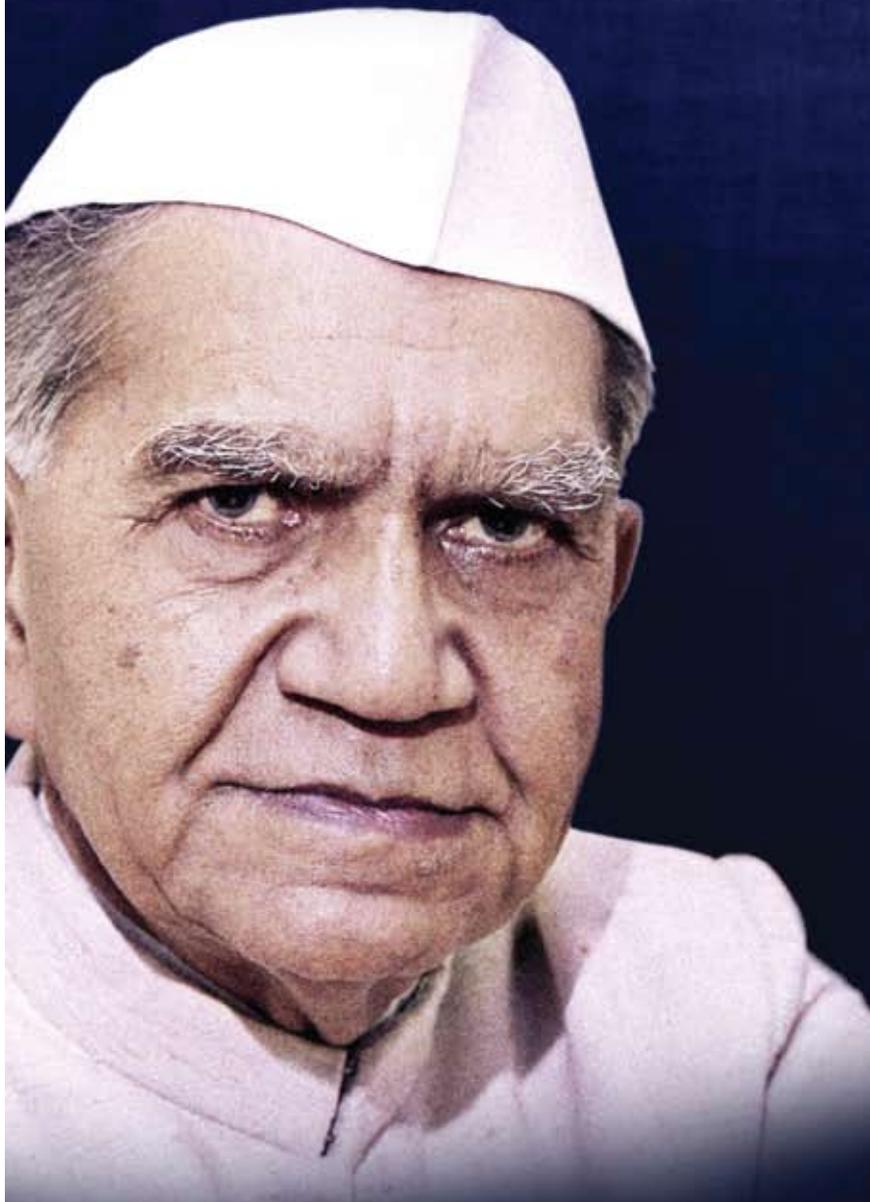




THE CHARTERED ACCOUNTANT JOURNAL

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
SET UP BY AN ACT OF PARLIAMENT



“ The Chartered Accountants by virtue of their qualifications, experience and training can render valuable services in these difficult times in areas which are vital to economic growth. It should be the duty of the members of the profession in the present context to approach problems in an objective and pragmatic manner. Apart from examining accuracy of transactions, the modern auditor should also look into the propriety of such transactions... the profession has to develop uniform accounting principles, standard terminologies and precise definitions of various accounting concepts. This was desirable from the point of view of providing reliable information in the financial statements for the benefit of the intending investors, members of the public, government agencies and financial institutions. This will enable individuals and organisations to form a fairly accurate judgement of the financial position by a study of audited financial statements of companies. ”

