Chairman CA. Jayant Gokhale, which would be submitted to the Ministry of Corporate Affairs for consideration and action shortly.

Initiatives for Profession

ICAI Past-Presidents Discussed Issues on Companies Bill, 2009:

We wish to inform all members of the profession that a meeting of the Past-Presidents of ICAI was convened recently to seek their guidance on issues arising out of new Companies Bill, 2009 and with regard to the surrogate practices carried out by some of the firms, its implications and the measures to be taken to overcome the same. The meeting threw up most radical views focusing on the emerging paradigm and the market-driven forces that confront the profession today. There was a consensus that the task of setting of auditing standards should remain with the Institute, as these auditing standards concern the profession at large. NACAAS can at best be an advisory body to review the standards. If at all the NACAAS comes up, its chair should lie with the CA profession and there should be a majority of our nominees in its Council. It was also desired to highlight the track record of the ICAI in standard-setting. The issues of rotation of auditors and joint audit were supported and accepted. It was suggested that if the concept of rotation of auditors can work well in public-sector audit, it can work for private-sector as well. There was a general consensus that rotation of auditors should be restricted to companies where there is substantial public interest, and this should not be extended to other entities. However, rotation within the network was not acceptable to the participants. A need to define management consultancy services in the perspective

of profession was expressed. The issue whether a firm should be made responsible for a criminal action of one of its partners was also discussed. It was opined that action against a firm should be initiated only in the rarest of rare circumstances, where there was collusion of all partners or a case of repetitive professional misconduct. The need for inclusive growth of profession was also highlighted.

CA Independent Directors on Board of Various Banks Meet:

An interactive meeting of chartered accountant independent directors on the Board of various banks was recently organised by the ICAI in New Delhi. More than 15 directors including those from private-sector banks attended the meeting, who assured us to extend their support, especially, when the matter regarding appointment of auditors and tax auditors in banks was being raised and discussed. ICAI Past-President CA. T. S. Vishwanath, Professional Development Committee Chairman and Vice-Chairman CA. Pankaj Jain and CA. C. S. Nanda respectively, and many other Council colleagues also attended the meeting.

Meeting of CA Firms: We also wish to inform our professional colleagues that a meeting of select CA firms having more than 10 partners was called recently. The undersigned along with ICAI Vice-President CA. G Ramaswamy, interacted with the representatives of those firms and discussed the current status of profession with regard to capacity building of small and medium practitioners and invited suggestions from them to improve the same. It was heartening to observe that members from 21 firms participated in this meeting at such a short notice. It was highlighted that the mergers & acquisitions may be encouraged for availing the benefit of synergy of locations and the expertise of various firms in different fields, rather than joining hands merely for empanelment. In the context of collaboration, creation of a portal of networking based on the synergy of location and profession was suggested. It was also decided to create a public discussion forum to invite members of profession to contribute on capacity building. A multinational firm present in the meeting expressed that they would promote hand-holding with SMPs rather than acquiring them.

Initiatives in the Institute For Corporates:

ICAI Awards for Excellence in Financial Reporting (2009-10):

The Shield Panel, a sub-Committee of the ICAI Research Committee, recently considered the short-listed entries in 10 categories specified for the competition 'ICAI Awards for Excellence in Financial Reporting' for 2009-10. About 140 entities participated in the competition in these categories based on functional classification. A meeting of jury for the Awards was held recently, which was chaired by Padma Vibhushan Shri Naresh Chandra, who is also the present Chairman of the National Securities Advisory Board. Other members of the jury present in the meeting were CA. Piyush Goyal, Member of Parliament (Rajya Sabha), CA. V. Balakrishnan, CFO, Infosys Ltd., Dr. A.K. Banerjee, former Deputy C&AG, Smt. K. J. Udeshi, former Deputy Governor, RBI & Chairperson, BCSBI, CA. Pallav Gupta, General Manager (Taxation), ITC Ltd., and Shri Prithvi Haldea, Central Council Member, ICAI. CA. Ashu Suyash, Managing Director and Country Head-India Fidelity International, also attended the meeting through teleconference. The Shield Panelists made a presentation on top three/four entries selected by them in each category to the Jury. The Jury decided the winners after a thorough deliberation. It may also be informed, that as per the Council's decision at its 261st meeting held in 2006, the names of winners of 'ICAI Awards for Excellence in Financial Reporting' are sent to the FRRB and the Disciplinary Directorate of the Institute to ascertain whether any proceeding against any winner of the competition is pending either before the Board or the Directorate.

For Members:

Orissa Governor Commends CA Profession:

Every year one Council meeting is organised outside the ICAI headquarters purporting to refresh the members. This year, it was held in the holy city of Puri. We are happy to inform you that the Hon'ble Governor of Orissa Shri Murlidhar C. Bhandare addressed the 301st meeting of our Council in Puri recently. He commended our Institute and said 'that Indian Chartered Accountants have made in growth of Indian economy in the era

of liberalisation and globalisation...the Institute has performed its role very well.' He afterwards expressed expectations of the Government that 'Government would welcome suggestions from the Institute on ways and means to introduce a greater transparency and accountability in financial accounting and reporting system at all levels of the Government utilising the services of its members.' We are thankful to him for praising our Institute and profession. We assure him we would continue to serve our society to the best of our capabilities. The undersigned, along with the ICAI Vice-President and some of the Council members, also addressed a group of some-400 students who showed great enthusiasm during the interaction. We are also thankful to the EIRC of ICAI and its Bhubaneswar and Cuttack Branches for extending a great hospitality and making our stay comfortable in Puri. We would also like to thank our Central Council colleagues CA. Subodh K. Agrawal, CA. Abhijit Bandyopadhyay and CA. Sumantra Guha for making this grand arrangement. We also paid obeisance to Lord Jagannath and sought His blessings.

42nd Regional Conference of SIRC at Kochi:

The undersigned along with the ICAI Vice-President CA. G. Ramaswamy and few Council colleagues recently attended the 42nd Regional Conference of SIRC, hosted by its Kochi Branch, which was inaugurated by **Shri Pranab Mukherjee**, Hon'ble Finance Minister of India, in the presence of Prof. K. V. Thomas, Hon'ble Union Minister of State for Agriculture, Consumer Affairs, Food and Public Distribution. Many distinguished guests including Members of Parliament Shri P. C. Chacko and Shri P. Rajeev, MLA and Former Finance Minister of Kerala Shri K. M. Mani, Member of Kerala Legislative Assembly CA. Thomas Chazhikadan, and Secretary to Government of India and Vice-Chancellor of NMI University Dr. C. V. Ananda Bose, were also present. It was also attended by senior functionaries of various banks including Federal Bank Limited MD & CEO Shri Shyam Srinivasan, Indian Overseas Bank CMD Shri M. Narendra, and State Bank of India CGM Shri B. S. Bhasin. Central Board of Direct Taxes Chairman Shri S. S. N. Moorthy delivered the valedictory address outlining various initiatives of

the Department having a bearing on the performance of our profession. The Conference got an overwhelming response, as it was attended by approximately 4,000 members.

Council Decides on EMD/Deposit:

The Council at its 301st Meeting considered the recommendations of the Ethical Standards Board on the payment of earnest or deposit money by various users of professional services or organisations while responding to tenders/enquiries issued from time to time. The Council recommended a cost-sheet to be maintained by the members of Institute while responding to tenders, incorporating details of the costs being incurred therein having regard to number of persons involved, hours to be spent, etc., so that the same may be called for by the Institute for perusal. The same may also be subject to the peer review.

CPE in e-Learning Mode: It is heartening to inform you that the Council at its 301st Meeting has approved CPE in e-learning mode. This decision will add yet another important dimension to the ICAI's endeavours to impart quality professional education to its members in the most convenient way. It will facilitate learning for the members just at the click of the mouse. We are sure that this decision will go a long way in helping members in actively pursuing our CPE programme very conveniently without undertaking the hardships of physical attendance and will prove to be beneficial for the CA community at large.

ICAI Allotted Land: It is a matter of happiness for the profession that the Institute has been allotted a plot of land measuring 2,128.50 square meters in Rohini, i.e. North-West Delhi. We would soon be given possession of the land.

Also, Kanpur Development Authority has allotted a land measuring approx. 2,460 square meters to the ICAI. I congratulate the Managing Committee Members of the CIRC of the ICAI for their efforts.

CA Qualification Recognised as Criterion for PhD:

I am happy to inform that IIM-Shillong would now recognise CA as a qualification for PhD. Director of the Institute, Dr. Ashoke K. Dutta, has expressed his willingness to collaborate with the ICAI on different programmes in the areas of common interest.

International Placement Programme through Video Conferencing:

It is gratifying for all of us that the ICAI organised a special placement programme through video conferencing mode for the organisations functioning in GCC/Middle East countries. Students selected at the interviews conducted with Qatar Insurance Co., Doha, were offered a package of ₹16 lakh per annum.

ICAI Creates Panel of Arbitrators through Certificate Course on Arbitration:

It is satisfying to note that the ICAI has been administering the Certificate Course on Arbitration for the benefit of our members while empathising with the role of ADR mechanism. The ICAI Panel of Arbitrators comprising members who have successfully undergone this Certificate Course is maintained by the Institute. We would like to share here that Hon'ble Rajasthan High Court has agreed to appoint arbitrators from our panel. The High Court of Gujarat and the High Court of Chhattisgarh have also expressed their desire to associate with us in the matter of promoting the ADR mechanism and to hold knowledge-sharing programmes for the benefit of their judicial officers, and we are in process of finalising the details with them.

Certificate Course on Valuation: 800 members have been registered for Certificate Course on Valuation till date. Examinations for the ongoing batches in Delhi, Mumbai, Chennai and Kolkata were held recently. A fresh batch of the course commenced in Hyderabad recently. Batches at other places too would start shortly.

National Conference of Chartered Accountants in Guwahati:

The undersigned also attended, with the ICAI Vice-President CA. G. Ramaswamy and some Central Council colleagues, a two-day National Conference of Chartered Accountants hosted recently by our Guwahati Branch. The Conference was inaugurated by His Excellency Hon'ble Governor of Bihar Shri Devanand Konwar, who highly appreciated our disciplinary mechanism. IIM-Shillong Director Dr. Ashoke K. Dutta and SBI - NE Circle CGM Shri R. K. Garg were present as the guests of honour. ICAI Past-President CA. Sunil Talati also delivered the keynote address.

For Students

Live Virtual Classes to Begin: We are happy to inform our students that the Live Virtual Classes will be inaugurated on December 28, 2010, on the occasion of the International Conference of CA students. It will be a historic step in our services towards CA student community, as it will also bring closer our students spread across the nation, especially from mofussil towns. The Board of Studies has organised demo classes at 25 centres in 22 cities in order to assess the impact of technology and to evaluate the quality of audio-visual by the participants attending these classes, prior to the formal inauguration. It is proposed to organise classes at all five regions. Classes are likely to formally commence in the third week of January 2011. We must congratulate CA. Vinod Jain, Chairman, Board of Studies, and his team for making efforts to make this project a reality.

Hosting of Suggested Answers: As part of our efforts to enhance the transparency of our examination system, it has been decided to host suggested answers to the November 2010 examinations well before the declaration of results, i.e. by December 31, 2010.

International Conference of CA Students: We are happy to inform all our students that an International Conference of CA Students will be organised in New Delhi on December 28-29, 2010. About 750 students have already registered showing their active interest in the Conference.

Modification/Revision of Final Course Study Material Complete: We are happy to inform that the entire study material for the Final course has been revised/modified substantially. We hopefully will make this (with practice manuals) available to our students by January 2011 through the respective Branches/Regions.

National Conventions, Regional and Sub-Regional Conferences of Students Organised: We would like to happily inform that the Board of Studies has successfully organised National Conventions of CA Students in Mumbai, Nagpur and Indore. These conventions were well-organised and attended by students in large numbers. In addition, Sub-Regional/Regional Conferences were also organised at Ernakulam, Jamnagar and Tirupati. The undersigned inaugurated the Conference at Tirupati and found it overwhelming to witness participation of

almost 900 students in this small city.

Meetings at Saharanpur, Dehradun and Roorkee: The undersigned also met our students at Saharanpur, Dehradun and Roorkee. Students everywhere were present in great numbers showing their enthusiastic response and keen interest in our Institutional activities. The undersigned also responded and addressed their queries suitably.

Initiatives of ICAI Committees

Four-Day Training Workshops on Audit

Excellence in Metros: The Auditing and Assurance Standards Board (AASB) has been working towards taking the auditing standards to the common members. In that league, it has already successfully launched and completed Four Day Training Workshops on Audit Excellence at the four metros, New Delhi, Mumbai, Chennai and Kolkata. While the undersigned inaugurated the workshop in New Delhi, ICAI Vice-President CA. G. Ramaswamy and United India Insurance Chairman-cum-MD Shri G. Srinivasan inaugurated the workshops in Chennai and Mumbai respectively. In view of the positive response received for these Workshops, the Board is now planning to organise similar workshops in Jaipur, Indore, Pune, Hyderabad and Bangalore in January 2011.

Conference on Management of Fiscal & Natural Wealth in Lucknow:

The undersigned recently attended the inaugural session of a two-day conference on *Management of Fiscal & Natural Wealth* organised by the Committee on Economic, Commercial Laws & WTO at the Lucknow branch of CIRC, which was inaugurated by Hon'ble Governor of Uttar Pradesh Shri B. L. Joshi. Committee Chairman and Vice-Chairman CA. Rajkumar Adukia and CA. Rajendra Kumar P., Central Council colleague CA. Manoj Fadnis and CIRC Chairperson CA. Kemisha Soni were also present during the Conference.

ICAI Submitted Bank Branch Auditors' Panel to NABARD:

We wish to inform all members of the profession that the Professional Development Committee has submitted the Bank Branch Auditors' Panel for the year 2010-11 to the NABARD for appointment of statutory auditors of regional rural banks and state/district central cooperative banks.

MCA Nominates Ms. Ila Singh on ICAI Disciplinary Committee: We would like to apprise all stakeholders

of the profession that the MCA has communicated the nomination of Ms. Ila Singh, Principal Director of Commercial Audit & Ex-officio Member, Audit Board-I, New Delhi (Office of the C&AG), on the Disciplinary Committee of our Institute constituted under the provisions of Section 21B of the Chartered Accountants Act, 1949 (namely, under the new disciplinary mechanism), in place of Shri Birendra Kumar, until further orders.

All of us have an inherent ability to transform our words and actions into sheer joy and happiness. Let us recall here the lines of probably the greatest twentieth century Brazilian poet, Carlos Drummond de Andrade: *Our pain doesn't come from the things that we've lived, but from the things that were dreamed up and not acquired...We suffer not because we age, but because the future is being confiscated from us, thus preventing a thousand adventures to happen to us, all those with whom we dreamed and we never ever try.* He later on goes on to say in the same verse, *Every day I live, the more I become convinced that the waste of life are in love that we don't give, the forces that we don't use, in the selfish prudence that nothing ventures, and that, dodging the suffering, we lose also the happiness.* How true these lines are even today!

Following on the line, we have been trying to help our society and our country appear better by extending all possible help that we can contribute; we have been endeavoring to help and empower members of our profession who are yet to take off in their career; we have been striving to reach distant locations across the world offering our technical and infrastructural resources. Fundamentally we have been making honest efforts to create a better world for all to live in.

Let us begin the New Year with a promise to help others and with a belief that only a happy and satisfied surrounding has the power to make us happy and satisfied.

Best wishes



**CA. Amarjit Chopra
President, ICAI**

December 26, 2010



Collection of Informative Articles and Presentation of Journal

It felt great to receive Deepawali greeting on a nicely designed and colourful cover page of November 2010 issue of the journal and Christmas feeling through cover page of December 2010 issue of the journal. The inside contents of the November and December 2010 issues were equally interesting and informative. Be it the editorial on 'Corporate Social Responsibility and Accountancy Profession', the highly informative 'From the President' column or articles titled 'IFRS-Exceptions' in Accounting section, 'Royalty & Fees for Technical Service- Analysis of Recent Judgments of Authority of Advance Rulings' in International Taxation section, 'New Competition Regime in India and the WTO - Opportunities For Chartered Accountants' in WTO section, 'Unique Identification Number to Pave Way for a New India' in General section, or regular informative features like 'National Update', 'Legal Update', 'Back Page', etc the collection and presentation of the content was excellent. The previous issue, which focused on XBRL, was equally exciting and enlightening. Congratulations.

-CA. S. Jain, Indore



The November 2010 issue of the journal carried interesting content which will definitely add to our knowledge base. The Cover of this issue came out really good. However, I would like to point out that some interesting features like 'Accounting Legend', 'Know Your Ethics' and 'EAC Opinion', which was otherwise published regularly, were missing in November 2010 issue of the journal. These features are constantly updating and adding to the practical knowledge base of the members, hence should be published regularly without any break. Other than that, I thank ICAI for upgrading the quality of our journal.

- CA. Amit K. Singh, Kolkata

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 those of the respective authors only, and not of the ICAI. The ICAI bears no responsibility of any sort whatsoever in case of any action taken by any reader based on any article published in the Journal.



The Journal of September, 2010 was knowledge-enhancing, particularly the articles on 'Introduction of IFRS' and 'IFRS the Future of Indian GAAP' were very easy to understand and helped us have overall idea of the dates of implementation and its various aspects. etc. Other articles too were equally informative and helpful to all CAs (both in industry and practice) as well as the CA students. Further I request you to publish articles on various aspects of Direct Tax Code after it is approved by Parliament Committee.

-CA P. V. Vittal, Visakhapatnam



Hats off to ICAI for e-Sahayataa

Hats off to the ICAI for starting the 'e-Sahayataa' facility on its website. My administrative difficulties that had remained unresolved for many months, were resolved within days after posting the difficulty on e-Sahayataa. All my fellow members and other users should make optimum utilisation of this wonderful facility provided by ICAI. This has surely helped the Institute to be more interactive with its members...and is a feather in its cap.

-CA. Chirag Kenkre



Corrigendum

Readers kindly note that the term 'CA.' has got inadvertently added to the name of Unique Identification Authority of India chairman Nandan Nilekani in his interview published on page 1018 of this issue. The inadvertent mistake was detected after the relevant pages had gone into print. The error is profoundly regretted.

-Editor

Write to Editor

'Information is Power' and our ever-evolving profession needs more and more of that today than ever before. Do you have any relevant points to make, experiences to share, and views to spread among the CA fraternity? If yes, e-mail us at eboard@icai.org/nadeem@icai.org or write to:
The Editor, The Journal Section, ICAI, A-29, Sector 62, Noida (UP) - 201309





**The President and Members of the Council of
The Institute of Chartered Accountants of India**

cordially invite you to the
**Grand Finale of ICAI Corporate Forum
ICAI Awards 2010 Corporate CA Achiever's Acclaim**

**At Science City, Kolkata
On Sunday, 30th January 2011 at 05.30 p.m.**

Followed by Cultural night
To confirm your presence call: 011-30110549/555, Email: cmii_events@icai.in

Invitation



42nd Regional Conference of SIRC

Shri Pranab Mukherjee, Union Finance Minister with CA. Amarjit Chopra, President, ICAI, CA. G. Ramaswamy, Vice-President, ICAI, CA. Babu Abraham Kallivayalil, Chairman, SIRC and other dignitaries at the inauguration of the 42nd Regional Conference of SIRC of ICAI at Kochi. (November 27, 2010)



All India Conference at Lucknow

CA. Amarjit Chopra, President, ICAI presenting a memento to His Excellency Shri Banwari Lal Joshi, Hon'ble Governor of Uttar Pradesh as Council Member CA. Rajkumar S. Adukia, CA. Kemisha Soni, Chairperson, CIRC and other dignitaries look on during All India Conference held at Lucknow. (December 2, 2010)



Minister of Corporate Affairs at Muscat

Members of Managing Committee, Muscat Chapter of ICAI with Shri Salman Khurshid, Hon'ble Union Minister of State for Corporate Affairs & Minority Affairs alongwith Mr. Anil Wadhwa, Ambassador of India, Sultanate of Oman during a luncheon meeting at Muscat, Oman. (November 23, 2010)



15th Meeting of SAFA Board – Kathmandu

CA. Amarjit Chopra, President, ICAI with Dr. Ram Baran Yadav, Hon'ble President, Government of Nepal and Mr. Komal Chitracar, President, SAFA during SAFA Summit held at Kathmandu, Nepal. (December 10, 2010)



35th Regional Conference of EIRC

ICAI President CA. Amarjit Chopra inaugurates the 35th Regional Conference of EIRC on the theme 'Role of CAs in the Era of New Financial Reporting Standards' at Kolkata as Central Council members CA. Sumantra Guha, CA. Abhijit Bandyopadhyay, EIRC Chairman CA. Krishanu Bhattacharya and other dignitaries look on. (December 16, 2010)



Orissa Governor Addresses ICAI Council

Governor of Orissa Shri Murlidhar Chandrakant Bhandare with ICAI President CA. Amarjit Chopra and ICAI Vice President CA. G. Ramaswamy at the 301st meeting of the Central Council of the ICAI in Puri. (December 20, 2010)



Interaction with Foreign Trade Officials

CA. Amarjit Chopra, President, ICAI with Council Members CA. Vinod Jain, CA. Devaraja Reddy M., CA. Charanjot Singh Nanda, and CA. Rajkumar S. Adukia and Trade Officials of various embassies in India during an interaction at New Delhi. (December 8, 2010)



SAFA Conference – New Delhi

CA. Amarjit Chopra, President, ICAI, presenting a memento to Sir David Tweedie, President, IASB during SAFA Regional Standards Setters Conference at New Delhi. (November 30-December 1, 2010)



National Conference at Ahmedabad

President ICAI, CA. Amarjit Chopra alongwith Council Members CA. Jayant P. Gokhale and CA. Dhinal Shah inaugurating the National Conference at Ahmedabad. (December 4, 2010)



Meeting with CA Independent Directors

President, ICAI CA. Amarjit Chopra with Council Members CA. Pankaj Jain, CA. Charanjot Singh Nanda, CA. Rajkumar S. Adukia, CA. Vinod Jain, CA. Jayant P. Gokhale, CA. Subodh K. Agrawal, CA. Sumantra Guha, CA. Jaydeep N. Shah, CA. Anuj Goyal and CA. V. Murli with CA Independent Directors on the Board of Banks during an interactive meeting at New Delhi. Mr Vijay Kapoor, Director, PDC and CA. Namrata Khandelwal, Secretary, PDC were also present at the meeting. (December 9, 2010)

ICAI Deserves to be Complemented, Says Union Finance Minister



The 42nd Annual Conference of Southern India Regional Council of the Institute of Chartered Accountants of India was held at Jawaharlal Nehru International Stadium Kaloor Kochi on 27th November, 2010. Various important topics of professional interest were discussed during this well-attended annual conference of the SIRC, which came into existence on 1st April 1952. Union Finance Minister Mr. Pranab Mukherjee, CBDT Chairman Mr. S.S.N. Moorthy, ICAI President CA. Amarjit Chopra and ICAI Vice President CA. G. Ramaswamy were among the dignitaries who graced the occasion. Following are the excerpts from the address of Mr. Pranab Mukherjee, given on the occasion.

"I am very happy to be here today at the 42nd Annual Conference of Southern India Regional Council of the Institute of Chartered Accountants of India. I believe this is a prestigious annual event which has become well known for deliberating topical issues of professional importance to your association. Issues like the International Financial Reporting Standards and the imminent implementation of our tax reforms have a bearing on the future of our reporting and disclosure framework which needs attention of a forum such as this.

If one were to go back a decade, few would have anticipated the Indian GDP to grow at rates of 8 to 9 per cent, or our stock market indices- SENSEX and NIFTY- to reach the levels that we see today. The resilience that India has demonstrated in recent times has been recognised and appreciated across the globe. There has been a significant increase in the economy's capacity to absorb shocks without major disruptions. It reflects a maturing of our management of economic policy and developments. That this has happened even as the economy has become far more globally integrated over the years indicates that globalisation and economic resilience can go hand in hand.

We have all contributed to this progress in our respective domains. ICAI deserves to be complemented.

Let me complement ICAI for its initiative to work with financial institutions in streamlining and fine tuning the financial reporting, auditing and accounting architecture of India. Such efforts create greater awareness among stakeholders about the challenges and opportunities that we have before us and help in identifying issues that need to be addressed for accelerating and sustaining the development tempo.

The Government is aware of the fact that India's economic legislation needs to be progressive and be in tune with global norms and best practices. Towards this end we have introduced the Direct Taxes Code Bill. The thrust of the Code is to improve efficiency and equity of our tax system by eliminating distortions in the tax structure, introducing moderate levels of taxation and expanding the tax base. The language has been simplified to enable better comprehension, remove ambiguity and encourage voluntary compliance. The new Code is designed to provide stability in the tax regime as it is based on well accepted principles of taxation and best international practices. I am confident that together with GST, this will streamline the tax administration of the country by making it efficient and equitable.

We have concluded tax information exchange agreements with eight countries and jurisdictions including

Bahamas, Bermuda, British Virgin Islands, Isle of Man, Jersey, Monaco, Cayman Islands and Argentina. Active negotiations are in progress with other jurisdictions. The renegotiation of Double Taxation Avoidance Agreement (DTAA) with treaty partners is being actively pursued and a revised DTAA with Switzerland has already been signed.

Indian companies are increasingly accessing the global markets to meet their capital needs by listing their securities on the stock exchanges outside India. To be able to communicate and effectively engage with the world we need a common language that is understood by every market in the world. This was the main objective of converging our national accounting standards with IFRS. India as a member country of G20 is committed to achieving a single set of high quality global accounting standards. The use of globally acceptable accounting framework helps in promoting investors' confidence and brings more clarity and uniformity for users of financial statements.

The use of standardised accounting practices helps in mitigating the problem of information asymmetry between various stakeholders such as managers, owners and creditors. While managers have the incentive to be more forthcoming on good news about the company's performance and prospects, they may want to hold back bad news. The accountants as information intermediaries between managers and shareholders need to identify and recognise losses at an early stage, thereby mitigating asymmetry in information. Accounting standards have to be based on principles, be uniformly applied and assist in presenting the true picture of the financial health of the company, while ensuring accountability in all respects.

This will help in avoiding unknown risks and allow everyone to have a fair assessment of the company. If financial performance is volatile, the function of a sound accounting procedure is to report the volatility. Volatility in the market can be managed by risk management tools. We should not fiddle with accounting standards to fix such problems.

“Let me complement ICAI for its initiative to work with financial institutions in streamlining and fine tuning the financial reporting, auditing and accounting architecture of India. Such efforts create greater awareness among stakeholders about the challenges and opportunities that we have before us and help in identifying issues that need to be addressed for accelerating and sustaining the development tempo.”

“We need to regulate better and at the same time ensure that regulation does not degenerate into obsessive control. While too tight a regulation may lead to a lack of development in financial products, a very lax regulatory structure may encourage financial misdemeanour.”

The responsibility for corporate governance is multilayered. Within a company internal audit department is the proverbial foot soldier to detect and prevent fraud on a day to day basis. The Board of Directors have the ultimate responsibility for in-house oversight. At the external level there are several components like market regulators, external auditors, tax authorities, banks and financial institutions besides investor groups or associations. Providing essential financial information on a company's performance to its shareholder and other stakeholders is an integral and important part of good corporate governance.

We need to regulate better and at the same time ensure that regulation does not degenerate into obsessive control. While too tight a regulation may lead to a lack of development in financial products, a very lax regulatory structure may encourage financial misdemeanour. Indeed, market regulation is no longer viewed as an irrelevant intrusion but is considered necessary to help achieve developmental goals. The recent experience from the global financial crisis has reinforced this belief.

As India gets more integrated with the global economy, we must have stronger disclosure standards in keeping with the international best practices. We must also build stronger supervisory frameworks to provide incentive for more responsible corporate conduct. I am sure you are all aware that the Ministry of Corporate Affairs brought out voluntary guidelines for corporate governance in December 2009. I urge all companies to adopt this guideline in the spirit of self regulation.

Recently there have been instances where the auditing community has been found wanting in its professional propriety while valuing complex financial products. I am confident that ICAI as a mentor will plug those loopholes. We must promote and encourage ethical use of information by avoiding, controlling and disclosing conflicts wherever they arise. While doing so we should ensure that the procedures established to control conflicts are not porous. As the Government and the market regulators continue to exercise vigil on the markets, it is up to the other stakeholders to contribute their share in ensuring good governance. Indeed, good governance makes for growth and long term sustainability in business. ■

CAs' Skills and Professional Excellence Remain Undisputed: CBDT Chairman

The Central Board of Direct Taxes (CBDT) Chairman Mr. S.S.N. Moorthy gave valedictory address at the 42nd Annual Conference of Southern India Regional Council of the Institute of Chartered Accountants of India, which was held at Jawaharlal Nehru International Stadium Kaloor Kochi on 27th to 28th November, 2010. Following are the excerpts from the address of Mr. Moorthy.



"I am delighted that in Cochin, a mega function has been organised, consisting of almost 4000 Chartered Accountants from south India and that too when the weather was not very pleasant. I was just wondering why they have termed it as *Jnana Marga* in that pamphlet which they gave me. Then I realised there is a real significance in that. The profession of Chartered Accountants has to be in *Jnana marga* in the coming two or three years. A lot of transformation is taking place in almost all the fields handled by the Chartered Accountants. The new Company Law is going to come in place, the direct taxes code is in the Parliament. The GST is under very serious consideration. The IFRS is going to take shape. What more you want to a *Jnana Marga*? You have to not only unlearn, but relearn a lot of things in the coming two years especially in the Company Law and the Direct Taxes Code. So I think the concept of *Jnana Marga* by the office bearers was very very appropriate.

Well, coming to the profession, I have a great regard for the profession of Chartered Accountants, in spite of 'Satyam' because, this is one profession which has set not only standards, but values in their performance. And I am happy those standards and values are updated day by day. I have to give you a word of caution. Indian economy is doing very well, it is strong. It doesn't have the recessionary problem of the western economy. We have seen the US economy. We now witness the European problems. But Indian economy is doing very well. But to keep the progress going, your role, your contribution will be important. Because, in most of the areas, you function, I would like to say 'watch dog' and I am sure, especially after the fiasco of Satyam, we have all woken up to keep the status of what you call, watch dog. And unless we protect the economy, the accounting standards and reporting, the economy will not be in good shape. I am sure all of you are aware of these facts and you are doing the job very well.

As I already said in the beginning, the economy is buoyant and we are witnessing a scenario, where apart from domestic and local transactions, we are moving to international cross border transactions, globalisation,

development of systems, they have contributed to substantial cross border transactions which are not reflected in your normal accounting procedures. So I have been just thinking – you have to have what I would call, an international tax language and an international accounting language. I am not speaking about the letters. I am not speaking about what you call the words or lexicon. I am speaking about the system, the interaction.

After all, we are all moving to a situation where transactions should be transparent. Because just a few minutes ago, I heard you are all contributing to nation building. If nation building has to take place, transparency is the most essential accounting and reporting basis and I think unless we have this international tax language, I mean, it is a very regular concept it is for you to develop, where transparency can be supreme and transactions will be available to all the countries for proper taxation and thereby development of the country.

Well, your role of course is quite tricky. You have to balance between as a role of contributor to nation building and also your loyalty and your responsibility to the clients. And this has to be very delicately matched and unless that is done, I think professional excellence cannot be achieved. And I am sure most of you are aware of that. Why I highlight the cross border issue is because, India has come into the international transaction status only for the last 10 years. We started our transfer pricing mechanism only in 2001 and we have traveled a long distance during the interregnum of 9 years and now we are accepted as one of the countries which apply the Transfer Pricing mechanism in a very sustainable way all over the world.

You know, among the OECD countries, among the UN forum and even among the American, UK, US for a, India has got a place of importance. Why? Because, our professionals and our tax administrators have taken care of the provisions of transfer pricing mechanism. But much more things have to be done. That is why in the new DTC we have brought in

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two main concepts. On the one hand we have brought in GAAR – The General Anti Avoidance Rule – to safeguard the interest of revenue. And on the other hand, the mechanism of APA – Advanced Pricing Arrangements, and the safe harbour routes so that there is a balance between aggressive tax planning and also tax payer-friendly measures. If this can be appreciated by all of you and applied in a very serious manner, the revenue will be substantially high both for the centre and for the State. So this is what we have planned.

In fact, while formulating the DTC, we took into account all the industry concerns all the concerns expressed by the Chartered Accountants and our professionals and I think we have done a reasonably good job. Because, the feedback which we get is not that all critical but more of a modificatory nature. So we feel protecting aggressive tax planning has been the problem in international taxation. So we brought in GAAR but it will be tempered in with all rules and regulations and also guidelines. So I think there will be nothing to worry about the implementation part of GAAR. At the same time, for the honest, for the straight forward assessee, we have to provide a safe harbour and also some mechanism by which the prices are determined early. So I think these two provisions in the DTC will be bringing in a revolution in international tax concept and also in international tax assessment.

You may be wondering why I am speaking only about international taxation? Because our concern now is mostly with cross border transactions. We had the Vodafone issue, we had the Microsoft issue, we have the Samsung issue – all running to hundreds of crores of revenue. At the same time, we have to provide a balanced taxation avenue to the honest tax payer. And once we take care of the small tax payer by a moderate rate of tax, I think 90 per cent of the small tax payers will be taken care of.

When we had a study, we found the first slab of that 10 per cent or whatever it is, which consists of and takes care of almost 90 per cent of our tax paying public. And in the DTC, we have put up the provisions in such a way that the salary, the house property and other income they are very simply tabulated and they need not go into the rules and schedules. The rules and schedules are meant for the corporates and the high network individuals. So I think we

are moving towards an era of simplicity, transparency and also tax payer-friendly administration.

Of course, I do admit we have to go a long way. Our TDS administration is not yet fully complete. Our processing of return is not yet fully fool proof. But we have made a strong beginning. And I think our AS 26 which takes care of your TDS payment has been reasonably successful in a very short period of time. So what I mean to say is, between the profession and the tax administrator there is going to be less of a bridge and more of a sort of convergence. And I am sure this will help in revenue mobilisation. And I am very happy that your IFRS convergence is a very slow going affair. Because, it is for you to consider and perhaps to think deeply whether we are equipped enough to implement the IFRS in all its full measure. My feeling is, we are not. Perhaps, because of international compulsions you may have to invoke it in a few cases in a very singular, exemplary fashion.

But as far as the Income Tax Department is concerned, and also the normal assessee is concerned, it is my opinion. I don't know how the profession looks upon it, but I think you are also going slow. And that is required. Because we can't go ahead with a revolutionary accounting practice when all other systems are not attuned to that shift or take off. I think you are conscious of that.

So, I don't want to give a long speech. What we are aiming at is a very transparent tax administration and we require your contribution and your help in making it more transparent and more meaningful. I am sure you can rise to the occasion because, your skills and professional excellence remain undisputed. And on our part, we are moving to a regime, where things will be simpler. Things will be more on the system and things will be more understandable to the common man in a very simple language. And I am sure, if this trend goes on, the collection from the revenue will be substantial in the next five years to come. Because, nobody imagined from 2001 to 2010, the growth of taxes would be

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substantially high as we witness now from 1 lakh crore to 4,30,000 crore.

And look at the indirect taxes. They are also growing at a faster pace at 44 per cent which is something phenomenal.

So taxes are bound to grow, economy is growing and your role as a watch dog, I repeat watch dog-because even though you may be in the back office preparing accounts monitoring the accounting practices, but your role in the corporate governance is very very important. Of course, the Satyam fiasco may be a contribution of so many factors. We can't blame any one single person for that fiasco.

Now we have learnt a lesson as to how to monitor taxation, accounting and our practices. And I think we have learnt a very hard lesson. So it is for you to take it forward, to keep that ethical governance there in corporates, which contributes to resource mobilisation and glory of the profession. So, I wish you all well. Once more I congratulate the office bearers for this grand function and I am also very happy to be with you here because I took over as an Income Tax Officer long ago in the year 1974 in Kerala and three decades, almost 37 years have passed and many of my senior Chartered Accountants many of them with whom I used to interact they are before me here. Some of them have retired into their consultancy rooms. I will also retire of course, shortly. So it is a very momentous occasion. I wish you all well. Wish the profession well.” ■



Where There are Opportunities for Profession, Growth Will Follow: CA. V. Rajaraman*

Our Past President CA. V. Rajaraman (1980-81) was recently at the ICAI in New Delhi to address the 300th Council Meeting as a special invitee. We present here the speech that he delivered in the Council hall on the occasion. He welcomed the positive signs both in the economy as well as in the accountancy profession. He appreciated the fact that the profession has been spreading to smaller townships and talukas effectively, and acknowledged it as one of the avenues of our professional growth. He also reminded the Council of the existing challenges associated with that and a need to address them with urgency.



“It is kind of the President (of ICAI) to have invited me to talk to the members of the Council during the 300th meeting of the Council. I consider this as a great honour and accept the same with all humility. My attachment with the Institute seems to have some connection with my initial years in the profession. I came to Delhi way back in the year 1954 after a few years of service in the Indian Accounts and Audit Department. I resigned and joined M/s Vaidyanath Aiyar and Co., when the late Shri Vaidyanath Aiyar was the President of the Institute during his second term as its President. Thereafter, Shri Rameshwar Thakur, who had succeeded in the firm after a few years of his migration to Delhi, was elected directly to the Central Council. That’s how my association with membership at large and the Institute developed and grew. After shri Thakur, served the Institute for two terms, I was initiated into the election process through the Regional Council and eventually elected to the Central Council.

I thought I would share with you a few thoughts as to how I see the profession in the years to come. I am an optimist. I do not despair. The future is bound to be bright. The membership at large strives to work hard to keep pace with the fast changes that are occurring both in technology and economy. India is on a growth path and is bound to succeed in raising the standards of life of its common citizen. It is making huge investments in infrastructure projects, which are being executed through public-private partnerships. Industry is growing and there is a robust GDP growth. The revenues and expenditure of the central and state governments are growing. The importance of transparency, accountability and monitoring of the institutions responsible for collecting huge resources and spending is being recognised. Various governmental authorities are prepared to take the assistance of accounting and auditing profession both for introduction and installation of accrual accounting and monitoring the economical results of the projects. The government is also introducing accrual accounting in the municipalities, corporations and other commercially-oriented government undertakings.

* (He can be reached at vrajaraman@icai.org)

All these activities are bound to give immense opportunities for the expected growth in the membership for both employment and practice opportunities. The only challenge to the profession is—‘Are we prepared for these great tasks ahead?’

I am very happy that both the Council of the Institute and the membership at large are aware of this challenge, and are preparing themselves both in the knowledge and technological field. The Institute is suitably amending the core syllabus for various examinations of the Institute as well as through continued educational programmes for existing members. Recently, the Institute has also adopted the IFRS so as to integrate the profession with the standards prevailing in most of the other advanced countries.

It is a welcome sign that growth in the profession, as witnessed, has spread to most cities and towns instead of concentrating in the state capitals and big cities only. It is bound to migrate to *taluka* headquarters and smaller towns. This would be the necessity of the day and the only way, perhaps, for the profession to grow. This is also a natural phenomenon in the sense that where there are opportunities, growth would follow. Membership should be prepared for this change and it may not be a difficult task, since social amenities are fast reaching the *panchayat* level and smaller towns.

Another question that is often asked is as to what would happen to the practicing small firms and individual practitioners in the face of competition from big-sized firms. In my view, this should also not present big hurdle, provided we realize the necessity to reorganise to the changing situations. With the growth in the complexities in the economic scenario, there is a necessity for the profession to change its organisational setup.

Whether one likes it or not, size would matter. Therefore, professional people must gather themselves in greater numbers to form partnership firms. The style of functioning of the firms must also adapt to the changes occurring in the organisational management like having trust, strict discipline to acting in a professional way as opposed to unorganised

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“Whether one likes it or not, size would matter. Therefore, professional people must gather themselves in greater numbers to form partnership firms. The style of functioning of the firms must also adapt to the changes occurring in the organisational management like having trust, strict discipline to acting in a professional way as opposed to unorganised way of working like family way of conducting business. The aim is pooling of talents and specialization in particular fields. The partnership should function in an impersonal way for the collective benefit of all the people, be it partners, employees, or clients.”

way of working like family way of conducting business. The aim is pooling of talents and specialization in particular fields. The partnership should function in an impersonal way for the collective benefit of all the people, be it partners, employees, or, clients.

Different sizes of firms can serve different sizes of business organisations, since business would also be carried on by organisations of different sizes. There will be some correlation between the size of a business organisation and that of a practicing firm. Highly specialised individual practitioners would also have room in this scenario. The size of the firm would depend on the urge for growth and specialisation, the demand for firm’s services and the satisfaction level of the mind of those involved in the organisation. Whether we wish or not, the size has to grow; but the growth would come only out of mutual trust and confidence in each other’s sincerity.

The ICAI has already had some regulations for some kind of leveling of the professional practice through minimum fee structure to be changed by different sizes of firms. Networking of smaller firms specialised in different fields and spread in different locations would also help in meeting with the challenge of size. But, all these would need an attitude of ‘give and take’ and, more than everything, ‘trust’ in others.

Lastly, a word about the students of the profession: There have been too many changes in the entry-level criteria. This is perhaps an area where more thought should be bestowed and experiences of other countries be taken into consideration. I have no fixed idea on this, except for the fact that excellence in theoretical knowledge and the ability to apply them to practical situations are the foundation stone for a competent professional to face the challenge in life.” ■

CAs Have a Critical Role in Ensuring That Business Growth is Fair: CA. Nandan Nilekani



'Padma Bhushan' CA. Nandan Nilekani, has been conferred with "Businessman of the Year" for Asia, 'World's most respected business leaders', Joseph Schumpeter Prize and 'Legend in Leadership Award'. *Time* magazine placed him in the Time 100 list of 'World's Most Influential People'. Born on 2nd June, 1955, he is often addressed as The "Bill Gates of Bangalore". He is currently the Chairman of the Unique Identification Authority of India (UIDAI), a position of Cabinet Rank, after a successful career in Infosys. He is also heading Government of India's technology committee called as TAGUP. Co-founder India's National Association of Software and Service Companies (NASSCOM), he has authored the much talked about book '*Imagining India: The Idea of a Renewed Nation*'. In a recent interview to ICAI, he shared his vision on a range of issues including UID project, Indian economy, corporate governance and Chartered Accountancy profession. Following is the interview.

Q 1. How does it feel moving from the helm of Infosys, leading IT giant of the country to become a part of the leaders of the national government? Does it reconcile with the thought process articulated by you to put India in the global front?

Ans. The Aadhaar initiative will build the foundation to bring remote services and resource access to a much broader swath of India, especially the poor. It would address some of the barriers in access that limit the poor from educational and employment opportunities, constrains access to social security, and that prevents them from migrating for better jobs and incomes. A chance to lead a project that would help address some of these challenges is indeed an exciting opportunity for me.

I think that the Aadhaar initiative, the effort to build a broad public information infrastructure in India, and the attempts in various states to address delivery problems in public programmes, all point in

one direction. Governments in India have recognised the power of IT and communication infrastructure, as a tool to address critical developmental challenges, and take resources to the poor more effectively. I think this is a great step, and will be instrumental in India's growth and its role in the world.

Q 2. What challenges have you faced or you foresee in managing the UIDAI? Were there any challenges on account of the differences in the management styles of the government and corporate world?

Ans. Of course the government and corporate sector work quite differently. But I have been lucky in that I have a great team within the UIDAI, a dedicated group of bureaucrats and people from outside Government who are truly committed to the goals of the project.

Q 3. A very large number of Indians have Election Commission identity cards. They also have ration cards, BPL card, driving licence and passports. There are PAN cards also. What is unique about

Aadhaar of UIDAI? Don't you think that more cards will mean more confusion for the public? What are the costs and benefits of having Aadhaar?

Ans. One very clear difference between the identity cards that exist and Aadhaar is that Aadhaar is a number, not a card. An individual, once they have an Aadhaar number, can prove their identity by providing their number and corresponding demographic or biometric information.

This will significantly ease the confusion people face today with identification. Because multiple identity documents are now available, different service providers in India often have varying requirements of how a person must verify their identity, before they receive a service. This makes identification procedures repetitive and exhausting for customers, and costly for service providers. The use of the Aadhaar number will offer a clear, uniform standard across applications and service providers, for establishing identity as well as proof of address.

Additionally, since Aadhaar numbers are unique due to being linked to a person's unique biometrics, one person can only have one number. This will help resolve the challenges of fraud and duplication we face today in our identification infrastructure.

Q 4. You have earned for yourself Padma Bhushan. You have also been awarded "Businessman of the Year" for Asia, 'World's most respected business leaders', Joseph Schumpeter Prize and 'Legend in Leadership Award'. Time magazine placed you in the Time 100 list of 'World's Most Influential People'. You have often been addressed as The "Bill Gates of Bangalore". How do you then explain your penchant for excellence? Normally when corporate CEOs write books, they tend to write either about their biggest deals or about their perspective on management theory or philosophy. You have authored a book about India (Imagining India: The Idea of a Renewed Nation), which is totally different from usual book?

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As we see more complex, global business models among Indian firms, the CA profession will have to specialise – in their knowledge base, geographical expertise, and in how they assess corporate risk and opportunity. With the use of IT tools and ERP gaining ground in business, we will also see technological expertise become a priority for chartered accountants.

Ans. While I am not personally ambitious, I am ambitious about what is possible for India, and all that we can potentially achieve during this period of growth. In my book, I had accordingly outlined some of the key policy and investment decisions we would need to see broad-based, equitable development. If we make the right decisions and investments, I believe India will see a path to development that is both high-growth and inclusive. I am doing what I can to help achieve this, through the UIDAI initiative. I also feel one should concentrate on adding value and being relevant at all times.

Q 5. In comparison to the world economy which has still not come-up from the recessionary phase, Indian economy is on the fast track revival and growth, what according to you are our strength areas for the resilience of Indian economy? What role does information technology play in it?

Ans. India has some substantial advantages, which is making its growth fairly resilient in the face of global recessionary forces. It has a substantial demographic dividend, which means that our young, working population substantially outnumber the number of dependents – young children and the retired elderly – in the population. Our working population is in fact, set to be the largest in the world, with over 800 million workers by 2020.

The second advantage India has is its vibrant domestic economy. This makes us less susceptible to shifts in global trading markets. The size of our domestic consumer market is growing rapidly, thanks to an expanding middle class and changing aspirations, especially among the poor.

The third factor in India's favour is our growing access, as well as openness to information and communication technologies. The spread of mobile phones has put communication devices in the hands of millions of poor residents across India – a device that can be the gateway to accessing critical

information, services and resources, wherever they are in the country. I think the use of technology through mobile phones and Internet access will be critical in intensifying our other advantages. It will help us leverage the strengths of our young workers, equip them with the right skills to move out of poverty, and contribute to India's growth and productivity. And it will also enable us to reach both our rural and urban markets more effectively, and provide consumers with the services they need.

Q 6. The issue of corporate governance is a hotly-debated one, particularly after the Satyam episode. Having established an impeccable corporate governance record yourself, how do you rate the governance standards in our Indian industry? How much scope is there for improvements on that front?

Ans. I think we have made significant progress in our standard of corporate governance in the last two decades, thanks to the efforts of SEBI and the Ministry of Corporate Affairs. Many significant corporate governance reforms, such as transparency in financial reporting and in director appointments, have become mandatory for listed companies, thanks to the amendment to Clause 49 of the Listing Agreement of Stock Exchanges. The voluntary guidelines issued by the MCA in 2009 have also set a high bar in governance for companies.

We have also benefited from the standards set by Indian firms that increasingly target global markets, and consequently adopted international best practices. However, while we have increasingly strong standards of governance in place, recent corporate scandals have highlighted the challenges we face in enforcing these standards. There is scope for improvement when it comes to compliance with existing governance standards, in ensuring accountability when compliance is not fulfilled, and fixing the problems that remain.

Additionally, it remains entirely possible for companies to follow the letter of standards in corporate governance but not their spirit when it comes to the functioning of independent directors, audits, the role

of promoters and minority shareholders. Effective corporate governance is finally, a voluntary act – the standards reveal themselves in how people within the corporation behave when they believe that they are not being watched. Such behaviour must be reinforced time and again within the company's culture, and reflected from the very top management. Such a culture is possible across industries and markets only when many more Indian companies set an example in their business processes and practice.

Q 7. Through rigorous training and education, the chartered accountants today are not merely confined to their core areas of accounting, auditing and taxation. Their roles are evolving. What corporate India expects from them. What in your opinion the challenges a chartered accountant is facing in the current business environment?

Ans. As we see more complex, global business models among Indian firms, the CA profession will have to specialise – in their knowledge base, geographical expertise, and in how they assess corporate risk and opportunity. With the use of IT tools and ERP gaining ground in business, we will also see technological expertise become a priority for chartered accountants.

In the coming years, with the impending adoption of International Financial Reporting Standards (IFRS), much more will be expected of our accounting and auditing professionals, in terms of how they perform valuations and interpret financial statements, as well as their independent judgement when it comes to the health of the firms.

Overall, I believe that chartered accountants have a critical role to play in ensuring that business growth is fair, transparent, and beneficial to the larger economy. This profession will be pivotal in determining how corporate governance evolves in India. The integrity, objectivity and professional competence of our chartered accountants will be key to ensuring high levels of transparency and adherence to standards among businesses, and in ensuring that the benefits of growth are distributed to not just employees, shareholders, and the management, but also to the greater community. ■



LEGAL DECISIONS¹

DIRECT TAXES

Section 9 read with Section 195 of the Income-tax Act, 1961 - Income - Deemed to accrue or arise in India

Payments made by Indian Insurance company to Singapore company for providing access to applications and to server hardware system hosted in Singapore and related support under the terms of Service Agreement is not in nature of 'royalty' within meaning of term in Explanation 2 to clause (vi) of Section 9(1)

Bharati Axa General Insurance Co Ltd, In re, August 6, 2010 (AAR)

The applicant insurance company entered into a Service Agreement with a Singapore company, AXA ARC for receiving assistance such as business support, marketing information technology support services and strategy support etc. The applicant states that these services are merely advisory in nature and are procured with the intention of carrying on business in line with the best practices followed by other AXA group entities globally. The applicant desires to know if AXA ARC has any liability to pay tax in India in respect of the fee received from the applicant.

The Authority for Advance Rulings held that the services rendered by AXA ARC may well be brought within the scope of this definition clause because they answer the description of consultancy services or some of them may be categorised as technical service also. But, in Treaty provision, the qualifying words "make available technical knowledge, experience, skills, know-how, which enables the recipients of services to apply the technology contained therein" make material difference. All the technical or consultancy services cannot be brought within the scope of this definition unless they make available technical knowledge, know-how, etc, which in turn facilitates the person acquiring the services to apply the technology embedded therein. The transfer of technology technical plan or know-how squarely falls within the purview of this definition. But, the question is whether in the instant case, the ingredients of clause (b) of Article 12.4 of the Treaty can be said to have been satisfied. As per Section 9(1)(vii) the income in the nature of 'royalty' or 'fees for technical services (FTS)' is taxable as deemed income irrespective of whether the income actually accrues or arise or is received in India. The fee for technical services paid by an Indian business entity in connection with the services received by it would constitute deemed income. However, it is well settled that if the provisions of the Tax Treaty are more beneficial to the assessee, then the provisions of the Act must yield to the Tax Treaty. The assessee can invoke the more beneficial treaty provisions to avoid taxation in India. In fact, this principle is specifically recognised in Section 90(2).

The definition of FTS as contained in clause (b) of Article 12.4 is explicitly designed to restrict the scope and ambit of the technical and consultancy services. Even if on proceeds on the basis that some of the services have the flavour of imparting technical knowledge and experience to the recipient of service, the further question is whether such provision of services enables the person acquiring the services to apply the technology contained therein. This

test specifically laid down in clause (b), is not satisfied and the legal position clarified by this Authority while interpreting more or less similar Treaty provisions applies with greater force to the present case in view of the narrow language employed in the India-Singapore Tax Treaty,

Providing comments and suggestions after reviewing the strategies and plans developed by the applicant, giving suggestions to the applicant to improve the product developed by it so as to bring it in line with the common practices followed by other AXA entities across the globe, providing HR support assistance, assisting the applicant in choosing cost effective re-insurance partners, reviewing the actuarial methodologies developed by the applicant and providing suggestions and inputs to achieve standard actuarial practices and processing guidelines in connection with the settlement of claims, marketing and risk analysis, fall short of the requirements laid down in the definition of fees for technical services in Tax Treaty between India and Singapore. It will be too much to say that by providing such services (assuming they are technical or consultancy services), the applicant receiving the services is enabled to apply the technology contained therein i.e. the technology, knowledge, skills, etc. possessed by the service provider or technical plan developed by the service provider. IT support services does not fall under the description of technical services as defined in the Treaty.

Coming to the payments made by the applicant to AXA ARC for providing access to software applications and to the server hardware system hosted in Singapore for internal purposes and for availing of related support services under the terms of the Service Agreement, cannot be brought within the scope of the definition of 'royalty' in Article 12.3 of the India- Singapore Tax Treaty. There is no transfer of any copyright contained in the computer software provided by AXA ARC. Applying the principle laid down in *Dassult Systems case 322 ITR 125* and the earlier ruling in *FactSet Research Systems Inc. 317 ITR 169*, etc., it is to be held that clause (a) of Article 12.3 of Tax Treaty relating to 'use of' or 'right to use', copyright of literary/scientific work is attracted. The payments made for access to the system hosted in Singapore is for availing of the facility provided by AXA ARC and it cannot be said that the applicant has been conferred any right of usage of the equipment located abroad, more so when the server is not dedicated to the applicant. Thus, the fee paid to the AXA ARC by the applicant does not amount to fee for technical services within the meaning of India-Singapore Tax Treaty.

Therefore, the payments made to AXA ARC does not amount to 'fee for technical services' and 'royalty' within the meaning of Article 12 of the India-Singapore Tax Treaty. Further, AXA ARC does not have a permanent establishment in India, and therefore, the payments received by it cannot be taxed as business profits under the Treaty. The receipts by AXA ARC from the applicant will not suffer withholding tax under Section 195 of the Act.

Section 9 read with Section 115A of the Income-tax Act, 1961 - Income - Deemed to accrue or arise in India

Where applicant offer accreditation mainly in respect of

¹ Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.org.

Management Systems Certification, Production certificate, Personnel certification, Inspection and Greenhouse Gas validation and verification through Conformity Assessment Bodies in different countries, income derived does not fall within 'royalty' clauses of Indo-Australia DTAA

Joint Accreditation System of Australia and New Zealand, In Re, August 6, 2010 (AAR)

The applicant, Joint Accreditation System of Australia and New Zealand is a not for profit, self funding organisation accorded the status of an international organisation and provides accreditation to CABs (Conformity Assessment Bodies) in several countries including India. The applicant accredits organisations which provide third party certification and/or inspection services. The main function of the applicant is to accredit, following the successful assessment, those bodies considered competent and impartial to provide an effective service in various spheres. The applicant offers accreditation mainly for programmes of Management Systems Certification, Production certificate – a codemark, watermark, Personnel certification, Inspection and Greenhouse Gas validation and verification. In consideration of the accreditation work done by the applicant, it receives fee from CAB in the form of application fee, programme fee, certificate fees and fee for conducting surveillance audit, witnessing audit and re-assessment visits.

The questions are formulated in order to seek advance ruling are whether the consideration received/receivable by the applicant from CABs can be classified as 'fees for technical services' as defined under Section 9(1)(vii) liable to be taxed in India according to the provisions of Section 115A(1)(b)(AA) or (BB).

The Authority for Advance Rulings held that there is no transfer of any skills or technical knowledge or experience, or process or know-how to the CABs on account of grant of accreditation to those entities. The skills, expertise or know-how possessed by the applicant for the grant of accreditation certificate cannot be said to have been made available to the CAB who gets the accreditation. What the applicant does is to evaluate and assess the capabilities, competence, potential and infrastructure possessed by the CAB in the light of certain set standards and parameters. The fact that the CAB is apprised of its shortcomings and deficiencies, if any, and that the CAB is given an opportunity to rectify, if possible, does not reasonably lead to the inference of 'making available' the skills, technical knowledge etc. possessed by the applicant to the CAB. CAB will, of course, be benefited by the accreditation certificate issued by the applicant but that fact has hardly any bearing on the point whether "make available" criterion has been satisfied or not. Viewed from any angle, it cannot be said that the applicant is imparting any knowledge or skills to the CABs which are utilised by the CAB in conducting its business. The nature of activity undertaken by the applicant clearly rules out any such inference.

Further, the income derived does not fall within the 'royalty' clause (which includes 'fees for technical services') under Article 12 of the Indo-Australia Double Taxation Treaty. No permanent establishment can be inferred on account of occasional visits of the applicant's personnel for the purpose

of on-site assessment and also in view of the fact that the applicant does not have a fixed place of business or PE in India and the visits of the applicant's personnel were of less than 90 days in a 12 month period.

Section 10(23C) read with Sections 2(15), 11 and 263 of the Income-tax Act, 1961 - Exemption - Religious Trust / Institution

Running of coaching classes and earning income therefrom and incurring expenditure thereon by ICAI is appropriate [Assessment Year 2005-06]

The Institute of Chartered Accountants of India v. CIT (Exemption), October 18, 2010 (ITAT-Delhi)

The CIT initiated proceedings under Section 263 against the assessee/Institute of Chartered Accountants of India (ICAI/Institute) on the ground that it was earning income and incurring expenditure on coaching classes, whereas the Chartered Accountants Act, 1949 nowhere provides for such coaching classes. Further running of coaching classes is a business and not a charitable activity and for this purpose, the assessee ought to have maintained separate books of account. Since the assessee has not maintained separate books, the profits and gains of the ICAI could not be exempt.

The ITAT Delhi held that various regulations of ICAI provide for coaching etc to the students of chartered accountancy course. These regulations *inter-alia* provide that no candidate shall be admitted to the professional examination unless he produces a certificate from the head of the coaching organisation to the effect that he is registered with coaching organisation and has complied with the requirements of the theoretical education scheme. The candidate is also required to pay such fees as may be fixed by the council for such professional education. Before a student is eligible for appearing in the examination, he has to produce a certificate from the head of the coaching organisation to the effect that he has complied with the requirements of postal tuition scheme. An articled clerk who has completed the practical training as provided in these regulations, before complying for membership of the institute, shall be required to attend a course on general management and communication skills. Similarly, an audit clerk who has completed the practical training is also required to attend the course on general management and communication skill or any other course as may be specified in the council from time to time. For this purpose, the council is to arrange funds for coaching candidates for the examinations at convenient centers in its region. For this purpose, the Institute is also conducting classes for chartered accountancy students registered with it. These classes are conducted for which nominal fee is charged from the students registered with the Institute. These classes are provided to the students registered with the Institute to train and prepare them for appearing in the main examination. Thus, Institute is discharging its statutory function as required by the Parliament, which does not amount to any commercial activity. From the detailed brochure, it may be found that Institute provides a comprehensive study package including large question bank for which no separate cost is charged from the students.



The Board of Studies also provides a CD for self-assessment and model test papers. Expenditure is being incurred for preparation of the study package, CD etc., salary of the faculty and other professionals, printing and stationery, research and development etc. The students registered for chartered accountancy are also provided on-line guidance through Institute's own website. At a very nominal cost, these services are provided to the students. The Institute also provides computer training to the students registered with it, at a very low fee. Thus, major activity of the Institute revolves around chartered accountancy education and training and as such, the observation of the DIT (Exemption) to the effect that coaching activity is not allowed under the Act is incorrect and against the facts. However, this is far more important activity of the Institute and the Institute is considered to be one of the best educational institutions of the world providing chartered accountancy education in India.

The Institute as such merely it is receiving coaching fee from students for imparting education, cannot be said to have been carrying on business and accordingly it is not required to maintain separate books of accounts as alleged by DIT(E). The income of the coaching classes earned by the assessee Institute is within its objects and its Regulations and further these activities are educational activity within the definition of Section 2(15), and consequently therefore cannot be activity of business for which separate books of accounts are required to be maintained. The order of the learned DIT(E) is therefore not sustainable as the income of the Institute is exempt not only under Section 10(23C)(iv) but also under Section 11. The Institute is an educational institute and hence its income will also be exempt under Section 11 as education falls within the meaning of charitable purpose under Section 2(15).

Section 40A(2) of the Income-tax Act, 1961 - Expenses disallowed – Excessive or unreasonable payments

In case of domestic transactions under-invoicing of sales

and over-invoicing of expenses, Assessing Officer may apply any of generally accepted methods of determination of arm's length price, including methods provided under Transfer Pricing Regulations

CIT v. Glaxo Smithkline Asia (P) Ltd, October 26, 2010 (SC)

In the case of domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage—

- i. If one of the related Companies is loss making and the other is profit making and profit is shifted to the loss making concern; and
- ii. If there are different rates for two related units (on account of different status, area based incentives, nature of activity, etc.) and if profit is diverted towards the unit on the lower side of tax arbitrage. For example, sale of goods or services from non-SEZ area (taxable division) to SEZ unit (non-taxable unit) at a price below the market price so that taxable division will have less profit taxable and non-taxable division will have a higher profit exemption.

All these complications arise in cases where fair market value is required to be assigned to the transactions between related parties in terms of Section 40A(2). The matter needs to be examined by Central Board of Direct Taxes. Since it is informed that the matter has been examined by CBDT and it is of the view that amendments would be required to the provisions of the Act if such Transfer Pricing Regulations are required to be applied to domestic transactions between related parties under Section 40A(2).

In order to reduce litigation, certain provisions of the Act, like Section 40A(2) and Section 80IA(10), need to be amended empowering the Assessing Officer to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties. The Assessing Officer may thereafter apply any of the generally accepted methods of determination of arm's length price, including the methods

provided under Transfer Pricing Regulations. Requirement for maintenance of documents or getting specific transfer pricing audit done by the taxpayers in respect of domestic transactions between the related parties.

Per Court: Normally, the Supreme Court does not make recommendations or suggestions. However, in order to reduce litigation occurring in complicated matters, we are of the view that the question of amendment, as indicated above, may require consideration expeditiously by the Ministry of Finance. In the meantime, CBDT may also consider issuing appropriate instructions in that regard. Accordingly, we direct the Registry to forward copies of this Order both to the Ministry of Finance and CBDT for consideration.

INDIRECT TAXES

Service Tax

Section 65 (90a) and Section 65 (105) (zzzz) of the Finance Act, 1994 – Renting of Immovable Property



Levy of service tax on providing of service to any person by any other person by renting of immovable property for business is not exclusively covered by Entry 49 List II, but it is covered by Entry 92C, read with 97 of List I and, thus, could not be said to be outside purview of Central legislature; amendment levying service tax on this service being made retrospectively operative from 1-6-2007 is not improper

Shubh Timb Steels Ltd. v. Union of India, November 22, 2010 (P&H)

Legislative competence

Service tax on service of renting of property is exclusively covered by Entry 49 List II. Entry 49 of List II relates to tax on land and building and not any activity relating thereto. Income tax on income from property, wealth tax on capital value of assets including land and building and gift tax on gift of land and building have been upheld. It cannot be held that renting of property did not involve any service as service could only be in relation to property and not by renting of property. Renting of property for commercial purposes is certainly a service and has value for the service receiver. Moreover, the aspect of service element in renting transaction is certainly an independent aspect covered under Entry 92C read with Entry 97 of List I. In any case, subject matter of impugned levy being outside the scope of entry 49 of List II, power of Union Legislature is undoubted. Question whether levy will be harsh being in addition to income tax and property tax is not a matter for this Court once there is legislative competence for the levy. Even if it is held that transaction of transfer of right in immovable property did not involve value addition, the provision cannot be held to be void in absence of encroachment on List II.

Retrospectivity of levy

It is well settled that competent legislature can always

clarify or validate a law retrospectively. It cannot be held to be harsh or arbitrary. Object of validating law is to rectify the defect in phraseology or lacuna and to effectuate and to carry out the object for which earlier law was enacted.

Section 66 read with Sections 65(12) and 65(105)(zm) of the Finance Act, 1994 – Charge of Service Tax

Service tax imposed on value of taxable services, insofar as it relates to financial leasing services including equipment leasing and hire purchase is constitutionally valid and within the legislative competence of Parliament by virtue of Article 366(29A) of Constitution

Association of Leasing & Financial Service Companies v. Union of India, October 26, 2010 (SC)

Equipment Leasing and Hire-Purchase Finance are activities of long term financing and they fall within the ambit of “banking and other financial services”. A financial lease is a lease that transfers substantially all risks and rewards incident to ownership, in the said lease, the lessor (NBFC) merely finances the equipment/asset which the lessee is free to select, order, take delivery and maintain. The lessor (NBFC) arranges the funding. It accepts the invoice from the vendor (supplier) and pays him. The income which the lessor earns is by way of finance/interest charges in addition to the management fees or documentation charges, etc. It is this income which constitutes the measure of tax for the purposes of calculating the value of taxable services under Section 67 of the Finance Act, 1994. Thus, a financial lease would come within “financial leasing services” in terms of Section 65(12)(a)(i). There are different types of financial leases, namely, a tax based financial lease, a leverage lease and an operating lease. Even in the matter of allocation between the principal and finance/interest charges, adjudication under the Act was warranted which has not been done. One must also bear in mind that Article 366(29A) is essentially sales tax specific. It was brought in to expand the tax base which stood narrowed down because of certain judgments of this Court. That is the reason for bringing in the concept of “deemed sale” under which tax could be imposed on mere “delivery” on hire-purchase [See clause (c)] which expression is also there in the second limb of the said article.

Entry 97 of List I with Article 246(1) confers exclusive power first, to make laws in respect of matters specified in Entries 1 to 96 in List I and, secondly, it confers the residuary power of making laws by Entry 97, Article 248 does not provide for any express powers of Parliament but only for its residuary power. Article 248 adds nothing to the power conferred by Article 246(1) read with Entry 97, List I. Entry 97, List I which confers residuary powers on Parliament provides “any other matter not enumerated in List II and List III including any tax not mentioned in either of those lists”. The word “other” is important. It means “any subject of legislation other than the subject mentioned in Entries 1-96”.

The impugned levy relates to or is with respect to the particular topic of “banking and other financial services” which includes within it one of the several enumerated services, viz., financial leasing services. These include long

time financing by banks and other Financial Institutions (including NBFCs). These are services rendered to their customers which comes within the meaning of the expression “taxable services” as defined in Section 65(105)(zm). The taxable event under the impugned law is the rendition of service. The impugned tax is not on material or sale. It is on activity/service rendered by the service provider to its customer. Equipment Leasing/Hire-Purchase finance are long term financing activities undertaken as their business by NBFCs. As far as the taxable value in case of financial leasing including equipment leasing and hire-purchase is concerned, the amount received as principal is not the consideration for services rendered. Such amount is credited to the capital account of the lessor/hire-purchase service provider, it is the interest/finance charge which is treated as income or revenue and which is credited to the revenue account. Such interest or finance charges together with the lease management fee/processing fee/documentation charges are treated as considerations for the services rendered and accordingly they constitute the value of taxable services on which service tax is made payable. In fact, the Government has given exemption from payment of service tax to financial leasing services including equipment leasing and hire-purchase on that portion of taxable value comprising of 90 per cent of the amount representing as interest, i.e., the difference between the instalment paid towards repayment of the lease amount and the principal amount in such instalments paid (See Notification No. 4/2006 Service Tax, dated 1-3-2006). In other words, service tax is leviable only on 10 per cent of the interest portion. (See also Circular F. No. B.11/1/2001-TRU, dated 9-7-2001 in which it has been clarified that service tax, in the case of financial leasing including equipment leasing and hire-purchase, will be leviable only on the lease management fees/processing fees/documentation charges recovered at the time of entering into the agreement and on the finance/interest charges recovered in equated monthly instalments and not on the principal amount). Merely because for valuation purposes *inter alia* “finance/interest charges” are taken into account and merely because service tax is imposed on financial services with reference to “hiring/interest” charges, the impugned tax does not cease to be service tax and nor does it become tax on hire-purchase/leasing transactions under Article 366(29A) read with Entry 54, List II. Thus, while State Legislature is competent to impose tax on “sale” by legislation relatable to Entry 54 of List II of Seventh Schedule, tax on the aspect of the “services”, vendor not being relatable to any entry in the State List, would be within the legislative competence of the Parliament under Article 248 read with Entry 97 of List I of Seventh Schedule to the Constitution.

Service tax imposed by Section 66 of the Finance Act, 1994 (as amended) on the value of taxable services referred to in Section 65(105)(zm) read with Section 65(12) of the said Act, insofar as it relates to financial leasing services including equipment leasing and hire-purchase is within the legislative competence of the Parliament under Entry 97, List I of the Seventh Schedule to the Constitution. ■

CIRCULARS/NOTIFICATIONS

INDIRECT TAXES

A. EXCISE

I. Circular

1. Circular No. 937/27/2010-CX dated 26.11.2010: Notification No. 29/2004 CE dated 09.07.2004 as amended by Notification No. 58/2008 – CE dated 07.12.2008 granted full and unconditional exemption to certain items of Textile Sector during the period 07.12.2008 to 06.07.2009.

While another Notification No. 59/2008 – CE dated 07.12.2008 prescribed a concessional rate of duty of 4 per cent on these items, with the benefit of Cenvat Credit during the above said period.

In this regard, Circular No. 937/27/2010 – CX dated 26.11.2010 has been issued to clarify that in view of the specific bar provided under section 5A (1A) of the Central Excise Act, the manufacturer can not opt to pay the duty under notification no. 59/2008 – CE dated 07.12.2008 and can not avail the Cenvat Credit of the duty paid on inputs.

B. SERVICE TAX

I. Circular

1. Circular No.131/13/2010-ST dated 07.12.2010: Transmission and distribution of electricity have been exempted from service tax vide Notification Nos.11/2010 & 32/2010 dated 27.02.2010 and 22.06.2010 respectively.

Circular No. 131/13/2010 – ST dated 07.12.2010 has been issued to clarify that supply of electricity meters for hire to the consumers is eligible for the above - mentioned exemptions for the reason of the same being an essential activity having direct and close nexus with transmission and distribution of electricity.

The complete text of the above circulars are available at <http://www.cbec.gov.in>

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



DBOD No. BL.BC.55/22.01.001/2005-06 dated January 23, 2006, and a soft copy should be e-mailed.

2. Processing and Settlement of Export related receipts facilitated by Online Payment Gateways

RBI/2010-11/281 A.P. (DIR Series) Circular No. 17 November 16, 2010

In order to facilitate small value export transactions and evade violation of the provisions of the Foreign Exchange Management Act (FEMA), the above referred circular issues a set of guidelines to allow the Authorised Dealer Category-I (AD Category-I) banks to offer the facility of repatriation of export related remittances by entering into standing arrangements with Online Payment Gateway Service Providers (OPGSPs), subject to the following conditions:

- (i) The AD Category-I banks offering this facility shall carry out the due diligence of the OPGSP.
- (ii) This facility shall only be available for export of goods and services of value not exceeding USD 500 (US Dollar five hundred).
- (iii) AD Category-I banks providing such facilities shall open a NOSTRO collection account for receipt of the export related payments facilitated through such arrangements. Where the exporters availing of this facility are required to open notional accounts with the OPGSP, it shall be ensured that no funds are allowed to be retained in such accounts and all receipts should be automatically swept and pooled into the NOSTRO collection account opened by the AD Category-I bank.
- (iv) A separate NOSTRO collection account may be maintained for each OPGSP or the bank should be able to delineate the transactions in the NOSTRO account of each OPGSP.
- (v) The following debits will only be permitted to the NOSTRO collection account opened under this arrangement:
 - a) Repatriation of funds representing export proceeds to India for credit to the exporters' account;
 - b) Payment of fee/commission to the OPGSP as per the predetermined rates / frequency/ arrangement; and
 - c) Charge back to the importer where the exporter has failed in discharging his obligations under the sale contract.
- (vi) The balances held in the NOSTRO collection account shall be repatriated and credited to the respective exporter's account with a bank in India immediately on receipt of the confirmation from the importer and, in no case, later than seven days from the date of credit to the NOSTRO collection account.
- (vii) AD Category-I banks shall satisfy themselves as to the bonafides of the transactions and ensure that the purpose codes reported to the Reserve Bank in the online payment gateways are appropriate.

FEMA

1. Reporting Mechanism – Data of Authorised Dealer Category-I Branches

RBI/2010-11/278 A.P. (DIR Series) Circular No. 16 dated November 16, 2010

Ref: A.P. (DIR Series) Circular No. 54 dated May 08, 2007.

In terms of the extant guidelines, all AD Category - I banks are required to inform any changes in the categorization of their branches dealing in foreign exchange to the Director of Reserve Bank of India.

The above information should be prepared in Proforma I or II, as specified in RBI circulars DBOD No. BL.BC.92/22.06.001/2004-05 dated May 20, 2005 and



- (viii) AD Category-I banks shall submit all the relevant information relating to any transaction under this arrangement to the Reserve Bank, as and when advised to do so.
- (ix) Each NOSTRO collection account should be subject to reconciliation and audit on a quarterly basis.
- (x) Resolution of all payment related complaints of exporters in India shall remain the responsibility of the OPGSP concerned.
- (xi) OPGSPs who are already providing such services as per the specific holding-on approvals issued by the Reserve Bank shall open a liaison office in India within three months from the date of this circular, after duly finalising their arrangement with the AD-Category-I banks and obtaining approval from the Chief General Manager, Reserve Bank of India, Foreign Exchange Department for this purpose.

In respect of all new arrangements, the OPGSP shall open a liaison office with the approval of the Reserve Bank before operationalising the arrangement.

AD Category-I banks desirous of entering into such an arrangement/s should approach the Chief General Manager, Reserve Bank of India, Foreign Exchange Department for obtaining one time permission in this regard and thereafter report the details of each such arrangement as and when entered into.

3. Know Your Customer (KYC) norms / Anti-Money Laundering (AML) standards / Combating the Financing of Terrorism (CFT) / Obligation of Authorised Persons under Prevention of Money Laundering Act, 2002 (PMLA), as amended by Prevention of Money Laundering (Amendment) Act, 2009 - Money changing activities.

RBI/2010-11/287 A.P. (DIR Series) Circular No.18 A.P. (FL/RL Series) Circular No.01 dated November 25, 2010

The RBI has issued clarifications/instructions with regard to the captioned subject and has further modified the instructions contained in A.P. (DIR Series) Circular No. 17 [A.P. (FL/ RL Series) Circular No. 04] dated November 27, 2009.

The above circular is available on RBI website at - <http://rbi.org.in/Scripts/NotificationUser.aspx?id=6113&Mode=0>

4. Know Your Customer (KYC) norms/ Anti-Money Laundering (AML) standards/ Combating the Financing of Terrorism (CFT)/ Obligation of Authorised Persons under Prevention of Money Laundering Act, (PMLA), 2002, as amended by Prevention of Money Laundering (Amendment) Act, 2009 - Cross Border Inward Remittance under Money Transfer Service Scheme

RBI/2010-11/288 A.P. (DIR Series) Circular No.19 A.P. (FL Series) Circular No. 02 November 25, 2010

The RBI has issued clarifications / instructions with regard to the captioned subject and has further modified the instructions contained in A.P. (DIR Series) Circular No. 18 [A.P. (FL/ RL Series) Circular No. 05] dated November 27, 2009.

The above circular is available on RBI website at -
<http://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=6114&Mode=0>

5. Know Your Customer (KYC) norms/ Anti-Money Laundering (AML) standards/ Combating the Financing of Terrorism (CFT)/ Obligation of Authorised Persons under Prevention of Money Laundering Act, (PMLA), 2002, as amended by Prevention of Money Laundering (Amendment) Act, 2009- Money changing activities RBI/2010-11/292 A.P. (DIR Series) Circular No.20 A.P. (FL/RL Series) Circular No.03 November 30, 2010

Further to A.P. (DIR Series) Circular No.18 dated November 25, 2010 issued by RBI, the RBI has issued more clarifications / instructions with regard to the captioned subject and has further modified the instructions contained in A.P. (DIR Series) Circular No. 17 [A.P. (FL/ RL Series) Circular No. 04] dated November 27, 2009.

The above circular is available on RBI website at -
<http://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=6122&Mode=0>

6. Know Your Customer (KYC) norms/ Anti-Money Laundering (AML) standards/ Combating the Financing of Terrorism (CFT)/ Obligation of Authorised Persons under Prevention of Money Laundering Act, (PMLA), 2002, as amended by Prevention of Money Laundering (Amendment) Act, 2009 - Cross Border Inward Remittance under Money Transfer Service Scheme RBI/2010-11/293 A.P. (DIR Series) Circular No.21 A.P. (FL Series) Circular No.04 November 30, 2010

Further to A.P. (DIR Series) Circular No.19 dated November 25, 2010 issued by RBI, the RBI has issued clarifications / instructions with regard to the captioned subject and has further modified the instructions contained in A.P. (DIR Series) Circular No. 18 [A.P. (FL/ RL Series) Circular No. 05] dated November 27, 2009.

The above circular is available on RBI website at -
<http://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=6123&Mode=0>

7. Prevention of Money-laundering (Maintenance of Records of the Nature and Value of Transactions, the Procedure and Manner of Maintaining and Time for Furnishing Information and Verification and

Maintenance of Records of the Identity of the Clients of the Banking Companies, Financial Institutions and Intermediaries) Second Amendment Rules, 2010- Obligation of Authorised Persons

RBI/2010-11/ 311 A.P. (DIR Series) Circular No. 24 A.P. (FL/RL Series) Circular No. 05 December 13, 2010

Ref.: DPSS.CO.AD.No.552/02.27.004/2010-2011 dated September 15, 2010

The Government of India vide its Notification No. 10/2010- E.S./ F.No.6/8/2009-E.S. dated June 16, 2010, has amended the Prevention of Money-laundering (Maintenance of Records of the Nature and Value of Transactions, the Procedure and Manner of Maintaining and Time for Furnishing Information and Verification and Maintenance of Records of the Identity of the Clients of the Banking Companies, Financial Institutions and Intermediaries) Rules, 2005. RBI has issued circular in this regard vide DPSS.CO.AD.No.552/02.27.004/2010-2011 dated September 15, 2010.

Any failure to comply with the requirements of the aforesaid Rules as amended, to the extent they are applicable to foreign exchange transactions, shall also be treated as failure to comply with the directions issued by the Reserve Bank of India under sections 10(4) and 11(1) of the Foreign Exchange Management Act, 1999.

The above circular is available on RBI website at -
<http://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=6144&Mode=0>

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

CORPORATE LAWS

1. Submission of Balance Sheet and Profit & Loss Account by NBFCs

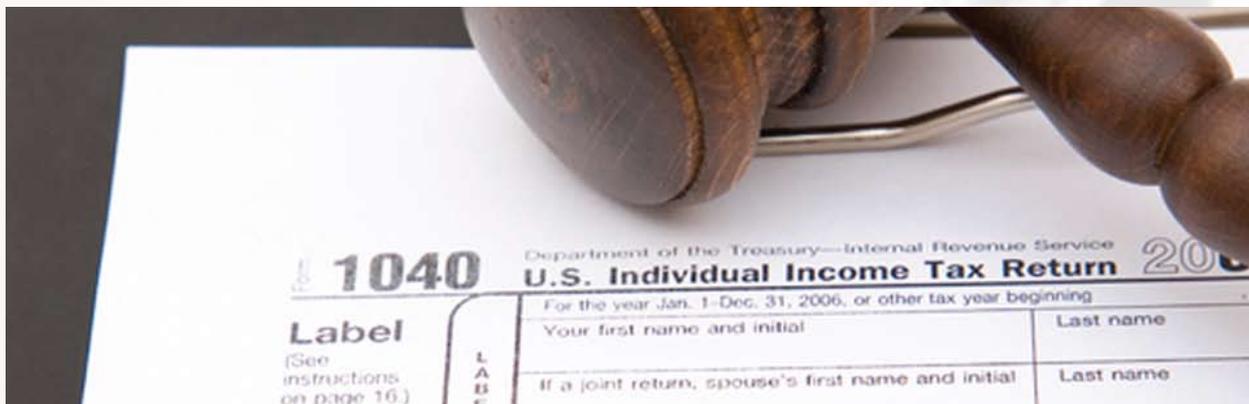
www.rbi.gov.in

The RBI has issued Notification No. DNBS. 217/CGM(US)-2010 dated 01.12.2010 amending the Non-Banking Financial (Deposit Accepting) Companies Prudential Norms Directions, 2007 and Non-Banking Financial (Non-Deposit Accepting) Companies Prudential Norms Directions, 2007 and providing that every NBFC shall finalise its balance sheet and profit and loss account as on March 31 every year within a period of three months from the date to which it pertains. For example, balance sheet as on March 31st of a year shall be finalised by June 30th of the year. One may refer to the above website for further details.



2. Credit Information Companies – new company added www.rbi.gov.in

The RBI has issued Circular No. CID. BC.64/20.16.042/2010-11 dated 01.12.2010 informing that it has issued 'Certificate of Registration' to High Mark Credit



Information Services Private Limited to commence the business of credit information. One may refer to the above website for further details.

3. Prudential Guidelines - Investment in Venture Capital Funds (VCFs)

www.sebi.gov.in

The RBI has issued Circular No. DBOD.FID.FIC.No 9/01.02.00/2010-11 dated 01.12.2010 observing that exposure of banks to Venture Capital Funds (VCFs) had been steadily increasing in pre-2006 periods and while noting at that time the significance of venture capital activities and need for banks' involvement in financing of venture capital funds was well recognised, it was also considered important to address the relatively higher risks inherent in such exposures. In view of this, the RBI had earlier in 2006 reviewed the entire issue of financing of VCFs and revised the prudential framework governing banks' exposure to VCFs whereby banks were advised to comply with the prudential requirements relating to financing of VCFs set out in the 2006 Circular No. DBOD. No. BPBC. 27/21.01.002/2006-2007 dated 23.08.2006. It has now been advised that the above referred guidelines as applicable to banks and issued to banks shall mutatis mutandis apply to the select All-India Financial Institutions. One may refer to the above website for further details.

4. Operation of Bank Accounts and Money Mules

www.rbi.gov.in

The RBI has issued Circular No. DBOD.AML.BC.No.65/14 .01.001/2010-11 dated 07.12.2010 noting that earlier several circulars had talked about the regulator's intent of preventing banks from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities Reserve Bank of India has issued guidelines on Know Your Customer (KYC) norms/Anti-Money Laundering (AML) standards/Combating of Financing of Terrorism (CFT). The RBI has noticed that "Money mules" can be used to launder the proceeds of fraud schemes (e.g., phishing and identity theft) by

criminals who gain illegal access to deposit accounts by recruiting third parties to act as "money mules" and in some cases these third parties may be innocent while in others they may be having complicity with the criminals. In a money mule transaction, an individual with a bank account is recruited to receive cheque deposits or wire transfers and then transfer these funds to accounts held on behalf of another person or to other individuals, minus a certain commission payment. Money mules may be recruited by a variety of methods, including spam e-mails, advertisements on genuine recruitment web sites, social networking sites, instant messaging and advertisements in newspapers. When caught, these money mules often have their bank accounts suspended, causing inconvenience and potential financial loss, apart from facing likely legal action for being part of a fraud. Many a times the address and contact details of such mules are found to be fake or not up to date, making it difficult for enforcement agencies to locate the account holder. The operations of such mule accounts can be minimised if banks follow the guidelines contained in the Master Circular on Know Your Customer (KYC) norms/ Anti-Money Laundering (AML) standards/Combating of Financing of Terrorism (CFT)/Obligation of banks under PMLA, 2002. Banks are, therefore, advised to strictly adhere to the guidelines on KYC/AML/CFT issued from time to time and to those relating to periodical updation of customer identification data after the account is opened and also to monitoring of transactions in order to protect themselves and their customers from misuse by such fraudsters. One may refer to the above website for further details.

5. Issuance of Non-Convertible Debentures (NCDs)

www.rbi.gov.in

The RBI has issued Circular No. IDMD.PCD.No. 24/14.03.03/2010-11 dated 06.12.2010 referring its earlier directions named Issuance of Non-Convertible Debentures (Reserve Bank) Directions, 2010 dated June 23, 2010 issued vide circular IDMD.DOD.10/11.01.01(A)/2009-10 covering the regulation of NCDs of maturity up to one year. Taking into account the feedback received from the



market participants, the Reserve Bank of India has issued an amendment Direction, i.e., Issuance of Non-Convertible Debentures (Reserve Bank) (Amendment) Directions, 2010, inter alia, permitting Financial Institutions (FIs) to invest in NCDs of maturity up to one year, Non-Banking Financial Companies including Primary Dealers that do not maintain a working capital limit to issue NCDs of maturity up to one year and FIs to invest in NCDs of maturity up to one year subject to extant provisions of FEMA and SEBI guidelines issued in this regard. One may refer to the above website for further details.

6. Easy Exit Scheme, 2011 ("EES, 2011")

www.mca.gov.in

The Ministry of Corporate Affairs ("MCA") has issued the EES, 2011 on 03.12.2010 since it was observed by the MCA that certain companies were registered under the Companies Act, 1956, but due to various reasons some of them are inoperative since incorporation or commenced business but became inoperative later on and are not filing their due documents timely with the Registrar of Companies. These companies may be defunct and may be desirous of getting their names strike off from the Register of Companies. In order to give an opportunity to the defunct companies for getting their names strike off from the Register of Companies, the Ministry had launched a Scheme namely, "Easy Exit Scheme, 2010" under Section 560 of the Companies Act, 1956 during May-August, 2010. A large number of companies availed this scheme. However,

on huge demand from corporate sector, the Ministry has decided to re-launch the Scheme as, "Easy Exit Scheme, 2011" under Section 560 of the Companies Act, 1956.

The Scheme shall come into force on the 1st January, 2011 and shall remain in force up to 31st January, 2011. The scheme is applicable to any "defunct company" which has active status on Ministry of Corporate Affairs portal may apply under EES, 2011 in accordance with the provisions of this Scheme for getting its name strike off from the Register of Companies. The scheme is not applicable to certain companies like listed companies, companies that have been de-listed, section 25 companies, vanishing companies, companies facing inspection or investigation, companies accepted public deposits which are either outstanding or the company is in default in repayment of the same, company having secured loan, company having management dispute, company in respect of which filing of documents have been stayed by court or Company Law Board (CLB) or Central Government or any other competent authority and company having dues towards income tax or sales tax or central excise or banks and financial institutions or any other Central Government or State Government Departments or authorities or any local authorities. The scheme provides a simple procedure for making an application. One may note that the MCA may initiate action against defaulting companies once the scheme period is over. One may refer to the above website for further details.

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

Non-Receipt of Journal

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Treatment of capital expenditure on assets not owned by the company.

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 public sector undertaking registered under the Companies Act, 1956, is engaged in refining and marketing of petroleum products.
2. The querist has stated that sometimes when a new project, for example, setting up of a new refinery is undertaken by the company, it has to incur expenditure on the construction/development of certain assets, like electricity transmission lines, railway siding, roads, culverts, bridges, etc., in order to facilitate construction of project and subsequently to facilitate its operations. The ownership of such assets (hereinafter referred to as 'enabling assets') as well as the land on which these assets are situated does not vest with the company. The existing accounting policy of the company with respect to such 'enabling assets' is as under:

"Capital expenditure on items like electricity transmission lines, railway siding, roads, culverts,* etc. the ownership of which is not with the company are charged off to revenue. Such expenditure incurred during construction period of projects is accounted as unallocated capital expenditure and is charged to revenue in the year of capitalisation of such projects."

(* "Oil Jetty" may be added in the year 2009-10.)

According to the querist, the 'unallocated capital expenditure' is presented in the balance sheet as capital work-in-progress (CWIP).

3. The querist has further stated that the existing accounting policy is being followed based on the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI), expressed on the treatment of such expenditure as contained in Volume IX, Query No.1.32 and Volume XII, Query No.1.3 of the Compendium of Opinions. In both the opinions, EAC has referred to paragraph 10 of the Guidance Note on Treatment of Expenditure during Construction Period¹. The conclusion of the said opinions, as per the querist, is as under:
 - (a) Fixed assets which, though having been built on land not belonging to the company, but are owned by the company, should form part of the relevant head of fixed assets belonging to the company and treated accordingly.

- (b) Regarding fixed assets created on land not belonging to the company, which are also not owned by the company, the expenditure incurred on the construction of such assets should be classified as 'Capital Expenditure' in the balance sheet indicating appropriately, the nature of the expenditure including the fact that the assets are not owned by the company. Also, after the commencement of commercial operations, the same should be written off to the profit and loss account.

Both the above opinions, in the view of the querist, clearly state that till the commencement of commercial operations, such expenses should be classified as capital expenditure and after the commencement of commercial operations, the same should be written off to the profit and loss account. Accordingly, as per the querist, the company is uniformly following the above accounting policy since 1999-2000.

4. According to the querist, the statutory auditors of the company hold the opinion that the existing accounting treatment of such enabling assets followed by the company does not appear to be correct. The views of the statutory auditors regarding treatment of expenditure of such nature are stated by the querist as under:

S. No.	Nature of expenditure	Accounting treatment
1.	Fixed assets created on land not belonging to the company but the fixed assets are owned by the company.	Capital expenditure shall form part of the fixed assets belonging to the company and treated accordingly.
2.	<ol style="list-style-type: none"> (a) Fixed assets created on land where neither the assets, nor the land, belongs to the company, or (b) The expenditure is incurred by way of payment to the government / private agencies for construction of bridge, roads, etc. and the company uses such enabling assets etc. for the purpose of completing its own project and subsequently for operational purposes. Such enabling assets are available for general public use also. 	<ol style="list-style-type: none"> (a) Expenditure to be debited to CWIP till the enabling asset is ready for use. (b) On completion of the enabling asset, the same to be capitalised. (c) Such capital expenditure to be reflected as "Capital expenditure on assets not owned by the company". (d) Such capital expenditure to be amortised over the period of its utility but not exceeding 5 years. (e) Amount amortised to be treated as expenditure during construction period till the completion of the project for which the enabling asset was originally created. After the completion of the project, the amortised amount is to be charged to the profit and loss account every year for the balance period of its utility.

¹ The Guidance Note on Treatment of Expenditure during Construction Period has since been withdrawn by the Council of the Institute of Chartered Accountants of India vide its decision taken at its 280th meeting held on August 7-9, 2008.

3.	(a) Upgrading, widening of certain portions / stretches of the road, culverts etc. on land not owned by the company to enable the movement of heavy construction equipment during the course of putting up of project.	To be accounted for as incidental expenditure during construction period.
	(b) Upgrading, widening, renovating, repairing, re-laying of certain portion / stretches of the road, culverts etc. after the completion of the project to enable the movement of vehicles / employees / general public.	To be charged to profit and loss account in the year of incurrence.

5. The querist has stated that after the withdrawal of the Guidance Note on Treatment of Expenditure during Construction Period, no direct reference to expenses of such nature is found either in Accounting Standard (AS) 10, 'Accounting for Fixed Assets', or in Accounting Standard (AS) 26, 'Intangible Assets'. However, to understand the accounting treatment of enabling assets, the querist has drawn attention to the following definitions:

Definition of Asset:

Paragraph 49(a) of the Framework for the Preparation and Presentation of Financial Statements, issued by ICAI, defines an asset as under:

"An asset is a resource *controlled* by the enterprise as a result of past events from which *future economic benefits* are expected to flow to the enterprise (emphasis supplied by the querist)."

Paragraph 6 of AS 26 defines, inter alia, an asset as under:

"An asset is a resource:

(a) controlled by an enterprise as a result of past events; and

(b) from which future economic benefits are expected to flow to the enterprise."