Dr. Fakhruddin Ali Ahmed
5th President of India (1974-77)

(At the inauguration of first-ever Commonwealth Conference of Accountants held in New Delhi from 6th to 8th February, 1975)

Budget 2012-13 and Challenges of Indian Economy

As the saying goes, *economy is the method by which we prepare today to afford the improvements of tomorrow*. This saying has been successfully lived by India in the past decade. The \$1.3 trillion Indian economy, with strong savings, remains irrefutably robust even in present times of global slump. It continues to march ahead on the path of progress at a rate of around 7% even in the face of formidable challenges. According to top policy makers of the country, our economy will probably expand 7.5% for the year ending 31st March, 2012. Several recent economic reports glowingly predict that by 2013 to 2015, India will start outpacing China's annual GDP growth rate. However, the instant dream is to take the country into a double-digit growth trajectory. And this dream is quite realisable, provided India unleashes its full potential and dares to challenge the challenges which have been restricting its growth engine from going full throttle. And there are some encouraging signals to this effect. Foreign direct investment into India has gone up by an impressive 56% to \$2.53 billion recently, signaling improvement in investor sentiment.

However, Indian economy may have to walk a tight rope this year. There are some immediate concerns to be taken care of, viz. to keep growth rate high and inflation rate and fiscal deficit low. Towards that end, it is high time that a number of investor-friendly policies are unveiled to nudge the entrepreneurs to invest more. Driving investments has to be a key area of priority with focus on measures for sectors such as infrastructure and others that benefit agriculture and employment generation.

But the main challenges of our economy are to achieve 'inclusive growth' and eliminate 'economic inequalities'. As many as 37% population in India live below the poverty line, says the Tendulkar Committee report. According to a World Bank estimate, 41.6% of India falls below the international poverty line of \$ 1.25 a day. Generally, our economic progress has not touched the lives of our rural poor, the way it should have.

High level of illiteracy, with about 35% of Indian women still not able to read or write (as per the provisional 2011 census), is another big challenge. Shortage of skills required for sustained growth is yet another daunting challenge. Increase in students entering the higher education is merely 5%, i.e. from 12.5% in 2007-2008 to 17.27% in 2009-2010. Government has identified a skills gap in between 240 to 250 million persons in the next ten years. Current vocational and technical training schools unfortunately only have the capacity to absorb 1.1 million students a year.

Poor infrastructure with a huge number of families lacking basic amenities is another grey area which calls for urgent attention. Infrastructure sector, which has a multiplier effect on the economy, is also under serious strain with reducing investments in research and development. Shortage of long-term funds for the infrastructure projects also needs to be addressed more effectively.

Our budget deficit limits the scope for increasing investment in public services like health and education. The Centre has pegged the fiscal deficit target for 2011-2012 at 4.6% of GDP but in view of current estimates fiscal deficit can be on the higher side. So, in order to make substantive further fiscal correction this year, the government has to put in even more effort than it had assumed it needed to. So, while raising a toast to economic resilience in the past, the government would do well to tighten its belt a little harder in the present.

What is needed is to seriously heed to the issues related to regulation and moving more quickly on long-delayed business reforms by introducing new or changing existing corporate governance norms, an area on which Corporate Affairs Minister Dr. M. Verappa Moily is actively working on. We in India need reforms that can actually raise our sustainable long-term growth rate. These have to come in areas like better targeting of subsidies, making projects in infrastructure viable so that they attract capital, raising the productivity of agriculture, improving healthcare and skill-creating education, bringing the parallel economy under the tax net, implementing fundamental reforms in taxation like GST and the Direct Tax Code and finally easing the myriad rules and regulations that make doing business in India difficult besides eradicating corruption.

Meanwhile, agriculture and allied sectors, which contribute about 15% of India's GDP and play an increasingly important role in the all round development of the country, are also under the scanner this fiscal. It is welcome that India has taken effective efforts to achieve complete food security to prop up rural economy.

Mr. Montek Singh Ahluwalia, Deputy Chairman of Planning Commission, rightly says that the growth of an economy depends upon three main factors: availability of capital, availability of appropriately skilled labour, and productivity of the economy to convert labour and capital into final products.