6. According to the querist, as is clear from the above definitions, in order to recognise the expenditure as an asset, the following two conditions must be satisfied:

- (i) The company must have *control over the asset*, and
- (ii) *Future economic benefits* must flow to the company from these assets. (Emphasis supplied by the querist.)

7. With respect to 'control over the asset', the querist has stated that 'control' has been defined/referred as under:

- Paragraph 56 of the Framework for the Preparation and Presentation of Financial Statements issued by the ICAI, states as under:

"56. Many assets, for example, receivables

and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, an item held under a hire purchase is an asset of the hire purchaser since the hire purchaser controls the benefits which are expected to flow from the item. Although the capacity of an enterprise to control benefits is usually the result of legal rights, an item *may nonetheless satisfy the definition of an asset even when there is no legal control*. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an enterprise controls the benefits that are expected to flow from it." (Emphasis supplied by the querist.)

- Paragraph 14 of AS 26 states as under:

"14. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can *restrict the access of others* to those benefits. The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way." (Emphasis supplied by the querist.)

The querist has stated that since in most of the cases of enabling assets, *the company cannot restrict the access of others to the benefits* arising from them, it can be concluded that the company does not have control over the assets (emphasis supplied by the querist).

8. With respect to 'future economic benefits', the querist has stated that future economic benefits are ensured from the enabling assets since they would facilitate operations of the company. Hence, as per the querist, even though the expenditure has been incurred for obtaining future economic benefits, the criteria for recognition as an asset are not met because the company cannot restrict the access of others to enabling assets.

9. The querist has also stated that paragraph 56 of AS 26 which deals with such expenses states, inter alia, as under:

"In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but *no intangible asset or other asset is acquired or created* that can be recognised. In these cases, the

expenditure is recognised as an expense when it is incurred.” (Emphasis supplied by the querist.)

Therefore, the querist has stated that, in the view of the company, the accounting treatment followed by the company of treating such expenditure incurred during construction of projects as unallocated capital expenditure and charging off the same to revenue in the year of capitalisation of such projects is in order.

B. Query

10. Due to divergence of opinion between the company and the statutory auditors and keeping in view the querist's view that subsequent to the withdrawal of the 'Guidance Note on Treatment of Expenditure during Construction Period', these issues have neither been covered in any of the Accounting Standards, nor the issue has been a subject matter of any query to the Expert Advisory Committee, the querist has sought the opinion of the Committee on the following issues:
- (i) Whether the current accounting treatment of considering the expenditure incurred on 'enabling assets' as CWIP during construction period of the project and charging off the same to revenue in the year of completion of the project is correct.
 - (ii) Whether the accounting treatment suggested by the auditors in paragraph 4 above is correct.
 - (iii) Whether such expenditure can be charged off to revenue;
 - (a) If yes, the accounting period in which such expenditure should be charged off to revenue, i.e., whether
 - in the accounting period of incurrence of such expenditure; or
 - in the accounting period in which the enabling asset is complete and ready for use; or
 - in the accounting period of completion of the main project for which such expenditure was incurred.
 - (b) If yes, what should be the treatment for such expenditure which is still lying as CWIP as on date.
 - (iv) If the answer to all or any of the above queries at (i) to (iii) is in the negative, what is the suggested accounting treatment for such expenditure.

C. Points considered by the Committee

11. The Committee notes from the Facts of the Case that the basic issue raised in the query relates to accounting for construction/development of electricity transmission lines, railway sidings, roads, etc. in order to facilitate construction of the project and subsequently to facilitate

its operations and the ownership of which does not vest with the company, collectively referred to by the querist as 'enabling assets'. The Committee has, therefore, considered only this issue and has not touched upon any other issue that may arise from the Facts of the Case, such as, fixed assets owned by the company but created on land not belonging to the company, etc. The Committee further notes from the Facts of the Case that the expenditure on 'enabling assets' includes payment to the government / private agencies for construction of the 'enabling assets' which will be available for general public use also. In the absence of any information to the contrary, the Committee presumes that the expenditure on 'enabling assets' is not adjustable against any payment to be made by the company towards future use of such assets.

12. The Committee notes that paragraphs 49 and 88 of the 'Framework for the Preparation and Presentation of Financial Statements', issued by the Institute of Chartered Accountants of India, give respectively, the following definition of and recognition criteria for, an asset:

“An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.”

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

From the above, the Committee notes that an expenditure incurred by an enterprise can be recognised as an asset only if it is a 'resource controlled by the enterprise'. Therefore, the issue raised by the querist requires examination from the point of view of the type of the resource that the company controls, if any, as a result of expenditure on 'enabling assets'. For this purpose, the Committee has examined whether the expenditure results into recognition of a tangible asset or an intangible asset.

13. The Committee is of the view that the above-mentioned expenditure can be considered to result into a tangible asset, only when, the company is able to control such asset(s). The Committee is of the view that an entity that controls an asset can generally deal with that asset as it pleases. For example, the entity having control of an asset can exchange it for other assets, employ it to produce goods or services, charge a price for others to use it, use it to settle liabilities, hold it, or distribute it to owners. Further, the Committee is of the view that an indicator of control of an item of fixed asset would be that the entity can restrict the access of others to the benefits derived from that asset. This view is also

supported by the principles enunciated in paragraph 14 of AS 26, as reproduced in paragraph 15 below.

14. The Committee notes from the Facts of the Case that the ownership of the 'enabling assets' does not vest with the company. The assets are available for general public use. Although the company is entitled to use these assets for the purpose of completing its own projects and subsequently for operational purposes, it has no say on the use of such assets by others. Thus, none of the factors mentioned in paragraph 13 above indicating control of the company is evident. Thus, 'enabling assets' are not resources controlled by the company and, therefore, the expenditure incurred by the company on such 'enabling assets' cannot be capitalised as a separate tangible asset.

15. The Committee now examines whether the above-said expenditure results into an intangible asset for the company. In this context, the Committee notes the following paragraphs from AS 26:

"An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

An asset is a resource:

(a) controlled by an enterprise as a result of past events; and

(b) from which future economic benefits are expected to flow to the enterprise."

"14. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. ..."

From the above, the Committee is of the view that the expenditure incurred by the company on 'enabling assets' not owned by the company does not meet the definitions of the terms 'asset' and 'intangible asset' as, even though the economic benefits are expected to flow to the enterprise from such facilities, the company does not have control over such facilities. Accordingly, such expenditure cannot also be capitalised as a separate intangible asset.

16. Now, the question arises as to whether the expenditure incurred on 'enabling assets' could be considered as a component of the cost of a fixed asset/project. In this context, the Committee further notes paragraphs 9.1 and 10.1 of AS 10, which are reproduced below:

"9.1 The cost of an item of fixed asset comprises its purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts

and rebates are deducted in arriving at the purchase price. ..."

"10.1 In arriving at the gross book value of self-constructed fixed assets, the same principles apply as those described in paragraphs 9.1 to 9.5. Included in the gross book value are costs of construction that relate directly to the specific asset and costs that are attributable to the construction activity in general and can be allocated to the specific asset. Any internal profits are eliminated in arriving at such costs."

From the above, the Committee is of the view that the basic principle to be applied while capitalising an item of cost to the cost of a fixed asset/project under construction is that it should be directly attributable to the construction of the project/asset for bringing it to its working condition for its intended use. The costs that are directly attributable to the construction/acquisition of a fixed asset/project for bringing it to its working condition are those costs that would have been avoided if the construction/acquisition had not been made. These are the expenditures without the incurrance of which, the construction of project/asset could not have taken place and the project/asset could not be brought to its working condition, such as, site preparation costs, installation costs, salaries of engineers engaged in construction activities, etc. The avoidance of costs as the basis of identifying directly attributable cost for the purpose of capitalisation is also supported by Accounting Standard (AS) 16, 'Borrowing Costs'. From the above, the Committee is of the view that the expenditure incurred on 'enabling assets' cannot be considered as directly attributable cost and accordingly, the same cannot also be capitalised as a component of fixed asset.

17. The Committee further notes that paragraph 56 of AS 26 provides as below:

"56. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. ..."

From the above, the Committee is of the view that the expenditure incurred on 'enabling assets' should be expensed and charged to the profit and loss account of the period in which these are incurred.

18. As far as accounting treatment given by the company in respect of such 'enabling assets' which are still lying as capital work-in-progress as on the date is concerned, the Committee notes that as per the Announcement on Clarification on Status of Accounting Standards and



Guidance Notes, issued by the Institute of Chartered Accountants of India, "In a situation where certain matters are covered both by an Accounting Standard and a Guidance Note, issued by the Institute of Chartered Accountants of India, the Guidance Note or the relevant portion thereof will be considered as superseded from the date of the relevant Accounting Standard coming into effect, unless otherwise specified in the Accounting Standard. ..." Accordingly, the Committee is of the view that the recommendations of a Guidance Note would be applicable only to the extent these are not contrary to an Accounting Standard. Hence, the recommendations of the 'Guidance Note on Treatment of Expenditure during Construction Period', after AS 26 becoming applicable to the company (even before the withdrawal of the said Guidance Note) were applicable only to the extent these were not contrary to the provisions of AS 26. Therefore, since, after AS 26 became applicable to the company, the expenditure incurred on 'enabling assets' was not expensed by the company as per the requirements of AS 26, as discussed above, the same is an error committed in the prior years which should be rectified in the financial statements and disclosed as a 'prior period item' of the period in which such rectification is carried out in accordance with the requirements of Accounting

Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

D. Opinion

19. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 10 above:
- (i) No, the existing accounting treatment followed by the company of considering the expenditure incurred on 'enabling assets' as capital work-in-progress during construction period of the project and charging off the same to revenue in the year of completion of the project is not correct.
 - (ii) No, the accounting treatment suggested by the auditors with regard to the 'enabling assets' is also not correct.
 - (iii) (a) Yes, the expenditure incurred on enabling assets not owned by the company should be charged off to revenue in the accounting period of incurrence of such expenditure.
(b) Expenditure on such assets not owned by the company appearing as CWIP, being an error should be rectified and disclosed as a 'prior period item' as per the requirements of AS 5 in the financial statements of the period in which such rectification is carried out as discussed in paragraph 18 above.
 - (iv) The expenditure on 'enabling assets' should be expensed by way of charge to the profit and loss account of the period in which the same is incurred.

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 eight volumes. A CD of Compendium of Opinions containing twenty eight volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.org .

Paradigm Shift in Indian Accounting Discipline: Convergence to IFRS

Globalisation of the capital market is crucial for establishing a uniform set of financial reporting rules worldwide. This has been a major driving force behind the convergence of accounting standards across the globe. The evolution of International Financial Reporting Standards (IFRS) marks the biggest revolution in financial reporting. Convergence in India would be facilitated by the fact that historically, Indian accounting standards have been based on principles as against rules. However, given the nature of accounting and peculiarities of the Indian economic environment, the process of convergence has its own challenges. This article aims to provide an insight into the increased awareness towards the challenges of convergence and the need for developing a road map to facilitate preparedness through advance planning.



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The International Accounting Standard Board (IASB) is a stand alone privately funded accounting standard setting body established to develop global standards of financial reporting. It is the successor to the International Accounting Standard Committee (IASC), which was created in 1973 to develop International Accounting Standards (IAS). Based in London, the IASB assumed accounting standard setting responsibilities from IASC in 2001. Since that time, the standards that the IASB develops and approves have been known as International Financial Reporting Standards (IFRS). IFRS is one of the biggest revolutions in the world of accounting industry. The term IFRS comprises IFRS issued by IASB, IAS issued by IASC; and the interpretations issued by the Standing Interpretations Committee (SIC) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB.

Providers of capital and hence the users of financial statements are

no longer limited to a single country and operate on a global basis. As a result they increasingly expect financial information to be presented in a comprehensive, transparent and commonly understood format. Convergence with IFRS, therefore, has gained significant momentum in recent years. More than 100 countries now require or allow the use of IFRS, and many other countries are replacing their national standards with IFRS. The European Union (EU), for example under a regulation adopted in 2002, required companies incorporated in its member states and whose securities listed on a EU regulated market, to report their consolidated financial statements using IFRS beginning with the 2005 financial year. The requirements had affected approximately 7,000 companies in the EU. The United States (US) Securities and Exchange Commission (SEC) has permitted foreign companies listed in the US to present financial statements in accordance with IFRS. Further there

is a proposal being considered for US domestic companies to transition to IFRS between 2014 and 2016 in a phased manner. More countries have plans to adopt IFRS as their national accounting standards in the future. By 2011, the number of countries requiring or permitting IFRS is expected to reach 150. The focus of IFRS implementation in most developed countries has been on listed companies. The IASB co-operates with national accounting standards to achieve convergence in accounting standards around the world.

India's Roadmap to Convergence

In line with the global trend, the Institute of Chartered Accountants of India (ICAI) has plans for convergence with IFRS for certain defined entities (listed entities, banks and insurance entities and certain large sized entities) with effect from accounting period commencing on or after 1st April, 2011. Large size entities are defined as entities with turnover in excess of ₹1 billion or borrowings in excess of ₹250 million. For other small and medium sized entities (SME), the ICAI has proposed the application of the proposed International Financial Reporting Standard for SME's (with or without modifications). The proposed standard represents a simplified set of standards for SME's with disclosure requirements reduced, methods for recognition and measurement simplified and topics not relevant to SME's eliminated. Given that the accounting standard setting in India is subject to direct or indirect oversight by several regulators such as National Advisory Committee on Accounting Standards (NASCAS) established by the Ministry of Corporate Affairs, Government of India, Reserve Bank of India (RBI), Insurance Regulatory and Development Authority (IRDA) and the Securities Exchange Board of India

IFRS eliminates barriers to cross border listings, by ensuring that financial statements are more transparent. Even in cases where listing an overseas exchanges is permitted using local (Indian) GAAP, international investors generally ascribe an additional risk premium if the underlying financial information is not in prepared in accordance with the international standards. Thus the adoption of global standards such as IFRS may reduce the risk premium and consequently the cost of capital.

(SEBI), the ICAI needs to work closely with these regulators on the roadmap to convergence. Adoption of IFRS in India would accordingly require changes to the regulatory environment and the ability of the ICAI to move towards its planned full convergence by 2011 which would be directly dependent on the pace of the required regulatory change.

Benefits of Convergence

Convergence with the IFRS is expected to result in several benefits to Indian entities, few are as follows:

- **IFRS significantly improves the comparability of entities:**

IFRS provides more comparability among sectors, countries and companies. Due to its universal approach, it can both improve and initiate new relationships with investors, customers and suppliers across the globe, since financial statements in accordance with IFRS cut across borders. IFRS will facilitate increased comparability of performance and compatibility among financial statements of countries, sectors, and companies. It may also result in greater transparency about a company's activities to outsiders such as investors, customers and other business partners.

As Indian businesses become more global in terms of their operations and investor base, IFRS would enable a comparison of Indian companies with global peers.

- **IFRS gives better access to global capital markets and reduces the cost of capital:**

IFRS are accepted as a financial reporting framework for companies seeking admission to almost all of the world's bourses. Currently, several companies that seek to raise capital and list securities in the US capital market or other exchanges such as the London Stock Exchange may be required to convert their financial statements to IFRS to meet the regulatory requirements or to meet the expectations of the investment bankers and investors. In such cases unless the company has previously adopted IFRS, it would be required to convert its historical financial statements to IFRS for the purpose of listing, which may result in delays and additional costs relating to dual set of financial statements.

IFRS eliminates barriers to cross border listings, by ensuring that financial statements are more transparent. Even in cases where listing an overseas exchanges is permitted using local (Indian) GAAP, international investors generally ascribe an additional risk premium if the underlying financial information is not in prepared in accordance with the international standards. Thus, the adoption of global standards such as IFRS may reduce the risk premium and consequently the cost of capital.

Similarly, companies raising capital and listed only on the local exchanges in India would be able to better attract international investors and reduce risk premium, by providing financial information that is more transparent and understandable for the international investor community. IFRS financial information can also

result in more accurate risk evaluations by the international lenders and low risk premium for international debt offerings. Improved communication and interaction with investors and analysts may provide companies with a competitive advantage and also wider access to capital at lower costs. Indian companies may be able to initiate new relationships with investors, customers and suppliers internationally since IFRS provides a globally accepted platform.

• **IFRS provides impetus to cross-border acquisitions:**

By providing transparent and comparable financial information, IFRS reporting provides an impetus to cross-border acquisitions, enables partnerships and alliances with foreign entities, and lowers the cost of integration in post acquisition periods. Currently, if an Indian company acquires a foreign entity, the financial position on the date of the acquisition and post acquisition results of the foreign entity have to be converted from its local GAAP (which maybe IFRS) to Indian GAAP. Similarly, if an overseas entity that follows IFRS acquires an Indian company, the post acquisition financial information would need to be converted from GAAP to IFRS, thereby increasing post-acquisition financial integration efforts and costs.

• **Improvement in quality and consistency of information, avoid multiple reporting and reduce cost of the finance function:**

Currently, different entities within a group, that reside in different jurisdictions may be required to prepare a dual set of financial statements for external financial reporting; one for the local statutory financial reporting in the home country and second for the reporting to the parent company (assuming that the parent company follows IFRS). The increase in efforts of finance function introduces complexity in financial reporting and increase costs of finance function.

Group wise adoption of IFRS will eliminate the need for such multiple reporting, if IFRS is accepted or required in all countries of operation.

Internal management reporting under IFRS will also improve the quality and consistency of information that management needs in order to make effective and timely decisions for the business. IFRS reporting actively contributes to effective management of business. When applied throughout a group's accounting processes, IFRS harmonises internal and external reporting by creating a single accounting language across the business.

• **An IFRS balance sheet will be closer to economic value:**

Historical cost will be substituted by fair values for several balance sheet items, which will enable a corporate to know its true worth. *Example:* intangible assets acquired in business combinations will be recorded separately at fair value, and all financial instruments and all investment properties will be reflected at fair values, thereby reflecting a better measure of the current value of the net assets of the entity.

• **Economic growth and opportunities for accounting professionals:**

Convergence with IFRS and to a

globally accepted standard will result in growth in international business, higher cross border capital flows and transactions and will provide an impetus for economic growth. Additionally, convergence with IFRS would also benefit the large pool of Indian accounting professionals who can develop IFRS skills and provide these skills to the global marketplace.

Challenges to Conversion

The ICAI issued "Concept Paper" in late 2007 on "Convergence with IFRS in India" which proposed a plan for certain defined entities, mutual funds and other large sized entities (based on threshold criteria of turnover or borrowings) with effect from accounting periods commencing on or after 1st April, 2011.

However, it is possible that convergence may eventually occur in a phased manner based on approach adopted in other countries, where the focus is initially only on listed entities. Similarly it is possible that the current thresholds of turnover or borrowings used for defining large-sized entities may be revised upwards. These measures would be intended to narrow down the number of affected companies and to ensure that the experience gained during the convergence by such companies can be leveraged by other relatively small companies.

ICAI has decided to follow a convergence approach to IFRS implementation rather than adoption of IFRS as issued by the IASB. It considers that the adoption of IFRS (without any modifications) as impractical in the Indian context due to various reasons as follows:

- The legal and the regulatory environment prevailing in the country have to be considered for implementing IFRS. There are instances where the legal and the regulatory requirements are

Under IFRS, convertible debt is split into a liability and equity portion whereby the proceeds from the issuance of the debt are allocated to the two components. The liability component is recognised at fair value by discounting at a market rate for non-convertible debt, while the balance proceeds are allocated to the equity component and recorded directly in equity. This results in recognising effective interest expense using rates applicable to non-convertible debt.

at variance with the requirements under IFRS. Hence relevant laws including the Companies Act, SEBI, IRDA, RBI regulations, tax laws, etc. will need to be suitably amended before IFRS can be implemented.

- Alternative accounting choices that are permitted in IFRS may be incompatible with the local requirements and considerations within specific sectors or industries. Hence, ICAI as part of the convergence process may restrict the available accounting alternatives.
- The current level of preparedness within the country for implementing IFRS is low and ICAI recognises the urgent and the pressing need to create a resource pool of professionals to manage the conversion and implementation process.

Regulatory Roadblocks

In order to reach convergence with IFRS there is an urgent need for change in several laws and regulations governing financial accounting and reporting and taxation in India.

In addition to accounting standards, there are legal and regulatory requirements that determine the manner in which financial information is reported or presented in financial statements. The Companies Act, 1956 directly provides guidance on accounting and financial reporting matters. Courts in India also have the powers to endorse accounting for certain transactions even if the proposed accounting treatment is not consistent with the Generally Accepted Accounting Principles (GAAP) in India.

As per the preface to the Indian Accounting standards, if a particular accounting standard is not found to be in conformity with a law, the provisions of the said law will prevail and the

financial statements shall be prepared in conformity with such a law. One of the most important works is for the government to frame and revise laws in consultation with ICAI and NASCAS to facilitate convergence with IFRS.

Revisions would be required in the Companies Act which currently prescribes the format for presentation of financial statements, the minimum rates of depreciation and classification of redeemable preference shares as equity. Many of these prescriptions directly conflict with accounting and presentation mandated by the IFRS and accordingly need to be amended to enable convergence and smooth adoption of the new accounting framework.

SEBI has also prescribed guidelines for listed companies with respect to presentation formats for quarterly and annual results and accounting for certain transactions, some of which are not in accordance with the IFRS, *example:* Clause 41 of the Listing Agreement permits companies to publish and report only standalone quarterly financial results. IFRS considers only consolidated financial statements as the primary financial statements of the entity.

Courts in India commonly approve accounting under amalgamation/restructuring schemes which may not be in accordance with the accounting principles/standards. Under the current accounting/legal framework, such legally approved deviations from the accounting standards/principles are accepted. Under IFRS, however, the accounting treatment in any proposal/scheme submitted to any court for approval would have to be in accordance with the IFRS. The need to amend procedures/laws to facilitate this is significant as the recent past there have been number of Mergers and Acquisitions (M&A) and restructuring transactions that have court sanction, but are not in conformity even with the

“Unlike Indian standards, where prior period items that represent correction of errors; and cumulative impact of change in accounting policies, are recorded as an adjustment in the current period, IFRS generally require accounting policy changes and correction of prior period errors to be made by adjusting opening retained earnings and restating comparatives. This is a relatively new concept for preparers, auditors, users, regulators, investors and analysts in India (although such restatements are required in certain limited situations that involve initial public offerings) and would require companies to clearly communicate with and educate investors and other users to highlight the impact of this change.”

accounting standards currently in force in India.

The RBI and IRDA regulate the financial reporting for banks, financial institutions and insurance companies, respectively, including the presentation format and accounting treatment for certain types of transactions. The RBI provides detailed guidance on provision relating to non-performing advances, classification and consistent with the requirements of IFRS.

In cases where a material error is discovered in previous reported financial statements IFRS requires that previously reported financial statements be *'restated'*. This process involves issuing new financial statements marked as *'Restated'* with detailed disclosures on the reasons and items contributing to the restatement. Where required, the external auditor of the entity would then issue an audit opinion on such *'restated'* financial statements. Currently, there are few or no general provisions in India that would permit

the revision of such previously reported financial statements.

Keeping in mind the above regulatory roadblocks, one of the main risks identified with IFRS convergence is that without adequate regulatory changes the financial statements prepared using converged Indian standards may still not fully comply with the IFRS issued by the IASB. In such a case, even if all the Indian Accounting Standards are converged with IFRS prior to 1st April, 2011, the financial statements prepared by Indian companies for the year ending 31st March, 2012, may not be compliant with IFRS. Thus, Indian companies that seek to prepare fully complaint IFRS financial statements (either because of overseas listings; or for meeting the expectations of international investors/partners; or for any other reasons) would still need to make adjustments to these financial statements to achieve compliance with IFRS. This would largely negate several expected benefits of convergence.

One of the other related challenges identified is the need to fully consider and clarify the proposed convergence

“1st April, 2011, still seems some way off, but as previously discussed, one of the fundamental principles of IFRS is the need to adopt many of its requirements retrospectively at first time application i.e., as though the company had always reported under IFRS. Meeting this requirement calls for accounting adjustments that often relate to events which took place several years ago, and it can be very difficult to generate all the necessary data from such a distant standpoint. Complete IFRS statements have to include comparative figures for the period before the one actually being reported.”

plan in matter related to income taxes and indirect taxes. Tax authorities need to ensure clarity in tax treatment of items arising from convergence to IFRS. *Example*: unrealised losses and gains on derivatives that are required to be marked to market under IFRS. Different taxation framework is possible for tax treatments of such unrealised losses and gains. Under one approach, taxable income would include such unrealised gains/losses included in the profit and loss account. While an alternative approach for taxable income would exclude such ‘*unrealised fair value related*’ adjustments. Every country that transits to IFRS standards from a financial reporting perspective would need to separately evaluate alignment of tax regulations. It is, therefore, important that the Indian tax authorities are engaged sufficiently in advance to decide on such critical aspects of taxation.

The IASB in order to assist first time adopters to overcome difficulties in applying IFRS has provided guidance in IFRS 1 “*First time Adoption of International Financial Reporting Standards*”. Most of the Indian entities will be adopting IFRS for the first time. However, regulators in India have reiterated that Indian Accounting Standards will be modified on an individual basis to converge with equivalent international standards. As a result there is a lack of clarity on whether full convergence and compliance with IFRS would require companies to transit to IFRS using principles established in IFRS 1 or if there would be any other alternative model that is proposed to be used in India.

IFRS 1 provides the basis on which entities should convert their financial statements to IFRS. It lays down the transition approach that is to be followed in an entity’s first set of IFRS financial statements, and in the preparation of its opening IFRS balance

sheet, which serves as a starting point for future accounting under IFRS. The key principle of IFRS 1 is full retrospective application of all IFRS in force at the closing balance sheet for the first IFRS financial statements. However, there are 10 areas of optional exemptions introduced by the IFRS 1 that aim to reduce the burden of retrospective application. Entities are required to make judgments and decisions about which option to apply in their first set of IFRS financial statements. The exemptions provide limited relief for the first time adopters mainly in areas where the information needed to apply IFRS retrospectively might not be available.

There are no exemptions from the demanding disclosure requirements of IFRS and many companies will need to collect and publish additional information. Though IFRS 1 goes some way to reduce the practical difficulties associated with retrospective application, retrospective application would still be required in many areas.

Further, there is a lack of clarity on the status of other authoritative and non authoritative accounting guidance (for *example* guidance notes issued by the ICAI, opinions of the expert advisory committee of the ICAI) subsequent to the stated ‘*convergence*’. In several instances while the Indian Accounting Standard are in full conformity with the equivalent IFRS, interpretive guidance provided in India may be inconsistent with interpretive guidance and practice in other countries that are fully compliant with IFRS.

Indian standard setters and regulators need to consider the above issues very carefully to ensure that the convergence with IFRS achieves the expected benefits for Indian companies. Similarly, Indian companies need to consider these issues while presenting their perspective to the standard setters and regulators.

“ Goodwill acquired may be allocated at segment level or profit center level to distribute the impairment loss. Goodwill will be accounted only on acquisition for the surplus of purchase consideration over the carrying amount of the assets and liabilities. If the acquisition is providing a value addition as a brand, the goodwill will be allocated to the level below segments so that, if required for test of impairment the amount charged off will be lesser. ”

Impact of key differences

• Acquisitions and consolidated financial statements

Currently, only listed Indian companies and banks are required to prepare consolidated financial statements. All other entities issue only standalone financial statements. Adoption of IFRS would require all defined entities (which include large-sized entities that are not listed on stock exchanges) to prepare and present consolidated financial statements.

Under Indian GAAP, there is no comprehensive standard that addresses accounting for acquisitions where one entity obtains control of another entity. The accounting for such transactions is largely dependent on the form of the acquisition. For *example*, the accounting treatment may differ dependent on whether the acquired company is retained as a separate legal entity, whether it is legally merged with the acquirer or whether a group of assets constituting a business is acquired. To add to the complexity and confusion, if the acquired company is merged with the acquirer through a court-approved scheme, the scheme itself may prescribe an accounting treatment that is required to be followed, which may be in variation with the accounting

standards. Thus, depending on the form of the arrangement and other factors, goodwill may be computed based on the book value of the assets of the acquired company or the fair value of the assets of the acquired company. Similarly, depending on the form of the arrangement, the resultant goodwill may either be amortised over a period or not amortised, but tested for impairment. In certain cases, the court-approved scheme may provide that the goodwill is adjusted against the reserves of the acquirer. Finally, Indian GAAP still permits the use of the pooling-of-interest method whereby the entire transaction is accounted based on carrying values and no goodwill arises.

Under IFRS, all acquisitions are generally accounted for using the purchase method whereby the purchase price is compared to the fair value of all identifiable tangible assets, liabilities, contingent liabilities and intangible assets of the acquired company, with the excess being recognised as goodwill. This goodwill is not amortised, but is assessed for impairment annually. The limited exception to this principle relates to acquisitions between entities under common control, whereby an entity can adopt an accounting policy choice of recognising the acquisition either by the purchase method discussed earlier, or by the pooling-of-interest method.

Another key area of difference relates to the date of acquisition from which the results of the acquired company are included in the consolidated financial statements. While conceptually, both Indian GAAP and IFRS prescribe consolidation from the date when control is obtained or the investment is acquired, in certain specific situations (for *example*, court-approved schemes), the scheme may provide for an acquisition date that precedes the date of investment or the date that control is actually obtained.

For most companies, application of the purchase accounting principles discussed above would result in an adjustment to the value of the assets and liabilities recorded recognition of previously unrecorded intangible assets and consequent adjustments to goodwill balances. These adjustments would subsequently affect the post-acquisition consolidated results, generally through increased amortisation and depreciation. Additionally, the ability of companies to include, in the consolidated financial statements, the revenues and profits of the acquired companies, prior to the date of the investment or prior to the date that control is obtained, would also be restricted.

• Intangible assets acquired

Under Indian GAAP intangible assets are generally recognised only if they are acquired separately. All intangible assets are amortised over their useful lives (and tested for impairment) and there is a rebuttable presumption that the useful life cannot exceed 10 years. Under IFRS, intangible assets are recorded either while accounting for acquisitions using the purchase method, or when intangible assets are acquired separately. IFRS acknowledges that certain intangible assets may have indefinite useful lives (for *example*, brands that demonstrate certain characteristics) and accordingly, such intangible assets are not amortised, but tested for impairment annually. Additionally, consistent with the treatment of all other depreciable assets, intangible assets are amortised over their estimated useful lives and there is no presumption that restricts the useful life.

On adoption of IFRS, Indian companies that may acquire certain long-lived brands and similar intangible assets, may reach a conclusion that these intangible assets, which are amortised under Indian GAAP, are no longer required to be amortised or that

these assets can be amortised over longer periods of time that represent their economic useful lives.

• Share-based payments to employees

Indian GAAP on share-based payment to employees (for example, employee stock options) provides entities with a choice to either adopt the intrinsic value method or the fair value method. Substantially all Indian companies have currently opted to adopt the intrinsic value method. Under this method, since most employee stock options are granted with an exercise price equal to the market price on the grant date, no compensation cost is recognised. IFRS mandates the use of the fair value method, whereby the fair value of the options is determined using an option pricing model such as the Black-Scholes model or the Lattice model. This would usually result in recognition of compensation cost even if the options are in-the-money on the grant date.

On adoption, most Indian companies that have issued share based payments may need to record previously unrecognised compensation cost relating to these award, based on the fair value approach.

• Financial instruments

Financial instruments where Indian GAAP differs significantly from IFRS include financial assets such as investments, financial liabilities such as convertible debt and preference shares and derivative instruments.

Under Indian GAAP, long-term investments are generally carried at cost, less impairment; and current investments are carried at lower of cost or market value. IFRS requires that investments be categorised into three categories: trading or investment carried at fair value, held-to-maturity and available-for-sale. Except for held-to-maturity investments (where the entity has the intent and ability to hold the investment till maturity), all investments

are carried at fair value. For investments categorised as trading, all unrealised gains and losses are recorded in the income statement. For investments classified as available-for-sale, the unrealised gains and losses are generally recorded directly as an adjustment to shareholders funds. Held-to-maturity investments are carried at amortised cost. It is likely that on adoption of IFRS, most investment securities held by Indian companies would be categorised as available-for-sale and accordingly would be carried at fair value. This would affect the reported value of the investment portfolio and net worth.

IFRS require that a financial instrument should be classified in accordance with the substance of the contractual agreement rather than its legal form (substance over form). Thus, redeemable preference share would be a financial liability and dividends on redeemable preference shares are recognised as interest expense under IFRS and impact the profits and loss for the year. This is different from the Indian GAAP classification of redeemable preference shares as equity and the related presentation of dividends on such preference shares as appropriation of profits. This would impact financial structures and debt-equity ratios.

Similarly, under IFRS, convertible debt is split into a liability and equity portion whereby the proceeds from the issuance of the debt are allocated to the two components. The liability component is recognised at fair value by discounting at a market rate for non-convertible debt, while the balance proceeds are allocated to the equity component and recorded directly in equity. This results in recognising effective interest expense using rates applicable to non-convertible debt. Under Indian GAAP, there is no specific accounting guidance for convertible debt and interest expense is generally

recognised based on the stated rate of interest. Thus, if the stated rate of interest is lower than the market rate on non-convertible debt (due to the presence of the conversion feature), adoption of IFRS will result in additional interest expense based on this split allocation approach.

Under IFRS, an entity must recognise all derivative instruments at fair value on the balance sheet. Unless certain specific rules for hedge accounting are met, all changes in fair value are recorded through the income statement. Indian GAAP currently provides limited guidance on accounting for derivatives. Thus, except for certain specific forward exchange contracts, most derivative instruments are currently not recorded on the balance sheet and do not affect the financial statements until realised/settled. The ICAI has already issued standards on presentation, recognition, measurement of financial instruments exactly on the basis of IFRS. However, these will be mandatory only from 1st April, 2011. Adopting these standards in relation to derivative instruments and hedge accounting will be a monumental shift in accounting for a large number of items on the balance sheet which will lead to recognition of many financial instruments which are currently kept off-

“The principle based accounting in IFRS puts much more value to work of the consultant who can make this conversion and also on the management to make a proper gap analysis and estimate of the cut over challenges which will unfold on conversion. It may not be possible to understand the ramifications and disclosure requirements at an early stage, so the plans and efforts for conversion should begin now to avoid last minute problems.”

balance sheet. Additionally, unless specific hedge accounting requirements are met, these standards will result in significant income statement volatility impacted by changes in fair value of the derivative instruments.

Restatement of Comparative Financial Statements for Changes in Accounting Policies and Correction of Errors

Unlike Indian standards, where prior period items that represent correction of errors; and cumulative impact of change in accounting policies, are recorded as an adjustment in the current period, IFRS generally require accounting policy changes and correction of prior period errors to be made by adjusting opening retained earnings and restating comparatives. This is a relatively new concept for preparers, auditors, users, regulators, investors and analysts in India (although such restatements are required in certain limited situations that involve initial public offerings) and would require companies to clearly communicate with and educate investors and other users to highlight the impact of this change.

Presentation of Financial Statements

Financial statements presentation formats under Indian GAAP are primarily driven by regulatory requirements specified in the Indian Companies Act and other regulation for specific industries (for example, banking and insurance). Under IFRS, IAS 1 sets out detailed requirements for presentation of financial statements, including their structure and minimum requirements for content.

Under IFRS, in addition to the balance sheet, income statement and cash flow statement, either a Statement of Changes in Equity (SOCIE) or a Statement of Recognised Income and

Expenses (SORIE) with supplementary notes is required. A SORIE is a subset of SOCIE. An entity includes in SORIE revaluation reserve, unrealised gains or losses on valuation of available-for-sale investments, which are not reported through the income statement, but are directly adjusted to equity. When an entity elects to present a SORIE, the additional information regarding capital transactions with owners (issuance of equity, distribution of dividends), movements in accumulated profit and loss and a reconciliation of all other components of equity is presented in the notes to the financial statements. No such statements are required under Indian GAAP. However, the movement in capital and reserves and appropriation of profit and loss account is presented in the income statement and the balance sheet.

Under IFRS, expenses can be classified by nature (salary, rent, power and fuel) or by function (cost of revenues, selling expenses, general and administrative). Schedule VI requires classification by nature. Companies would need to carefully evaluate the presentation requirements of IFRS to identify incremental disclosures and changes to presentation requirements.

Critical Success Factors for IFRS Convergence Projects

On the basis of the study conducted on IFRS, following common critical success factors are identified for Indian companies for successful IFRS conversion projects:

- Strategy
- Leadership
- Communication
- Resources
- Knowledge
- Project management
- Time

Strategy

Although with effect from 1st April 2011, Indian companies may have no

choice about adopting IFRS, they can approach conversion in one of two ways:

- The conversion to IFRS of financial statements prepared under local accounting standards by various entities within the group, as part of the group consolidation process; or
- Implementing IFRS in the accounting process across the entire organisation, across geographies.

The second of these two options involves using IFRS as the trigger for harmonisation of internal and external reporting. Companies might also need to revisit the basis for calculating management incentive payments given the likely impact of IFRS on financial performance measures. The decision about which option to choose revolves around a company's intended use of IFRS and more importantly on whether IFRS is permitted or required in all geographies where the company operates. The broader its proposed application, the more sense it makes to implement IFRS throughout the accounting process. Our experience indicates that this course of action is more efficient and effective, since it provides companies with an internal reporting language, which is fully consistent with their external reporting framework.

Leadership

Conversion to IFRS is nothing less than a major change programme. It requires senior management to take responsibility for the project and to demonstrate clear leadership and sponsorship throughout its implementation.

This is the only way to gain the widespread acceptance of change, which is required by conversion. Furthermore, the complexity of the process demands a high degree of priority from those assigned

to its implementation; and those responsible on day to day basis will need to be given enough time to do their job. They also need to be properly motivated.

Communication

The decision to convert to IFRS needs to be communicated to all those who will be affected by it. This is an essential task in mobilising the whole organisation behind conversion to IFRS. Effective communication of the conversion of project's different elements is essential. There are both external and internal audiences involved:

- The company's employees, who should understand why the project is taking place, how it affects them and its progress at key points.
- Other stakeholders, including investors (especially institutional and analysts) and lenders, who need to be made aware of how IFRS conversion impacts the company's financial data.

Resources

In deciding on the resources required to see conversion through to successful completion, there are a number of issues to be addressed, including:

- How many people are required?
- Who should be deployed on the project?

Knowledge

The qualification for membership of the project team is knowledge. This is not just knowledge of the technical aspects of IFRS, equally important is:

- A good overview of the company's business issues, together with the events and transactions that typically characterised the company's activity;
- Familiarity with the reporting processes currently in place and the technology that supports

them; and

- An understanding of the methodologies and tools that will be used to implement IFRS within the company's reporting processes.

Since no one individual is likely to have all these skills, the project team needs to bring together people with a variety of different experience and expertise. Their challenge will then be to work effectively as a team towards the common goal.

Conversion teams typically need to include specialists with a wide range of professional backgrounds. These might include technical accounting, treasury, tax, legal, actuarial and systems experts, as well as specialists in human resources and project management. Some of the individuals required can be found internally, while others may need to be brought in from external advisers. Our experience indicates that auditors and other external advisors need to work closely with internal staff to ensure a smooth transition.

Project Management

Complex tasks are easier when divided into manageable pieces. This is no less applicable to IFRS conversion projects which, once the decision to go ahead has been taken, can be broken down into key phases.

Assess

The Assess phase is essential in identifying what the major IFRS impact areas are for the organisation and agreeing the way forward on a right first time basis. It starts with the high level identification of the key areas of impact and an assessment of the likely degree of complexity the organisation is likely to face in converting to IFRS.

The impact of IFRS conversion needs to be considered in terms of four critical areas:

1. Accounting and reporting issues;
2. The impact on the business;
3. How conversion affects systems and processes;
4. The implications for people.

The degree of complexity likely to be faced is the product of many different factors, and will be influenced by issues such as technical accounting matters, the number of countries the business operates in, the current state of financial reporting systems and processes, and the availability of internal resources with the appropriate technical skills and project management experience.

This phase includes a detailed assessment of the differences between the accounting standards currently in use (Indian GAAP) and those under IFRS. An assessment is also needed of how the new information requirements will affect management information systems, as well as the impact on the

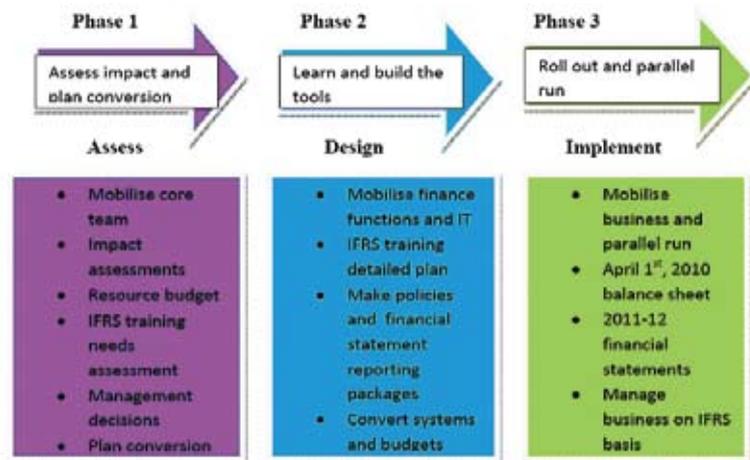


Diagram 1: Phases of Project Management



business and its key activities including acquisitions, alliances or joint ventures. The objective is to enable management to make informed decisions about the impact of IFRS and to determine a path forward which is cost effective and minimises disruption to the business.

In order to arrive at these decisions, the gaps need to be identified between old policies and procedures and the new ones required in following IFRS such as accounting and disclosure issues and the impact on statutory reporting. This also applies to gaps in systems and processes and training needs.

Having made an assessment of where the organisation is now, and the position it needs to get to, a master conversion plan and budget can be developed for the conversion process. This includes formulating additional objectives and benefits, such as streamlining financial reporting processes or improving timeliness, which the organisation wants to derive from the conversion.

A multi-disciplinary team needs to be assigned to the IFRS conversion project to help make sure that the Assess phase is successfully completed.

Design

The second phase is about mobilising the organisation for closing the gaps identified in the Assess phase. These might include, for *example*, a redevelopment of the reporting package, a transition programme

for the harmonisation of local GAAPs followed in different geographies. Under IFRS, a plan for enhancing or speeding up the consolidation process, planning and implementing the necessary system changes, as well as developing a detailed training programme for financial and operational staff needs to be mapped out. This phase also involves developing a detailed timeline for a dry-run, data collection, testing and analysis. A rigorous project management plan is also essential.

Implement

This is where the plans are finally put into action and the businesses start to make IFRS part of their day-to-day operations.

The training programme needs to be rolled out so that everyone understands the new accounting regime, how to use the reporting packages and how to account for events and transactions under IFRS. The data-gathering process also needs to start at this point, including at least, a one-year parallel run to produce internal IFRS numbers for comparative purposes.

Finally, all the information gathered has to be consolidated to produce IFRS financial statements. Since it is unlikely that this process will work perfectly the first time, dry-runs of the procedures should be carried out. This will enable weaknesses to be identified, which can be eliminated before the organisation goes live with IFRS.

Time

1st April, 2011, still seems some way off, but as previously discussed, one of the fundamental principles of IFRS is the need to adopt many of its requirements retrospectively at first time application i.e., as though the company had always reported under IFRS. Meeting this requirement calls for accounting adjustments that often relate to events which took place several years ago, and it can be very difficult to generate all the necessary data from such a distant standpoint. Complete IFRS statements have to include comparative figures for the period before the one actually being reported. This means that for a company with a 31st March year end, in order to comply with IFRS for accounting period commencing on or after 1st April, 2011, an IFRS balance sheet as at 1st April, 2010 at the latest, will be required.

The earlier companies start the conversion process, the more time they will have to find and solve any teething problems.

Managing the IFRS Changeover

Indian enterprises that will convert to IFRS have the opportunity to learn from the experiences of those who have already adopted IFRS worldwide as well as in India. By examining the approaches used in successful IFRS implementation projects across the world, Indian companies can smoothen their IFRS transition projects.

Below are a few of the key steps and questions that need to be addressed by an entity as it approaches IFRS convergence.

Each enterprise usually begins its IFRS project with a high level assessment:

- What areas of IFRS are likely to have the biggest impact on its financial reporting?
- How complex is the transition likely to be?

- What challenges it might encounter during the implementation?
- Who needs to be involved in the project?

After completing this initial scoping and mobilising the necessary resources, the project team moves to a more detailed level. Team members should undertake systematic and detailed gap analysis to establish the potential impact of conversion. These detailed gap assessments require significantly more time and effort by the conversion team. Doing the work well the first time is essential as it creates a blue print for the design and implementation phases of the project and sets the foundation and addressing the project's impact across the organisation.

Need for a Structured Approach

This methodology focuses on the impact transition in four clusters: systems and processes; business-related issues; the people function and accounting and reporting.

Accounting and reporting:

Focus on such actions such as:

- Mapping each line of financial statements, notes to the applicable IFRS standard.
- Conducting a systematic gap analysis of the differences between IFRS and current accounting policies and detailed practices relating to balance sheet items, income statement items, general or special topics and disclosure issues.
- Weighing the pros and cons of the many IFRS 1 elective exemptions, to help reduce the burden of applying IFRS standards retroactively to past transactions.
- Assessing the impact of various accounting policy choices available under IFRS (such as revaluation or amortisation cost methods of measuring property, plant and equipment).

Systems and processes

Decisions in all other work streams will

likely affect systems, processes and controls. Assess their impact by:

- Addressing the level of flexibility for changes in the current systems ledger structure, chart of accounts, mapping, functionality and suitably.
- Understanding the current IT project priorities and determining whether any planned projects should be deferred or revised.
- Assessing the impact on current data gathering processes in which additional information is required or will change under IFRS.
- Determining the effect on your internal control processes. Which key controls could change with the implementation of IFRS?
- Determining the need for multiple GAAP reporting due to tax or other regulatory considerations.

Business and people

Address the impact of IFRS on people throughout the business by:

- Providing training for staff at all levels to the extent required. Since IFRS will be India's new accounting language many people who provide support or use financial information may need to understand the new accounting technical standards that will affect the organisation and any new processes that will need to be implemented.
- Investigating impacts on normal business and financial contracts (example debt covenants) budgeting processes, performance management metrics, incentive compensation plans and other operations.
- Analysing the likely effect on tax calculations and reporting.
- Evaluating the implications for regulatory submissions for *example* banking and insurance companies.
- Formulating and implementing communications plans for an enterprise's many stakeholders

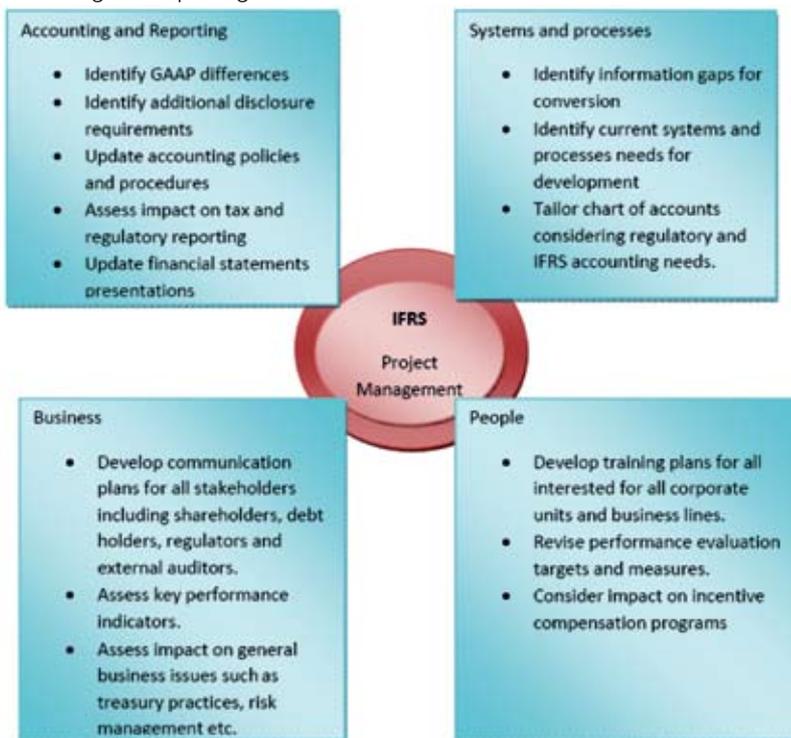


Diagram 2: Structural Approach to IFRS

who will need to understand the IFRS changeover from a variety of perspectives.

Benefits of a Phased Approach

This phased approach is extremely relevant in the current Indian environment due to the regulatory uncertainties.



Diagram 3: Phased Approach to IFRS: Benefits

Diagnostic

Detailed gap analysis between current accounting practices and disclosures under Indian GAAP and IFRS requirements.

- Identify accounting policy choices and options under IFRS.
- Evaluate identified gaps to determine:
 - Impact on IT systems
 - Impact on processes
 - Impact on internal financial reporting controls
 - Impact on business practices and contracts
- Develop a convergence path and plan along with related manpower/ cost budgets

Design and planning

- Training strategy and implementation of training plan.
- Designing templates to capture historical information
- Designing templates of pro-forma financial statements and disclosures
- Evaluating systems and process changes as required

Solution development and parallel reporting

- Implement system and process changes as required.
- Preparation of updated accounting policy manuals and standard operating procedures manuals, as required.
- Preparation of opening balance sheet as per the final transitional

requirements.

- Preparation of financial statements for interim and annual comparative periods as per the final transitional requirements.

Cut-over

- Reporting for the first reporting period as per the final transitional requirements.
- Post-implementation review.
- Multi-GAAP reporting for tax and regulatory purposes, as required.

Ongoing communication and project management

- Managing expectations of internal and external stakeholders through timely and regular communications.
- Overall project management to track progress against defined milestones.

Given the current regulatory uncertainty on the manner of transition, companies may find it useful to implement the Diagnostic phase and certain elements of the Design and Planning phase. Efforts expended



during these phases are likely to be beneficial for companies irrespective of the ultimate manner of transition adopted in India.

Conclusion

The transition from GAAP to IFRS is not only inevitable, but a positive development that would help make capital markets more competitive. Transitioning to IFRS would allow companies to compete for capital in other countries, while reducing cost and complexity for companies operating internationally; we also think that embracing a single set of global accounting standards would contribute to a higher degree of investor understanding and confidence. And finally India should follow the league by joining hands with the major countries following IFRS which is expected to be 150 by year 2011. ■

Human Resource Accounting



Over the past few decades, world economies have undergone a fundamental transformation from an Industrial Economy (manufacturing based) to the knowledge and information based Service Economy (Contribution in GDP 53.7 per cent) for survival and profit. Success of any service industry totally relies upon the quality of human resources it possesses. The increasing awareness and recognition of human and intellectual capital as a core economic resources of the current era, have forced the firms to shift their focus from investment only in traditional physical assets (such as inventories, plant and equipment) towards the investment and development in human capital. Human capital and intellectual property are seen as determinants of economic success at both the macroeconomic and the firm level. This has made the investment in training and development programmes very critical and there is a need to develop new methods, tools and concepts for monitoring and evaluation of management development programmes in terms of their impact, results and value or return on investment. Unfortunately, no specific Accounting Standard has been developed by any regulatory authority for valuing human resources of any organisation. The article focuses on concepts of “Human Resource Accounting” and various techniques to determine the value of human resources.



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Human Resource or Human Capital valuation refers to identifying and measuring the value of human resources of an entity. Unlike other resources, human beings are not owned by organisations and hence they are relatively free to supply or withhold their services. There is a debate as to determine whether human capital is an organisational asset as conventionally defined Assets. But there should be no doubt that they are indeed a huge and major source of revenues for the entities

existing today. Accordingly whether or not human capital is reported in external financial statements, it is a critical Economic Resource and it needs to be managed.

The accountants in the past have not given due consideration to this important asset working in the enterprise. In our traditional accounting practices, the heavy amount incurred on the recruitment, placement, selection, training and development of the personnel is generally treated

as revenue expenditure and hence it is debited to profit and loss account of the period during which such amount is incurred. But today, it is argued that these expenditures incurred by an enterprise to get the benefit of the services of its manpower force in future is against the accounting principle to treat them completely of a revenue nature. In fact, such expenditure should be capitalised and be shown as an Asset in the Balance Sheet. The failure of professional accountants to treat human resources as asset just like physical and financial assets has led to the evolution of the concept of Human Resource Accounting, which emphasises that human resources should be treated like physical assets and should be shown in the balance sheet of the enterprise.

“Human Resource Accounting (HRA) is a technique to assess the value of human resources and increased value contributed by management development and communicating this information to the interested parties.”

Need for HRA

Human Resource Accounting is necessary because:

- People are valuable resources for an enterprise.
- To find out the productivity of investment on human beings in organisation. It can be used as a scaling tool that generates and reports Quantitative Control Information about the contribution of human resource for promoting industrial productivity.
- The usefulness of manpower as organisational resources is determined by the way in which it is managed.
- Information on investment and value of human resources is useful for decision-making in an enterprise. It helps in developing financial assessments for the people within the organisation and

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monitoring of these assessments in the light of net accounting policy of the concern from time to time.

The purpose of HRA is to improve the quality of human resources decisions made both internally and externally concerning and organisation. However, the specific objectives of Human Resource Measurement may be outlined as under:

- (1) To assess the efficiency of human resources in obtaining productivity and profitability.
- (2) To assist the management in taking suitable decisions regarding investment on human resources.
- (3) To provide information to all people concerned regarding the earning potential of human resources of the organisation.
- (4) To provide comparative information regarding costs and benefits associated with investment in human assets.

Human Capital Valuation

The biggest challenge in HRA is that of assigning monetary values to different

dimensions of HR costs, investments and the worth of the employees. The two main approaches usually employed for this are:

1. **The Cost approach** – The basis for valuation of human resources is the costs incurred by the company, with regard to an employee.
2. **The Economic Value Approach** – The basis for valuation of human resources is the economic value of the human resources and their contribution to the company's growth. These approaches perceive human resources as assets and estimate the benefits that will be generated from the human resources.

Cost Approach:

Cost is a price paid to obtain some anticipated benefit or service. Two types of costs are of special importance in HRA. These are original or historical cost and replacement cost.

1. **Historical Cost Approach** – The cost associated with the acquisition and development of human resource of an organisation. This includes:

- Recruiting
- Selection
- Hiring
- Placement
- Orientation
- Job training, etc

While some of the costs like salaries are direct costs, other costs e.g. the time spent by the supervisors during induction and training, are indirect costs.

Limitations

- The valuation method is based on false assumption that the currency is stable.
- Since the assets cannot be sold, there is no independent check of valuation.
- This method measures only the costs to the organisation, but ignores completely any measure

of the value of the employee to the organisation.

2. **Opportunity Cost Approach** – This approach focuses on the calculation of what would have been the returns if the money spent on HR was spent on some other alternatives.

Limitation

This method does not fulfill the objective and not a perfect method to value HR. So, it is limited to internal reporting and assessment only.

3. **Replacement Cost Approach:** This approach focuses on the cost associated to replace the present employees the costs can be classified as

- Costs of Recruitment
- Selection
- Hiring
- Placement
- Orientation
- Job Training
- Loss in revenue due to unavailability of a particular employee.

That will occur in order to replace them.

Limitation

Substitution of replacement cost method for historical cost method does little more than update the valuation, at the expense of importing considerably more subjectivity into the measure. This method may also lead to an upwardly biased estimate because an inefficient firm may incur greater cost to replace an employee.

The Economic Value Approach:

The economic value approach of human capital valuation is based on the expected present value of the services (in economic terms) that is expected to be generated by the human resources of any organisation. This may be the value of individuals, groups or the total

human organisation. The methods for calculating the economic value of individuals may be classified into *Monetary and Non-Monetary Methods*.

Monetary measures for assessing Individual Value

1. Flamholtz's model of determinants of Individual Value to Formal Organisations
2. The Lev & Schwartz Model
3. Morse Net Benefit Model:
4. Hekimian and Jones Competitive Bidding Model

1. Flamholtz's Stochastic Model

- According to Flamholtz, the value of an individual is the present worth of the services that he is likely to render to the organisation in future till his/her balance service life. As an individual moves from one position to another, at the same level or at different levels, the profile of the services provided by him is likely to change. The present cumulative value of all the possible services that may be rendered by him during his/her association with the organisation is the value of the individual to the organisation.
- The possibility that people can leave organisations does not eliminate them as capital, it merely creates a dual aspect

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to an individual's value as an organisational resource. Specifically, we can conceptualise a person's value to an organisation under two different conditions:

1. *Remaining as an economic resource for the full period of economic benefit or service life*
2. *Remaining as an economic resource for less than the full period of economic benefit or service life.*

Economic Conditional Value (ECV)

It is the amount that an organisation could potentially realise from the employee's services during the period of his or her productive service life in the organisation. It is composed of following factors:

1. **Productivity or performance** – These are the set of services that an individual is expected to provide in his/her present position.
2. **Transferability** - These are the set of services that he/she is expected to provide if and when he/she is in different positions at the same level, if he is transferred.
3. **Promotability** - These are the set of services that are expected when the individual is promoted to a higher level positions within an organisation.
4. **Exit** – Leaving the firm, either voluntarily or by request.

These factors depend, to a great extent, on *individual determinants* like activation level of the individual (his motivation and energy level) and *organisational determinants* like opportunity to use these skills or roles and the reward system.

Economic Realisable Value (ERV)

The amount actually expected to be derived, taking into account the person's likelihood remaining in the organisation. The ultimate measure of a person's value is to be expected realisable value because this concept

is a function of the expected conditional value, and the *probability that the individual will remain* in the organisation for the duration of his/her productive service life. Since individuals are not owned by the organisation and are free to leave, ascertaining the probability of their turnover becomes important. The interaction between the individual and organisational determinants mentioned above, leads to *job satisfaction*. The higher is the level of job satisfaction; the lower is the probability of employee turnover. Therefore, higher is the expected realisable value.

- **Service State:**

These are the different roles that an individual may occupy in a firm, thus performing different levels of service. The value of an individual

In the absence of Human Resource Accounting, the management may not realise the negative effects of certain programmes aimed at improving profits in the short-run. Such programmes may result in decreased value of human assets due to fall in the productivity levels, high labour turnover, low morale, etc. HRA in any organisation should be designed to serve mainly two functions. First it should focus more on recognition of human resource as a critical success factor for any organisation, as it is the men behind the organisation who drive it towards success. The emphasis on the human capital should be increased to remain in the competition in today's economic era. The second aim of HRA is to provide an alternative accounting system designed to measure the cost and value of human assets to an organisation.

to a firm depends upon the value of the service states the person will occupy in an organisational hierarchy (present position, next higher position, exit and so on) as well as the probabilities that the person will occupy each possible service state.

- **State Transition:**

In time, people move in the organisational hierarchy from one service (or role) to another. These movements from state to state are termed as *state transition* and these transitions are probabilistic in nature.

Steps in implementing Flamholtz Model:

- Step -1: Define the mutually exclusive set of the various possible roles that an employee can take in his service life in the organisation.
- Step -2: Determine the value of each state $[(S_1, S_2, S_3, \dots, S_n)]$ to the organisation, or the services state values.
- Step -3: Estimate a person's expected tenure, or service life, in the organisation
- Step -4: Find the probability that a person will occupy each possible state at specified future time $(P(S_i))$.
- Step -5: Calculate the expected conditional future value by aggregating all employees value at different states and multiplying it with the remaining service life of an employee.
- Step -6: Discount the expected conditional future value to determine their present value.
- Step -7: Calculate the expected realisable future value by aggregating all employees value at different states and multiplying it with the realisable service life of an employee.
- Step -8: Discount the expected

realisable future value to determine their present realisable value.

Formula Used for Valuation:

$$ECV = \sum_{i=1}^{T_t} \left[\frac{S_i * P(S_i)}{(1+R_d)^i} \right]$$

Where;

ECV = Expected Conditional Value

T_t = Total remaining service life

S_i = value generated in a particular state

$P(S_i)$ = probability of a person to occupy a particular state

R_d = Rate of Discount

After calculating the ECV, we calculate ERV by using the conditional probability of an employee to retain in an organisation using the following formula:

$$ERV = \sum_{i=1}^{T_r} \left[\frac{S_i * P(S_i)}{(1+R_d)^i} \right]$$

Where;

ERV = Expected Realisable Value

T_r = total realisable service life = $T_t * P(r)$

$P(R)$ = probability of remaining in the organisation = $P(R) = 1 - P(T)$

$P(T)$ = probability of turnover

Methods for valuation of expense centre groups

FlamHoltz proposes three methods for valuation of Human Resources:

- *Capitalisation of Compensation*
- *Replacement Cost Valuation*
- *Original Cost Valuation*

Capitalisation

The capitalisation method is based on capitalising a person's salary and using it as a measure of human value. The value may be ascertained for groups as well as individuals. The value of the group is essentially the aggregate value of the individuals comprising the group. Capitalisation of compensation method is not considered an



ideal method of group valuation because it ignores the possible effects of synergy. However, this method may be used to arrive at an approximation of a group's value to the firm.

Any of the above method can be used to value the human resources at each state.

Limitations of Flamholtz Model:

1. The soundness of the valuation depends wholly on the information, judgment, and impartiality of the person who values the State Value
2. Determining the exact realisable life is difficult.
3. Determining the probability to acquire any particular state is based on assumption, because it's not possible to judge the performance of any employee in the future roles. A good salesman is not necessary will become a good sales manager.

2. The Lev & Schwartz Model

The Lev and Schwartz model states that the human resource of a company is the summation of value of all the Net present value (NPV) of expenditure on employees. The human capital embodied in a person of age r is the present value of his earning from employment

Under this model, the following steps are adopted to determine HR Value:

- Step -1: Calculate the present earnings of each employee on an annual basis
- Step -2: Calculate the remaining service life of each employee
- Step -3: Determine the average annual earnings growth rate of the employee
- Step -4: Calculate the future value of the expected earnings of each employee on the basis of compounding rate = Annual earnings growth rate and time = remaining service life.
- Step -5: Discount the average earnings at a predetermined discount rate (i.e. cost of capital) and time = remaining service life, in order to get present value of human resource
- Step -6: Aggregation of the present value of all employees gives the total HR Value.

Formula used for valuation: $HRV = \frac{P.E. (1 + CAGR)^t}{(1 + r_d)^t}$

Where;

- HRV = the value of an Individual

- PE. = the individual's present annual earnings
- CAGR = annual growth rate of earnings
- t = remaining service life and r_d = a discount rate specific to the cost of capital to the company

Taking an example for Lev and Schwartz model:

Assumptions :

- i. Rate of discount = 8 %
- ii. Annual growth rate of earnings (CAGR) = 10 %

Employee	Band	Age	Service remaining	CTC	Future Value	PV
A1	1	25	35	10000	\$ 3,372,292.42	\$ 228,083.46
A2	2	35	25	15000	\$ 1,950,247.07	\$ 284,770.99
A3	3	45	15	20000	\$ 1,002,539.56	\$ 316,042.28
A4	4	30	30	25000	\$ 5,234,820.68	\$ 520,222.52
A5	5	21	39	30000	\$ 14,812,120.00	\$ 736,360.96
A6	6	34	26	35000	\$ 5,005,634.15	\$ 676,770.57
A7	7	55	5	40000	\$ 773,044.80	\$ 526,121.30
A8	8	54	6	45000	\$ 956,642.94	\$ 602,847.32
					Total NPV	\$ 3,891,219.40

Total employees	1000
Skilled	500
Semi skilled	300
Technical	50
Managerial	150
Total income	11001111
Total employee cost	11001111
Value added	2323232
Nopat	1111111
Total value of human resources	\$ 3,891,219.40
Skilled	\$ 3,112,975.52
Semi skilled	\$ 389,121.94
Technical	\$ 194,560.97
Managerial	\$ 194,560.97

Limitations of the Lev & Schwartz model: –

- It is essentially an input measure .It ignores the output i.e. productivity of employees.
- Service state of each individual employee is not considered.
- The attrition rate in organisation is also ignored.
- Factors responsible for higher earning potentiality of each individual employee like seniority,

bargaining capacity, skill, experience, etc. which may cause differential salary structure are also ignored.

3. Morse Net Benefit Model

Morse suggested that the value of human resources is equivalent to the difference between present value of the services to be rendered by employees and the value of direct and indirect future payments to the employees.

Steps of valuation:

1. The gross value of the services to be rendered in future by the employees in their individual and collective capacity.
2. The value of direct and indirect future payments to the employees is determined.
3. The excess of the value of future human resources derived over the value of future payments is calculated. This represents the net benefit to the enterprise because of human resources.
4. By applying a predetermined discount rate (usually the cost of capital) to the net benefit, the present value is determined. This amount represents the value of human resources to the enterprises.

4. Hekimian and Jones Competitive Bidding Model

This method is based upon the judgment of the managers under whom an employee works and the value of the employees is determined by the managers. Managers bid against each

other for human resources already available within the organisation. The highest bidder 'wins' the resource. There is no criteria on which the bids are based. Rather, the managers rely only on their judgment.

Conclusion

In the absence of Human Resource Accounting, the management may not realise the negative effects of certain programmes aimed at improving profits in the short-run. Such programmes may result in decreased value of human assets due to fall in the productivity levels, high labour turnover, low morale, etc. HRA in any organisation should be designed to serve mainly two functions. First it should focus more on recognition of human resource as a critical success factor for any organisation, as it is the men behind the organisation who drive it towards success. The emphasis on the human capital should be increased to remain in the competition in today's economic era. The second aim of HRA is to provide an alternative accounting system designed to measure the cost and value of human assets to an organisation.

In this sense HRA represents both dimensions, a way to view human resources as critical part of the company and a set of measures to quantify the effects of human resource management strategies upon the cost and value of people as organisational resources. The methods discussed above are in their infant stages and there is an urgent need to develop a new accounting standard for valuing human resources of the organisations. The application and usefulness of Human Resource Measurement depends on the future efforts and experiments to be made by practicing managers, accountants and academicians. The application of HRA also needs support from the professional bodies and Government. ■

National Accounting System in Panchayat Raj Institutions (PRIs) in West Bengal: Adoption or Convergence



Following the recommendation of the Government Accounting Standard Advisory Board (GASAB) on Accounting Reforms for Government Accounting, and Government of India's major push in this direction, West Bengal government has decided to introduce accrual based double entry system in all the rural local bodies, i.e., all the three tiers of Panchayats in the State. The double entry accrual basis of accounting system will gradually replace the existing system of double entry cash basis of accounting system in all the three tiers of Panchayats, viz. *Zilla Parishads*, *Panchayat Samitis* and *Gram Panchayats*. The Central Government, Ministry of Panchayati Raj and Comptroller and Auditor General of India have also proposed that every State Governments have to follow 'National Accounting System' for the maintenance of accounts of the rural local bodies. So far as the accounts of the rural local bodies are concerned, West Bengal Government is cautious in introducing all the features of this sophisticated accounting system. Read on to know more.



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Panchayat Accounting is a sub-division of Government Accounting. Most people have a tendency to associate accounting with the operations of the business organisations. But accounting is not meant only for the business enterprises. It has to deal with non business operations as well. The subject of Government Accounting is very broad. It encompasses a number of governmental organisations such as the Central Government, State Government and Local Government. Although there are variations in accounting practices between the governmental entities operating at different levels, but the basic principles

on which these practices are based appear to be almost the same. Government Accounting is concerned with the identification, measurement and communication of information about the economic activities performed by governmental entities.

Government Accounting has some unique features, which makes it desirable to treat it as a separate branch of accounting. Government Accounting is basically a budget-driven accounting. Accounts in government accounting usually follow the parameters of budget. The budget orientation is maintained in governmental accounting in order to provide

“The accounting system in Panchayats of West Bengal, like accounting system of rural local bodies of other states in this country, is suffering from a number of limitations. One such limitation is that the lack of definite accounts heads and ancient audit rules hampers financial control on modern lines. Without the help of trained employees, sophisticated accounting practices cannot be adopted. In Panchayats, there is shortage of trained employees.”

budgetary control over governmental revenues and expenditures. Government Accounting is heavily tilted in favour of legal compliance. Where there is any conflict between accounting logic and legal compliance, the latter must get the priority.

It is true that Government Accounting uses many of the tools and techniques of business accounting. But there still exists a great deal of difference between the two. In business accounting, the main focus is on the determination of periodic profit through the matching of revenues and expenses. A large body of principles and rules has developed in business accounting, which aims at providing guidelines as to how the matching process is to be performed under different conditions. Since the profit motive is absent in governmental entities, the matching oriented principles and rules have practically no relevance in the context of governmental accounting.

Accounting System in West Bengal PRIs

Present Scenario:

In the context of the limitations of the 1990 Accounts Rules as well as the problems faced in the accounting practices followed at the Gram Panchayat Level in West Bengal, the

Panchayat and Rural Development Department has rightly approached to adopt the following changes in the principles and techniques of the accounting system for the Gram Panchayat along with the introduction of the new Accounts Rules in the year 2008 with special features:

1. For the first time, it is proposed in the new Accounts Rules that the books of accounts of the Gram Panchayats will be maintained by following double entry system of accounting.
2. The cashbook will be maintained under double column basis, i.e., separate column will be kept for recording transactions through bank accounts in addition to cash column. As a result, the transactions between cash and bank, i.e., either cash deposited into bank or cash withdrawn from bank for meeting different expenses will be possible to be recorded in the cash book through contra entry.
3. The recording of accounting information along with other management and administration related information are also possible to be performed with the help of computerised accounting system to be installed at each Gram Panchayat. The installation of computerised accounting system in West Bengal PRI Bodies has almost been completed.
4. To ensure better flow of fund and effective financial management, certain provisions are included in the new Accounts Rules for the preparation of statements showing the periodical fund position to help the decision-makers in taking fund related decisions quickly and effectively.
5. All the irrelevant books and registers, which are not usually maintained by the Gram Panchayats and also not required

to be maintained at all for proper maintenance of accounting information, are either withdrawn or modified to make the accounting system more specific and purposeful.

6. A separate chapter has been included in the new Accounts Rules covering the accounting system of the Gram Unnayan Samiti. However, the Gram Unnayan Samiti will maintain its books of accounts and other records only on single entry system, not on double entry system. Also, the cashbook of the Gram Unnayan Samiti will be maintained under single column basis, i.e., without making any distinction between cash transactions and transactions through bank, all the transactions will be recorded in one column of the cashbook.

Limitations of the Existing Accounting System:

The accounting system in Panchayats of West Bengal, like accounting system of rural local bodies of other states in this country is suffering from a number of limitations. Following are some of the important limitations of the existing Panchayat Accounting System in West Bengal:

- a. Lack of definite accounts heads and ancient audit rules hampers financial control on modern lines.
- b. Without the help of trained employees, sophisticated accounting practices cannot be adopted. In Panchayats, there is shortage of trained employees.
- c. Details about different programmes are not available from the books of accounts, because accounting break up of programmes are not prepared.
- d. Valuation of assets is considered in accounts without any application of either appreciation or depreciation of assets, which

- fails to show the correct present value of the assets.
- e. All properties belonging to the Panchayat bodies are not valued.
 - f. No income and expenditure account is prepared in the accounts; only receipts and payments account is prepared. Hence, real operating performance and the results thereof are not revealed.
 - g. Nothing like the balance sheet is prepared. As a result, the financial state of affairs cannot be obtained.
 - h. The present internal audit system is too old, ineffective and inadequate.
 - i. There is neither any accountability nor any motivation for maximising collection of own source of revenue.
 - j. There is no concrete guideline for the utilisation of fund collected through own source of revenue in case of Zilla Parishads and Panchayat Samitis.
 - k. The present statutory audit practices are not very useful in the sense that such audit usually gets converted into cash transaction audit only. Besides, serious attention to the lapses pointed out by the auditors is not given by the authorities as a whole.

Roadmap of West Bengal PRIs Accounting System:

Most of the above mentioned limitations of the PRI accounting system in West Bengal can be removed by adopting accrual basis of accounting. The present system of double entry cash basis of accounting will be replaced by double entry accrual system of accounting. The road map for conversion into double entry accrual basis of accounting from the existing system has been developed keeping in view the typical nature of operations of rural local bodies.

The road map for the conversion process of the existing accounting system into double entry based accrual accounting system includes certain steps and proposals to make the conversion process 'easy to adopt' for the employees of the PRI Bodies in West Bengal. These steps and proposals include:

Steps for conversion into accrual system:

In the year 2008, the Government of India has given a target to the state governments for switching over to accrual basis of accounting by the rural local bodies within a period of 12 years. Throughout this time span, the State Government will have to take the initiative step by step to convert their cash basis of accounting system into accrual basis of accounting on the following lines:

Step 1: Accounting of expenses under accrual basis in the initial step. The Gram Panchayat Accounts Rules have already included certain reporting formats which will incorporate outstanding expenses and committed liabilities for expenses. In addition to this initiative, certain accounting entries are recommended for adoption in the maintenance of PRI accounts, which will ensure the recognition and measurement of expenses accrued but not yet paid. The initiative for the inclusion of the same type of reporting formats and accounting treatments in the Zilla Parishad and the Panchayat Samiti Accounts and Finance Rules have also been taken.

Step 2: Recognition of Assets owned and under the disposal of the PRI Bodies will be the next step. The PRI Bodies has already started recognition of assets created under different govt. sponsored programmes and in the Acts and Rules relating to Accounting and Financial Management in force in West Bengal PRI Bodies, there are provisions for the maintenance of

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assets registers. However, there is lack of clarity in the recognition of assets in the books of accounts, which should be developed by the competent authority.

Step 3: After completion of the above two steps, the next step is to recognise the liability in their totality. A part of the liability would be recognised in step one along with the recognition of the outstanding expenses and committed liabilities. The liabilities which are not directly related with the incurrance of expenses are mainly recognised in this step. At this stage, the rural local bodies of the State of West Bengal will be able to prepare their balance sheets.

Step 4: When the PRI Bodies will be able to prepare their statement of financial position, i.e. balance sheet, the next and final requirement is then to prepare the statement of financial performance, i.e. the income and expenditure account. For this purpose, the final step is the accounting for accrued incomes and recognition of expected revenues by the PRI Bodies in the State.

After completing the above steps, the accounts of the PRI Bodies will be converted into accrual based accounting system. For this purpose, the State Government will have to take proper initiatives on timely basis and if necessary, the regulatory framework

governing the maintenance of accounts of PRI Bodies will be amended to suit the requirement of conversion.

Proposals for conversion into accrual system:

1. The PRI accounting system in West Bengal will be fully computerised with the help of the two internally developed accounting software-IFMAS SARAL for the Zilla Parishad and the Panchayat Samitis and GPMS for the Gram Panchayats.
2. All the employees involved in the maintenance of accounts in all the three tiers of Panchayat System will be given support through proper training on both accrual system of accounting and accounting software having accrual basis of accounting features.
3. The new accrual basis of accounting system should comply with the following requirements of the regulatory framework under which it has to operate:
 - Generally Accepted Accounting Principles, i.e., Accounting Standards issued by the Competent Authority from time to time.
 - The West Bengal Panchayat Act, 1978.
 - The West Bengal Zilla Parishads and Panchayat Samitis Accounts Rules, 2003.
 - The Gram Panchayat Accounts, Audit and Budget Rules, 2007.

Introduction to National Accounting System

Background

The rural local bodies in West Bengal were following single entry cash basis of accounting. However, from the year 2003-2004, the Zilla Parishads and the Panchayat Samitis have adopted double entry system of accounting and the Gram Panchayats have adopted

the double entry system of accounting on and from the financial year 2008-09. It may be noted in this context that the rural local bodies in West Bengal have not yet adopted accrual basis of accounting. As a result, the cash basis of accounting records transactions only on receipts and payments of cash (for incomes and expenses items) and not when such incomes or expenses accrue to rural local bodies. As a result, an analysis of the true and fair view of the activities of the rural local bodies is not possible as income accrued but not received and expenses incurred but not yet paid are not reflected in the financial statements of the rural local bodies.

As per the recommendation of the Government Accounting Standard Advisory Board (GASAB) on Accounting Reforms for Government Accounting, Government of India has shown its interest and Government of West Bengal has decided to introduce accrual based double entry system in all the rural local bodies, i.e., all the three tiers of Panchayats in the State. The double entry accrual basis of accounting system will gradually replace the existing system of double entry cash basis of accounting system in all the three tiers of Panchayats, viz. Zilla Parishads, Panchayat Samitis and Gram Panchayats.

The Central Government,

 **The Central Government, Ministry of Panchayati Raj and Comptroller and Auditor General of India have also proposed that every state governments have to follow 'National Accounting System' for the maintenance of accounts of the rural local bodies. Through the adoption of National Accounting System', the Central Government is trying to ensure uniformity of the accounting practices by all the rural local bodies in the states.** 

Ministry of Panchayati Raj and Comptroller and Auditor General of India have also proposed that every state governments have to follow 'National Accounting System' for the maintenance of accounts of the rural local bodies. Through the adoption of National Accounting System', the Central Government is trying to ensure uniformity of the accounting practices by all the rural local bodies in the states.

Concept and Objectives of National Accounting System

National Accounting System is a system depicting simplified procedure under cash basis of accounting and meant for all the levels of government accounting- Central Government, State Government as well as urban and rural local government.

Objectives of the National Accounting System in the context of rural local government are:

- a. To prescribe the Accounting Principles, this will be followed by all the three tiers of Panchayats under the new double entry cash basis of accounting.
- b. To prescribe a uniform Chart of Accounts, that will facilitate comparison between different rural local bodies and facilitate double entry system of accounting.
- c. To prescribe new formats that will have to be followed by the rural local bodies.
- d. To prescribe Guidelines for recording transactions in the books of accounts of the rural local bodies.

Features of National Accounting System

In National Accounting System, accounting transactions are required to be recorded in the books of accounts of the rural local bodies by following certain codes of accounts. The chart of accounts prepared for this purpose

by the authority bearing different codes for accounting heads are the basis of recording transactions in the books of accounts. The main features of national accounting system are as under:

1. The chart of accounts includes accounting codification covering four important aspects of the items of transactions to be recorded—major head, minor head, sub head and objective head.
2. The receipts side may not have any object head as because it may not be possible to identify the purpose for which the amount is received at the time of receiving the money.
3. The payment side should have all the four components of heads and unlike the receipts head, the payment head is based on the function or purpose of the fund received. The receipts side is basically recorded on the basis of the source of the fund received.

General Observations on National Accounting System

- The model formats are simple, comprehensive and robust and will aid in capturing expenditure

In national accounting system, accounting transactions are required to be recorded in the books of accounts of the rural local bodies by following certain codes of accounts. The chart of accounts prepared for this purpose by the authority bearing different codes for accounting heads are the basis of recording transactions in the books of accounts. The chart of accounts includes accounting codification covering four important aspects of the items of transactions to be recorded—major head, minor head, sub head and objective head.

under the correct head uniformly.

- The State would stand to benefit from being able to track the flow and usage of funds and accordingly decide on the subsequent releases.
- The Panchayats would gain in terms of better financial management and enhanced credibility.
- The list of codes for functions, programmes and activities of PRIs is based on a three-tier classification system. In addition to that a sub-head has been incorporated.
- The nomenclature of the major heads has been devised in equivalence with the 29 subjects listed in the Eleventh Schedule to the Constitution.
- Within this three-tier classification, there is a flexibility to open subject heads under a particular minor head based on future devolution to PRIs or other contingencies.
- Although initially, the accounts are to be prepared on cash basis, requisite features have been built into the simplified system to enable subsequent transition to the accrual system.

Pre-condition for the adoption of National Accounting System

- It is intended to switchover to the revised formats of the National Accounting System for PRIs with effect from 1-4-2011. Accordingly, opening balances as on 1-4-2011 will be required. Where amounts are in arrears and the required balances are not available, Panchayats would need to prepare a 'Statement of Affairs' based on which, opening balances can be worked out.
- Though the software will be web-based, an offline version of the same will be available so that users can enter account details

locally and update the data periodically on the online site.

Defects identified in National Accounting System

Following are the defects identified while going through the proposals for National Accounting System received from the Central Government in the initial stage of discussion in the year 2008. It may happen that the National Accounting System has got revised from time to time to eliminate the defects within it. However, the observations regarding the defects identified are on the basis of the initial discussion paper issued by the Central Government in the year 2008.

- Most of the formats developed are on the basis of the old Local Self Government Act.
- Accounts are maintained under Single Entry Accounting System. No double entry accounting being adopted.
- Adjustment entries, viz. ledger to ledger adjustment entry is not possible.
- Only Reports and Returns are possible to be produced. Cash Receipts and Cash Payment Vouchers are not produced.
- No Accounts Ledgers are maintained.
- Register of Receipts and Register of Payments are backdated concepts.
- Refund of revenue/reimbursement of expenditure treatment are defective.
- There is no provision for rectification entry.
- Codification of different accounts heads are not well drafted.

Convergence of West Bengal PRIs Accounting System with National Accounting System

The new Accounts Rules for the Zilla Parishads and the Panchayat

“In certain States, there may be instances where the currently used formats of accounts by PRIs differ from the Simplified System in the areas of classification and heads of accounts. PRIA Soft (accounting software for national accounting system) has an inbuilt mechanism to link these heads of accounts with the simplified system. This linking will be a one-time activity and subsequent action would be necessary only when a new head of account is prescribed.”

Samitis was introduced in the year 2003 making it effective on and from 1.4.2003. These rules introduced the double entry system of accounting in the maintenance of accounts of the Zilla Parishads and the Panchayat Samitis. The new Accounts Rules of the Gram Panchayats was also introduced in the year 2007 making it effective on and from 1-4-2008.

The latest accounts and audit procedures of the PRI Bodies are laid down in these West Bengal (Zilla Parishads and Panchayat Samitis) Accounts and Finance Rule, 2003 and in the West Bengal (Gram Panchayat Accounts, Audit and Budget) Rules, 2007.

Therefore, the Government of West Bengal has already prepared the ground for the adoption of new national accounting system and according to the recommendation of the Thirteenth Finance Commission, the development of charts of accounts including the generation of codification pattern for different accounts heads are also in the pipeline.

Objectives of convergence with National Accounting System

- A sound Accounts and Audit System would ensure transparency and accountability.

- Improved and simplified Accounting System would help enhance credibility of Panchayats.
- An efficient accounts system would induce greater devolution of funds and functions to PRIs.
- Effective mechanism is urgently needed for aggregating data relating to Panchayat Finances for a better higher level decision making.
- Improved and efficient accounting system would be made simpler by using ICT and uniform accounting practices.

Major benefits for the conversion with the National Accounting System

- In certain States, there may be instances where the currently used formats of accounts by PRIs differ from the simplified system in the areas of classification and heads of accounts. PRIA Soft (accounting software for national accounting system) has an inbuilt mechanism to link these heads of accounts with the simplified system. This linking will be a one-time activity and subsequent action would be necessary only when a new head of account is prescribed.
- In States where PRI accounts are already computerised in State specific software, PRIA Soft will provide easy and trouble free interface between the data generated by the existing software and the simplified system. A prerequisite for this interface is linking of the State PRI heads of accounts with the heads of accounts in national accounting system. Necessary technical facilities for linking the heads of accounts will be available.

Forthcoming Tasks

To improve the existing practices of

maintenance of accounting records including books of accounts and supporting registers and also to have better accounting and financial management of the Zilla Parishads, Panchayat Samitis, Gram Panchayats and Gram Unnayan Samitis, certain measures are required to be taken. These measures are to be adopted taking into consideration the Acts and Rules governing the accounting and financial management system of the Panchayats Bodies, the existing practices with which the Panchayat Officials are at present familiar with in maintaining the books of accounts, the accounting principles adopted in recording the financial transactions in the books of accounts and registers of the Panchayats and above all the capacity and efficiency level of the employees of the Panchayats involved in the maintenance of accounting records.

The following core tasks may be considered very important for implementation of the policy of the department regarding better financial management and maintenance of effective accounting information:

- Orientation of Zilla Parishads, Panchayat Samitis and Gram Panchayat office bearers and officials either directly or indirectly associated with the maintenance of accounts about the New Accounts Rules and National Accounting system.
- Training on GPMS and IFMAS (SARAL) software to Gram Panchayat and Zilla Parishad as well as Panchayat Samiti office bearers and officials and installation of GPMS and IFMAS software in Gram Panchayats and Zilla Parishad as well as Panchayat Samitis.
- Training on Principles and Techniques of Double Entry Accounting System to Gram Panchayat and Zilla Parishad

as well as Panchayat Samiti officials either directly or indirectly associated with the maintenance of accounts.

- Identification of gap between GPMS and IFMAS (SARAL) and the New Accounts Rules and National Accounting System and modify as well as upgrade the software from time to time.
- Training on proper implementation of New Accounts Rules and National Accounting System to Gram Panchayat and Zilla Parishad as well as Panchayat Samitis office bearers and officials either directly or indirectly associated with the maintenance of accounts.
- Training on better utilisation of fund available to Gram Panchayats and Zilla Parishad as well as Panchayat Samiti and their management to Gram Panchayat and Zilla Parishad as well as Panchayat Samiti office bearers and officials either directly or indirectly associated with the maintenance of accounts.
- Review of the existing internal audit system and development of standardised auditing practices in Gram Panchayats and Zilla Parishad as well as Panchayat Samitis.
- Interaction with the officials of the Examiners of the Local Accounts making them conversant about the practices followed by the Gram Panchayat and Zilla Parishad as well as Panchayat Samitis officials in recording accounting information and obtaining feedback from them for follow-up actions.
- The Gram Panchayat and Zilla Parishad as well as Panchayat Samiti Accounts Rules will have to be translated into regional language as earlier as possible along with the supporting handbook on financial man-

agement and accounting practices issues separately for the Gram Panchayats and Zilla Parishad as well as Panchayat Samitis.

Taking into consideration the above core tasks of the department, the implementation strategies of the National Accounting System and new Accounts Rules of the Gram Panchayats and Zilla Parishad as well as Panchayat Samitis by the department will be chalked out well in advance, so that within a short period it will be possible to adopt the National Accounting System and new Accounts Rules in the Panchayats to make the accounting process error-free, transparent and productive.

Conclusion

Government Accounting has until recently been operated on cash flow basis. This is in sharp contrast with the practice followed in business accounting. Business accounting is consistently being based on accrual system of accounting. At present, the Government is also thinking about the introduction of accrual basis of accounting in the near future. Urban Local Government in West Bengal has already introduced accrual basis of accounting in maintaining the books of accounts of the corporations and the municipalities. The West Bengal Government has decided to introduce double entry system in the maintenance of accounts of the urban local bodies along with the accrual basis of accounting and the progress at present is not unsatisfactory. However, so far as the accounts of the rural local bodies are concerned, West Bengal Government is cautious in introducing all the features of this sophisticated accounting system. It has been decided to introduce double entry accounting system along with the concept of double column cash book in the maintenance of accounts of the rural local bodies, viz. the Zilla



Parishads, Panchayat Samitis and the Gram Panchayats. Once the rural local bodies can successfully adopt this process of modern accounting practice, then the concept of accrual basis of accounting will be initiated to be applied. The Comptroller and Auditor General of India has also recommended a road map for migration from cash basis accounting to the accrual basis accounting within a period of twelve years, which can be considered reasonable and feasible. The CAG has also suggested the steps to be followed in reaching the destination following the roadmap for the migration to the accrual basis of accounting along with the national accounting system and West Bengal Government is rightly approaching in the phased manner towards the attainment of goal of migration to accrual basis of accounting in rural local government. ■

Audit of a Public Sector Undertaking – An Overview



The Audit of a Public Sector Undertaking (PSU) has certain unique procedures/steps as compared to a normal audit of a company. This article tries to give a step by step analysis of the various events in a PSU Audit and actions required to be taken by a Statutory Auditor of a PSU. The article also highlights the recent changes made in the reporting format by CAG which is applicable from 2010-11.

Chronological Steps in an Audit of Public Sector Undertaking

- Receipt of Appointment Letter from CAG, New Delhi – addressed to the PSU concerned and copy marked to the auditors.
- Auditors to intimate their acceptance within three weeks from the receipt of the appointment letter to CAG, New Delhi, the head of the PSU concerned and the concerned Principal Director in whose jurisdiction the PSU is situated.
- An Appointment Letter from the

PSU concerned would be received. Form 23B to be filed with Registrar of Companies attaching the said appointment letter. The receipt for having filed Form 23B to be sent to the PSU concerned.

- Subsequently there would be a communication from the Principal Director of Commercial Audit which would contain *inter alia* the following instructions to be followed by the statutory auditor:
 - a. Time Schedule for conducting the audit to be drawn up indicating the period of audit of different department/units and



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also the name and qualifications of personnel deployed for audit of each unit.

- b. The Directions issued under Section 619(3) of the Companies Act should be followed.
 - c. Before commencing the audit, it should be verified that the undertaking has complied with or taken action on the assurances as well as the comments issued by the CAG and Statutory Auditors of previous year's accounts.
 - d. The implications of various notes on accounts may invariably be qualified and suitably quantified in your report.
 - e. The last three years qualifications and notes to accounts may be compared to ascertain whether the Management has taken rectificatory action.
 - f. In case of computerised accounts, the auditor should assess and report the areas of computerisation and how it impacts the work of auditing the accounts.
- A Meeting of the Auditors would take place along with the Top Management of the company wherein in the following would be broadly discussed:-
 - a. The Closing Guidelines for the relevant year would be discussed and the auditors are required to suggest various changes/amendments.
 - b. The Guidelines given to the branch auditors would also be discussed and auditors should ensure that it broadly covers all the areas. In case there are any special points which the statutory auditor would like to emphasise, the same would be included in the Guidelines.
 - c. The list of branch auditors and

the list of nodal officers for each Region/Division should be obtained.

- d. The Draft Accounting Policy for the year would be discussed and any corrections/amendments which are brought in during the year would be analysed and a final draft would be made ready.
 - e. The time frame for commencement and completion of the Audit would be discussed and fixed. Time frame would have to be fixed for the Branches, Operating offices, Department of Head office and Final Consolidation.
 - f. In case of Joint Audits, the work allocation among the auditors would be discussed and a decision would be arrived at.
 - g. The Work Allocation Statement would be drawn and would be signed by all Joint auditors as a token of their acceptance.
- It is advisable to have a Meeting at the various regions (before the year end) where the Heads of the Operating offices and the Branch auditors are present. The statutory auditor would address the meeting with special emphasis on the unique points which would have to be carefully looked into by the Branch auditors. Any clarifications/queries of Branch auditors would be addressed at the meeting.
 - There would be a Meeting at the CAG's office in the presence

The auditor on receipt of the audit reports from the branches should carefully scrutinise the same and ensure that the entries which are required to be passed at Head Office are duly passed, and the issues which the branch auditors have not been able to take a decision are noted down and corrective action taken at the head office level.

of Deputy Director wherein the Auditors would explain the allocation of work among them and the time frame for completion of the audit work. After this the Deputy Director would explain the Additional Sub-Directions for the said year under Section 619(3) of the Companies Act. A copy of the Additional Sub Directions would be handed over to the auditors.

- Each Statutory Auditor would draw up an Audit Programme for the department he has been allotted in accordance with the auditing standards including fixing the extent of verification, Materiality level to be adopted etc. While framing the audit programme it is advisable to consult with the joint auditors who would have conducted the audit of that department in the previous year which would give a fair idea on the areas to be focused upon.
- The Statutory auditor would call for the internal audit reports/CAG transaction audit reports and other audit reports for the financial year.
- The adequacy of the internal control systems should be evaluated and accordingly the audit programme can be altered.
- The Guidelines issued by the concerned Board of the PSU delegating various financial powers to be obtained.
- The Production flowchart, note on inventory management and system, Costing Systems used, Compliance report on the various statutes to be obtained before starting the audit.
- In computerised environments the auditor is required to verify whether the software used has been tested/validated, Systems Audit has been conducted and in case of change in software whether Migration Audit has been conducted.
- The auditor should verify and

ascertain whether there are any new statutory or regulatory changes which would have material impact on the financial stability or profitability of the entity. An Impact analysis should be done on any material change in the regulatory requirement.