It is hoped that Union Budget 2012-2013 will take all these complex challenges in stride and help propel India into double digit growth with all inclusive growth, stable prices, improved infrastructure, more and more skilled workforce, a more rationalised tax regime and better fiscal discipline and consolidation. And to help our Government's efforts to this effect, our basic credentials remain high. Indian economy is, in many ways, better placed than many other nations to withstand global economic turmoil. India's resilience results from the fact that the bulk of India's GDP is domestic demand driven.

Even though Budget 2012-2013 may not be a panacea, it will set the outline for the economy for the near future. The country expects the Budget 2012-2013 to make the impact India needs.

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

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DELHI: No.7, 1st Floor, Nizamuddin (West) Market. New Delhi-110013. Tel: +91 (11) 4669 9999.

BENGALURU: Old No. 583, New No. 9, Sri Manjunatha Krupa, 80 Feet Road, 3rd Cross, Opp. Koramangala Police Station, Bengaluru-560095. Tel: +91(80) 4161 8966/77.

KOLKATA: 206-Jodhpur Park, Kolkata - 700068. Tel: +91(33) 2473 5896. Telefax: +91(33) 2413 7973.

CHENNAI: AKS Pooja Complex, 2nd Floor, Old No: 203 New No: 154, R. K. Mutt Road, Mandavelli (Next to Jagan Mohan Clinic), Chennai-600028.

HYDERABAD: H.No: 8-2-684/3/R/1&2, Flat No: 304, Alankrith Apts, Gulmohar Avenue, Rd No: 12, Banjara Hills, Hyderabad. Tel.: +91 9676666691.

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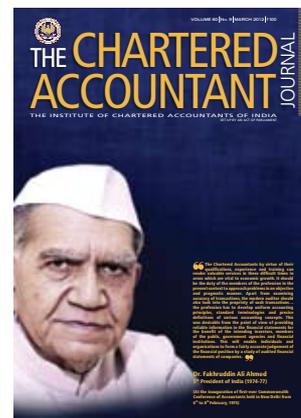
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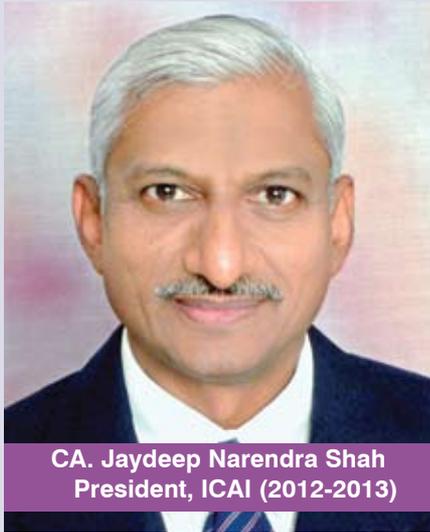
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CA. Jaydeep Narendra Shah
President, ICAI (2012-2013)

A man of efficiency and discipline and a combination of intellect, prudence and professional excellence, CA. Jaydeep Narendra Shah has become the supreme torch-bearer of Indian accountancy profession as the President of Institute of Chartered Accountants of India (ICAI) for the year 2012-2013. Having a deep-rooted interest in academic discipline, he has been a fellow member of the ICAI with more than 24 years of standing and an outstanding track record of constant and dedicated service to accountancy profession. He was elected as the President of the ICAI by the 21st Council of the Institute on 12th February, 2012. Bestowed with exceptional organisational and administrative skills, he was serving as the Vice President of the ICAI for the year 2011-2012. A man of his word with a penchant for hard work, he has always dazzled his fellow members with his altruistic and selfless service to the profession that he has been serving since 1987 with an inextinguishable enthusiasm.

CA. Jaydeep Narendra Shah has shown his professional skills and acumen in all tasks and responsibilities assigned to him both at the international, national and Council level. A resident of Nagpur, Maharashtra, CA. Shah started his illustrious professional journey as member of the Nagpur Branch Managing Committee in 1991 and went on to record his magnetic presence in the Western India Regional Council of the Institute in 1995 and, then, in the Central Council of the Institute for three terms since 2004.