- The auditor should verify the minutes of the Board Meeting, Audit Committee Meetings, Investment Committee and any other Committee set up by the Board and make note of the decisions arrived at in the Board.
- The auditor should also verify the Budgets which are given to the Ministries concerned on a periodical basis.
- The auditor should get a copy of the new guidelines/instructions issued by the regulatory authorities during the year in respect of accounts including reconciliation.
- During the course of audit, the auditor can also inspect any of the operating offices independently to get first hand information about the process and have discussion with the branch auditor concerned.
- The auditor on receipt of the audit reports from the branches should carefully scrutinise the same and ensure that:
 - (i) The entries which are required to be passed at Head office are duly passed.
 - (ii) The issues which the branch auditors have not been able to take a decision are noted down and corrective action taken at the head office level.
- In case of Joint audits, Periodical meetings should be conducted during the course of audit, and ensure that each meeting is properly minuted and signed by all auditors.
- Similarly there must frequent interaction between the top management and the auditors

“ Simultaneously during the course of Audit, the Statutory auditors have to prepare the Report under section 619(3) of the Companies Act. The report is broadly categorised in to XVI different heads. The format as prescribed by CAG is in a questionnaire format and encompasses all the possible areas of the PSU including internal control, frauds, business risks, control over assets, investment functions, costing systems, environmental management, corporate social responsibility, systems security, fixed assets, etc. ”

in order that the issues are being sorted out then and there and the management is also being made aware of the issues. Here again the meeting discussion and the decisions arrived at should be minuted and signed by both auditors and the management.

- Wherever the Management relies on expert's opinion (like Actuary report), the same should be made available to the auditors and the auditors can also discuss the issue with the expert, if any clarifications are required on the assumptions made by the expert.
- A Management Representation Letter would be given by the management to the auditors which would cover all the areas of accounting/internal control.
- On finalisation of the accounts, a final meeting would take place with the management wherein the following would be placed and discussed:-
 - (i) Accounting Policy for the year
 - (ii) Notes forming part of the accounts
 - (iii) Final observations/issues of the auditors
 - (iv) Reply by the management to the issues raised

(v) Financial Statements including cash flow statement

(vi) Various certificates/disclosures required under the statute.

- Once the financials are finalised the date of meeting of Audit Committee and Board would be finalised.
- The auditors would be present at the Audit Committee meeting and they would have to present their views/observations in addition to clarifications required by the ACB members.
- The accounts would be adopted in the Board meeting. If required the auditors would also be requested to participate during the approval of accounts.
- Simultaneously during the course of Audit, the Statutory auditors have to prepare the Report under Section 619(3) of the Companies Act. The report is broadly categorised in to XVI different heads. The format as prescribed by CAG is in a questionnaire format and encompasses all the possible areas of the PSU including internal control, frauds, business risks, control over assets, investment functions, costing systems, environmental management, corporate social responsibility, systems security, fixed assets, etc.
- The replies to the questions are to be framed in consultation with all the Joint auditors and the management. Wherever the reply is based on the information of management the same should be disclosed and a certificate should be obtained from the Management.
- The replies to the questions should be to the point and should not be vague.
- Proper back-up papers should be available for the report under Section 619(3) of the Companies Act.

“ The Format of the Report under Section 619(3) of the Companies Act as prescribed by CAG has undergone drastic changes. This new format is applicable for the accounting period starting with 2010-11 (Revision made vide CAG office Circular No.134-CA-IV/42-2001(III) dated 15.04.2010) ”

- The CAG has powers to call for the working papers and other information collected during the course of audit.
- The most important point to be ensured is that the Report to CAG has to be prepared simultaneously with the audit of accounts as the report would have to be normally submitted within a few days after signing the financials. If any negative reporting is made then it must be ensured that the same has been considered in the financial statements. Hence if there are negative comments in the report it must be those for which the impact is already considered in the financial statements or the negative comments are on a subject which has no financial impact.
- CAG, on completion of the statutory audit, would adjudge the performance of the auditors. The

auditors are required to furnish the details of man-power deployed for the work including the man days of partners. The broad parameters on which the assessment is made are:

- Coverage of Audit
 - Compliance to various requirements of Companies Act, other statutes
 - Compliance with established Accounting Standards
- CAG conducts their audit/review after the approval of accounts in the Board meeting. Audit Paras are raised during their course of audit and finally preliminary comments are given to the Management and to the auditors.
 - The auditors are required to give their reply to the preliminary comments along with the management.
 - Normally there would be a meeting between the Audit officers of CAG, management and the statutory auditors to discuss the replies given to the preliminary comments. The auditors are required to give their views on the issues raised and also explanation as to why the same was not considered in their report.
 - If the replies are acceptable to the CAG, a final Comment is issued by

the Principal Director, commercial audit and ex-officio member, Audit Board of the respective region mentioning that nothing significant has come to their knowledge which would give rise to any comment upon or supplement to Statutory Auditors Report under Section 619(4) of the Companies Act, 1956. These final comments should be prominently disclosed in the Annual Report of the PSU.

- In the event that replies are not convincing/acceptable in the view of CAG, then the accounts are required to be restated or in the discretion of the management where they have strong grounds against the comments they would list out the same in the Annual report along with the reply.

Changes in the Format for Reporting Under Section 619(3) of the Companies Act, 1956

- The Format of the Report under Section 619(3) of the Companies Act as prescribed by CAG has undergone drastic changes. This new format is applicable for the accounting period starting with 2010-11 (Revision made vide CAG office Circular No.134-CA-IV/42-2001(III) dated 15-04-2010)



The changes have been made into the transactions in detail. As the on certain sensitive issues which in all the major areas and emphasis audits of PSUs are expected to be would definitely put pressure on the has been made to a greater extent completed before 30th of April auditors. on Proprietary Audit. For certain in most of the cases, it is highly The additional data, which is now questions it involves more of probing impractical to require comments called for, is given below:-

Head	Additional Questions
Corporate Governance and Audit Committee	Whether the Audit Committee has reviewed and discussed with the management and the internal and external auditors, the adequacy and effectiveness of the accounting and financial controls, including the company's financial and risk management policies.
Business Risk	(i) The process used for identification of business risks and steps taken to mitigate it by the management. (ii) The capital expenditure/capital invested not put to use. (iii) The cost benefits analysis of major capital expenditure/expansion including IRR and pay back period. (iii) The existence of Macro, Sector and Operation Threats that could drive fundamental changes in business model.
System of Accounts & Financial Control	(i) Please report which of the accounting policies adopted by the company are not in conformity with the accounting policies applicable to the industry/companies in the same sector, particularly the government companies. What is the impact of such polices on the accounts? (ii) Indicate separately the amount of balances remained unconfirmed from government departments/PSUs and private parties and their percentage to total amount under each head. (iii) Whether any incidence involving improper use or wastage of funds was noticed. (iv) Whether work flow and document flow is in place to ensure proper controls and systems commensurate with the delegation of work?
Fraud/Risk	(i) Whether the company has formulated code of conduct for senior management. (ii) How the company has dealt with reported frauds and what are the remedial measures taken for preventing recurrence? (iii) Whether the Company has "whistle blowing" policy. (iv) Whether the fraud policy has been periodically reviewed and evaluated to determine whether it was designed and implemented to achieve optimal effectiveness.
Assets	(i) Whether the company has conducted physical verification of Fixed Assets during the year and a format report is being prepared for the same? (ii) Whether there is a policy to review and implement impairment of assets.
Investment	(i) Whether any surplus funds are invested? Is there any effect on availability of funds for working capital because of investments leading to borrowings at higher rates? (ii) How often market value is reviewed and whether profits are made on sale of investments.
Liabilities and Loans	Whether any study was conducted to avail any other instruments or derivatives instead of high cost loans?
Award & Execution of Contracts	(i) Whether there are any disputes/claims unsettled for a long time. (ii) What is the procedure followed by the company for purchasing proprietary items? What is the procedure for ascertaining the authenticity of the propriety items certificate given by an official based on which tendering is not resorted to and goods are purchased from a particular supplier?
Costing Systems	(i) Whether there is any system to evaluate the abnormal losses and taking remedial measures to control such losses? (ii) What is the method being followed by the company to charge overheads? How is the overhead rate being arrived at? In case of cost plus contracts, are the overheads being recovered completely or not?
Internal audit System	(i) Whether internal audit is independent and reports directly to the Chairman/Head of the Company (ii) If internal audit is outsourced then whether the selection process is fair and transparent. (iii) Whether entities which are not under the jurisdiction of the professional institute are being given the work of Internal Audit. (iv) Does the Internal Audit report contain any serious irregularity which needs immediate attention of Management/Government. (v) What is the total impact of all shortcomings/deficiencies pointed out in the latest Internal Audit Report and pending for compliance as on date? (vi) Whether mistakes/shortcomings pointed out in the latest report is of the same kind/type as pointed out in earlier reports.
Legal/Arbitration Cases	Is there any system to ensure proper documentation (like minutes if the meetings, foreseeing contingencies, foreign exchange fluctuation etc.) before agreement with foreign parties as well as Indian parties?
EDP Audit	(i) Whether the company has detailed/comprehensive list of all reports/statements which can be generated by the system in use? (ii) Whether there is an effective IT Steering Committee. (iii) Whether there exists effective disaster recovery plan for EDP department which is periodically reviewed and evaluated. (iv) Whether any of the findings and recommendations noted in the EDP Audit Report was considered significant and whether the issues were satisfactorily resolved.
Corporate Social Responsibility	(i) How is the company discharging its Corporate Social Responsibility? (ii) Whether any Board approved policy is in place and is being properly followed. (iii) Whether there is a system of fixation of targets for CSR activities. (iv) Whether adequate monitoring mechanism exists for implementation of CSR activities.
General	(i) Whether contribution of employer and employee to Provident Fund is kept separately out of business and proper safeguard of the same is taken care of. (ii) Where land acquisition is involved in setting up new projects an enquiry as to whether settlement of dues and rehabilitation of those affected are being done expeditiously and in a transparent manner to ensure that the benefits go to the really affected people and is not diverted to agents and intermediaries including political parties. (iii) Whether the Company has done any mergers and acquisitions during the year? Whether a thorough need analysis was done before merger or acquisition? Whether shareholders acceptance was taken before decision on merger/acquisition was arrived at? What was the impact thereof on the profitability of the company? (iv) If test checking was applied by statutory auditors, the manner in which areas of checking have been identified may be specified. Extent of sample selected and methodology of sampling adopted may also be specified.

Refund of CENVAT Credit to Exporter of Goods



Original Notification No. 41/2007 dated 06-10-2007 and further precedents were being introduced to grant exemption to exporters of goods from service tax on taxable services received and used by them while exporting the goods. To overcome the deficiencies and grant the refund to exporter of goods as early as possible, the government has revised Notification No. 41/2007 in 2009-10 with a new Notification 17/2009 dated 07-07-2009. This article compares the earlier and new notification of refund and compiles the problems faced by exporters followed by departmental clarifications on the same.

Original Notification No. 41/2007 dated 06-10-2007 and further precedents were being introduced to grant exemption to exporters of goods from service tax on taxable services received and used by them while exporting the goods. This notification was blessing for all the exporters of goods, either manufacturer exporter or merchant exporter, who hardly had any service tax liability to set off the CENVAT Credit available on taxable services received and used by them while exporting the goods. Refund may not be immediate but assured cash flows to them.

This refund scheme had faced a lot of issues after its introduction and ultimately resulted into only unrealistic on-paper benefits.

To overcome the deficiencies and grant the refund to exporter of goods

as early as possible, the government has revised Notification No. 41/2007 in 2009-10 with a new Notification 17/2009 dated 07-07-2009.

Highlights of Notification No. 17/2009 dated 07-07-2009

1. Both manufacturer exporter and merchant exporters are allowed to claim the refund by filling A-1 Form.
2. Merchant Exporter, before filling the claim of refund, is required to take a Service Tax Code (STC) from Assistant or Deputy Commissioner of Central Excise by filling Form A-2 and the same shall be granted within seven days of filling of A-2 Form.

However, it has been observed that if a merchant exporter is already registered in Service Tax then he



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is not required to file A-2 and can directly apply for a refund.

3. The refund claim shall be filed within one year from the date of export of the said goods and date of export is the date of export order as passed by custom officer under section 51 of Customs Act, 1962. Earlier, under Notification No. 41/2007 dated 06-10-2007 refund shall be filed on a quarterly basis, within sixty days from the end of the relevant quarter during which the said goods have been exported. Further, the word "sixty days" has been substituted with the words "six months" by Notification No. 32/2008 dated 18-11-2008.

4. Refund shall be filled to the Assistant or Deputy Commissioner of Central Excise, as the case may be, having jurisdiction over the factory of manufacture, registered office or the head office, as the case may be, of such exporter in Form A-1.

However, in cases of merchant exporters, central excise officers have denied accepting the claim of refund and forwarded the files to Service Tax Commissioners for verification and further processing just because they are allotted Service Tax Numbers. In fact, as per Notification, only Central Excise Commissioners are required to process the claims and non-acceptance of the claim by them results into unnecessary delay, paper work and expensive procedure on the part of assessee.

5. No refund allowed below ₹500.

Conditions to be Satisfied to Claim the Refund

1. No CENVAT Credit shall be taken on the amount claimed as refund.
2. Service Tax should have been disbursed first to Central Government i.e. first pay and then get it refunded.

3. Only 17 specified services are allowed as refund listed below –

Sr. No.	Classification in Section 65(105)	List of Services
1	(d)	General Insurance services of goods exported
2	(zn)	Port services of goods exported
3	(zzh)	Technical Testing & Analysis Service
4	(zzi)	Technical Inspection & Certification Service
5	(zzi)	Other Port and any Authorised Person Services
6*	(zzp)	Transport of Goods by Road only up to Port
7	(zzzd)	Cleaning Services of Exported goods
8	(zzzp)	Transport of Goods by Rail only up to Port
9	(zzzzj)	Supply of Tangible Goods Service
10#	(zzzzl)	Service provided for transport of export goods through national water way, inland water, and coastal shipping.
11	(f)	Courier Services
12	(h)	Customs House Agent Service
13	(j)	C & F Agent Service
14	(zm)	Banking & other Financial Service
15	(zza)	Storage and Warehouse Service
16	(zzk)	Money Exchange Service
17	ANY	Terminal Handling Charges

* Refund of this service will be available if exemption under Notification No. 18/2009 is not availed. However, it is always feasible to go for exemption to save the cash flows today in terms of exemption instead of relying on the future cash flows i.e. refund.

The said service was being later on added by Notification No. 40/2009 dated 13-09-2009.

4. Exporter should have been registered with any Export Promotion Councils sponsored by the Ministry of Commerce or the Ministry of Textiles. No such registration was required in the original Notification 41/2007.

This shows that this was being covered in new Notification to encourage the schemes of Ministry Commerce or Ministry of Textiles.

5. If the refund claim is greater than 0.25 per cent of total FOB value of exports then a certification from the Company auditor or tax auditor (Chartered Accountant only) should be provided along with the claim of refund stating the fact that the refund is higher than 0.25 per cent of total FOB value of exports. No such certification requirement was prescribed in the original Notification 41/2007.
6. Sale proceeds of exported goods should have been received by exporter within the time limit prescribed under FEMA, 1999 and if not then refund will be considered as erroneous.

Problems Faced by Exporters and Board Clarifications

1. Whether refund is admissible retrospective?

As clarified in Circular No. 112/06/2009-ST dated 12-03-2009,

As clarified in Circular No. 112/06/2009-ST dated 12-03-2009, being prospective in nature, refund could only be sanctioned on taxable services provided on or after the date they are notified in the said notification, i.e., 06-10-2007. Refund is prospective, even if the goods, in relation to which these services are used, are exported after the date when such services are notified under notification No. 41/2007-ST. However, no such circular is being issued in relation to Notification No. 17/2009 because period prior to this notification i.e. before 07-07-2009 refund is eligible under Notification 41/2007.



being prospective in nature, refund could only be sanctioned on taxable services provided on or after the date they are notified in the said notification, i.e., 06-10-2007. Refund is prospective, even if the goods, in relation to which these services are used, are exported after the date when such services are notified under notification No. 41/2007-ST. However, no such circular is being issued in relation to Notification No. 17/2009 because period prior to this notification i.e. before 07-07-2009 refund is eligible under Notification 41/2007.

2. The service provider providing services to the exporter provides various services but having registration of only one service. Can refund be denied on the grounds that the taxable services that are not covered under the registration of service provider are not eligible for such refunds?

Granting refund to exporters, on taxable services that he receives and uses for export do not require verification of registration certificate of service provider. Therefore, refund should be granted in such cases, if otherwise in order. (Circular No. 112/06/2009-ST dated 12-03-2009)

3. Incomplete Invoices Circular No. 120/01/2010-ST dated 19-01-2010 has clarified that if invoices and other documents submitted by exporter of goods are incomplete to prove the nexus of the use of taxable services in export of goods then the exporter should provide a certificate by a chartered accountant stating the nexus of the taxable services used in exporting goods.
4. Submission of Original Invoices It is always hardship for the exporter to provide original documents with the claim of refund. Such documents are

“Refund is always a distant reality. Though period of granting refund was not mentioned in original notification, Circular No. 120/01/2010-ST dated 19-01-2010 requires authorities to disburse the refund claims within 30 days of receipt of the claim. The same circular also mentions that any lapse in this regard will be viewed seriously and exporters are facilitated a special officer.”

required under the law to be kept in the Head Office for audit. The same can be avoided by either certifying by the management or by the chartered accountant after duly verified the same by him. Only in case of in-depth enquiry original documents can be verified. (Circular No. 112/06/2009-ST dated 12-03-2009).

5. Drafting Errors in forms

In Form A-1 Table No. 1 entry number 4 word “Let order” is wrongly written as “Late order”. “Let order” means order passed under Section 51 of Customs Act, 1962 by custom officer after custom physical verification. However, no such clarification has been received till date.

Conclusion

Refund is always a distant reality. Though period of granting refund was not mentioned in original notification, Circular No. 120/01/2010-ST dated 19-01-2010 requires authorities to disburse the refund claims within 30 days of receipt of the claim. The same circular also mentions that any lapse in this regard will be viewed seriously and exporters are facilitated a special officer.

With the introduction of revised notification and circular at the beginning of year 2010, refund procedures are expected to be expedited. ■

Taxation of Limited Liability Partnership



Limited Liability Partnership (LLP) and general partnership is being treated as equivalent (except for recovery purposes) in the Income-tax Act, 1961. As opposed to a corporate entity, distribution made by an LLP to its partners is tax exempt i.e. there is no dividend distribution tax on distribution to partners and further, an LLP is not subject to Minimum Alternate Tax. The Finance Bill, 2010 has proposed the much awaited provisions with respect to tax treatment on conversion of existing private companies and unlisted public companies into LLPs. Introduction of a tax regime will provide a road of certainty in relation to the tax cost associated with carrying the business via the LLP mode. However, further clarifications and suitable amendments to the Act are desired to remove the cloud of uncertainty in relation to certain issues. Read on to know more.

Limited Liability Partnership (LLP) is a buzz word today in India. However, it is not a new concept but an international wine in an Indian bottle. LLP Law is prevalent in many countries like UK, Japan, Canada, USA, Germany, etc.

Limited Liability Partnership Act

Limited Liability Partnership Act, 2008 was published in the official gazette on 9th January, 2009, but it was made effective in parts. Initially some of the provisions were made effective on 31st March, 2009. Afterwards most of the provisions which were left were made effective from 31st May, 2009. However, there are still some provisions left which are to be notified so as to make them effective.

Limited Liability Partnership Rules

Limited Liability Partnership Rules, 2009 were published in the official gazette on 1-4-2009. Rules 1 to 31, 34 to 37 and 41 came into force from

the date of publication in the official gazette itself and rest of the rules were made effective from 31-5-2009.

Limited Liability Partnership Rules, 2010 were published in the official gazette on 11-1-2010 and were made effective from 15-1-2010.

Taxation of LLP

LLP is a hybrid form of business having the colours of both, General Partnership and Company. It provides the benefits of limited liability but allows its members the flexibility of organising their internal structure as partnership based on a mutually arrived agreement. As soon as the Limited Liability Partnership Act got the legal consent, the need for a clear cut tax regime in respect of the income of the LLP was essential to give certainty in all respects of conducting business via this mode of business.

Finance Act, 2009 substituted the definition of firm, partner and partnership given under Section 2(23) of the Income Tax Act as under:-

'(i) "firm" shall have the meaning



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assigned to it in the Indian Partnership Act, 1932 (9 of 1932), and shall include a limited liability partnership as defined in the Limited Liability Partnership Act, 2008 (6 of 2009);

(ii) "partner" shall have the meaning assigned to it in the Indian Partnership Act, 1932 (9 of 1932), and shall include,—

(a) any person who, being a minor, has been admitted to the benefits of partnership; and

(b) a partner of a limited liability partnership as defined in the Limited Liability Partnership Act, 2008 (6 of 2009);

(iii) "partnership" shall have the meaning assigned to it in the Indian Partnership Act, 1932 (9 of 1932), and shall include a limited liability partnership as defined in the Limited Liability Partnership Act, 2008 (6 of 2009);

By the above amendments it was clarified that LLP shall be taxed at par with general partnership i.e. taxation in the hands of the entity and exemption from tax in the hands of its partners. Accordingly, all the provisions of the Income-tax Act, 1961 which are applicable on firm, partner and partnership shall also be applicable on LLP, partner of LLP and Limited Liability Partnership unless otherwise provided in the Act. Therefore, LLP shall pay tax @ 30.09 per cent (30% + 3% education cess) on its profit earned during any previous year. Since the LLPs have been treated at par with the general partnership, the provisions of Minimum Alternate Tax and Dividend Distribution Tax will not be applicable for LLP.

Remuneration and Interest to Partners

LLP shall be eligible to claim remuneration and interest paid to its partners up to the permissible limit given under section 40(b) subject to LLP Agreement authorises such

payment. Maximum rate of interest allowable is 12 per cent per annum. Section 40(b) was amended by the Finance Act, 2009 so as to provide uniform limit of remuneration for both professional and non professional firms for simplicity and administrative ease. The revised limits of remuneration are as under:

On the first ₹3 lakh of book profit or in case of a loss	₹1,50,000 or 90 per cent of Book Profit whichever is more
On the balance of Book Profit	60 per cent

Taxation of Partners

Profit of LLP credited to the accounts of the partners shall be exempt to tax under Section 10(2A) in the hands of partners to avoid double taxation. However, remuneration and interest paid by the LLP to its partners shall be taxable in the hands of partners up to which deduction has been claimed by the LLP under Section 40(b) under the head "Profits and gains of business or profession". However, any amount exceeding the limit specified under Section 40(b) paid by LLP to its partner shall be taxable in the hands of LLP and therefore, not chargeable to tax in the hands of partners.

Forms of Business Convertible into LLP

Following forms of business can be converted into LLP:

- Partnership firm, in pursuant to Section 55 of Limited Liability Partnership Act, 2008, can be converted into LLP following the provisions given under Section 58 and Second Schedule to the Act.
- Private company, in pursuant to Section 56 of Limited Liability Partnership Act, 2008, can be converted into LLP following the provisions given under Section 58 and Third Schedule to the Act.
- Unlisted public company, in pursuant to Section 57 of Limited Liability Partnership Act, 2008, can

be converted into LLP following the provisions given under Section 58 and Fourth Schedule to the Act.

However, there are no provisions available in Limited Liability Partnership Act to reconvert back into a partnership or a company from LLP. In such a case, the decision has to be well evaluated realising that there is no "u turn" available down the road.

Conversion of Partnership into LLP: Tax Implications

As per definition given under Income-tax Act, 1961 Firm includes LLP. Therefore, conversion of Firm into LLP will be conversion to itself i.e. no change (nothing happened) in the eyes of Income Tax Law, subject to right and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. Explanatory Memorandum of the Union Budget 2009-10 clarifies as follows:-

"As an LLP and a general partnership is being treated as equivalent (except for recovery purposes) in the Act, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after

By certain amendments it was clarified that LLP shall be taxed at par with general partnership i.e. taxation in the hands of the entity and exemption from tax in the hands of its partners. Accordingly, all the provisions of the Income Tax Act which are applicable on firm, partner and partnership shall also be applicable on LLP, partner of LLP and Limited Liability Partnership unless otherwise provided in the Act. Therefore, LLP shall pay tax @ 30.09 percent (30% + 3% education cess) on its profit earned during any previous year.

conversion and if there is no transfer of any asset or liability after conversion. If there is a violation of these conditions, the provisions of Section 45 shall apply."

Therefore, there will be no capital gain on conversion of firm into LLP either in the hands of firm or in the hands of partners. All the provisions of the Income-tax Act, 1961 shall continue to apply on LLP as they would have applied on firm as if no conversion had taken place.

Conversion of Private or Unlisted Public Company into LLP: Tax Implications

Income Tax Law was silent about the tax implications, on conversion of Private Company or Unlisted Public Company (hereinafter referred to as company) into LLP. The Finance Bill, 2010 has proposed to make provisions for the same. Proposed provisions are as under:-

A. Transfer of Asset shall not be regarded as transfer

Section 47 of the Income-tax Act has been proposed to be amended so as to include new clause (xiiiib). As per proposed Section 47 (xiiiib), any transfer of a capital asset or intangible asset by a company to a LLP as a result of conversion of the company into LLP in accordance with the provisions of Section 56 or Section 57 of the Limited Liability Partnership Act shall not be regarded as transfer if and only if following six conditions are satisfied [given in the proviso to proposed Section 47(xiiiib)]:-

1. All the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the LLP;
2. All the shareholders of the company immediately before the conversion become the partners of the LLP and their capital contribution and profit sharing ratio in the LLP are

in the same proportion as their shareholding in the company on the date of conversion;

3. The shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the LLP;
4. The aggregate of the profit sharing ratio of the shareholders of the company in the LLP shall not be less than 50 per cent, at any time during the period of five years from the date of conversion;
5. The total sales, turnover or gross receipts in business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed ₹60 lakh; and
6. No amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

Above mentioned six conditions are cumulative and each one of them has to be satisfied to claim exemption. The first four conditions are on the same line as provided for conversion of firm/AOP/BOI into company in Section 47(xiii). Fifth condition seems to be added to discourage the big

“ If before conversion, company issues bonus shares to its equity shareholders out of its accumulated profit by capitalising its whole profit and on the next day it converts itself into LLP, then, shareholders (prospective partners) shall get their part of accumulated profit to the credit of their capital account as contribution in LLP without any tax implication which is not the intention of Law.”

companies to be converted into LLP. Since there is a liability to pay dividend distribution tax @ 16.995 per cent for the company on declaration/payment/distribution of dividend out of its current or accumulated profit, therefore, sixth condition restricts the partners of LLP to distribute its accumulated profit standing on the date of conversion in the accounts of the company to avoid the conversion only for saving dividend distribution tax.

However, issuing bonus shares to equity shareholders is not dividend as per definition given under Section 2(22) and thus out of the ambit of dividend distribution tax. Therefore, if before conversion, company issues bonus shares to its equity shareholders out of its accumulated profit by capitalising its whole profit and on the next day it converts itself into LLP, then, shareholders (prospective partners) shall get their part of accumulated profit to the credit of their capital account as contribution in LLP without any tax implication which is not the intention of Law. Hence sixth condition introduced by Finance Bill, 2010 needs reconsideration.

B. Withdrawal of Exemption

New sub section 4 to Section 47A has been proposed to be inserted by the Finance Bill, 2010 so as to provide that:

- Capital gain not previously charged under Section 45 due to fulfillment of six conditions laid down in the proviso to Section 47(xiiiib) shall be deemed to be the profits and gains of the successor LLP if any of the conditions laid down in the proviso to Section 47(xiiiib) are violated.
- Such income shall be chargeable to tax in the previous year in which the requirements of the said proviso are violated.
- It is not clear from the language of proposed Section 47A(4) as to the head under which such income would be taxed. However, having

regard to the placement of Section 47A(4) in the provisions relating to taxation of capital gains, it appears that it would be treated as capital gains.

C. Amortisation of expenditure incurred under Voluntary Retirement Scheme (VRS)

Section 35DDA(1) provides deduction of the total amount, paid by an assessee under VRS to an employee, in five equal annual installments commencing from the previous year in which such amount is paid by the assessee.

A new sub section (4A) to Section 35DDA has been proposed to be inserted by the Finance Bill, 2010 providing that, if a company is converted into LLP satisfying the six conditions laid down in the proviso to Section 47(xiiib), then, provisions of Section 35DDA shall apply to the successor LLP as they would have applied to the said company as if reorganisation of business had not taken place. Thus the deduction shall be available for the remaining period to the LLP.

Sub section (5) to Section 35DDA has also been proposed to be amended by Finance Bill, 2010 so as to provide that, no deduction under Section 35DDA shall be allowed to the said company for the previous year in which such conversion has taken place.

D. Actual cost of any capital asset of specified business referred under Section 35AD

Explanation 13 to Section 43(1) has been proposed to be amended by Finance Bill, 2010 so as to provide that, the actual cost of any capital asset on which deduction has been allowed or is allowable to the assessee under Section 35AD, shall be treated as NIL, if the capital asset is acquired or received on conversion of company into LLP satisfying the six conditions laid down in the proviso to Section 47(xiiib).

E. Cost of Block transferred on conversion

New Explanation 2C to Section 43(6) has been proposed to be inserted by the Finance Bill, 2010 so as to provide that, where in any previous year, any block of assets has been transferred by a company to LLP on its conversion, satisfying the six conditions laid down in the proviso to Section 47(xiiib), then, the actual cost of the block of assets in the case of LLP shall be the written down value of the block of assets on the date of conversion in the case of the said company.

F. Cost of Acquisition

Section 49(1)(iii)(e) has been proposed to be amended by the Finance Bill, 2010 so as to provide that, where a LLP acquires capital asset satisfying the six conditions laid down in the proviso to Section 47(xiiib), then, the cost of acquisition of such asset for LLP shall be deemed to be the cost for which the previous owner (company) of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the successor LLP, as the case may be.

G. Carry Forward of Business Loss and Unabsorbed Depreciation

A new sub section 6A to Section 72A has been proposed to be inserted, in consequent to which clause (a) and (b) of Section 72A(7) has also been proposed to be amended by the Finance Bill, 2010 so as to provide that, if there is a conversion of company into LLP satisfying the six conditions laid down in the proviso to Section 47(xiiib), then, accumulated business loss (not being a loss sustained in a speculation business) and unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance of depreciation of the successor LLP for the purpose of the previous year in which such conversion has taken place and other provisions relating

“ A new sub section (4A) to Section 35DDA has been proposed to be inserted by Finance Bill, 2010 providing that, if a company is converted into LLP satisfying the six conditions laid down in the proviso to Section 47(xiiib), then, provisions of Section 35DDA shall apply to the successor LLP as they would have applied to the said company as if reorganisation of business had not taken place.”

to set off and carry forward of loss and allowance for depreciation shall apply accordingly. Meaning thereby LLP can carry forward such business loss for the fresh period of eight years under Section 72 of the Income-tax Act and unabsorbed depreciation can be carried forward for the indefinite period under Section 32(2) by the successor LLP.

However, if any of the six conditions laid down in the proviso to section 47(xiiib) is violated subsequently, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor LLP, shall be deemed to be the income of the LLP chargeable to tax in the year in which such violation has taken place.

H. MAT Credit shall Lapse

A new sub section 7 to Section 115JAA has been proposed to be inserted by the Finance Bill, 2010 so as to provide that, if there is a conversion of a company into LLP irrespective of the fact it satisfies the six conditions laid down in the proviso to Section 47(xiiib), MAT credit available to the predecessor company shall lapse and the LLP cannot enjoy the benefit of the same.

I. Taxation of Shareholders

On conversion of company into LLP the shares held by the shareholders of the company will get extinguished and will be substituted by balance in their respective capital accounts.

As per definition given under Section 2(47) of Income Tax Act, transfer in relation to a capital asset, includes, the extinguishment of any rights thereon and thus chargeable to tax under Section 45. But unlike cases of amalgamation and demerger, the proposed amendments do not clarify the position of tax neutrality in the hands of the shareholders and still is an open question.

Who to Sign the Return

Section 140 has been amended by the Finance Act, 2009 so as to provide that, in the case of a LLP, return of income can be signed by the designated partner thereof, or where for any unavoidable reason such designated partner is not able to sign and verify the return, or where there is no designated partner as such, by any partner thereof.

Liability of Partners in Liquidation

A new Section 167C has been inserted by the Finance Act, 2009 so as to provide the provisions regarding liability of partners to pay tax in the case of liquidation of LLP. It provides that where any tax due and cannot be recovered from-

1. LLP in respect of any income of any previous year, or
2. Any other person in respect of any income of any previous year during which such other person

“The existing provisions of the Income-tax Act, 1961 provide an option to the assessee for taxation of income on presumptive basis in the case of construction business, income from goods carriages and business of retail trade under Section 44AD, 44AE and 44AF respectively. However, a LLP can enjoy presumptive taxation scheme only up to assessment year 2011-12, except that provided in Section 44AE.”

was a LLP.

In such case, every person who was a partner of the LLP at any time during the relevant previous year, shall be jointly and severally liable for the payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP.

Section 167C supersedes the Limited Liability Partnership Act, 2008. Although this Section appears to be in conflict with the scheme of the Limited Liability Partnership Act, 2008, which does not make the partners personally liable for the liabilities of the LLP, it seems to be in line with existing provisions of Section 179 of the Income-tax Act, which cast a similar liability on the Directors of a private company in liquidation.

Presumptive Taxation Scheme under Section 44AD

The existing provisions of the Income-tax Act, 1961 provide an option to the assessee for taxation of income on presumptive basis in the case of construction business, income from goods carriages and business of retail trade under Section 44AD, 44AE and 44AF respectively. However, a LLP can enjoy presumptive taxation scheme only up to assessment year 2011-12, except that provided in Section 44AE. As Section 44AD has been made inapplicable on LLP and Section 44AF has been made inoperative from assessment year 2011-12 by the Finance Act, 2009.

Amalgamation of LLP

There are certain provisions under Limited Liability Partnership Act, 2008 in pursuant to which LLP can opt for amalgamation or demerger, etc. The words amalgamation and demerger have been defined in Income-tax Act, 1961 itself under Clause (1B) and (19AA) to Section 2 respectively. Definitions of amalgamation and demerger given

under Income-tax Act, 1961 are only with respect to companies. There are detailed provisions under Income-tax Act, 1961 about the tax implications, if amalgamation or demerger of companies takes place. Transfer of capital asset by the amalgamating company or demerged company to the amalgamated company or resulting company as the case may be, is not considered as transfer hence does not attract capital gain subject to fulfillment of certain conditions given under Section 47. On the other hand, transfer of shares in the amalgamating company or demerged company as the case may be, by the shareholders, does not tantamount to transfer subject to fulfillment of certain conditions given under Section 47.

However, there are no such provisions for LLPs. It is recommended to amend the definitions of amalgamation and demerger given under Income Tax Act so as to cover the amalgamation and demerger of LLP too or to provide separate provisions for the same.

Conclusion

Taxation scheme for LLP has been prescribed on the same lines as currently applicable for Partnership Firms (except for recovery purposes), and all the provisions of the Income-tax Act applicable to Firm apply to LLP also unless otherwise provided in the Act. There are specific provisions in Income Tax Act for the tax implications on conversion of private company or unlisted public company into LLP. Despite some clarity being provided by the Income-tax Act, 1961 and Finance Bill, 2010 there are still certain issues like tax implications on amalgamation or demerger of LLP, taxation of shareholders upon acquiring an interest in the LLP as a result of conversion of company into LLP, etc. which require clarifications to remove the uncertainties. ■

Controlled Foreign Companies



The Direct Tax Code (DTC) 2010 has proposed a host of new and revised provisions concerning cross-border taxation of income. One of the major provisions proposed by DTC 2010 relates to introduction of Controlled Foreign Company (CFC) regulations. CFC regulations are a broad set of regulations which are primarily aimed to prevent avoidance/deferral of tax by resident taxpayers by establishing intermediate foreign subsidiaries in low tax jurisdictions and parking income in those entities. This article attempts to decode the CFC regulations.

With the opening of world-trade, more and more companies have tried to spread their operations in a number of countries by either establishing a formal/informal place of business in other countries or by setting up of local subsidiaries to manage the business in those country/surrounding regions. The income earned by subsidiaries suffers from dual taxation on distribution of the same as dividend by such subsidiaries (first in the hands of the subsidiaries in the respective source country and second in the hands of the holding company on receipt of dividend). To avoid this dual

taxation, companies started structuring their overseas operations by setting up an intermediary holding company in a tax-favourable jurisdiction. The profits earned by the subsidiaries would be distributed to such intermediary holding companies as dividend and would be parked there.

While this would certainly help in reducing the overall tax cost (or at least deferment of tax till the income is distributed by such foreign company), non-repatriation of funds to the parent company jurisdiction results in a loss of revenue for the country where the parent is located. With a view to prevent such accumulation and non-distribution of income by

(Contributed by the Committee of International Taxation of the ICAI. Comments can be sent to citax@icai.org)

intermediate holding company, many countries started introducing the CFC regulations in their tax laws. The main aim of CFC regulations is to prevent the accumulation of income/funds in tax-favourable jurisdiction by including the undistributed income of such foreign companies in the total income of parent company.

CFC regulations were initially introduced in the United States of America as early as 1962. With the passing of time, CFC regulations grew in prominence with a number of countries incorporating similar provisions in their tax laws. Currently, many developed countries like Canada, Germany, Japan, France, UK, New Zealand, Australia and emerging economies like Mexico, Argentina, Indonesia and China have CFC regulations in their tax laws.

Incorporation of CFC regulations in the tax laws to counter use of tax-friendly jurisdictions for avoidance/deferment of tax is encouraged even by the Organisation for Economic Co-operation and Development (OECD) in its report on Harmful Tax Competition.

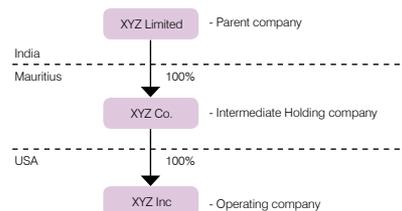
CFC Regulations – Concept

As explained earlier, CFC regulations are a broad set of regulations designed to prevent the deferral and avoidance of tax by residents, (including domestic companies) by establishing foreign entities/subsidiaries, in low tax jurisdictions and parking income in those countries. The International Bureau of Fiscal Documentation (IBFD) has explained CFC legislations as under:

“The term is generally used in the context of tax avoidance rules designed to combat the diversion by resident taxpayers of income to companies they control and which are typically resident in countries imposing low-or-no taxation. Under these rules income of the controlled company is typically either deemed to be realised directly

by the shareholders or deemed to be distributed to them by way of dividend. Often only part of the controlled company’s income is dealt with in this way, typically passive income such as dividends, interest and royalties (“tainted income”). Many, but not all controlled foreign company regimes apply only to corporate shareholders.”

Operation of a typical CFC regulation is explained by the following illustration:



The above is a typical illustration of an organisation structure wherein the CFC regulations may become applicable. In the above case, XYZ Co. is an intermediate holding company established in favourable tax jurisdiction as a holding company for various operating companies in other jurisdictions. The profits earned by XYZ Inc would be distributed as dividend to XYZ Co and parked there to escape higher tax rate in the parent company XYZ Limited’s country, India. Under the CFC regulations, XYZ Co. would be deemed to be a controlled foreign company/corporation and the undistributed income of the same would be taxed in the hands of XYZ Limited, even though actual dividend is not declared by XYZ Co., Mauritius.

CFC Regulations – Approaches

CFC regulations typically have the following approaches

- 1) Jurisdictional approach
- 2) Transactional approach
- 3) Entity-level approach

1) Jurisdictional approach

Under the jurisdictional approach of CFC regulations, foreign companies

set-up by resident companies in low-tax jurisdictions are targeted. Accordingly, where a resident company sets up a subsidiary mainly to act as an intermediate holding company or non-operating holding company in a low-tax jurisdiction, such foreign company is deemed to be a controlled foreign company for the purpose of CFC regulations. In such a scenario, CFC regulations are deemed to be applicable on such foreign companies in low-tax jurisdiction and all the income earned by such foreign companies is taxed in the hands of the resident company.

2) Transactional approach

Under the transactional approach, the focus is generally restricted to the passive income earned by foreign subsidiaries of resident companies. Passive income would tend to include incomes like royalty, interest, rent, capital gains, etc.

3) Entity-level approach

This is a hybrid approach combining the principles of jurisdictional approach and transactional approach. Under this approach, CFC regulations are triggered both when the foreign

“The Indian tax authorities have woken up to the needs of having CFC regulations as an effective anti-avoidance regulation. DTC 2010 proposes to introduce the CFC regulations to prevent avoidance/ deferral of tax by parking income in tax friendly jurisdictions. The CFC regulations under DTC 2010 propagate an ‘entity-level approach’. Under this approach, the focus is on the CFC as an entity rather than on its income, although the nature of its income (whether active or passive income) is an important factor in the determination of whether or not the CFC rules apply.”

subsidiary is set up in a low-tax jurisdiction and when the foreign subsidiary has passive income stream.

The CFC regulations proposed under DTC 2010 follow the entity level approach.

CFC Regulations – Indian Perspective

The Indian tax authorities have woken up to the needs of having CFC regulations as an effective anti-avoidance regulation. DTC 2010 proposes to introduce the CFC regulations to prevent avoidance/deferral of tax by parking income in tax friendly jurisdictions.

The CFC regulations under DTC 2010 propagate an 'entity-level approach'. Under this approach, the focus is on the CFC as an entity rather than on its income, although the nature of its income (whether active or passive income) is an important factor in the determination of whether or not the CFC rules apply. Once a foreign company qualifies as a CFC (and none of the exemptions apply), all of the income of the CFC is taxed in the hands of the resident-controlling shareholder on a proportionate basis. The future dividend distribution of the attributed income by the CFC is deductible.

CFC regulations under the DTC 2010 are applicable on all Controlled Foreign Companies. Controlled Foreign companies have been defined to include all the foreign companies which fulfill the following conditions:

- a) A minimum of 50 per cent control either by way of equity or voting power is exercised by a resident taxpayer or a significant influence over the foreign company is exercised by such resident taxpayer;
- b) Is a resident in tax jurisdiction having an effective rate of tax less than 50 per cent of the rate of tax it would have paid under the

provisions of DTC 2010 if it were a domestic company. Accordingly, if a controlled foreign company is paying tax at an effective rate which is more than 50 per cent of the tax rate applicable under the DTC 2010, then the income of such company would be exempted from the CFC regulations;

- c) Shares of such foreign company are not listed on any stock exchange in the foreign country of which it is a resident;
- d) The specified income of such foreign company does not exceed ₹25 lakh or equivalent of such income; and
- e) It is not engaged in active trade or business (meaning it only earns passive income). A company would be deemed to carry on active trade or business if it fulfills the following conditions:
 - i) It actively participates in industrial, commercial or financial undertakings through employees or other personal in the country of residence of such foreign country; and
 - ii) The following income constitutes less than 50 per cent of the total income of such foreign company:
 - a) Dividend;
 - b) Interest;
 - c) Income from house property;
 - d) Capital gains;
 - e) Annuity payment;
 - f) Royalty;
 - g) Sale or licensing of intangible rights on industrial, literary or artistic property;
 - h) Income from sale of goods or supply of services including financial services to persons controlled by such foreign company or an associated enterprise of such foreign company. Accordingly, if the foreign

The proposed CFC regulations, when made effective could have a significant impact on the many corporate houses of India having global presence with likelihood that the profits of their foreign subsidiaries be taxable in India. Given the same, it would be advisable for such companies to review their current business structure and if required, restructure the same to adequately address the challenges which would be posed by the CFC regulations.

company derives a majority of income from onward selling of goods/services to its group concerns only, then in spite of being involved in active trade or business, such foreign company may still be considered as a CFC for the purpose of applicability of these regulations. To illustrate, in the earlier figure of CFC, if XYZ Co. (Mauritius) purchases its goods for XYZ Limited and more than 50 per cent of its income is derived from sales made to XYZ Inc and/or other associated enterprises, then the XYZ Co. would be deemed to be a controlled foreign company and its income would be liable to tax in India.

- i) Income from management, holding or investment in securities, shareholdings, receivables or other financial assets;
- j) Income falling under the head residuary sources.

If the above conditions are fulfilled by a foreign company controlled by a resident person, then CFC regulations

would be applicable to such a foreign company. The above can be explained by way of the illustration:

Where E is the number of days during which the foreign company remained a CFC; and

Particulars	Conditions fulfilled					
	✓	✗	✓	✓	✓	✓
Minimum 50 per cent of equity/ voting power in foreign company is held by resident taxpayer or significant influence is exercised by such resident taxpayer	✗	✓	✓	✓	✓	✓
Effective tax rate of foreign company is less than the 50 per cent of tax rate under DTC 2010	✓	✗	✓	✓	✓	✓
Shares of foreign company is not listed on stock exchange in foreign company's country	✓	✓	✗	✓	✓	✓
Specified income of foreign company does not exceed equivalent of ₹25 lakh	✓	✓	✓	✗	✓	✓
It is not engaged in active trade or business	✓	✓	✓	✓	✗	✓
Foreign company is CFC for the purpose of CFC regulations	✗	✗	✗	✗	✗	✓

In such case, the income of the foreign company, which would form part of the resident taxpayer controlling the foreign company, would be computed as per the below formula:

$$\text{Income attributed to resident taxpayer} = A \times \frac{B}{100} \times \frac{C}{D}$$

Where A is the specified income of foreign company to be determined as the formula provided;

Where B is the percentage of capital/ voting share or interest held in the foreign company;

Where C is the number of days out of D, voting shares/ interest held by resident taxpayer in foreign company; and

Where D is the number of days, the foreign company remained as controlled foreign company.

The formula to compute the value of A is provided as under:

$$\text{Specified Income} = (A + B - C - D) \times \frac{E}{F}$$

Where A is the net profit of the foreign company as per its profit and loss account;

Where B is provisions made for liabilities (other than ascertained liabilities);

Where C is amount of interim dividend paid, if such dividend was not already debited to the profit and loss account;

Where D is the loss which was not earlier deducted while computing income of such foreign company;

Where F is the total number of days in the accounting period of the foreign company.

The above formulae can be explained with the help of the following illustrations:

Illustration 1:

XYZ Co is a foreign company. During the FY 2009-10, its net profit was equivalent of ₹2 crore. It had made a provision for unascertained liabilities to the tune of ₹5 lakh. It paid an interim dividend of ₹20 lakh during FY 2009-10. During the whole of FY 2009-10, XYZ Limited held 60 per cent of the total paid up capital of XYZ Co. In such a case, the income to be attributed to XYZ Limited for FY 2009-10 would be determined as under:

$$\begin{aligned} \text{Specified Income} &= (2,00,00,000 + 5,00,000 - 20,00,000) \times (365 / 365) \\ &= (1,85,00,000) \times 1 \\ &= 1,85,00,000 \end{aligned}$$

$$\begin{aligned} \text{Income to be attributed to XYZ Limited} &= (1,85,00,000) \times (60/100) \times (365/365) \\ &= 1,85,00,000 \times 0.6 \\ &= 1,11,00,000 \end{aligned}$$

In the above case, if the income earned by the foreign company, XYZ Co is accumulated by it and remains undistributed, then as per the provisions of DTC 2010, ₹1,11,00,000 would be added to the total income of XYZ Limited.

Under the jurisdictional approach of CFC regulations, foreign companies set-up by resident companies in low-tax jurisdictions are targeted. Accordingly, where a resident company sets up a subsidiary mainly to act as an intermediate holding company or non-operating holding company in a low-tax jurisdiction, such foreign company is deemed to be a controlled foreign company for the purpose of CFC regulations. In such a scenario, CFC regulations are deemed to be applicable on such foreign companies in low-tax jurisdiction and all the income earned by such foreign companies is taxed in the hands of the resident company.

Illustration 2:

If in illustration 1 above, XYZ Limited had acquired its stake only on 1st January 2010, then the income would be worked out as under:

$$\begin{aligned} \text{Specified Income} &= (2,00,00,000 + 5,00,000 - 20,00,000) \times (90 / 365) \\ &= (1,85,00,000) \times 0.2466 \\ &= 45,62,100 \end{aligned}$$

$$\begin{aligned} \text{Income to be attributed to XYZ Limited} &= (45,62,100) \times (60/100) \times (90/90) \\ &= 45,62,100 \times 0.6 \\ &= 27,37,260 \end{aligned}$$

Way forward

The proposed CFC regulations, when made effective could have a significant impact on the many corporate houses of India having global presence with likelihood that the profits of their foreign subsidiaries be taxable in India. Given the same, it would be advisable for such companies to review their current business structure and if required, restructure the same to adequately address the challenges which would be posed by the CFC regulations. ■

Applicability of Transfer Pricing Provisions to Domestic Related Party Transactions – Analysis of Recent Ruling of Supreme Court



Transfer pricing has become most important international tax issue for multinational enterprises operating in India. The recent ruling of Supreme Court in the case of *CIT v. GlaxoSmithKline Asia Private Limited (2010-TII-02-SC-LB-TP)* has cleared the controversy surrounding an important issue of applicability of transfer pricing provisions to domestic related party transactions. The ruling of Supreme Court has provided relief to the taxpayers, as Supreme Court held that transfer-pricing provisions in its current form are not applicable to domestic related party transaction. However, Supreme Court made certain suggestions to Ministry of Finance for amending the Income-tax Act, 1961 and thereby increasing the scope of TP provisions even to domestic related transactions under certain circumstances. If the suggestions of Supreme Court are implemented it can cause significant increase in compliance requirement of taxpayers.

Transfer Pricing (TP) has become the most important international tax issue for multinational enterprises (MNE's) operating in India. TP regulations were introduced in India in financial year (FY) 2001-02 and since then it has been subject to various interpretations. Most of TP litigations have recently been reaching the tribunal level, which is the highest fact-finding tax court in India. Accordingly, TP litigations at tribunal level are at nascent stage.

With the recent ruling of Supreme Court (SC) in case of *CIT v. GlaxoSmithKline Asia Private Limited (2010-TII-02-SC-LB-TP)*, SC has

cleared the controversy surrounding an important issue of applicability of TP provisions to domestic related party transaction.

Applicability of TP Provisions

As a precursor, Section 92(1) of the Income-tax Act, 1961 (the Act) requires that any income arising from international transaction shall be computed having regard to arm's length price. Thus, for applicability of TP provisions to international transaction following conditions need to be satisfied:

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- a) There should be two or more associated enterprise (as defined under Section 92A of the Act); and
- b) These associated enterprises enter into international transaction (as defined under Section 92B of the Act)

If the above conditions are satisfied then TP provisions are applicable and such transactions should be at arm's length price. Thus in this connection it is pertinent to understand the definition of international transactions as given under Section 92B of the Act.

Definition of International Transaction

Section 92B (1) of the Act defines "international transaction" as

"a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises"

Thus, what is essential is that international transaction should be between associated enterprises and either or both such associated enterprises must be a non-resident. Hence, the Act intends to bring all cross-border inter-company transaction within the scope of TP provisions.

In this connection, it is pertinent to highlight the ruling of Punjab and Haryana High Court in case of *Coca Cola India Inc v. ACIT*. In this judgment one of the question raised by Coca Cola India Inc before the High Court was on

applicability of TP provisions, where both the parties to the transactions are subject to tax in India. The High Court held that the only condition precedent for invoking Transfer Pricing provisions is that there should be income arising from international transaction; and such income has to be computed having regard to arm's length price.

The High Court was thus of the view that there was no ambiguity or absurd consequence of application of Transfer Pricing in a scenario where both the parties to the transaction are subject to jurisdiction of taxing authorities in India.

Further, in India the definition of international transaction has been kept very wide and there is concept of deemed international transaction which is given under Section 92B (2) of the Act. As per Section 92B (2) of the Act:

"A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise."

Thus, even a transaction with an enterprise, which is not an associated enterprise are intended to be covered within scope of TP provisions.

Section 40A (2) of the Act

Section 40A (2) of the Act states that:

- Where the assessee incurs any expenditure in respect of which payment has been or is to be made to a related person as defined in clause (b) of this sub-section (2) of Section 40A of the Act, and
- the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard

to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom.

Then so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction.

Ruling of Supreme Court

• Facts of Case

M/s GlaxoSmithKline Asia Private Limited (GSK Asia) is a company engaged in the business of manufacture and sale of fast-moving consumer products. GSK Asia did not have any employee other than a Company Secretary. The administrative services relating to marketing, finance, human resource, secretarial services etc were provided by Glaxo Smith Kline Consumer Healthcare Limited ('GSKCH'), a widely held public limited Indian company. The agreement between the GSKCH and the GSK Asia was that the GSK Asia would reimburse the costs

Normally SC does not make recommendations or suggestions. However, SC in order to reduce litigation suggested that certain provisions of the Act, like Section 40A (2) and Section 80IA (10), need to be amended empowering the AO to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties using any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing Regulation.

incurred by GSKCH for providing the various services plus 5 per cent mark-up (referred to as "cross charges").

Assessing Officer ("AO") held that the payment of cross charge to GSKCH was not fully and exclusively for the purpose of business of the GSK Asia and, therefore, could not be justified in terms of its legitimate business requirements. The AO held that the payment of cross charges to the extent of 7 per cent of net sales alone was justified and balance was disallowed. The disallowance was confirmed by the Commissioner of Income-tax (Appeal). However, the Income Tax Appellate Tribunal ("ITAT") held that there is no provision to disallow any expenditure on the ground that such expenditure is excessive

or unreasonable unless the case falls within the scope of Section 40A(2) of the Act. Since there were no material on record to show that such provisions could be attracted ITAT provided relief to GSK Asia and deleted the disallowance made by AO. Against the ITAT Revenue filed appeal to High Court which was also dismissed.

For subsequent years, however, the AO continued to disallow the claim and recovered the demand through attachment. GSK Asia got relief from the ITAT and Revenues' appeal are pending with the High Court. However, for the delay on the part of the Revenue to give effect to the ITAT's order, GSK Asia filed a writ petition with the High Court. The High Court issued a direction by way of a mandamus to

the Revenue to refund the amount and also held that the GSK Asia is entitled to interest on such amount of refund as well as interest on delayed refund as per the provisions of the Act. Against the said order of the High Court, Revenue filed Special Leave Petition (SLP) before the Supreme Court.

- **Ruling of SC**

Based on the perusal of materials SC held that GSK Asia and GSKCH are not related parties in terms of Section 40A (2) of the Act and that the entire exercise is revenue neutral. Hence, the SLP filed by the Revenue was dismissed.

However, SC then raised a question whether TP provisions should be limited to only to cross border transactions or whether TP provisions should be extended to

“ Thus, the SC ruling provides comfort that TP provisions as is currently stated under the Act are not applicable to domestic related party transactions. The ruling also acknowledges that domestic transactions between related parties are revenue neutral (except under specific circumstances mentioned by SC). ”

domestic transactions. SC observed that in the case of domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage -

- I. If one of the related companies is loss making and the other is profit making and profit is shifted to the loss making concern; and
 - II. If there are different tax rates for two related units [on account of different status, area based incentives, nature of activity, etc.] and if profit is diverted towards the unit on the lower side of tax arbitrage
- **Suggestions of SC**

Normally SC does not make recommendations or suggestions. However, SC in order to reduce litigation suggested that:

- certain provisions of the Act, like Section 40A(2) and Section 80IA(10), need to be amended empowering the AO to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties using any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing Regulation;

- consideration should also be given to whether the law should be amended to make it compulsory for the taxpayer to maintain Books of Accounts and other documents on the lines prescribed under Rule 10D of the Income Tax Rules, 1962 in respect of such domestic transactions and whether the taxpayer should obtain an audit report from his Chartered Accountant in this regard; and
- the questions of the above amendments may require consideration expeditiously by Ministry of Finance. In the mean time, the Central Board of Direct Tax could consider issuing appropriate instructions on these issues.

Conclusion

Thus, above ruling provides comfort that TP provisions as is currently stated under the Act are not applicable to domestic related party transactions. The ruling also acknowledges that domestic transactions between related parties are revenue neutral (except under specific circumstances mentioned by SC).

Based on the ruling and suggestions given by SC, a few instances of domestic related party transactions/relationships that could probably be covered under TP provisions includes:



However, if the suggestions made by SC to amend the Act and thereby extend scope of TP provisions to domestic related party transactions are implemented then, it can have significant impact on taxpayer by increase the compliance burden of taxpayers. ■

Sr No.	Scenario	Particulars
1	Area based incentives	When one of the related parties to domestic transaction is located in Special Economic Zone and thereby enjoys tax holiday under Section 10AA of the Act and the other related party is subject to normal tax regime. Any transaction between these enterprises could attract TP provisions.
2	Nature of activity	When one of the related parties to domestic transaction is engaged in infrastructure development and thereby entitled to tax deduction under Section 80IA of the Act and the other related party is subject to normal tax regime. Any transaction between these enterprises could attract TP.
3	Different tax status	When one of the related parties to the transaction is a foreign company subject to Income-tax in India at the rate of 40 per cent and other party to the transaction is a domestic company subject to tax at the rate of 30 per cent (This view is even upheld by Punjab and Haryana High Court in case of Coca Cola India Inc v. ACIT)

Changing Role of Audit Committees and Risk Management



Audit Committee (AC), as an element of corporate governance, is responsible for improving director's understanding and awareness of accounting related issues and other important matters concerning the behaviour of the organisation and the integrity of any financial information that is reported to the stakeholders. Accounting scandals and the growing concern about the quality of financial statements have led to the broadening of the scope of the Audit Committee to encompass risk management as one of its fiduciary duties. The manner in which the directors discharge their duties is increasing under scrutiny. As per the provisions of all codes of good practice in corporate governance and stock exchange listing criteria, listed companies are required to have Audit Committee to discuss and review the firm's risk assessment strategies. This article highlights how the remit of audit committees has expanded to include oversight of risk management and control systems to create an environment for adherence to the practices of good corporate governance.

"An audit committee is unique in that it provides a forum where directors, management and auditors can deal together with issues relating to the management of risk and with financial reporting obligations"¹

In the light of this statement, it can be said that the role of Audit committee (AC) is not just limited to financial reporting, but also encompasses the responsibility of forecasting and assessing risk that an organisation faces.

Corporate governance is a method used by corporations for streamlining the various participants in an organisation, having conflicting interests². Corporate governance can be said to deal with the entire network of formal and informal relationships both between the company's management and its shareholders and between the management and other key stakeholders including employees, customers, suppliers, creditors, local communities, and society in general.³

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1 AARF, 1997; *Audit Committees: Best Practice Guide, Australia: Australian Accounting Research Foundation, Australian Institute of Company Directors and Institute of Internal Auditors.*

2 Daily et. al (2003), *Corporate governance: Decades of dialog and data. Academy of Management Review, 28: 371-382*

3 Zhao, X(2006), *The voluntary adoption of corporate governance reforms in the Post - Enron, The University of Texas at Dallas, Pg.34*



After several scandals like Enron, Tyco, WorldCom, etc. the audit committees became a common mechanism of corporate governance internationally. This prompted various legislative and regulatory reforms, for example The Sarbanes-Oxley Act of 2002 in the US, the recommendations of the Smith Committee (2003) and the Higgs (2003) review in the UK advocating expanded roles for Audit Committees. These reforms have drastically redefined the roles and responsibilities of the Audit Committees.⁴

With changes in technology, the advent of globalisation, the nature and complexity of business transactions, and the rapid evolution of business life cycles, managing risk has become a challenging task for an organisation's AC. The assessment of risk can prove to be daunting, as risk drivers now arise from both internal and external factors. This has broadened the scope of activities of AC.

Even the recent financial crisis in the US clearly shows the banks did not have an adequate awareness of their risk exposure and their audit committees were, ignoring the truth. For example, the warnings at Royal Bank of Scotland and Lehman's Bros were clearly ignored.

“ One of the obligations of public companies towards the shareholders is the disclosure of complete and accurate financial information. This is important from the investor's perspective as these statements are the indicators of the financial health of a company. The AC approves the accounting practices adapted by the company and monitor their reliability and compliance with the required regulations, thus preventing any accounting frauds. ”

This article talks about the role of Audit Committee in corporate governance and how it has changed over the years to encompass the assessment of risks as another responsibility. Further, it talks about the risk that an organisation faces and how Audit Committee can help in assessing and preventing it and the various regulatory provisions framed governing the role of Audit Committee. Furthermore, the financial crisis in US and UK and their impact on the Audit Committee is discussed.

Role of Audit Committee

Agency theory suggests that, there is a separation of interest between corpo-

rate management and ownership, where shareholders act as principles and the managers as their agents. Shareholders require protection because managers may have agendas different from their owners (shareholders), and thus may not always act in the owners' best interests.⁵ For instance, managers may manipulate earnings or commit financial fraud at the shareholders' expense. In order to mitigate this agency problem, the BOD monitors the extent to which the various corporate participants retain control, the costs and benefits of such attempts, and the resulting balance of power among them. The BOD is also liable for approving the corporation's strategy, and monitoring its operating and internal control systems. Given its diverse responsibilities, the BOD delegates some of its oversight to the audit committee and other committees of the board invariably acting as representatives of shareholders in the process.⁶

The concept of ACs is not new and has developed over the years to adapt to the changing environment. The New York Stock Exchange (NYSE) was the first to recommend Audit committees of the BOD in 1939. Establishment of audit committees by publicly held companies was first recommended by SEC in 1972.⁷ The Audit Committees are designed to assist Boards in discharging their duties with regard to internal controls, reported financial information and corporate standards of behavior. It aimed at avoiding any dominance of the senior executives on the audit process and act as a bridge between the external auditor and the board. An Audit Committee is a standing committee of the main board comprising completely or predominantly of Non Executive Independent Directors (INED's). It should

⁴ Refer to Financial Reporting Council site for information on these reports, <http://www.frc.org.uk/>

⁵ Michael, J. (2000), *A theory of the firm: Governance residual Claims and organizational forums*, *Journal of Financial Economics (JFE)*, Harvard University Press, Volume 3, No. 4, 1976

⁶ Sandra, C. (2005), *Corporate Governance Reforms: Redefined Expectations of Audit Committee Responsibilities and Effectiveness*, *Journal of Business Ethics*, Springer, 62: 115-127.

⁷ Fraser, I. and Henry, W., *Embedding risk management: structures and approaches*, full text archive of this journal is available at www.emeraldinsight.com/0268-6902.htm.

meet at least three times a year to discuss details of audit-related matters, note recommendations from the auditor and consider any contentions that had arisen during the audit process.⁸

Recent claims made in various professional and governmental reports about AC's benefits on a number of aspects of corporate governance have led to the acceptance of the AC as a relevant governance structure resulting in many improved legislations regarding the same. Corporate governance involves decision making, accountability and monitoring. Correspondingly, responsibilities of AC can be broadly classified into three categories –⁹

Overseeing Financial Reporting

One of the obligations of public companies towards the shareholders is the disclosure of complete and accurate financial information. This is important from the investor's perspective as

“The Smith Report was prepared as guidance to UK's Combined Code, which further formed the basis for a number of the Corporate Governance codes issued in Asia. The Combined Code basically laid down the various best practices picked from the various committees and guidance report, such as the Cadbury Report, Greenbury Report, Hampel Committee etc. eventually hand picking those regulations that systematically streamlined corporate governance structures.”

these statements are the indicators of the financial health of a company. The AC approves the accounting practices adapted by the company and monitor their reliability and compliance with the required regulations, thus preventing any accounting frauds.¹⁰ They are expected to ascertain whether the annual accounts of the company present a 'true and fair' picture.¹¹ The management of a company has an incentive in presenting a rosy picture of the annual reports to attract investors. Thus it is important for the AC to be prudent while assessing the accounts of the company.

Evaluating the Audit Process

A company's audit process is executed by the internal audit department responsible for monitoring the performance of the company's internal controls and the independent audit firm responsible for auditing and attesting to the company's financial statements. It provides a channel a communication between the external and internal auditors and the board helping to ensure that the board is fully aware of all the relevant issues related to the audit and that any difference in opinion between the auditors and the board is addressed. The Audit Committee is now required to be directly responsible for the appointment, compensation i.e. audit fees and the fee paid for non audit work and review of the work of the external auditors.¹²

Management becomes more accountable in the act of being custodians of the shareholders interest in the company because of

the increasing role and importance of the audit committee.¹³ They not only ensure good corporate governance through internal monitoring but also a mechanism to ensure that an opportune relationship exists between the auditors and the company management who are under the scanner for all the financial reports being audited.¹⁴

Assessing Risks and Control Environment

AC has a role to play in the Internal Audit function and on the internal controls and in risk management. It has to ensure that the policies implemented by the management are effective in identifying company's risks and that the controls are adequate.¹⁵ As a part of its responsibility towards risk management they are expected to oversee management's identification and assessment of business risk i.e. both internal and external risk. According to Article 1 paragraph 24 of the 2006 Directive on Statutory Audits, audit committees and an effective internal control system not only help to minimise financial, operational and compliance risks, but also "enhance the quality of financial reporting."¹⁶

Since audit committee acts as a representative of shareholders interests, it is not only responsible for monitoring the financial reporting process, but also the effectiveness of the company's internal controls, the internal audit and risk management systems.

In simple terms risk may be defined as a threat that an organisation's ability to achieve its objectives may be adversely affected by action or event.

8 Wallace, P. and Zinkin J. (2005), *Mastering Business in Asia: Corporate Governance*, Wiley-India

9 Daly, K. (2006), *Refocusing the Audit Committee's Agenda*, *Directorship*, pg.35.

10 Turley, S. and Zaman, M. (2004), *The Corporate Governance Effects of Audit Committees*; *Journal of Management and Governance*, 8: 305-332, Kluwer Academic Publishers

11 As mandated by Companies Act, 1956, 227(2).

12 Mallin, C. A. (2004), *Corporate governance*, Indian Edition, pg. 128, Oxford Press

13 Beattie, V. and Fearnley, S., *Auditor Independence and Non audit services*, pg. 1, see www.icaew.co.uk/publicass.

14 Beattie, V., Fearnley, S. and Brandt, R. (2001), *Behind Closed Doors: What the Company Audit is Really About* Institute of Chartered Accountants in England and Wales, pg. 29; Also see Cadbury Report 1992

15 *Supra* note 13, pg. 131

16 *The Role of External Auditors in Corporate Governance: Agency Problems and the Management of Risk*, Electronic copy available at: <http://ssrn.com/>

Running a business involves risk and it is well known that the greater the risk, the greater the potential return to the enterprise. The challenge for the board is to maintain a balance between risk and reward. Corporate Governance involves creating business value whilst managing risk.¹⁷ Investors focus on the nature and the extent of risk in the companies and the industries they want to invest in. Companies having professional enterprise risk management and transparent risk reporting are considered superior globally by investors. Thus, directors need to understand and identify the points at which the company is critically exposed to risk and develop relevant risk strategies and policies. This requires a formal authority, like the audit committee to ensure that the risk is properly assessed and managed throughout the company. Since risk assessment needs a proactive, forward looking orientation, it has been included in the mandate of the Audit Committee. Thus, the role of audit committee relating to risk management in an organisation is to provide risk oversight i.e. first and foremost to understanding the risks that a company may be exposed to, processes and policies used by management for identifying, assessing and mitigating those risks and identifying who's responsible for the management and oversight of risks.

The existent study on audit committee's outlook identifies risk in two broad spectrums: the financial reporting risks which could be accounting judgments and estimates and the non-financial reporting risks with their reporting implications such as marketing practices without affecting revenue recognition, supply chain

“ The board's insight in firm's future and a robust risk management is required by the firms as a remedy to the continuing effects of the fallout. It still remains an aspect of corporate governance that is often neglected due to potential weakness of the boards and their competencies. In many OCED countries the remuneration of the members of the board and the senior management remains a highly controversial issue. ”

management or a product recall.

In modern corporations, audit committees may traditionally be lapsed in their efforts towards financial reporting and its accompanying compliance risk but there are still daunting challenges awaiting them if the lapse of non-traditional risk: cultural, operational, regulatory and others transform into financial reporting risks. Inadequate informational dissemination on risk can hamper efforts to overcome the lapse. Also at times in organisations there is no clear distinction over the responsibility for overseeing the risk. The lack of congruence between the internal and external audit committees over key focus areas of risk further fuels the lapse making things more difficult as there is no clear distinction on the elements of risk. The company control environment is directly and indirectly influenced by these issues, hence these issues cannot be sidelined.¹⁸ The audit committee must look into the future prospects of the firm and not just the current scenario to access situations adeptly. The audit committee can only identify perceptible risks and mitigate them if they have a clear

understanding of the environment the firm exists in and the organisational pressures that the management faces.¹⁹

The risk faced by firms varies largely to the environment they exist in, factors like the control environment, management's capabilities and understanding of industry market conditions and expectations, the operational and financial stability of its related functions and the nature of their assets. All these factors integrate within an organisation creating a unique risk profile for the firm. The nature of the risk profile dictates the audit committee's core responsibilities of accessing the firm's procedures relating to its risk and control environment and overseeing the financial reporting and constantly evaluating and updating internal and independent audit processes.²⁰

Over time the context in which audit committees operate reflect the cultural and structural differences, which eventually influences their operations, yet there has been a constant codification and harmonisation of best practices.

Legal and Governance Regulations Affecting the Role of Audit Committee

Various committees have been formed globally to improve the effectiveness of Audit committees. From Cadbury Report in 1992 to the Turnbull Report in 1999 in UK to Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees in 1999 to Sarbanes-Oxley Act 2002 in US, issues of corporate governance and risk management have become major concerns for corporations all over the world. Ensuring that the potential threats to an organisation have been identified

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¹⁷ Tricker, B. (2009), *Corporate Governance: Principles, Policies and Practices*, pg. 328 – 330, Oxford University Press

¹⁸ Dionne, G. and Triki, T. (2005), *Risk Management and Corporate Governance: The Importance of Independence and Financial Knowledge for the Board and the Audit Committee*,

¹⁹ *Effective Enterprise Risk Oversight: The role of Board of Directors; Committee of sponsoring organizations of the Treadway Commission (2009)*

²⁰ *Oversight of Risk Management: Considering the Audit Committee's Role and Responsibilities Audit Committee Roundtable Highlights, Spring (2006), Audit Committee Institute, KPMG International*

“The increased responsibilities on the audit committee have placed an added emphasis on not only the financial reporting process, but also throughout the company’s operations. To provide an effective risk oversight a four-part framework can be adapted by the Audit committees, to better visualise the key aspects, which addresses: 1) organisation and operation; 2) financial reporting and risk assessment; 3) internal control; and 4) oversight authority.”

carefully assessed and evaluated and effectively controlled has become some of the major responsibilities of the BOD and the Audit Committee.

The concept of corporate governance saw a revolution in UK after a series of governance failures like the Maxwell case of misuse of pension funds or the share price manipulation by Guinness’ directors.

Cadbury Report

Cadbury’s report on the *Financial Aspects of Corporate Governance* (1992) specifically identified the looseness of accounting standards, the absence of a clear framework for ensuring that directors kept under review the controls in their business, and competitive pressures on companies and auditors, as the cause of governance breakdowns. The committee advocated that boards should appoint Audit Committees as this would enable the board to delegate to a sub-committee a thorough review of the matters of audit. Also, the non-executive directors can give an independent opinion. Thus, appointment of AC doesn’t diminish the responsibility of the Board; it gives an

important assurance that the board’s duties relating to audit are carefully discharged.²¹

Hampel Report

The recommendations of Hampel’s Committee on Corporate Governance (1998) resulted in both a step forward and a step back from the earlier Cadbury report. Hampel widened the concept of internal control to address ‘business risk assessment and response, financial management, compliance with laws and regulations and the safeguarding of assets, including the minimising of fraud’²². Moreover, in the Report’s authors explicitly stated that ‘we are not concerned only with the financial aspects of governance’. Hampel took a wide view of internal control, arguing that directors should have responsibility for all aspects of control and a duty to establish a robust system of risk management, designed to identify and evaluate potential risks in every aspect of the business operation. This reflected the growing recognition that breakdowns in non-financial areas could have significant financial repercussions for companies.

Criticism of Hampel Report: In the view of many risk professionals, however, not all was well with the new recommendations. When it came to identifying what represented such effective control, for instance, the Report fell desperately short of giving clear guidance. Thus, at one stage, the Report states that ‘the word “effectiveness” has proved difficult both for directors and auditors’ and should therefore be dropped. The problem with this view is that if it is impossible to require that internal control be effective, the very meaning of the concept of self-regulation as a guiding principle is undermined. In this regard, Hampel may have encouraged a move away from measurement and

accountability towards statements of general intent and direction, a move away from tangible codes to more nebulous principles²³.

Turnbull Report

The Institute of Chartered Accountants in England and Wales (ICAEW, 1999) set up a working party chaired by Nigel Turnbull which published its final report titled, *Internal Control: Guidance for Directors on the Combined Code* to provide guidelines for the directors. The committee focused on managing the risks that an organisation may be exposed to. Turnbull’s guidance document filled many of the gaps left by Cadbury and Hampel. The drafting of Turnbull’s report was driven by the recommendations of the Combined Code and the underlying Hampel recommendations that directors review all controls. As agreed by the ICAEW and the London Stock Exchange, the report’s primary purpose was to provide listed companies with guidance to implement the requirements in the Code relating to internal control. While the intention of the report was to leave companies a free hand to explain their governance policies, the guidance obliged the board to report on the effectiveness of the company’s system of internal control.

Underlying Turnbull’s emphasis on risk control is the idea that risk management and control should be embedded in the business processes. The Turnbull approach, accordingly, has been interpreted as involving three steps. Firstly, the board or relevant board committee members have to identify the key risks and assess how they have been evaluated and managed.

Turnbull’s integrated approach requires application of external standards to the matters of financial reporting and internal controls by

²¹ Cadury, Sir Adrian (1992), *Report of the committee on : The financial aspects of Corporate Governance, GEE and Co. Ltd.*

²² Hampel, S. R. (1998), *The Committee on Corporate Governance: Final report, Gee Publishing Ltd.*

²³ Charkham, J. (1998); *Corporate Governance: Overcoded? Has Hampel meant Progress? European Business Journal, Vol. 10, No. 4, pp. 179-183.*

the external auditors. The 'Big Five' accountancy firms are currently offering a business risk assessment-based approach to external audits. However, external auditor's expertise is doubted in the case of non-financial issues.

These concerns are coupled with more traditional reservations about auditor independence and objectivity.²⁴

Smith Guidance

The Smith Review of audit committees, a group appointed by the FRC, reported in January 2003. The review made it clear the important role of the audit committee 'while all directors have a duty to act in the interests of the company, the AC has a particular role, acting independently from the executive, to ensure that the interests of the shareholders are properly protected in relation to financial reporting and internal control. (Paragraph 1.5) the review defined the role of AC in terms of oversight, assessment and review.

The Smith Report was prepared as guidance to UK's Combined Code, which further formed the basis for a number of the Corporate Governance codes issued in Asia. The Combined Code basically laid down the various best practices picked from the various committees and guidance report, such as the Cadbury Report, Greenbury Report, Hampel Committee, etc. eventually hand picking those regulations that systematically streamlined corporate governance structures. The combined code was initially framed in 2002 and has been constantly updated to match the turbulent environment that organisation exists in, the last update being in 2008.²⁵

Blue Ribbon Committee

Further, to protect the interests of investors in a more efficient manner and strengthen the audit committee in the United States of America, the Securities and Exchange Commission (SEC) adopted many new regulations based on the recommendations of the Blue Ribbon Committee in December 1999.²⁶ The new regulations required the audit committee to discuss and review the audited financial statements with the board of directors, to settle important differences over accounting practices and significant accounting policies the audit committee needs to confer with independent auditors who also required to provide written disclosures to support their independence and finally submit a audit committee report mentioning how it had carried out all the regulations within the organisational framework.²⁷

Changing Role of Audit Committee

There were various issues that were brought to light with the fallout of Enron especially relating to auditors and the audit committee independence. The Sarbanes-Oxley Act, 2002 was introduced in the U.S. as a result of the following public outcry from the Enron case and it aimed at providing a definitive structure to the governance of corporation to safeguard the shareholders.²⁸

The regulations set out by the Sarbanes-Oxley Act included functions recommended for the audit committee for its appointment and overseeing the work of the firm's accounting practices to prepare the audit report. However, the Sarbanes-Oxley Act is applicable only to U.S. listed companies on their stock exchange.²⁹ Thus, it becomes

apparent that the representatives of shareholder in the firm, the board need to be thoroughly involved with the audit committee to ensure seamless functioning, it is also expected that this would ensure the board authority over the management, ensuring that they cannot use flexible accounting practices for their benefit. This leads to accounting frauds and loss of value on the part of shareholders. It is essential that the auditor is independent on the firm as this would reduce the risk of being biased or influenced by management. The financial accounting and reporting situations necessitate a need for independence of the auditor to remove ambiguity, such as one faced when the client is experiencing financial distress and there is a temptation to see things the way he does.

The financial crisis in U.S. and UK were due to the over exposure of firms to risk. The crash of the subprime mortgage market initiated the financial crisis, during the financial boom, the subprime mortgages and other banking products were easily available and with the hope to receive higher returns the lenders lent credit

Role of audit committee is not just limited to overseeing the financial reports, but also has to identify and assess the risk that an organisation is exposed to. It is now seen as an instrument of corporate governance best able to prevent fraudulent financial reporting and as the best possible way to ensure more effective monitoring of the financial reporting process, thus making risk management as one of its fiduciary duties.

²⁴ Turnbull, N. (1999) *Corporate Guidance for Internal Control*, London: Gee & Co. Ltd

²⁵ *Guidance on Audit Committees (THE SMITH GUIDANCE)*, (Oct 2005); *Financial Reporting Council*.

²⁶ *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, (1999), *New York Stock Exchange and the National Association of Securities Dealers*.

²⁷ Smith, M. L. (2006), *Audit committee effectiveness: did the blue ribbon committee recommendations make a difference?* *International Journal of Accounting, Auditing and Performance Evaluation*, Vol. 3, No. 2.

²⁸ Lindberg D.L (2004) *Corporate Governance – The Role of the Audit Committee*;

²⁹ Romano R., *the Sarbanes-Oxley Act and the Making of Quack Corporate Governance*; *European Corporate Governance Institute Finance Working Paper No. 52/2004, Yale Law School*.

to borrowers who did not completely qualify as per the basic criteria. It is a risky investment to give loans to less creditworthy borrowers who may not have the potential to repay the loans; this fact was neglected by the bank for the want of greater gains by sidelining the risks.³⁰ Using credit derivatives and collateralised debt obligations (CDOs) the subprime market mortgages were repackaged into securities, it was a reckless investment. Absence of a proper regulatory mechanism and inappropriate use of financial innovations triggered the growth of the housing bubble eventually leading it to a point where it crashed and placed the financial system of the economy under great strain. The aftermath of the situation was the collapse of banks one after another while going bankrupt (Bear Stearns, AIG, Lehman Brothers) or being bought over by their rivals or other firms (Fannie Mae, Freddy Mac, Merrill Lynch, Royal Bank of Scotland, Dexia)³¹

The sub prime markets had become a heavily invested area to earn high and quick profits. The elements like securitisation, interest-rate swaps and credit default swaps made the efforts of bankers to make quick money an easier task.

The financial crisis showed the global economy the fallacy of the existent system of corporate governance. It put to test the corporate governance routines which failed to safeguard the excessive risk being taken by the various financial companies. It laid bare the weaknesses of the system, even the risk management systems in many firms failed due to weak corporate governance structures rather than inefficient computer systems and models, the information about the crash did not filter to the senior management at the early levels even when risk

management was activity based rather than enterprise based, which were board responsibilities. Other cases showed that the implementation was an issue even when suitable metrics were put into place to manage risk. There are a lot of reforms desired in the company disclosures about foreseeable risk factors with system in place for monitoring and managing risk. A review was on way in most firms by relevant standard setters for accounting standards and regulatory requirements. Lastly, remuneration systems have not been closely integrated with strategy and the risk appetite of the firm looking for its long term future. The financial crisis showed that a difficult task of managing the complex and interconnected risks related to business lies ahead for the board, thus increasing the focus on the effectiveness of the board's risk oversight policies.

The board's insight in firm's future and a robust risk management is required by the firms as a remedy to the continuing effects of the fallout. It still remains an aspect of corporate governance that is often neglected due to potential weakness of the boards and their competencies. In many OCED countries the remuneration of the members of the board and the senior management remains a highly controversial issue.³²

As Tim Copnell, Head of KPMG's Audit Committee Institute in the UK said:

"Recession related risks as well as the quality of the company's risk intelligence are two of the major oversight concerns for audit committee members. But there is also concern about the culture, tone and incentives underlying the company's risk environment, with many saying that the board and/or audit committee

needs to improve their effectiveness in addressing risks that may be driven by the company's incentive compensation structure."

The recent scandals in the global markets and the exposure of companies to newer regulations to improve the governance structures and enhance shareholder involvement and benefit have made the audit committee incorporate risk management as one of its integral functions. The FSA is awaiting the Walker Review to further enhance the audit committee's regulations to streamline the system and commit to risk management more efficiently. The review is considering the independence of the risk management function as the fiduciary duties of the audit committee are rather broad and the need for a specific department to understand risk factors and mitigating their consequences are imminent. This has increased the responsibilities of the Audit Committee. The members of the audit committee are burdened with the new regulations and the provisions given by the new laws and Acts implemented to improve the effectiveness of Audit Committees from the perspective of managing risk. In short they want a clear understanding of the reporting. Thus, the members of the audit committee are expected to be proficient with the complex compliance provisions. Further, risk management requires professional knowledge for identification and assessment of risks which the directors may lack. Hence, they may not be able to accurately assess risk.

The audit committee has also been entrusted with the job of addressing the risk management at the level of executive compensation and tying it to the risk function to make the compensation more performance oriented and shareholder friendly.

30 Park, Y.(2009), *The role of financial innovations in the current global financial crisis*, *Seoul Journal of Economics*

31 Soros, G.(2008), *The housing bubble and the financial crisis*, *real-world economics review*, issue no. 48, <http://www.paecon.net/PAEReview/issue48/Soros48.pdf>

32 Krintpak, G.(2009), *The, Corporate Governance Lessons from the financial crisis*, *Financial Market Trends*, OECD 2009, Vol. 2009/1

This has also led to an improved level of commitment by the Non Executive Independent Directors (INEDs) as there have understood the importance of having an in-depth understanding of the organisation and its functions to analyse the dimensions of risk being undertaken. Also, greater involvement of institutional investors in the recent times have ensure that the audit committee is more efficiently considering shareholders view and concerns in firm decisions. This has removed the age old problem of individual shareholders not having a voice in the firm's decisions.

Since risk management has become a concern for all the corporations, Enterprise Risk Management has been embraced by the boards and management teams to better connect their risk oversight with the creation and protection of shareholder value. ERM provides a vigorous and holistic top-down view of key risks that an organisation is exposed to. COSO issued its Enterprise Risk Management – Integrated Framework in 2004 to develop an understanding in the management of the elements of an enterprise-wide approach to risk management. That framework defines ERM as follows:

“Enterprise risk management is a process, affected by the entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within the risk appetite, to provide reasonable assurance regarding the achievement of objectives.”

The increased responsibilities on the audit committee have placed an added emphasis on not only the financial reporting process, but also throughout the company's operations. To provide an effective risk oversight a four-part framework can be adapted by the Audit committees, to better visualise

the key aspects, which addresses: 1) organisation and operation; 2) financial reporting and risk assessment; 3) internal control; and 4) oversight authority. This framework can help committee members visualise better the key considerations that lie before them. Such a risk based framework can help audit committee understand and monitor the processes and can act as an important element in protecting its company and itself from undue risk exposure. Although it is yet to be seen if the current measures are effective in nature, arming the audit committee to more effectively manage and mitigate risk or just more regulations to further camouflage the structural fallacies.

Even as we hear that signs of economic recovery may be emerging it is increasingly evident that the current economic crisis is fundamentally different from past recessions and that the board and audit committee oversight is changing, perhaps permanently as a result.

Conclusion

Initially in the paper the role of audit committee as an element of corporate governance was discussed. It was seen that the role of audit committee is not just limited to overseeing the financial reports but also has to identify and assess the risk that an organisation is exposed to. It is now seen as an instrument of corporate governance best able to prevent fraudulent financial reporting and as the best possible way to ensure more effective monitoring of the financial reporting process, thus making risk management as one of its fiduciary duties.

The importance of audit committee assuming the duties of the risk management can be understood from the fact that it reduces the influence of board on the auditing process thus protecting the shareholders interest. However, the question that arises here is that of the independence that should

be given to the audit committee. Various committees formed advocates that the audit committee should have at least three non executive independent directors. The Turnbull report in 1999 and the recommendations of the Blue Ribbon Committee defined the importance of risk identification and assessment by the audit committee.

The need for better governance and risk management arises out of the scandals and fallouts. Enterprises of all types are looking at improved risk oversight processes in the light of the aftermath of the sub-prime meltdown. Expectations for greater board involvement in risk oversight are creating more demands on senior executives to strengthen their risk management practices and their monitoring of the enterprise's top risk exposures. Evidently, financial crisis resulted in an increased focus on the efficiency of the risk oversight practices adopted by the board. The corporate governance rules laid down by New York Stock Exchange requires risk assessment and risk management policies to be on the agenda for discussion by audit committees of listed companies. Also, assessment of enterprise risk management procedures has become a part of the credit rating analysis of credit rating agencies like Standard and Poor's. Regulatory bodies have suggested that there may be some new regulatory requirements and some changes may be made to the existing ones relating to the risk oversight responsibilities. The business leaders are well aware of the fact that risks have to be taken regularly to increase the shareholders value therefore effective organisations understand the strategic advantages in managing risks.

Thus, it can be said that through Audit Committees organisations are trying to effectively integrate Enterprise Risk Management with Corporate Governance. ■

Negotiable Instruments Act

Compoundability of Offences – Hits and Misses



Our Supreme Court enjoys the reputation of giving verdicts which display a rare practical pragmatism. This is what it has done very recently on 3-5-2010 in a pioneering verdict in the case of *Damodar S. Prabhu V/s. Sayed Babalal H. 2010 (2) RLW 1599* by taking radical steps aiming at curbing the tendency among bouncers to sit over the amount through a cheque. In this judgement authored by Chief Justice K.G. Balakrishnan, it is laid down that defaulters opting for early settlement before the trial court would have to pay just the principal amount with applicable interest. However, in the event of their approaching the District Court for settlement after being convicted by the trial court, the penalty would rise to 10 per cent in District Court and 15 per cent in High Court to a whopping 20 per cent in Supreme Court. The court therefore laid down such guidelines which were not available in the provisions of Negotiable Instruments Act even after insertion of Section 147 by amendment. Here the court, short of being a legislator, showed an aggressive instance in interpreting the law. This was probably felt as essential for the judiciary to be sufficiently relevant and responsive. It is more or less a judicial-law-making so that bouncers are put on their alert. It is in tune with the spirit of time. The author in this article has dealt with this aspect of prescribing guidelines for compounding the offences under the Act as has been propounded and endorsed by the apex court.



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Section 320 of Criminal Procedure Code (Cr.P.C.) deals with offences which are compoundable either by the parties without the leave of court or by the parties, but only with the leave of the court. Sub section (1) of Section 320 enumerates the offences which

are compoundable without the leave of the court while sub section (2) of the said Section specifies as to which are compoundable with the leave of the court. Then, sub section (9) of Section 320 mentions that no offence shall be compounded except as provided by

this Section. Obviously the offences not referred to in sub Section (1) and (2) of Section 320 and not included in the Table are not compoundable. Similarly, offences punishable under laws other than the Indian Penal Code could not be compounded.

Naturally, a question arose whether an offence punishable under Section 138 of the Negotiable Instruments Act which is a special law could be compounded. On this, some High Courts ruled that if the matter was settled between the parties the offence could be compounded, but other High Court took a contrary view. This position persisted in spite of the insertion of Section 147 of the Negotiable Instruments (Amendment & Misc. provisions) Act 2002 (Act 55 of 2002). According to this, offence punishable under the Act become compoundable.

The Supreme Court in the case of *O.P. Dholkia V/s. State of Haryana (2000) 1 SCC 672*; *Shiv Shankaran V/s. State of Kerala & another (2002) 8 SCC 164*; *Kishore Kumar V/s. J.K. Corporation Ltd. (2004) 12 SCC 494* and *Shailesh Shyam Parsekar V/s. Baban (2005) 4 SCC 162* besides other cases, endorsed the view that compounding of the offence could be permitted. Ultimately for addressing the deficiencies perceived in the working of this enactment, Section 10 of the 2002 Amendment inserted

Sections 143 to 147 into the Act. These amendments dealt with aspects such as the power of the court to try cases summarily, mode of service of summons, evidence on affidavit, bank slips to be considered as prima-facie evidence of certain facts and lastly the offences under the Act could be compoundable of which aspect we are concerned in this article.

The Negotiable Instruments Act 1881 was first amended in the year 1988 by Banking Public Financial (Amendment) Act 1988 (Act 66 of 1988) to regulate financial promises in growing business, trade, commerce and industrial activities of the country and the strict liability to promote better vigilance in financial matters. Then again it was amended in the year 2002 and Sections from 143 to 147 were inserted. The second amendment was resorted-to, to plug the loop holes that were perceived even after the insertions of Sections i.e. 138 to 142. The object was obvious that Legislature wanted to give it all possible teeth so that a bouncer of cheque does not escape the rope. This all was necessitated because of an open market economy where we have compulsions of the primordial need to maintain transparency and harmony in business transactions and with a view to arrest the reasonable prognostication of possible future manifestation arising out of the bouncing of cheques, the provisions have been made all the more stringent. Then our Apex Court by its judicial dissection cut down the dead woods that crept in the administration of this law by trimming of the side branches of the provisions so that the holder of a cheque is not lost in such thickets and branches.

This may kindly be noted that when the offence was inserted in the statute in 1988, it carried the provision for imprisonment upto one year which was revised to two years following the amendment to the Act in 2002.

Naturally this stringent and strong criminal remedy encouraged the institution of a large number of cases that are relatable to the offence contemplated by Section 138 of the Act. The disproportionately large number of cases involving the dishonour of cheques ran into several lakhs and this state of affairs practically choked our criminal justice system. It has, therefore, been thought that there should be some stiff measures besides those provided in the Act which could bring down the number of cases in this regard and in this sequence the accused should be made to bear the brunt of the litigation. Our Supreme Court, which has reputation of giving verdicts which display a rare jurisprudential vision so it succinctly captured this point of Negotiable Instruments Act in the case of *Damodar S. Prabhu V/s. Sayed Babalal 2010 (2) RLW 1599*. In this case the court preferred practical pragmatism to legal formalism. Obviously when a statute is enacted, it must be remembered that it is not within human powers to foresee the manifold set of facts which may arise, and, even if it were, it is not possible to provide for them in terms of free from all ambiguity. This position surfaced in the administration of this law.

Section 147 of the Act has made the offences compoundable, but it has not provided any guidance on how to proceed with the compounding of offences under the Act and as has been observed in Section 320 of the Cr.P.C. cannot be followed in the strict sense. So it is felt that there is some legislative vacuum which should be filled up by judicial-law-making. Law bristles with uncertainties and obscurities which can only be removed by judicial law making in accordance with the principle that in the event of conflict between the dictates of law and demands of justice, the conflict should be resolved in favour of justice.