An ardent proponent of 'brand Indian CA' and accountancy profession globally, CA. Shah is also currently a member of International Accounting Education Standards Board (IAESB) of International Federation of Accountants (IFAC) for the period January 2012 to December 2014 besides being on the board of the Confederation of Asian and Pacific Accountants (CAPA) and a member of CAPA Sub Committee on Environmental Accounting. He is also an elected member of the Nominations Committee of XBRL International for the period October 2011 to October 2013 in addition to being a member of Asian Oceanian Standard Setters Group. He has also been nominated on South Asian Federation of Accountants Assembly (SAFA) and the SAFA Board.

At the national level, he has been an outstanding facilitator of ICAI as 'Partner in Nation Building'. As such, he has been nominated on 'Central Direct Taxes Advisory Committee' constituted by the Central Board of Direct Taxes, and on 'Regional Direct Taxes Advisory Committee.' He is also a member of 'RBI Sub-Committee (Audit) of the Board for Financial Supervision,' Reserve Bank of India's 'Working Group to Study the Scope and Effectiveness of Concurrent Audit in Banks,' 'Working Group constituted for addressing implementation issues and formulation of operational guidelines in the context of IFRS convergence for banks and NBFCs in India,' 'Working Group to review the norms for empanelment of statutory auditors in public sector banks,' and 'Task Force for Working Groups of G20'. He also represents the ICAI in the 'Insurance Advisory Committee' constituted by the Insurance Regulatory and Development Authority (IRDA), and in 'High Level Steering Committee for Implementation of XBRL-based Data Submission by Banks.' CA. Shah is also the Chairman of XBRL India.

Under the Ministry of Corporate Affairs, CA. Shah is a member of 'National Advisory Committee on Accounting Standards,' 'Working Group for matters related to trade in accounting, book-keeping and

OUR NEW PRESIDENT

auditing services and other related issues,' 'India-UK (Indo-UK) Task force on Corporate Affairs,' 'Task Force in regard to the Plan Budget of the Ministry of Corporate Affairs for the 12th Five Year Plan,' 'Working Group in the areas of Corporate Governance, Corporate Social Responsibility and other aspects of Corporate Affairs' (in connection with Agreement inked by MCA with the Ministry of Economic Affairs, Agriculture and innovation of Netherlands on Corporate Governance and Corporate Social Responsibility) He is also a member of Indian Team under India-UK Accountancy Task Force.

A thorough professional, CA. Jaydeep Narendra Shah has also been nominated on 'Audit Advisory Board,' 'Government Accounting Standards Advisory Board (GASAB) for Union and the States,' and Audit Boards for conducting performance audit of 'Corporate Social Responsibility of the PSUs in Steel Sector covering issues of safety, environment, fraud and corruption and ethical practices' and performance audit of 'Fund Management and Special Purpose Vehicles of Power Finance Corporation and Rural Electrification Ltd,' of C&AG, besides being on the 'Committee on Internal Audit' constituted by the Office of Controller General of Accounts.

He has also been nominated on the 'Advisory Body (Ad-hoc Task Force (ATF)) for finalising the MoU between Administrative Ministries and the Managements of the PSEs' constituted by the Ministry of Heavy Industries and Public Enterprises besides being on the 'Task Force of Department of Public Enterprises to provide professional and technical support to DPE in the process of finalisation of MoU documents.' He is also representing the Institute on the 'Advisory Committee on Mutual Funds' constituted by Securities & Exchange Board of India, 'Governing Body of the National Institute of Public Finance And Policy,' and in the 'High Level Committee' constituted by Ministry of Finance's Department of Economic Affairs for the G20 issues alongwith Inter-ministerial Meeting on G-20. He is also a member of 'Panel of Experts on Reforms in Central Public Sector Enterprises constituted by Planning Commission.

A seasoned professional, he is Director (Ex-Officio) of the Accounting Research Foundation of the Institute of Chartered Accountants of India besides being a member of the ICAI-IFRS Task Force of the Institute. He has been actively involved with the functioning of the Central Council of the Institute in various capacities, viz. as Vice President and Chairman, Vice-Chairman and member of its various Committees. As President, he is the chairman of all the standing committees of the ICAI viz. Examination Committee, Finance Committee and Executive Committee besides being Presiding Officer of the Board of Discipline (under Section 21-A), Disciplinary Committee (under Section 21-B), Disciplinary Committee-Satyam Bench (under Section 21-B) and chairman Disciplinary Committee (under section 21D). He is the ex-officio Member in all the Non-Standing Committees of ICAI and Editor of *The Chartered Accountant* journal.