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“ It is felt that this radical step through a pioneering judgement of the Apex court will go a long way in reducing the pendency of our 30 lakh cheques bounce cases which have jammed the wheel of justice which is already burdened by very many cases. Surely the rush of cases would be arrested by this epoch making judgement. ”

In this case before their Lordships Mr. Goolam Vahanate Solicitor appeared as amicus curiae and for disincentivise litigants in this regard suggested that the compounding of the offence be made easy and at an early state. It was felt that interest of justice could indeed be better served if party resorted to compounding as a method to resolve their disputes at an early stage instead of engaging in protracted litigation before several forums thereby causing undue delay, expenditure and strain on the part of judicial system. This could be done by endorsing some scheme and this could be conveniently done because Section 147 does not put up any fetters on the compounding exercise. The problem with which the Apex court was concerned in this case was the tendency of litigants to belatedly choose compounding as a means to resolve their dispute.

Ordinarily accused persons in cheques dishonour cases are willing to take the chance of progressing through the various stages of litigation and then choose the route of settlement only when no other route remains. This accounts for opting for compounding the case at a late stage. If the accused persons ultimately compromise the case then obviously there is some merit in the case of complainant. So it would be desirable if parties choose compounding.

The learned Attorney General, therefore, urged the Apex court for a



graded scheme of deterrent imposing cost on parties who unduly delay compounding of the offence. It was also argued that the requirement of deposit of cost would act as a deterrent for delayed composition since at present free and easy compounding of offences at any stage, however belated, gives an incentive to the drawer of the cheque to delay settling the case for very many years. The Supreme Court, therefore, directed that the following guidelines be followed:

“ Guidelines ”

- (a) That directions can be given that the Writ of Summons be suitably modified making it clear to the accused that he could make an application for compounding of the offences at the first or second hearing of the case and that if such an application is made, compounding may be allowed by the court without imposing any costs on the accused.
- (b) If the accused does not make an application for compounding as aforesaid, then if an application for compounding is made before the Magistrate at a subsequent stage, compounding can be allowed subject to the condition that the accused will be required to pay 10 per cent of the cheque amount to be deposited as a condition for compounding with the Legal Services Authority, or such authority as the Court deems fit.
- (c) Similarly, if the application for compounding is made before the Sessions Court or a High

Court in revision or appeal, such compounding may be allowed on the condition that the accused pays 15 per cent of the cheque amount by way of costs.

- (d) Finally, if the application for compounding is made before the Supreme Court, the figure would increase to 20 per cent of the cheque amount.

It was also clarified by the Supreme Court that the cost imposed with these guidelines should be deposited with the “Legal Service Authority” of the court concerned. Incidentally, while agreeing with anxiety of the learned Attorney General for controlling the filing of multiple complaint that related to the same transaction the court made it mandatory henceforth for the complainant to disclose in the complaint that no other complaint has been filed in any other court in respect of the same transaction and that such disclosure should be given on an affidavit.

It is felt that this radical step through a pioneering judgement of the Apex court will go a long way in reducing the pendency of our 30 lakh cheques bounce cases which have jammed the wheel of justice which is already burdened by very many cases. Surely the rush of cases would be arrested by this epoch making judgement.

The financial incidence on the accused would be immense and some via media shall be invested to escape the same. The working of the guidelines would naturally therefore be on sticky wickets and we shall just wait and see in spite the laudable objectives. ■

The Prospect and Problems of New Pension Scheme in India



This write up is a critical review of New Pension Scheme (NPS) in India. It outlines the comparative analysis of different investment schemes. It intends to give an individual a choice of savings and investment products with different asset allocations, professional fund management, centralised administration and an option to transfer pension rights from one job/location or form one fund manager to another at low cost. The NPS is the most important pension reform in the world today. It targets a pension coverage gap that is larger than the populations of most countries. It seeks to enable today's young to achieve a dignified retirement through thrift and self-help. It gives individuals a portable account, nationwide access, simple choices, high real returns and important rights. And it will not cause a fiscal blow-up deep in to the future which our children will be taxed for. This write up also explains the advantages and disadvantages of this new scheme.

It is said that reforms are a precondition to successful development. Yet, reforms can backfire if they are not well-conceived. The much-awaited NPS thrown open to the unorganised sector in its early days but is already driving a debate on the long-term benefits it would offer to an individual.

The scheme is set to replace the philosophy of pension assets in India from a defined benefit mode to a superior defined contribution mode. It intends to give an individual a choice of savings and investment products with different asset allocations, professional fund management, centralised

administration and an option to transfer pension rights from one job/location or from one fund manager to another at low cost.

The NPS was launched on 1st May 2003, but it has been finally implemented with effect from 1st January, 2004, and could become the only real safety for hundreds of millions of people in the unorganised sector, although it is open to everyone. The initial response though has been lukewarm from the Personal finance experts. And one of the reasons for this has been the pension regulator's failure to mention clearly how an individual would accrue the income and be taxed on it under



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the scheme every year. The offer document lacks information and clarity, which has meant financial planners are a little hesitant to recommend this product to the masses. To help you decode the mysteries of the NPS, here a ready reckoner on what it is all about and how it pits against other retirement products.

Important out lines of New Pension Scheme (NPS)	
<ul style="list-style-type: none"> • NPS will not attract any Security Transaction Tax (STT) and Dividend Distribution Tax (DDT) • Currently only tier-1 of the NPS is available, where there is lock in period • Investors can invest at least ₹ 500 per month • Age ranges from 18 years to 55 years to buy NPS • Funds collected by NPS will be invested equity, government securities and credit risk bearing fixed income instruments. • There will not be more than 50 per cent exposure to equity market 	<ul style="list-style-type: none"> • Under the auto option, portfolio of investors gets automatically rebalanced depending upon age. • Major drawback is that NPS is taxable on withdrawal. • NPS not at with other instruments such as PPF, were the gains in maturity is tax free. • The ideal pension fund would be a combination of PPF and index fund.

Measure Up

For the not so adventurous investors, the scheme comes close a personalised investment opportunity, in which you make choices relating to the fund manager and the risk profile. Yet in terms of flexibility to invest in equity, the scheme has its limitations, as there is cap of 50 per cent on money you can allocate in equity. If you compare the scheme with other retirement schemes such as Public Provident Fund (PPF) and Employees Provident Fund (EPF), it is non-tax friendly. However, the management charge of the NPS is low in comparison to the funds and thus, the effective and efficient Management of the NPS fund needs to be seen in the times to come.

These things apart, the scheme

offers no guaranteed assurance on security of capital fund and interest income. In the first tier scheme, premature withdrawal is not permitted. Withdrawal attracts tax implications under the Exempt-Exempt-Taxable (EET) model. The Pension Regulator, however, is lobbying hard with the government for parity in treatment like in the case of other government retirement schemes. However, since the exact tax benefits and treatment at the time of withdrawal are not yet clear, it may not be a right time to draw any inference on the NPS. From a tax perspective, PPF right now appears to be far more superior or even a bank recurring deposit is a better option compared to this scheme.

Dos and Don'ts

To begin with, tax experts say you must take time to work out your cash flows, including future requirements carefully before you decide to invest in the scheme. Since the scheme offers low liquidity and it comes with no guarantee as to the security of your funds, it is advisable to meticulously read the fine print relating to the fund type you opt for. A section of tax experts, in fact, believe one must only opt for the scheme when a little more clarity is available in respect of details. Further clarity is required on the tax implications, as also the issue of how and when the Pension Fund Regulatory and Development Authority (PFRDA) will, as per the stated investment strategy, evaluate market mechanism for investor protection guarantees which can be offered for the various schemes.

In the current scheme, there is an auto choice option, which is in the nature of a lifecycle fund. But one should look at a retirement plan where the amount required for sustaining the current cost of living is ascertained. In this case, they feel Retirement Advisory Consultants (RACs) would

be useful for contributors in charting out their retirement plan. You must be also aware of the fact that premature withdrawals are allowed only up to 20 per cent of the pension wealth in the NPS (under type I accounts) and therefore, the amount saved should be calculated after accounting for short-term requirements. Tax experts say one must be careful to commit substantial amount in the scheme, as there is no assurance as to the principal.

Retirement is a major milestone in one's journey through life, so make sure that you don't simply retire from something, but have something to retire to.

Allocation of NPS Fund

NPS is more or less like other pension plans where you invest throughout your working career and reap the benefit when you retire by withdrawing the amount. Currently, only tier-I of the NPS is available, where there is a lock-in period. Investors can invest a minimum ₹ 500 per month (i.e. 6,000 a year). The age ranges from 18 to 55 years to buy NPS and one cannot exit before the age of 60 years. Also, while exiting one has to buy an annuity.

Funds collected by NPS would be invested in three-asset classes - equity, government securities and credit risk bearing fixed income instruments. Also, within the equity class, a fund manager will only invest in the index funds and not more than 50 per cent of anyone's portfolio will be allocated to equity. Investors also have the choice to choose the auto choice option. Under the auto option, if the age of investor is up to 35 years, 50 per cent

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of his wealth will be invested in equity. Rest of the amount will be allocated to government securities and credit risk bearing fixed income instruments in the ratio of 20:30. However, once the investor's age crosses 35 years, participation towards equity and credit risk bearing fixed income instruments will start coming down annually. Finally, at the age of 55 year, the ratio of equity, government securities and credit risk bearing fixed income instruments will be 10:80:10.

Cost of NPS

As the contours of the NPS unfold, it is becoming clear that it is an expensive, even unattractive, mass-market retirement scheme. The fixed charges of the NPS are very steep, which loads the scheme in favour of wealthier investor. The pension regulator should have negotiated harder. Each subscriber is required to pay an annual record keeping charge of ₹350. In addition, any subsequent transaction would invite ₹30 as levy and ₹10 by the CRA (Central Record keeping Agency) and ₹20 from the intermediaries, point of presence (PoPs). Since there will have to be at least four transactions every year, the minimum annual cost comes to ₹470. The base charges would drop to about ₹350 a year once the subscriber numbers increase, but even that would be steep for the lowest bracket saver who puts in the minimum four contributions of ₹500 each. For every ₹2,000 he contributes to the scheme, such a saver is paying nearly ₹350 in fixed costs every year. Why should such a small saver not put the entire ₹2,350 in a fixed deposit or other

schemes such as the public provident fund? On the other hand, those having provident fund accounts could top up their contributions instead of putting in the NPS. To be fair, as contributions build up, total charges would fall as a percentage of assets because the fund management fee for NPS is very low. But the idea is to encourage small savers and they will be put off by the big initial levy.

Role of Government Regarding NPS

The government could consider being a co-contributor to the scheme for the unorganised sector. Under the Employees Provident Fund Organisation's (EPFO) pension scheme, the government contributes 1.16 per cent of employees' salary to the pension fund. If the government makes a similar contribution into the NPS savings of the poor, it would ease the costs burden for them.

In view of the PFRDA in the long run, the record-keeping charges would become a very small fraction of total savings. Besides, these charges will enable customers to get access to a professional service from NSDL, which has invested heavily in a new system to maintain records of millions of subscribers and needs to recoup its investment. An estimated eight crore people are eligible to join the NPS, which has very low fund management fees.

The PFRDA is also suggesting that the government should provide similar tax breaks to NPS as available to other retirement schemes, such as the PPF and the General Provident

Fund. An early clarification on the tax benefits would determine the scheme's popularity.

Comparative Analysis among different Schemes

NPS has not come at par with other instruments in the same category such as PPF, where the gains on maturity are tax free. Also, the other disadvantage is lack of a distribution channel.

There are other two instruments—mutual funds and the Unit-Linked Insurance Plans (ULIPs), which compete with NPS. A part of the money invested in ULIPs gets reinvested in equity and fixed income securities, while rest is used to provide insurance to the investor. Here investors can choose the contribution that they want to make towards equity and fixed income securities. The major advantage of ULIP is that on maturity the entire amount is tax – free and the down side is that it has high commission structure and in fact, the cost is the highest in the first couple of years. This expense makes a significant dent in the post maturity amount.

Mutual funds, on the other hand, have much lower expense in comparison to the ULIPs. After the changes in ULIP norms by the insurance regulator in June 2010, charges were reduced. According to the new provisions, for the first five years, the difference between the returns earned on investments and the net returns given could not be more than 4 per cent, taking both commissions and charges into account. By the tenth year this figure narrows down to 3 per cent and in the 15th year with 2.25 per



cent. In comparison, mutual funds may charge only 2.25 per cent for their equity products. Mutual funds also enjoy tax benefits akin to the ULIPs if one chooses an equity-based scheme. Also, in equity mutual funds the maturity amount of tax-free if the investment is made for more than one year. However, generally in the debt mutual funds one has to pay capital gain tax.

(Please see the Table below)

Benefits & Problems

The major advantage of NPS is that it is much cheaper than a mutual fund or a ULIP. The total cost is merely 0.0009 per cent for NPS. Also, it is easy to invest in and operate. In case you choose the auto option, your portfolio gets automatically rebalanced depending upon your age.

But the major drawback is that NPS is taxable on withdrawal, which means

any gain that you make while exiting will attract tax. The NPS is a great product but since it is taxable on maturity, it loses the charm.

NPS has not come at par with other instruments in the same category such as PPF, where the gains on maturity are tax-free. Also, the other disadvantage is lack of a distribution channel. Another disadvantage is that under the proposed cost structure, savers will need to shell out ₹470 in costs each year with ₹350 going to the National Securities Depository Ltd (NSDL) for account maintenance and at least another ₹120 in the form of levies on contributions. These charges, which could drop in the years ahead as rising numbers of subscribers bring in economies of scale in administration costs, are seen as high, especially for poor subscribers, and could discourage small savers from the scheme.

Recommendations

1. The present tax treatment of NPS (EET) puts subscribers at a clear disadvantage vis-a-vis insurance and non-government PFs will further depress customer interest. Since these are fairly obvious concerns, should PFRDA have rolled out the NPS on 1st May 2003? The right answer, of course, is yes. The NPS target a heterogeneous mass of 284 million individuals of whom barely 5 per cent are actively saving for old age. It's unlikely that

Retirement is a major milestone in one's journey through life, so make sure that you don't simply retire from something but have something to retire to. From a tax perspective, PPF is right now appears far more superior or even a bank recurring deposit is a better option compared to the NPS.

PARTICULARS	NEW PENSION SCHEME	EPF	PPF	INSURANCE LINKED PENSION PLAN
Taxability				
Contribution	Exempt up to max Ceiling of 1000,000 under Section 80CCD r.w.s, 80CCE	Employees contribution exempt up to max ₹ 1000, 000 under Section 80C r.w.s 80CCE; Employee's contribution up to 12 per cent of basic salary exempt	Exempt up to max ceiling of ₹ 1000, 000 under Section 80C r.w.s. 80CCE	Exempt up to maximum ceiling of 1000,000 under Section 80CCC r.w.s. 80CCE
Accumulation	Exempt	Exempt	Exempt	Exempt
Withdrawal	Taxable	Exempt	Exempt	Commuted pension exempt (up to 1/3 of total) Annual pension-taxable
Flexibility				
Minimum contribution (in ₹)	6,000 p.a.	Min. contribution of 12 per cent - Compulsory for establishment with over 20 employees (those earning up to ₹ 10, 000 covered)	500 p.a.	Depending upon terms of scheme (generally higher)
Maximum contribution (in ₹)	No ceiling	Up to 27 per cent of basic salary, considered together with superannuation	70,000	No ceiling
Withdrawal	Below 60 years 20 per cent can be withdrawn and 80 per cent to be used for buying life insurance annuity. Above 60 years ratio is 40:60	Only after retirement or termination of employment	Only after 7th year. Can withdraw 50 per cent of amount accumulated 3 years before. Loan after 3 years	No surrender value before expiry of 3 years
Risk				
Risk involved	Depends upon the selection of scheme	Nil	Nil	Depends upon the type of instruments
Security of capital fund and interest income	No assurance by the government	Assured principal and interest	Assured principal and interest	No assurance by the government
Cost involved				
Fund management charge	0.0009 per cent	Nil (to employee)	Nil	Variable
Annual charges (in ₹)	Approx. 400 (assuring 1 transaction)	Nil (to employee)	Nil	Variable
Fixed cost (account opening)	50 (for opening an account)	Nil (to employee)	Nil	Variable

we will achieve a perfect one-size-fits-all pension solution for India if we continue to debate the shapes on the drawing board.

2. The PFRDA should get into the trenches, closely monitor implementation progress and respond rapidly with ongoing improvements. Once it is sure that the presently scaled down NPS model is stable, it should aggressively embark on the larger battle of achieving meaningful voluntary coverage within the tenure of India's present demographic advantage. The NPS launch, after all, is only the first critical step on a long and tricky road. It is not an event.
3. The four most important changes that should be part of version 2.0 of NPS include the following matters-
 - (a) scrapping the artificial partition between the civil servant pensions and private pensions because a similar apartheid in health-care between Central Government Health Service and Employees' State Insurance has led to substantially different quality, costs and effectiveness,
 - (b) making available investment options with higher equity weightage for people with longer time horizons and higher risk taking abilities,
 - (c) equalise the tax regime with small savings and provident fund where contributions, income and payout are tax-exempt or change those, and
 - (d) allowing companies with more than 10 employees to opt out of paying monthly contributions to the Employee Provident Fund Organisation (EPFO) and pay in to NPS because EPFO today does not have customers but hostages.

All four these changes to NPS will mutually reinforce each other by increasing sustainability, amplifying economies of scale and scope, reducing costs and raising inclusiveness. Nobody should doubt that NPS is a synthesis of cutting-edge thinking around old age security. But nobody should believe that the job is done.

4. Ideally, there should be a product where both equity and debt components do not attract any tax. This is where PPF comes in. PPF offers 8 per cent tax-free return and the capital is guaranteed to be protected by the government. In case one has to avail the benefit of section 80C of the Income-tax Act, he can go for a combination of PPF and equity-linked savings schemes.
5. The ideal pension fund would be a combination of PPF and index fund. The redemptions from both are tax-free on maturity. An index fund has very low cost and replicates the index such as the BSE Sensex or the NSE Nifty.
6. The government should meet the account maintenance costs of NPS as it aimed mainly at the country's poor.

Conclusion

No reform is better than bad reform. But good is not the enemy of the great and, just like every virus needs a host or a carrier, starting something in public policy may be more important

Funds collected by NPS would be invested in three-asset classes-equity, government securities and credit risk bearing fixed income instruments. The major advantage of NPS is that it is much cheaper than a mutual fund or a ULIP. The total cost is merely 0.0009 per cent for NPS



than getting it right on first pass. Nobody should doubt that NPS going live is more important than NPS being perfect.

The NPS is easily the most important pension reform in the world today. It targets a pension coverage gap that is larger than the populations of most countries. It seeks to enable today's young to achieve a dignified retirement through thrift and self-help. It gives individuals a portable account, nationwide access, simple choices, high real returns and important rights. And it will not cause a fiscal blow-up deep in to the future which our children will be taxed for.

Context and storytelling matters a lot in public policy. The world financial markets and equity returns are in a different place today than they were when NPS was conceived. While the global financial crisis with its roots in financial markets does not change the long-term case for equities, it sure does make the short-term optics of asset allocation reform difficult. Version 1.0 of NPS that has gone live does not have birth defects, but it has an unfinished agenda that may be long and controversial. Nonetheless, it is absolutely necessary for NPS to live up to its potential. ■

ICAI Past Presidents Meeting on the Companies Bill 2009- A Report

The Companies Bill 2009 which was introduced in Lok Sabha in July 2009 was referred to the Parliamentary Standing Committee on Finance for examination and report thereon. After various meetings and deliberations, it submitted a report in August 2010. The Institute of Chartered Accountants of India (ICAI) submitted earlier its detailed comments/views/suggestions on the Bill, submitted its observations before the Parliamentary Standing Committee and also observations on the Report of Parliamentary Standing Committee on Finance to the Ministry of Corporate Affairs. In view of the several implications arising out of the provisions of Report on the Parliamentary Standing Committee on Finance on the Companies Bill, 2009 and views emerging the members of the profession across the country, the Institute thought it fit to have further broad based discussions on the same.



A meeting of all the Past Presidents of the Institute was called on 29th November, 2010 at New Delhi to obtain their views. The meeting was attended by the following persons:

1. CA. Amarjit Chopra, President, ICAI
2. CA. V. B. Haribhakti, Past President
3. CA. V. Rajaraman, Past President
4. CA. R. Balakrishnan, Past President
5. CA. S. K. Dasgupta, Past President
6. CA. K. G. Somani, Past President
7. CA. A. H. Dalal, Past President
8. CA. N. C. Sundararajan, Past President
9. CA. N. P. Sarda, Past President
10. CA. B. P. Rao, Past President
11. CA. T. S. Vishwanath, Past President
12. CA. Ashok Chandak, Past President
13. CA. R. Bupathy, Past President
14. CA. Kamlesh Shivji Vikamsey, Past President
15. CA. Sunil H. Talati, Past President
16. CA. Uttam Prakash Agarwal, Past President
17. CA. S. Santhanakrishnan, Central Council Member
18. CA. Vinod Jain, Central Council Member
19. CA. Nilesh Vikamsey, Central Council Member



At the outset the President, ICAI welcomed the illustrious past presidents for their yeomen contribution to the Institute and the profession and having spared their valuable time for attending the meeting. He briefed the members the background on which the Companies Bill 2009 emerged from surrounding circumstances like Satyam episode, Joint Parliamentary Committee Report on stock scam, Dr JJ Irani Committee Report, Concept paper on Company Law, Companies Bill 2008 (which lapsed) and finally the Companies Bill, 2009 which was introduced and referred to the Parliamentary Standing Committee on Finance on which Report was laid in August, 2010.

He stated that the said Report need to be introspected and reviewed thoroughly in view of certain provisions having a major impact on the CA profession and, therefore, the Institute has convened this meeting. He further stated that though the Institute had earlier submitted its suggestions on the Bill as well as on the Report of the Parliamentary Standing Committee on Finance, a need was felt that provisions relating to the accountancy profession requires discussion at the larger forum. He requested the members to give their views/comments.

After the opening remarks by the President, the following were the quick reactions from the members on the subject-matter:

- ICAI to formulate a strategy for giving more suggestions to the Government for fine-tuning of the law.
- To take into account the perspective of the nation as well as the CA profession while drafting the law
- Question emerged whether the new law is in the right direction.
- Members suggested that the Corporate Governance should be criteria.
- Members suggested that a re-look should be done on such of those provisions which has tremendous impact on the auditors.
- Members also pointed that the new law is towards harsher treatment for non-compliance of the law and the Companies Bill 2009 has provided for fines, etc at 26 places and out which 4 relate to the profession.
- Certain provisions relating to the CA profession have far reaching complications.
- One should look as to what the new law tries to achieve and how can it be achieved.
- Members suggested for zero-based analysis of the entire new company law.
- Members suggested that there should be clear demarcation between substantive and procedural law and this would be a significant exercise if done

before the law comes into existence.

- Overall, there was an emerging opinion that a new law is necessary and need to be redrafted.

The following were main issues arising out of the Companies Bill, 2009 and the report of the standing committee thereon that were discussed and suggested:

On NACAAS (National Advisory Committee on Accounting and auditing Standards)

- The process of setting the Auditing standards is independent of the council of ICAI. Auditing standards are different form Accounting Standards and Auditing Standards is one area where the Institute has already followed International fraternity. In the case of the Accounting Standard, the status quo may be maintained.
- No need of Panel of audit firms.

Rotation of Auditors

- Though there was a broad consensus on the need for rotation of auditors, still the process by which it should be carried out was discussed.

Prohibition on auditors rendering certain services

- There is a need for defining 'management services' which is stated under clause 127(h)

Punishment for contravention of certain provisions by the auditor

- Criminal liability should not be imposed upon the auditing firm

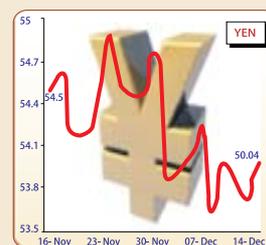
Surrogate practices by some of the firms

- The meeting discussed the measures for stopping surrogate practices by the auditing firms. ■

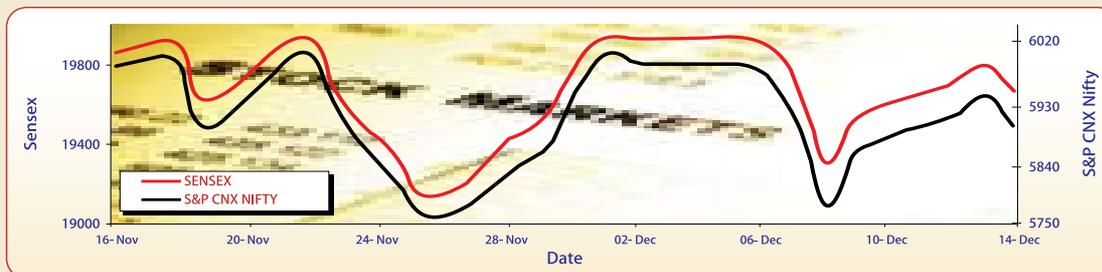
Economic Indicators



Indian Rupee vs. Major Foreign Currencies (November 16, 2010 to December 15, 2010)



Stock Markets



Selected Indicators

(per cent per annum)

Item	Unit/Base	2009		2010				
		Dec- 04	Oct- 29	Nov- 05	Nov- 12	Nov- 19	Nov- 26	Dec- 03
Cash Reserve Ratio ⁽¹⁾	Per cent	5.00	6.00	6.00	6.00	6.00	6.00	6.00
Bank Rate	Per cent per annum	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Base Rate ⁽²⁾	Per cent per annum	11.00-12.00	7.50-8.50	7.50-8.50	7.50-8.50	7.50-8.50	7.50-8.50	7.60-8.50
Deposit Rate ⁽³⁾	Per cent per annum	6.00-7.50	7.00-8.00	7.00-8.00	7.00-8.00	7.00-8.00	7.00-8.00	7.00-8.00
Call Money Rate (Low/High)	Per cent per annum	1.50/3.35	2.75/12.00	3.25/8.00	3.25/7.50	3.30/7.15	3.30/7.05	2.00/6.90

Notes: (1) Cash Reserve Ratio relates to Scheduled Commercial Banks (excluding Regional Rural Banks).
 (2) Base Rate relates to five major banks since July 1, 2010. Earlier figures relate to Benchmark Prime Lending Rate (BPLR).
 (3) Deposit Rate relates to major banks for term deposits of more than one year maturity.

Readers are Invited to contribute write-ups or any relevant and interesting piece of information for this feature at eboard@icai.org.

SAFA Regional Standards Setters Conference in New Delhi - A Report

The SAFA Regional Standard Setters (RSS) Conference hosted by the Institute of Chartered Accountants of India (ICAI) was organised in New Delhi from 30th November to 1st December, 2010 at the Indian Habitat Centre, New Delhi. Approximately 150 participants including 30 participants from Pakistan, Nepal, Bangladesh and Sri Lanka took part in the conference. The Chief Guest at the Conference was Hon'ble Shri K. Rahman Khan, Deputy Chairman, Rajya Sabha. Sir David Tweedie, Chairman, International Accounting Standards Board (IASB) and Prabhakar Kalavacherla, Member, IASB were Guests of Honour. The Ceremonial Inaugural Session was chaired by CA. Amarjit Chopra, President ICAI and the Technical sessions chaired by Reyaz Mihular, Chairman, SAFA Accounting and Auditing Standards Committee.



▲ Deputy Chairman Rajya Sabha CA. Rahman Khan inaugurates the conference as ICAI President CA. Amarjit Chopra, ICAI Vice President CA. G. Ramaswamy, Central Council Member CA. Rajkumar Adukia and Chairman SAFA Committee on Accounting Auditing Standards Mr. Reyaz Mihular look on.

Inaugural Session

CA. Amarjit Chopra, President ICAI in his welcome address highlighted the importance of organising the instant Conference at this point of time when all the SAFA countries are in the process of either adopting or converging with IFRS. He added that the instant Conference would provide a platform to the standard-setters of SAFA Region to discuss and resolve various region specific hindrances with IASB, that they are facing while converging or adopting with IFRS. He stated that ICAI has decided to Converge with IFRS as they felt that Convergence is better than Adoption as it still provides the opportunity to take care of country specific issues.

During the Inaugural address Chief Guest Hon. **Shri K. Rahman Khan**, Deputy Chairman, Rajya Sabha emphasised on the need for the IASB to recognise civil society as an important part of the constituency and that the accounting profession should play the role of a Trustee for civil society. He pointed out the need for vigilance by the accounting profession.

In the key note address, **Sir David Tweedie**, Chairman, International Accounting Standards Board (IASB) pointed out benefits of IFRS adoption to economies. He specifically mentioned that Convergence is not the same as Adoption and that Convergence will



Deputy Chairman Rajya Sabha CA. K. Rahman Khan, Chairman, International Accounting Standards Board (IASB) Sir David Tweedie, ICAI President CA. Amarjit Chopra and ICAI Vice President CA. G. Ramaswamy release a comparative study of SAFA Countries Accounting & Auditing Standards vis-à-vis International Accounting & Auditing Standards

still result in higher costs of capital. He disclosed the IASB's modified strategy and work plan and the simplified approach to expected loss model for impairment of financial assets to be issued by IASB soon. Sir David Tweedie requested Regional support for post implementation reviews.



ICAI Vice President
CA. G. Ramaswamy

In the discussion of India's approach towards convergence with IFRS, **CA. G. Ramaswamy**, Vice President of the Institute of Chartered Accountants of India specified that due to legal and economic environment in India, adoption of IFRS without any modification is not practicable. Therefore ICAI has decided to converge rather than adopt IFRS and decided on a phased transition to IFRS. He stated that as far as possible, no changes have been made unless absolutely essential keeping in view the Indian conditions and circumstances. He added that conceptual differences, if any, are being taken up with IASB. He also informed about the various initiatives taken by the ICAI for proper implementation of IFRS converged Standards including organising various

Workshops and Conferences throughout the country on IFRS and initiation of 100 hours IFRS certification course by ICAI.

A comparative study of SAFA Countries Accounting & Auditing Standards vis-à-vis International Accounting & Auditing Standards was also released at the occasion by Hon'ble CA. K. Rahman Khan jointly with Sir David Tweedie.

Technical Session 1

Ms. Usha Janakiraman – Deputy General Manager Reserve Bank of India, presenting on behalf of Mr. Ravi Mohan, Chief General manager, Reserve Bank of India (RBI), in her presentation on "Implementing IFRS on Financial instruments IAS 39/ IFRS 09 : Challenges for Banks" pointed out the practical difficulties

in implementing IAS 39 / IFRS 09 for the Indian banks. She mentioned that that RBI being an active participant decided to get involved in the standard setting process due to concerns of financial stability. Further she pointed out that balance sheet size is bigger under IFRS due to fair value approach and the prudential ratios get skewed. In her discussion she enumerated the challenges of implementing IFRS 9, overlap of disclosures and prudential norms between IFRS and Basel and



ICAI President
CA. Amarjit Chopra

the challenge of changing the mindset from incurred loss model to the expected loss model.

CA. Amarjit Chopra, ICAI President in his presentation on

"IFRS Implementation: Challenges for SMPs" stated that like other countries of SAFA Region, India has also been dominated by SMPs. He stated that he was surprised to know the fact that in one of the meeting he had with Past Presidents of ICAI that 45 per cent of the top 600 companies in India have been audited by SMPs. He stated that auditors in India have faced much of the blame for the scams that took place in India. He expressed his views that a stable platform for India was required to converge with



Mr. Reyaz Mihular, Chairman, SAFA Committee on Accounting & Auditing Standards addresses the delegates. Other dignitaries on the dais are Sir David Tweedie, Chairman IASB, CA. G. Ramaswamy, Vice-President ICAI, Hon'ble Shri K. Rahman Khan, Deputy Chairman Rajya Sabha and CA. Amarjit Chopra, President ICAI.

IFRS. During the presentation, he highlighted the key areas of impact requiring auditor's involvement for successful implementation of IFRS converged standards. He stated that the implications of application of fair valuation approach would be far more complex and challenging as compared to the existing Indian accounting standards. He informed that IFRS converged standards need to be translated to Hindi before notifying under the Companies Act in India. In addition he discussed more on tax view of unrealised gains and problem in determination of discounting rates from the market. He emphasised on the need of harmonisation of tax laws along with the IFRS. Further he pointed out that costs to SMPs of adopting IFRS will increase while fees are decreasing and the challenge of keeping upto date is also increasing.

Technical Session 2 - Convergence Experience of SAFA Countries

Md. Humayun Kabir, Past President, ICA Bangladesh shared the convergence experience with IFRS in Bangladesh. He mentioned that Bangladesh has taken adoption approach to transitioning to IFRS as

against Convergence. According to Md. Humayun Kabir, Bangladesh suffers from lack of technical resources and their local laws and regulations which contradict with IFRS is a problem.

Sharing convergence experience with IFRS in India, **Mr Manoj Fadnis**, Chairman, Accounting Standards Board of ICAI, specified that India will adopt a convergence approach. There may be a carve out in respect of revenue recognition for real estate development - departure from IFRIC 15 and opt for use of percentage completion method for Real Estate companies in India. Further there is another carve out is in respect of bargain purchases (take the credit to Capital Reserve and not to the profit and loss account). India has taken the decision not to adopt the Agriculture standard (IAS 41). According to Mr Manoj Fadnis, consolidation is not mandatory under Indian Corporate law and only listed companies are required to consolidate. IFRS will apply to consolidated as well as separate financial statements. In India, IFRS 9 will not be required for companies converging on 1-4-2011.

Mr. P. K. Shrestha, Chairman, Accounting Standards Board, Nepal

stated that 15 Nepal Accounting Standards (NAS) are in compliance with IFRS while 11 standards have some changes to accommodate compliance with local laws and regulations. Mr P. K. Shrestha stated that they will revise all NAS to make them fully compliant with IFRS by 1-7-2011 and will issue guidance as required. Nepal is in the process of implementing revised standards for listed companies by 1-7-2012, other public limited companies by 1-7-2013 and rest by 1-7-2014.

Mr. Rashid Rahman Mir, Chairman, Accounting Standards Committee, Pakistan shared the convergence experience with IFRS in Pakistan. According to Mr. Rashid Rahman, all IFRS have been adopted except for IFRS 9 and IFRS 1. IFRS 9 is under consideration for adoption. Further IFRIC 4 and 12 application has been deferred by SEC of Pakistan (SECP) and applicability of IAS 40, 39 and IFRS 7 deferred by State Bank of Pakistan (SBP) for Banks and DFI's. At the same time, application of IAS 39 for Insurance companies has been deferred by SECP. In Pakistan, the issue of consolidation of mutual funds is under consideration and Pakistan is in the process of adopting IFRS for SME's.

Sharing convergence experience with IFRS in Sri Lanka, **Mr. Nishan Fernando**, Chairman, Accounting Standards Committee Sri Lanka, specified that the Institute of Chartered Accountants of Sri Lanka took a bold decision to adopt all IFRS by 1st January 2012 and early adoption is encouraged. Mr Nishan explained about the limitations of resources in applying Accounting Standards in the Sri Lankan context. He mentioned that the Accounting Standards Committee has decided to reallocate its resources to providing application guidance and providing comments on the IASB documents at their Exposure Draft stage.



▲ CA. Manoj Fadnis sharing the Indian experience of convergence with IFRS. Others seen on the dais are Mr. P.K. Shrestha, Chairman ASB of Nepal, Mr. Rashid Rahman Mir, Chairman, Accounting Standards Committee of ICA Pakistan, Md. Humayun Kabir, Past President, ICA Bangladesh and Mr. Nishan Fernando, Chairman Accounting Standards Committee of ICA Sri Lanka

Technical Session 3 - Implementing IAS 32/39 in a Bank

Mr. V. Venkataramanan discussed about the practical problems of Implementing IAS 32 & 39 in a bank and specified that fair value is not a major issue for banks. Mr. V. Venkataramanan pointed out that Indian banks have weathered the crisis better than most countries. But this is due to certain unconventional steps taken by RBI, i.e. loosening of provisioning requirements during the credit crisis.



Mr. V. Venkataramanan

SAFA IFRS Cell with 20-30 qualified people.

Mr. Uday Phadke, President, Finance, legal and Financial Services Sector and Member of the Group Executive Board, Mahindra & Mahindra Limited, discussed about implementing IFRS in a Non-Financial Diversified Institution and possible workarounds in overcoming the challenges. He pointed out the importance of project management skills and a comprehensive implementation plan in the conversion process. Further importance in training and knowledge



Mr. Uday Phadke

Mr. Sanath Fernando, Member, IFRS Implementation Group for SMEs presented a paper on the topic 'IFRS for SMEs - A possible way forward for converging with IFRS in emerging/developing economies'. Mr. Fernando explained the need to make a choice about using full IFRS or IFRS for SME's and since a larger proportion of companies in our region are of the SME category, we can adopt IFRS for SME's and be IFRS compliant.



Mr. Sanath Fernando

The Conference concluded on the second day with an **interactive**

Technical Session 4

Mr. Prabhakar Kalavacherla, IASB Board Member made a presentation on IASB's response to helping overcoming challenges faced by emerging/developing economies in implementing IFRS. He specified that the cost of capital has come down by 48 basis points for those countries which have adopted IFRS (Federal Reserve study states that to reduce 38 bp on a 10 year bond, the government has to flood the market with \$ 1000 bn). He mentioned that the purpose of regulation is to protect capital markets and thereby financial stability and on the other hand the purpose of financial statements is to provide information to the users of FS on the future cash flows. He highlighted problems with local endorsement, i.e. urge to tinker, time delay, politicisation, and what the audit report will refer to and related cost issues. Mr. Prabhakar Kalavacherla proposed to start a



IASB Board Member Mr. Prabhakar Kalavacherla



Mr. Nadeem Yusuf Adil presenting a paper on 'Issues in First time adoption of IFRS'. Others seen on the dais are Mr. Sanath Fernando and Mr. Reyaz Mihular.

management was highlighted in his presentation. He also dealt with problems around assessment of de-facto control.

Technical Session 5

Mr. Nadeem Yusuf Adil presented Issues in first time application of IFRS in Pakistan. He highlighted the importance of working with regulators to ensure that there is proper application of IFRS and that they are in the process of sorting out issues to facilitate adoption of IFRS 9.

panel discussion chaired by Sir David Tweedie, with CA. Amarjit Chopra and Prabhakar Kalavacherla, **Mr. C. Ramakrishnan**, CFO TATA Motors and **Mr. P.S. Bannerjee**, Executive VP (Corporate Accounts) and CRO, Larsen & Toubro, joining the panel.

As noted above the presentations and deliberations at the Conference were of very high quality and the participants expressed complete satisfaction on the subject content of the conference. ■

ACCOUNTANT'S BROWSER

'PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE'

Index of some useful articles taken from Periodicals/Newspapers received during November-December 2010 for the reference of Faculty/Students & Members of the Institute.

1. ACCOUNTING

Framework for Financial Reporting Standards: Issues & A Suggested Model by AAA FASC. *Accounting Horizons*, Vol. 24/3, 2010, pp.471-485.

Global Accounting Convergence & the Potential Adoption of IFRS by the U.S. (part I): Conceptual Underpinnings & Economic Analysis by Luzi Hail etc. *Accounting Horizons*, Vol. 24/3, 2010, pp. 355-394.

How do Firms React to the Prohibition of Long-Lived Asset Impairment Reversals? Evidence from China by Ran Zhang etc. *Journal Account Public Policy*, Vol. 29, 2010, pp.424-438.

Is Negative Goodwill Valued by Investors? by Eugene E. Comiskey etc. *Accounting Horizons*, Vol. 24/3, 2010, pp. 333-353.

Measuring the Convergence of National Accounting Standards with International Financial Reporting Standards: The Application of Fuzzy Clustering Analysis by Xiaohui Qu & Guohua Zhang. *The International Journal of Accounting*, Vol.45, 2010, pp.334-355.

Report of Standing Committee on Finance (2009-10) on *The Chartered Accountants (Amendment) Bill, 2010*. *Company Law Journal*, Vol.4, 2010, pp.90-94.

Report of Standing Committee on Finance (2009-10) on Cost & Works Accountants (Amendment) Bill, 2010. *Company Law Journal*, Vol.4, 2010, pp.95-103.

Section 404 Compliance & Financial Reporting Quality by Albert L. Nagy. *Accounting Horizons*, Vol. 24/3, 2010, pp.441-454.

2. AUDITING

Audit Committee Characteristics & Investment in Internal Auditing by Abhijit Barua etc. *Journal Account Public Policy*, Vol. 29, 2010, pp. 503- 513.

Balancing the Costs & Benefits of Auditing & Financial Reporting Regulation Post-SOX, Part II : Perspectives From the Nexus at the SEX by Zoe-Vonna Palmrose. *Accounting Horizons*, Vol. 24/3, 2010, pp. 487-507.

Effect of Magnitude of Audit Difference & Prior Client Concessions on Negotiations of Proposed Adjustment by Richard C. Hatfield. *The Accounting Review*, Vol.85/5, 2010, pp.1647-1668.

Effect of Social Confrontation on Individuals' Intentions to Internally Report Fraud by Steven E. Kaplan etc. *Behavioral Research in Accounting*, Vol.22/2, 2010, pp.51-67.

Effects of Trust & Management Incentives on Audit Committee Judgments by Anna M. Rose etc. *Behavioral research in Accounting*, Vol.22/2, 2010, pp. 87-103.

Exploring Sarbanes-Oxley's Effect on Attitudes, Perceptions of Norms, & Intentions to Commit Financial Statement Fraud from a General Deterrence Perspective by Joseph C. Ugrin & Marcus D. Odom. *Journal Account Public Policy*, Vol. 29, 2010, pp. 439-485.

Internal Control Reporting Differences Among Public & Governmental Auditors: The Case of City & County Circular A-133 Audits by Dennis M. Lopez & Gary F. Peters. *Journal Account Public Policy*, Vol. 29, 2010, pp.481-502.

Prior Audits & Taxpayer Compliance: Experimental Evidence on the Effect of Earned Versus Endowed Income by Scott J. Boylan. *JATA*, Vol.32/2, Fall 2010, pp. 73-88.

Review 2010: Audit, Financial Reporting Consultations by Aidan Lambe & Mark Kenny. *Accountancy Ireland*, December, 2010, pp.42/6, pp.7-9.

3. ECONOMICS

Comparatives Study of Special Economic Zones & Land Acquisition: Magical Similarity or Mere Eyewash? by Avani Bansal. *Company Law Journal*, Vol.4, 2010, pp.49-52.

Corporate Disclosure Practices: A Comparative Study Between India & America by Deepesh Tiwari. *Pranjana*, Jan.-June 2010, pp.72-87.

Performance of Private Corporate Business Sector: 2009-10 by

Department of Statistics & Information Management. *RBI Bulletin*, Oct. 2010, pp.1779-1799.

Preparing Indian Banks for Global Competitiveness: Strategic & Policy Perspectives by Subir Gokarn. *RBI Bulletin*, Oct. 2010, pp.1961-1965.

Time for Global Capital Account Regulations by Jose Antonio Ocampo. *Eco. & Pol. Weekly*. November.13, 2010, pp.32-45.

4. EDUCATION

Accountability & Transparency in University Governance by A. Anandakrishnan by M. Anandakrishnan. *University News*, November 8-14, 2010, pp. 18-23.

Governance in Higher Education Institutions in India: Some Aspects by S.K. Khanna. *University News*, November 8-14, 2010, pp.10-13.

Governance in Higher Education: International Scenario by R.C. Sobti. *University News*, November 8-14, 2010, pp. 31-45.

Right to Education Act, 2009: Salient Features & Major Problems of Implementation by J.S. Jakhar. *University News*, November 22-28, 2010, pp.6- 12+18.

5. INVESTMENT

Competitive Analysis of Vusiness Valuation Services by Michael A. Crain. *Journal of Accountancy*, November 2010, pp.36-40.

Frequency of Corporate Announcements via Stock Exchange Websites & Market Efficiency by Asheq Rahman & Roger Debreceeny. *Journal of Accounting, Auditing & Finance*, Summer 2010, pp. 457-490.

Use of Independent Fairness Opinions & the Performance of Acquiring Firms by Lucy Huajing Chen. *Journal of Accounting, Auditing & Finance*, Summer 2010, pp. 323-350.

6. MANAGEMENT

Corporate Governance & Business Ethics: Challenges for Corporate Sectors by Arindam Ghosh. *Chartered Secretary*, December 2010, pp.1782-1787.

Designing & Implementing a Performance Measurement System by Maurice Gosselin. *CMA Management*, 15th November 2010, pp.14-18.

Guiding Values for Corporate Governance: A Consciousness Perspective by Om Prakash Dani. *Chartered Secretary*, December 2010, pp.1713-1715.

How to be a Better Mentor by Erik Thompson. *Journal of Accountancy*, November 2010, pp.42-46.

Management Accounting in Pharmaceutical Sector – A Vital Role in the Decision-Making Process by L.N. Koli. *The Management Accountant*, November 2010, pp.876-879.

Stress-Test Your Strategy: The 7 Questions to Ask by Robert Simons. *Harvard Business Review*, November 2010, pp.93-100.

7. TAXATION & FINANCE

Deductibility of 'Set-On' Amount Under Payment of Bonus Act by Pradip Kapasi & Gautam Nayak. *BCAJ*, November 2010, pp.45-49.

International Taxation: Recent Global Developments in International Taxation by Mayur B. Nayak etc *BCAJ*, November 2010, pp.59-76.

IRS Amends Plan for Uncertain Tax Positions by Alistair M. Nevius. *Journal of Accountancy*, November 2010, pp.26-29.

Role of Transfer-Pricing Schemes in Coordinated Supply Chains by Kashi R. Balachandran etc. *Journal of Accounting, Auditing & Finance*, Summer 2010, pp.375-404.

Tax Classification of Foreign Entities in China: The Current State of Play by Wei Cui. *Bulletin for International Taxation*, November 2010, pp.559-563.

Vision 2010: It Was Almost Good News. In 2009, The Average Canadian by Robert Colapinto. *CA Magazine*, December 2010, pp.20-27.

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

IASB Proposes Improvements to Hedge Accounting

The International Accounting Standards Board (IASB) recently published for public comment, an exposure draft on the accounting for hedging activities. The exposure draft proposes requirements that will enable companies to reflect their risk management activities better in their financial statements, and, in turn, help investors to understand the effect of those activities on future cash flows. The proposed model is principle-based, and will more closely align hedge accounting with risk management activities undertaken by companies when hedging their financial and non-financial risk exposures. The proposals also include enhanced presentation and new disclosure requirements. These proposals sweep away the existing rule-based, complex and inflexible hedge accounting requirements and replace them with a simple, principle-based approach. The result, if adopted, will be a much simpler model that better reflects risk management practices whilst providing more useful information to investors. The exposure draft builds on proposals contained in the IASB's discussion paper *Reducing Complexity when Reporting Financial Instruments* published in March 2008. The exposure draft forms part of the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement*, and when its proposals are confirmed they will be incorporated into IFRS 9 *Financial Instruments*. The exposure draft *Hedge Accounting* is open for comment until 9th March 2011 and can be accessed via the 'Comment on a proposal' section of the IASB website. During the consultation period, the IASB will undertake further outreach to seek views on the proposals. The IASB will deliberate the proposals with a view to completing the new hedge accounting requirements in the first half of 2011. In addition to the general hedge accounting proposals in the exposure draft, the IASB is continuing to discuss portfolio macro hedge accounting.

(Source: <http://www.ifrs.org/News>)

IASB Issues Narrow Amendments to IFRS 1

The International Accounting Standards Board (IASB) issued recently two narrow amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* (IFRSs). The amendments confirm proposals that were published as separate exposure drafts for public comment in August and September. The first amendment replaces references to a fixed date of '1 January 2004' with 'the date of transition to IFRSs', thus eliminating the need for companies adopting IFRSs for the first time to restate derecognition transactions that occurred before the date of transition to IFRSs. The second amendment provides guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe hyperinflation. The amendments to IFRS 1 are set out in *Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters* and are effective from 1st July 2011. Earlier application is permitted. Further details are available from the IASB website at www.ifrs.org.

(Source: <http://www.ifrs.org/News>)

IASB Issues Amendments to IAS 12 Income Taxes

The International Accounting Standards Board (IASB) recently issued amendments to IAS 12 *Income Taxes*. The

amendments set out in *Deferred Tax: Recovery of Underlying Assets*, result from proposals published for public comment in an exposure draft in September. IAS 12 requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in IAS 40 *Investment Property*. The amendment provides a practical solution to the problem by introducing a presumption that recovery of the carrying amount will, normally be, be through sale. As a result of the amendments, SIC-21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets* would no longer apply to investment properties carried at fair value. The amendments also incorporate into IAS 12 the remaining guidance previously contained in SIC-21, which is accordingly withdrawn.

(Source: <http://www.ifrs.org/News>)

Companies Will Get to Use Real Value for Tax Purpose in IFRS too

Indian corporates sweating over the new International Accounting Standards increasing their tax liability can relax because the government is likely to allow them to estimate their taxes using the current accounting standards. The fair value accounting of assets and liabilities under IFRS, will give rise to notional profits and losses because of market fluctuations in prices. Such book valuation gains or losses would have distorted the profit and loss accounts of the nearly 300 big companies that will start preparing their financial statements based on IFRS from the next fiscal and in a situation of rising asset prices find their tax liability go up. All notional gains arising out of the convergence process will be disclosed separately without them directly impacting a company's taxable net profits as stated by an official of ministry of corporate affairs. Under the current accounting standard assets and liabilities are stated at their historical cost. The relaxation follows after the finance ministry raised concern that sentiment-driven volatility in fair valuing assets and liabilities could impact taxation. Following the convergence, profit and loss accounts of companies will have to include unrealised gains and losses on many item such as property values, and on instruments like derivatives and risk hedges. As per the road map laid down by the ministry of corporate affairs, companies listed on domestic stock exchanges, abroad and all companies with a net worth of over ₹1,000 crore will have to converge their financial statements with IFRS on 1st April, 2011. In effect, the relaxation will mean that IFRS converged financial statements, which are more realistic in terms of assessing the worth of a firm, will not be used by the taxmen. They will compute the tax liability of a firm based on the current Indian accounting norms, which is largely based on the historical cost of an asset or liability. As is in Germany, a framework fully consistent with IFRS for statutory accounts, and which have separate adjusted records for tax purposes is desired. The proposal will, however, add to companies' burden as they will have to prepare two sets of accounts. In the long run, experts argue, there has to be a broad reconciliation between IFRS and Indian GAAP profits. Without a detailed study and a comprehensive approach, any short cut methods in the long run can make the income tax environment for corporates very chaotic, confusing, litigative and challenging. The income-tax (IT) authorities must review the converged accounting standards and come up with a

comprehensive way of treating unrealised gains and losses for the purposes of taxation.

(Source: <http://bx.businessweek.com/international-accounting>).

IASB Publishes IFRS Practice Statement on Management Commentary

The International Accounting Standards Board (IASB) recently published an IFRS Practice Statement *Management Commentary*, a broad, non-binding framework for the presentation of narrative reporting to accompany financial statements prepared in accordance with IFRSs. Management commentary fulfils an important role by providing users of financial statements with a historical and prospective commentary on the entity's financial position, financial performance and cash flows. It serves as a basis for understanding the management's objectives and strategies for achieving those objectives. The Practice Statement permits entities to adapt the information provided to particular circumstances of their business, including the legal and economic circumstances of individual jurisdictions. This flexible approach will generate more meaningful disclosure about the most important resources, risks and relationships that can affect an entity's value, and how they are managed. The Practice Statement is not an IFRS. Consequently, an entity need not comply with the Practice Statement to comply with IFRSs.

(Source: <http://www.ifrs.org/News>)

IPSASB Publishes International Public Sector Conceptual Framework Documents for Comment

The International Public Sector Accounting Standards Board (IPSASB) recently released, for comment, an exposure draft (ED) and two Consultation Papers related to its project to develop a Conceptual Framework for the general purpose financial reporting of public sector entities. The Conceptual Framework is the IPSASB's key strategic objective for 2010–2012 and is of fundamental importance to the future of global public sector standard setting for at least the next 10–15 years. Conceptual Framework Exposure Draft 1 (CF-ED1), *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority, and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity*, refines the issues highlighted in a Consultation Paper published in 2008 and reflects the IPSASB's consideration of the responses to that Consultation Paper. CF-ED1 proposes that the objectives of financial reporting should be to provide information for accountability and decision-making purposes. It also proposes that the scope of financial reporting should extend beyond the traditional financial statements to include more comprehensive financial and non-financial information. The Consultation Paper, *Elements and Recognition in Financial Statements*, identifies alternative asset and liability-led and revenue and expense-led approaches to financial statements and considers the key characteristics of assets, liabilities, revenue and expenses. It also discusses whether further elements should be defined and examines approaches to the recognition of elements. The Consultation Paper, *Measurement of Assets and Liabilities in Financial Statements*, considers the measurement bases that may be appropriate for the elements that are recognised in financial statements. It discusses historical cost, market value, and replacement cost and then examines deprival value as an approach to select the most relevant measurement basis.

(Source: <http://press.ifac.org/news>)

IPSASB Publishes 2010 Annual Improvements Standard

The International Public Sector Accounting Standards Board (IPSASB) recently published *Improvements to IPSASs—2010*. The publication completes the IPSASB's improvements project for 2010. The IPSASB's improvements project is modeled on the IASB's annual update program. Improvements are made to existing IPSASs to maintain alignment with International Financial Reporting Standards (IFRSs), as well as other general improvements. The 2010 amendments relate primarily to requirements for recognition, measurement, and disclosure. They do not represent substantive revisions to the content of existing standards. International Public Sector Accounting Standards (IPSASs) is continually reassessed by the IPSASB to ensure that they remain relevant to users of public sector financial statements. *Improvements to IPSASs—2010* is available to download free of charge from the IPSASB section of IFAC's Publications and Resources site (web.ifac.org/publications). The IPSASB encourages IFAC members, associates, regional accountancy bodies, and firms to use these materials and to promote their availability to members and employees.

(Source: <http://press.ifac.org/news>)

IAESB Proposes Clarified Standard on Continuing Professional Development

The International Accounting Education Standards Board (IAESB) recently released for public exposure a proposed revision of International Education Standard (IES) 7, *Continuing Professional Development: A Program of Lifelong Learning and Continuing Development of Professional Competence*. IES 7, drafted in 2004, introduces the concepts of continuing professional development (CPD)—learning that develops and maintains competence to enable professional accountants to perform their roles effectively—as relevant, verifiable, and measurable learning activities and outcomes. The proposed redrafting aims to assist the ongoing worldwide development of CPD systems and compliance mechanisms. IAESB expects to increase the opportunity for mobility of labor, and in so doing to contribute to the global economy through these revision efforts. This exposure draft is the first in a series of planned revisions over the coming year. The IAESB plans to clarify the obligations of CPD through the revision of IES 7, and to draw international attention to prequalification education for accounting professionals and the competencies of an auditor through revisions of additional standards.

(Source: <http://press.ifac.org/news>)

IASB and FASB Progress Report on Converging IFRSs and US GAAP

The IASB and the FASB published recently, a progress report on their work to improve IFRSs and US GAAP and to bring about their convergence. Since the last progress report was published June 2010 the boards have jointly issued major exposure drafts on Leases and Revenue Recognition, completed the first phase of the Conceptual Framework project and begun discussions to seek to align their respective Financial Instruments accounting proposals. The boards have also further prioritised board time available to discuss convergence projects.

(Source: <http://www.ifrs.org/News>)

■ ■ ■ Goods and Services Tax Would be Implemented From April 1, 2012

Finance Minister Pranab Mukherjee has that Goods and Services Tax (GST) would be implemented from April 1, 2012. "We wanted to introduce it earlier, but due to some problems in implementation of the new indirect tax system, constitutional amendments are needed to levy it in states," he said. The finance minister said the Centre would take into account the concerns of the states and work towards forging a common ground for implementation of the major tax reform. The GST aims to dismantle the complexities and non-transparency in tax regime for goods and services. It encourages a consumer-friendly product pricing that should benefit the common man, he said. While VAT brought a steady increase in the revenues of the states, were now moving towards an economy-wide generalised system of GST, which is likely to improve tax collections and boost India's economic development by integrating the Indian market through a uniform tax rate, he said.

(Source: <http://www.business-standard.com>)

■ ■ ■ Commission to Agents of Foreign Artistes Non-Taxable: ITAT

The commission paid to foreign agents of international artistes performing in India is not taxable, ruled the Income Tax Appellate Tribunal (ITAT). The tribunal also ruled that reimbursement of expenses to international artistes performing here is also not taxable. This recent ruling by an ITAT bench has provided relief to many event management companies who hire foreign agents to procure international entertainers to perform in India. The order was passed on November 19, in an appeal filed by the Income Tax (I-T) department against Wizcraft International Entertainment Private Limited. The department filed an appeal after the commissioner of income tax (Appeals) ruled in favour of the company (Wizcraft) saying that payment to an agent and reimbursement of expenses to the performing artistes are not taxable. As per the case, Wizcraft entered into an agreement with UK-based Colin Davie who provides artiste management services around the world. The company hired Davie to get singers Diana King and Shaggy, both from the United States of America for various performances in India in 1999 and 2000. While Wizcraft deducted the tax at source (TDS) while paying the artistes, and deposited the same with the I-T department, the company did not deduct tax while reimbursing their travel and other expenses and while paying commission to Davie. The assessing officer of the I-T department was of the view that the payment to Davie was part of the payment to the entertainers. The officer also held that the nature of services agreed to be rendered by Davie was such that he had to be present in India to perform them. Wizcraft said the commission paid to Davie is not taxable in India because he had rendered services outside the country only to coordinate the engagements of the international artistes. For reimbursement of expenses to artistes, the company said there is no element of income and therefore there is no obligation to deduct TDS from the payment. In the

order, NV Vasudevan, judicial member and Pramod Kumar, member of ITAT held that scheduling performances of such reputed artistes in India is not easy. The ITAT further held that these artistes are known for their unpredictable behaviour. Here comes the role of agent who has the acumen and skills to negotiate with such artistes, the order said. It added that for rendering such services, depending upon the nature of the deals and time and effort involved, such agents claim commission from organisers. There is no material on record to substantiate the conclusion of the assessing officer that the entire consideration including fees paid to Davie is in fact fees payable to the artistes to perform in India, the order said adding that this conclusion of the assessing officer is purely on surmises. On reimbursements, the tribunal observed, the law is well settled that any payment towards reimbursement of expenses is not chargeable to tax.

(Source: <http://www.hindustantimes.com>)

■ ■ ■ Comptroller and Auditor General Moots Lower Corporate Tax

The Comptroller and Auditor General (CAG), has mooted lower corporate taxes to stop many non-resident firms from misusing the Double Taxation Avoidance Agreements (DTAAs) on account of higher levies in India. In a latest review report on direct taxes submitted to Parliament, CAG observed that in several countries with which India has a DTAA, tax rates range between 20 per cent to 30 per cent of net business income of companies while in India, the tax deduction at source ranges between 10 per cent to 20 per cent on gross receipts which would be much higher than the tax rates in other countries. "We feel that a lower flat rate of tax applicable across streams of incomes irrespective of destinations would be a workable alternative," the report said. The Income Tax Act and DTAA together provide for a multitude of exemptions to the incomes arising to Non-Resident Indians which are currently unquantified in terms of revenue foregone, the report said while suggesting the need to phase out these exemptions. The CAG study pointed out that by lowering levy, it would facilitate greater taxpayer compliance, reducing cost of doing business in India and also cutting down on instances of disputes.

(Source: <http://economictimes.indiatimes.com/>)

■ ■ ■ HC: Govt Can Levy Service Tax Rent on Immovable Property

The Punjab and Haryana High Court has upheld the Constitutional validity and retrospective levy of service tax on renting of immovable property. The ruling, in favour of the government, will protect over ₹1,000 crore of revenue the tax department was expecting from the service. In the Finance Bill 2010, amendments were made in the definition of renting of immovable property to provide explicitly that the activity of renting itself is a taxable service. The change was made with retrospective effect from June 1, 2007. This was likely to get the government another ₹1,000 crore, apart from ₹200 crore in the current financial year.

■ ■ ■ CAG Study: Evasion Lead to Deceleration in VAT Revenues

Amid states claim that switch over to VAT has resulted in substantial growth of revenues, government auditor CAG has found tax evasion leading to deceleration in tax receipts in many states post VAT, that is touted as predecessor of proposed national-level GST. Lacunae like deviation from agreed rates have also come into light in a study report compiled from Accountants General of 23 states and deficiencies noticed in other compliance audit exercises. This prompted CAG core team, that conducted the study, to recommend that a mechanism should also be installed to monitor any deviations from GST rate, that could distort the national-level indirect tax system, implementation of which has seen delay of two years from the original schedule. "Of the 23 states in our study, we found that ten states have registered a dip in the average growth of revenue during the post-VAT regime against those relating to the pre-VAT periods," said the study, that covered a period between April 2005 and March 2009.

(Source: <http://beta.profit.ndtv.com/news>)

■ ■ ■ SC: No Excise Exemption on Medicine with Short Shelf Life

A product with a very short shelf life is still marketable and cannot claim exemption from excise duty on that account, the Supreme Court stated while dismissing the appeal of Nicholas Piramal India Ltd against the view of the Commissioner of Central Excise, Mumbai. The pharma company had argued that its Vitamin A in crude form had a shelf life of only two to three days and therefore the product was not marketable. Therefore, central excise cannot be imposed on it. The tribunal rejected the contention. On appeal, the Supreme Court upheld the tribunals view and clarified: Short shelf life cannot be equated with no shelf life and would not *ipso facto* mean that it cannot be marketed. A shelf life of two to three days is sufficiently long enough for a product to be commercially marketed.

(Source: <http://www.financialexpress.com/>)

■ ■ ■ Global Mergers & Acquisitions Rise for the First Year Since 2007

Mergers and acquisitions rose for the first year since 2007, potentially marking the start of a new, multiyear M&A cycle in which emerging economies account for a bigger share of global dealmaking. Thomson Reuters data showed announced M&A grew nearly a fifth this year, to \$2.25 trillion globally. The preliminary figures show emerging markets made up a record 17 per cent of transactions, and energy was the busiest sector. Next year could be busier still. Executives, bankers, big investors such as Schrodgers, and analysts at banks including Credit Suisse, Nomura, and Societe Generale are among those predicting a further rise. Cheap debt, record cash piles, the need to outpace sluggish economic growth, and positive market reactions to many deals in 2010 should embolden companies to strike more deals, they say.

(Source: <http://www.thehindubusinessline.com/>)

■ ■ ■ ACES - An e-Initiative by CBEC

The Central Board of Excise and Customs (CBEC), Ministry of Finance has successfully implemented an e-governance initiative under the Mission Mode Project (MMP) of the Government of India by developing and deploying a software application called Automation of Central Excise and Service Tax (ACES). The software is aimed at improving tax-payer services, transparency, accountability and efficiency in the indirect tax administration in India. The application has automated all major processes in Central Excise and Service Tax through a web-based and workflow-based system. ACES is the most significant e-initiative undertaken in post-independence India that has transformed the way about 16.75 lakh indirect taxpayers conduct their business with the department. It has indirectly touched the lives of millions and benefited a large number of Indians, foreign nationals and members of trade, industry and commerce.

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

■ ■ ■ SEBI Takes Up Rising Investor Complaints with MFs

Market regulator SEBI met chief executives of several mutual funds last week to take stock of rising investor complaints. The regulator is upset over the complaints against some of the leading players, two industry people have said. That the regulator is serious was borne out by the fact that it wanted the fund houses to list the measures they were taking to address the grievances. SEBI is also learnt to have come down hard on a few fund houses that have a long list of pending complaints. Its particularly worried about systemic issues like discrepancies in account statements and delay in mailing unit certificates. According to Amfi records, 39 mutual fund houses have more than 4.5 lakh complaints against them.

(Source: <http://economictimes.indiatimes.com/>)

■ ■ ■ In Both Direct & Indirect Taxes, Govt Confident of Achieving Collection Targets

With economic growth showing impressive resilience, the government has said it is confident of reaching its tax collection targets, both in the direct and indirect tax segments. "As things stand now, we will definitely reach the target," Central Board of Direct Taxes (CBDT) Chairman S S N Moorthy has said. Overall, the government had fixed a revenue target of ₹7.45 lakh crore, including indirect taxes, for the current fiscal, which is about 19 per cent higher than last fiscal. According to official figures, the net direct tax collection surged by 17.85 per cent to ₹2.16 lakh crore during April-November this year compared to the same period last fiscal, thereby crossing the 50 per cent of the full year target. During April-November 2009, net direct tax collection had stood at ₹1.83 lakh crore. In the Budget, the government had targeted to collect ₹4.30 lakh crore from direct tax for the current fiscal.

(Source: <http://beta.profit.ndtv.com/news>)

The Institute of Chartered Accountants of India duly acknowledges the following members for making generous contributions to the Chartered Accountants Benevolent Fund (CABF):

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Note: Readers attention is invited to the fact that CA. PP Pareek has generously contributed a total of ₹1,09,000 so far and not 66,000 as wrongly mentioned in December 2010 issue of the journal. The inadvertent error is deeply regretted.

Plagiarism: A Matter of Growing Concern

[Our journal, *The Chartered Accountant*, is a means to enhance our members' knowledge and update them on contemporary developments in the area of accountancy and other allied professions and topics of professional interest. We cater this service to all our members, e.g. more than 1,60,000 in number. Our Journal is read by more than 2 lakh readers across India and abroad.]

We receive articles from our authors either on their own or in response to our invitation when we bring out special issues. In the recent past, we have come across the practice of *plagiarism* in some of the submissions by our authors. Contents of some articles have been found to be lifted from resources including books, websites, etc., and presented to us as authors' original work, which is nothing but plagiarism, an infringement of others' intellectual property rights and, therefore, a punishable offence. It is an intellectual crime.

Authors who submit plagiarised work for publication will be strictly proceeded against as per policy and rules of Institute of Chartered Accountants of India and the law of the land. We will also represent such cases to authorities of the organisations where these authors work.

We appeal, therefore, to all our prospective authors not to send a plagiarised work to us for publication and not try to take credit for a work which is not theirs. Any reference of other sources/authors/content should be duly given within quotes with the name of the source in the body of the submitted articles' text itself. By following this practice, we will essentially show respect towards the creative community which all of us value immensely.

- Editor





Committee for Capacity Building of CA Firms & Small and Medium Practitioners
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Committee on Accounting Standards for Local Bodies Exposure Drafts of ASLB 1 and ASLB 7 Released for Comments

The Committee on Accounting Standards for Local Bodies (CASLB) is primarily engaged in the formulation of Accounting Standards for Local Bodies (ASLBs) keeping in view the need of establishing a single set of high quality financial reporting standards for this sector of the economy. Moving forward in this direction, the Committee has finalised the Exposure Drafts of two ASLBs namely ASLB 1 on 'Presentation of Financial Statements' and ASLB 7 on 'Inventories'.

ASLB 1 'Presentation of Financial Statements' prescribes the manner in which general purpose financial statements of Local Bodies should be presented to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. To achieve this objective, this Standard sets out overall considerations for the presentation of financial statements, guidance for their structure, and minimum requirements for the content of

financial statements prepared under the accrual basis of accounting.

ASLB 7 'Inventories' recommends the accounting treatment for inventories. The Standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Comments are invited on the Exposure Drafts of the above mentioned ASLBs. The text of the Exposure Drafts is available on the website of ICAI i.e. www.icai.org. Comments should be submitted in writing to the Secretary, Committee on Accounting Standards for Local Bodies, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to be received not later than **January 31, 2011**. Comments can also be sent by e-mail at caslb@icai.org or tdte@icai.org.

Request to Contribute Articles on Bank Audit

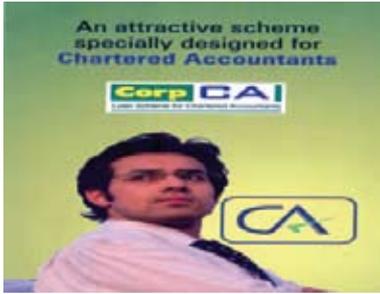
The Editorial Board of the Institute of Chartered Accountants of India has decided to put special focus on the theme 'Bank Audit' in the February 2011 issue of *The Chartered Accountant* journal.

As such authors and experts in the field are requested to contribute articles on different aspects of Bank Audit, particularly the following:

- (1) Overview of Bank Branch Audit
- (2) Audit of Investments in Bank
- (3) Audit of Treasury Operations in a Bank
- (4) Audit of Advances with special reference to Prudential Norms

- (5) Conducting Statutory Branch Audit in CBS Environment
- (6) Long Form Audit Report
- (7) Disclosures in Financial Statements of a Bank
- (8) Role of Audit Committee in ensuring good corporate governance practices in banks

The articles of not more than 3000 words (original and not having been published or hosted anywhere else) with executive summary and authors photographs should be sent at eboard@icai.org or journal.ca@gmail.com latest by 7th January, 2011. The authors also required to submit a declaration of originality along with the articles.



An Initiative of the Committee for Capacity Building of CA Firms and Small & Medium Practitioners, ICAI

The Committee for Capacity Building of CA Firms and Small & Medium Practitioners, ICAI has taken a major initiative to arrange financial assistance to all members in practice / firms in the form of specially designed loan scheme through Corporation Bank. Through the scheme, eligible Chartered Accountants can avail finance for setting up of offices including cost of furniture/fixture/office equipments-computers and other accessories. The scheme would also enable the Chartered Accountants to finance a part of the working capital for building their profession and will also take care of the needs of fresher (CAs with experience below three years).

*** Members & firms may avail the benefits of this loan scheme. For further details, please contact nearest branch of Corporation Bank.**

Highlights of the loan scheme are given below:

<p>Eligibility: # Chartered Accountants, individually/jointly or Proprietorship Concern or a Partnership Firm/ Partnership with Limited Liability # Age of the individual/ proprietor shall not exceed 65 years. # The applicants/Firms are registered and also holding valid certificate/license for carrying out the practice. # The applicant's/firm's name shall not appear in the RBI defaulters list/CIBIL report. # In case of Firms, all partners shall join as co applicants. # The applicants/firms should not have been subjected to disciplinary action by the Institute.</p>	<p>Purpose: # For construction of office premises # For acquisition of ready built new office premises, partly or fully constructed # To finance cost of land and construction thereon # To finance cost of furniture & fixture, fittings of office equipments /computers/other accessories etc. # To finance working capital and /or financing receivable</p>
<p>Nature of facility: # Demand Loan/Term Loan for acquisition of fixed assets and/or Cash Credit/Overdraft for working capital</p>	<p>Margin: # For Term Loan/Demand Loan: Uniform margin of 20% # For Working Capital: 25% for Book Debts/Receivables for cash credit or clean overdraft # Value of land shall not exceed 50% of project cost in case of purchase of site and construction of premises</p>

Quantum of loan:

Applicable For Freshers: (Experience below 3 years)					Applicable For Existing Firms (Having Practice for 3 Years & Above)				
		Metro	Urban	Other Centres	A] WHERE LATEST GROSS ANNUAL INCOME IS UPTO RS. 5 LACS (income includes professional fees/consultancy fees etc..)				
I.	Maximum eligibility: TL/DL * Out of which:	Rs. 20 lacs	Rs. 15 lacs	Rs. 10 lakhs	I	Maximum eligibility : TL/DL * Out of which:	Rs. 30 lacs	Rs. 20 lacs	Rs. 15 lakhs
a.	For office premises	Rs. 15 lacs	Rs. 12 lacs	Rs. 8 lacs	a	for office premises	Rs. 20 lacs	Rs. 15 lacs	Rs. 12 lacs
b.	For furnishing & Other assets	Rs. 5 lacs	Rs. 3 lacs	Rs. 2 lacs	b	For Furnishing & Other assets	Rs. 10 lacs	Rs. 5 lacs	Rs. 3 lacs
II.	For Working capital requirement	Rs. 2 lacs	Rs. 1 lac	Rs. 1 lac	II	For Working capital	Rs. 2 lacs	Rs. 1 lac	Rs. 1 lac
B] WHERE LATEST GROSS ANNUAL INCOME IS ABOVE RS. 5 LACS & UPTO RS.10 LACS AS PER LATEST IT RETURN (with experience of 3 years and above)					C] WHERE LATEST GROSS ANNUAL INCOME IS ABOVE RS.10 LACS, AS PER LATEST IT RETURN (WITH EXPERIENCE OF 3 YEARS AND ABOVE)				
		Metro	Urban	Other Centres			Metro	Urban	Other Centres
I	Maximum eligibility: TL/DL * Out of which:	Rs. 50 lacs	Rs. 25 lacs	Rs. 20 lakhs	I	Maximum eligibility : TL/DL * Out of which:	Rs. 125 lacs	Rs. 65 lacs	Rs. 30 lakhs
a	For office premises	Rs. 40 lacs	Rs. 20 lacs	Rs. 15 lacs	a	For office premises	Rs. 100 lacs	Rs. 50 lacs	Rs. 25 lacs
b	For Furnishing & Other assets	Rs. 10 lacs	Rs. 5 lacs	Rs. 5 lacs	b	For Furnishing & Other assets	Rs. 25 lacs	Rs. 15 lacs	Rs. 5 lacs
II	For Working capital	Rs. 5 lacs	Rs. 2 lacs	Rs. 2 lacs	II	For Working capital	Need based		

<p>Security: # Term Loan /Demand Loan: Assets acquired out of the loan. # For Working Capital Loan: Assignment of Book Debts/Receivable. #Collateral security: Suitable third party guarantee or Tangible securities.</p>	<p>Repayment: # Term Loan - Repayable in maximum period of 10 years by EMI/PMI, initial moratorium of upto 18 to 24 months. # Demand Loan - Repayable in maximum 3 years by EMI/PMI, including initial moratorium of 6 months. # Repayment to commence from date of commercial operations or after completion of initial repayment holiday or as per the terms of sanction. # Interest shall be serviced as and when debited.</p>
<p>Rate of interest: Upto Rs. 10 lacs – Min. 10% (Base Rate + 2.25%) Above Rs. 10 lacs – Min. 10.75% (Base Rate + 3%) (Investment in fixed assets less than Rs. 100 lacs) Above Rs. 10 lacs – Min. 11.75% (Base Rate + 4%) (Investment in fixed assets above Rs. 100 lacs) * Subject to gradation of the borrower # Rate of interest at floating rate linked to Base Rate # Rate of interest is subject to review</p>	<p>Note: Concession of 0.50% extended, if additional collateral security viz., property, LIC policies, Deposit etc., to the extent of 25% of loan amount is provided.</p> <p>Processing Charges: 0.25% of loan amount subject to a minimum of Rs.5000/-</p> <p>Prepayment charges: -Nil-</p>

Shifting of Some Departments/Committees to Newly Constructed Building of ICAI at Sector-62, Noida

We would like to inform you that some sections/committees which were earlier housed in Institute's Head Office, I.P. Marg, New Delhi and its rented premises at Sector-58, Noida have been shifted to its new premises at Plot No. A-29, Sector-62, Noida and are functional now. The details of Committees/Sections shifted and their contact numbers are as under:

Sl. No.	Name of the Section/Committee	Ph.No.	Sl. No.	Name of the Section/Committee	Ph.No.
1	Board of Studies	0120 -3045902	9	Internal Audit Standards Board.	0120 -3045949
2	Auditing & Assurance Standards Boards	0120 -3045920	10	Committee on International Taxation	0120 -3045923
3	Committee for Capacity Building of CA Firms & Small and Medium Practitioners.	0120-3045952	11	BOS Store.	0120 -3045943
4	Continuing Professional Education Committee	0120 -3045957	12	Peer Review Board	
5	Direct Taxes Committee	0120-3045922	13	Regional Branch Affairs	
6	Committee on Financial Markets & Investor's Protection	0120-3045915	14	HRD Administration	
7	Editorial Board	0120-3045926	15	Committee on Management Accounting, IFRS Group	0120 -3045910
8	Indirect Taxes Committee.	0120 -3045906	16	Committee on Public Finance & Govt. Accounting	0120-3045950

The Address of the new location is under:

The Institute of Chartered Accountants of India
"ICAI Bhawan"
Plot No- A- 29, Sector- 62,
NOIDA
Dist: Gautam Budh Nagar
Uttar Pradesh
PIN- 201309



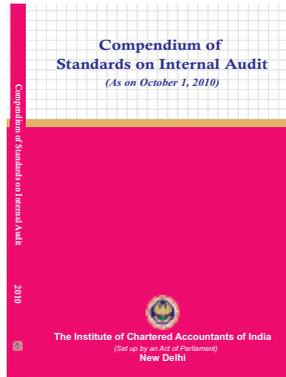
New Publication Internal Audit Standards Board

Compendium of Standards on Internal Audit (As on October 1, 2010)

(Pages: 180 + 10 initial pages + 2 cover pages)

Price: ₹300/- (including CD)

Quality is the cornerstone of internal audit and will require an even greater focus in today's environment as internal audit functions will be more intensively scrutinised by stakeholders. The best way for internal auditors to enhance their value is to ensure that they adopt the best practices and processes in carrying out internal audit engagements. Standards on Internal Audit issued by the Internal Audit Standards Board of the Institute focus on the principles to be followed, the objectives to be achieved and the essential considerations for the internal auditor in planning, conducting, documenting and reporting on internal audit. The Standards represent the basic principles of the practice of internal audit and establish the basis for evaluation of internal audit performance. This updated edition of Compendium contains text of all the seventeen Standards on Internal Audit issued till date including the latest in the tally, i.e., SIA 17, "Consideration of Laws and Regulations in an Internal Audit".



Significant Features of the Compendium are:

- Contains the text of all the 17 Standards on Internal Audit as well as the Framework and the Preface.
- Contents of each Standard given at the beginning for quick reference and overview.
- Availability of technical literature in internal auditing at one place.
- One stop reference for members as well as all professionals and academicians.

This Compendium of Standards on Internal Audit comes with a CD of the entire material to ensure ease of reference and reusability.

Ordering Information:

The publication can be obtained from the sales counter at the Head Office or at the Regional Offices of the Institute. Copies can also be obtained by post. To order by post, send a demand draft for the amount of price of the publication (add the charges indicated below for the desired mode of delivery) in favour of the "The Secretary, The Institute of Chartered Accountants of India, New Delhi", payable at New Delhi, to the Postal Sales Department, the Institute of Chartered Accountants of India, A-29, Sector -62, Noida - 201309 - (U.P.).

Postal Charges:

By Courier:	Within Delhi:	₹ 20 /-
	Rest of India:	₹ 25 /-
By Registered Parcel:	Within India:	₹ 36 /-

**Office Of The Comptroller And Auditor General Of India
10, Bahadur Shah Zafar Marg, New Delhi – 110 124**

Empanelment of Chartered Accountant firms for the year 2011-2012.

Applications are invited **online** from the firms of Chartered Accountants who intend to be empanelled with this office for the year 2011-2012 for appointment as auditors of Government Companies/Corporations. The format of application will be available on our website: www.cag.gov.in from 1st January 2011. Chartered Accountant firms can apply/update the data showing the status of the firm as on 1st January 2011, till 31st March 2011 and generate online acknowledgement letter for the year. Only firms who have generated online acknowledgement letter for the

year 2011-2012 will be considered for empanelment.

Any changes in the constitution of the firm occurring after the cutoff date of 1st January 2011 should continue to be updated by the CA firms in the website which will be available throughout the year. However, the changes in the firm occurring after 1st January 2011 till the time of preparing the panel that will lead to a reduction in the rank of the applicant firm shall only be taken into account for ranking the CA firms.

**Sd/-
Director General (Commercial)**

CPE

12

Hours

Residential Refresher Course on Banking, Insurance and Pension at Amritsar

Organised by: Committee on Banking, Insurance and Pension
Hosted by: Amritsar Branch of NIRC of ICAI

Date & Time	Venue
21 st , 22 nd and 23 rd January, 2011 (Programme will be commence at 11.00 a.m. on January 21, and conclude at 3.00 p.m. on January 23)	Hotel Comfort Inn at Amritsar
Theme	
The Programme is aimed to equip members of the Institute to play a proactive role in banking, insurance and pension sectors and to expand professional opportunities therein.	
Topics to be Discussed	
(i) Insurance Sector – A Rising Era of Professional Opportunities for CAs	
(ii) Risk Management in Banking and Financial Services	
(iii) Audit of Entities involved in Insurance Business	
(iv) Issues in Bank Branch Audit	
(v) Insurance Survey and Loss Assessment	
(vi) An Elucidate on New Pension System	
(The programme will have local site seeing opportunities as well)	
Programme Chairman CA. C.S. Nanda, Chairman Committee on Banking, Insurance and Pension ✉: cobip@icai.org ☎: 011- 30110566	Programme Co-ordinator CA. Sanjeev Gupta, Chairman Amritsar Branch of NIRC of ICAI ✉: amritsar@icai.org ☎: 9814053191
For Registration and Further Details:	
Sr. Executive Officer, Committee on Banking, Insurance and Pension ICAI Bhawan, Indraprastha Marg, New Delhi – 110 002 ☎: (011) 30110566, ✉: cobip@icai.org , www.icai.org	

Classifieds

4829 Delhi based Chartered Accountant firm looking for practicing Chartered Accountant having 2-3 years experience to merge with the firm for mutual benefits. Firm willing to open branch in Bangalore. Freshly qualified chartered accountants holding COP may also apply. Please contract: vkverma@vkvermaco.com

4830 CA Firm with offices at Chennai and Madurai, one partner of 40 years experience and one partner of 10 years experience with DISA /CISA/ DRM qualifications, looking for merger with firms based at Mumbai/Delhi. Contact subbu@sify.com /9442258724

TRAINING WORKSHOPS ON AUDIT EXCELLENCE

24 CPE
HOURS

Organised by the Auditing and Assurance Standards Board

The Auditing and Assurance Standards Board of the Institute is organising *Training Workshops on Audit Excellence* to impart in depth knowledge on implementing the new/revised Standards on Auditing issued by the ICAI under the Convergence and Clarity Project in the recent past.

After successful completion of the Training Workshops at New Delhi, Chennai, Mumbai and Kolkata in December, 2010, the Board is now organising these Workshops in the following cities in January, 2011:

- Jaipur: January 12, 13, 15 & 16, 2011
- Pune: January 27 to 30, 2011
- Indore: January 22 to 25, 2011
- Hyderabad: (dates to be announced soon)
- Bangalore: (dates to be announced soon)
 - ✓ Practical case study-based approach
 - ✓ Interactive classes
 - ✓ Professionally developed reading material

Workshop highlights

Will also include industry specific Standards on Audit implementation issues e.g. Bank audit, Audit of PSE's etc.

Trainers

Senior and experienced members from the profession as well as faculty from reputed academic Institutions

Duration

Four days with six hours of technical sessions in each day

Participants

Maximum fifty per workshop

Fees

₹5000/- per participant (includes cost of reading material and lunch, Tea etc.)

Registration will be strictly on first come first served basis.

Workshop structure



Topics Covered:

- Basic concepts of Assurance Engagements (Framework for Assurance Engagements and SA 200)
- Terms of Audit Engagement (SA 210)
- Engagement Planning (SA 300)
- Risk Assessment Procedures (SA 315)
- Risk Assessment
 - Fraud Considerations (SA 240)
 - Laws and Regulations (SA 250)



Topics Covered:

- Materiality in Audit Planning & Performance (SA 320)
- Evaluation of Misstatements (SA 450)
- Evidence Gathering-I
 - Audit Evidence (SA 500 & SA 501)
- External Confirmation (SA 505)
- Analytical Procedures (SA 520)
- Audit Sampling (SA 530)
- Accounting Estimates (SA 540)
- Related Parties (SA 550)
- Subsequent Events (SA 560)
- Going Concern (SA 570)



Topics Covered:

- Risk responses (SA 330)
- Initial Engagement Considerations (SA 510)
- Management Representations and Communications with Management (SA 580, SA 260 & SA 265)
- Using Work of Others (SA 600, SA 610 & SA 620)
- Documentation (SA 230)



Topics Covered:

- Audit reporting (SA 700, SA 705, SA 706, SA 710 & SA 720)
- Quality Control of Audit (SQC 1)
- Additional Reporting Requirements (CARO, 2003)
- Industry Specific Audit Issues:
 - Bank Audits
 - Audit in Public Sector Enterprises
- Specific Audit Issues
 - Implementing auditing standards in smaller audit clients

For further details please contact:

CA. Puja Wadhwa, Secretary, Auditing and Assurance Standards Board at 93507 99938/ 0120-3045920

Email: auditworkshop@icai.org

NATIONAL SUMMIT ON NETWORKING & CAPACITY BUILDING OF CA FIRMS

Organised by :
Committee for Capacity Building of
CA Firms & Small and Medium Practitioners, ICAI

Hosted by:
Western India Regional Council of ICAI

Do you desire to expand the size of your practice..... ?

Are you planning to strengthen the capacity of your Firm.....?

Are you looking at expanding your reach to business clients across the Country.....?

If yes, then Networking could be the solution. The expectations of today's users are that of – *'Expertise, Experience & Efficiency'*. Networking enables professionals to provide Multi-location services through a 'Single Window', which is the need of the hour. Networking can expand your business opportunities exponentially and take you to the next orbit of professional practice.

In order to facilitate members to meet, interact & identify partners for forming Networks, the Committee for Capacity Building of CA Firms and Small & Medium Practitioners (CCBCAF&SMP) has organized this unique Networking Summit where like-minded peers may initiate collaborative approach to expand their professional opportunities. It will provide visionary keynote sessions on the practical aspects of capacity building measures and foster a productive networking environment for interested members. Do not miss this opportunity to network, establish connections, exchange ideas and gain knowledge.

TOPICS OF THE SUMMIT

- ◆ **Need for Capacity Building**
 - Scope, Objective, Deliverables, Advantages, Disadvantages, Opportunities.
- ◆ **Practical aspects of Networking**
 - Scope, Objective, Experience, Success Stories, Do's & Don'ts, Advantages, Disadvantages.
- ◆ **Practical aspects of Merger & Corporate Form of Practice**
 - Scope, Objective, Experience, Success Stories, Do's & Don'ts, Advantages, Disadvantages.
- ◆ **Open Networking Session**
 - Face to Face interaction amongst Members/Firms for Networking & Merger

**6 CPE
Hours**

Day & Date	: Saturday, 22 nd January, 2011.
Time	: 9:30A.M. to 5:30P.M.
Venue	: Hotel Kohinoor Continental, Andheri Kurla Road, Andheri (E), Mumbai
Registration Amount	: Rs. 1000/- per participant. (Remit cheque in favour of WIRC of ICAI)
Program Director	: Chairman, CCBCAF & SMP, ICAI Mobile No.-09821119043
Program Coordinator	: Secretary-CCBCAF&SMP, ICAI, New Delhi Mobile No.-09350799922 Tel: 0120-3986945-952, E-mail: ccbcaf@icai.org
For Registration and further details, please contact	: Deputy Secretary, WIRC of ICAI, Mumbai Mobile: 09321239892, Tel: 022-39802952

***Participants may visit www.caconnect.co.in to identify firms & members for Networking. Tablespace will be provided in the Summit for one to one meetings among the members.**

CROSS

WORD | 055

ACROSS

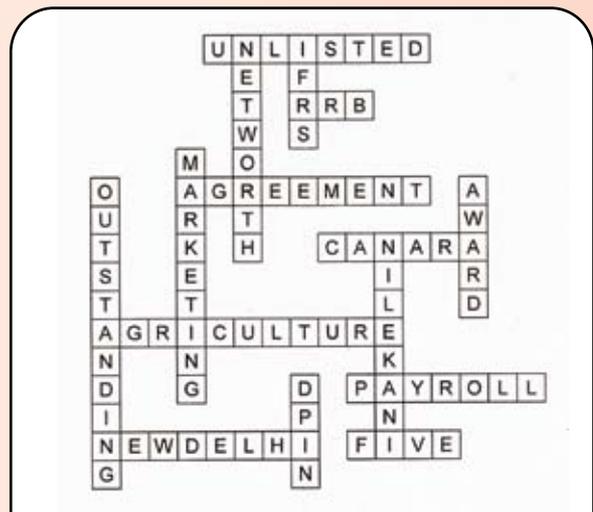
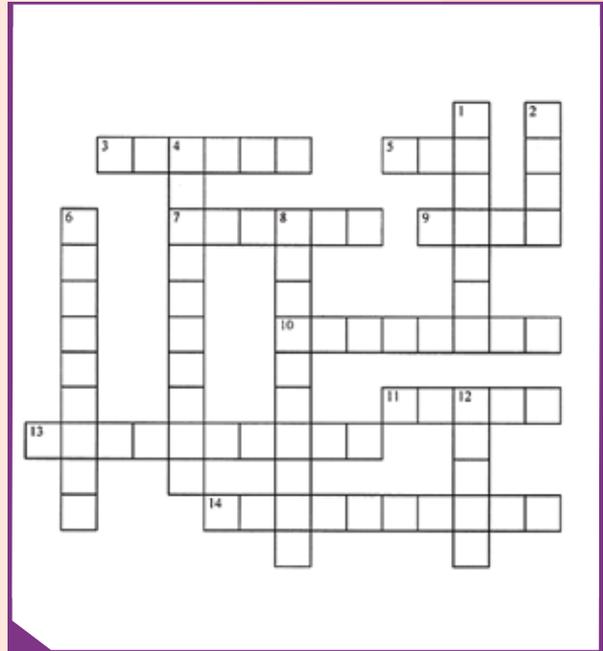
3. The amount raised by issue of the Infrastructure Bonds by Infrastructure Finance Companies will not be treated as '_____ Deposit' within NBFCs Acceptance of Public Deposits (Reserves Bank) Directions, 1998. (6)
5. Appeals would not be filed by the CBEC in High Courts in cases where the duty involved or total revenue including fine or penalty is ₹ _____ lakhs and below. (3)
7. The opportunity cost is often measured as the Contribution _____ that is being foregone. (6)
9. First single lump-sum investment amount received by the portfolio managers should not be less than _____ lakhs. (4)
10. SEBI has recently allowed introduction of _____ Style Stock Options in India. (8)
11. As per revised Section 44AE of the Income-tax Act, 1961 the presumptive amount of income arising from _____ vehicles is ₹ 5,000 per vehicle for every month or part thereof. (5)
13. Name of the Past President of ICAI who addressed the 300th meeting of the Council held recently. (1,9)
14. When a company has a limited number of machine hours available, the number of machine hours is often referred to as a _____. (10)

DOWN

1. A _____ is merely a trustee of the deceased's property, asset or estate. (7)
2. When examining the future cash flows, it is critical to consider the _____ value of money. (4)
4. Chairman of the Committee constituted by the SEBI to Review Ownership and Governance of Market Infrastructure Institutions (MII). (5,5)
6. A street in Tamil Nadu where our _____ branch is situated has been named as ICAI *Salai* (road). (9)
8. SEBI has clarified that while computing the 50 per cent shareholding of non-promoters in demat form in a company, the _____ holding in non-promoter category may be excluded. (10)

Note:

Members can claim one hour – CPE Credit – Unstructured Learning for attempting this crossword by filling the details in the self-declaration form to be submitted to your regional office annually to avail CPE hours credit for Unstructured learning activities under the activity 'Providing solutions to questionnaires/puzzles available on Web/Professional Journals'. There is no need to individually send this crossword in hard copy or email.



SOLUTION Crossword 054



- 1 Two friends, who had lost contact for many years, were catching up with each other. One asked, "So, you've got your own company, huh? How lucky!" The other replied, "Just a small one, nothing to be proud of." Disbelieving, the first queried, "Small? How many people work in your company?"

The other sadly answered, "About half of them."