He is also leader of Coordination Committee with Sister Institutes. Presently, he is also Chairman of International Affairs Committee, Public Interest Advisory Committee and Vision and Perspective Planning Committee and Co-ordination Committee with Sister Institutes. Earlier, he has also been the Chairman Board of Studies for years and also Chairman for Committee for Commerce Education & Career Counseling, Ethical Standards Board, HR and Administration Committee and Financial Reporting & Review Board. He has also served as Vice-Chairman of the Committee for Financial Market and Investor Protection, the Peer Review Board, the Committee on Information Technology and Capacity Building and Small & Medium Practitioners Committee.

Before being elected to Central Council, CA. Shah served at various Committees of the Western India Regional Council of ICAI for nine years (1995-2004) in various capacities, including as the Vice-Chairman of WIRC of the ICAI for the year 1997-1998. He was also a member of Managing Committee of Nagpur Branch of WIRC of ICAI during 1991-1995 and served as its Secretary for 1991-1992, 1992-1994 and Chairman for 1994-1995.

As an avid academic, CA. Jaydeep Narendra Shah has attended and contributed to numerous national and international seminars and conferences on the issues of professional interest including on E-learning initiatives of ICAI at International Innovation Network's conference in Hong Kong, on Initiatives on Education for Chartered Accountancy Course at International Conference in Dublin, Ireland, and in the International Conferences held on Investment Strategies and Networking of firms in Nepal, showing his passion for the profession and its core concerns.

Having been a student of thorough merit and brilliance, CA. Jaydeep Narendra Shah had secured first rank in M. Com in the Nagpur University. He, therefore, was awarded P Satyanarayanan Gold Medal and an Award from the Jawaharlal Nehru Memorial Fund. He passed B.Com from Nagpur University Standing 8th in the order of Merit and has also been a recipient of Government of India Open Merit Scholarship. He has also been a member of Board of Studies, Accounts and Statistics Board of Nagpur University for three years, and a visiting faculty to 47th IRS batch in National Academy of Direct Taxes. ■



OUR NEW VICE PRESIDENT

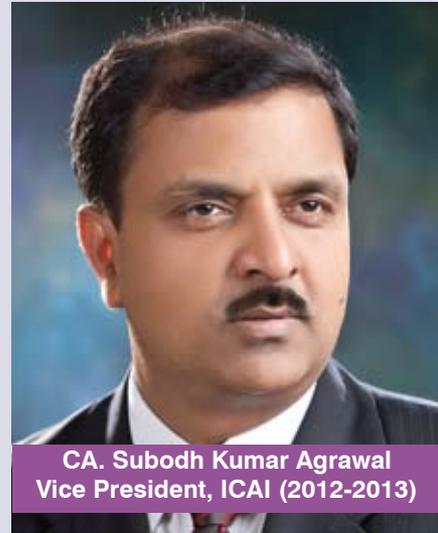
A combination of erudition, foresight and professional excellence, CA. Subodh Kumar Agrawal has become the Vice President of the Institute of Chartered Accountants of India (ICAI) for the year 2012-2013. A fellow member of the ICAI with 23 years of standing, he was elected as the Vice President by the 21st Council of Institute on 12th February, 2012. An altruistic hard-worker bestowed with exceptional organisational, networking, administrative and leadership skills, he has been serving as Central Council member for two terms since 2007. An illustrious and versatile accountancy professional since 1988, he is known for his passion for professional uplift.

Hailing from Kolkata, he has specialisation in the area of Internal and Statutory Audit of Private and Public Sector Entities viz. Banks and Insurance Companies. He has also been providing Consultancy Services in the fields of Accounting & Auditing, particularly matters relating to Indian and International Auditing and Accounting Standards, Corporate Laws, Corporate Governance, Restructuring of Business - Mergers, Amalgamations, Demergers, SEBI and NBFC Matters, etc.

Having passionately represented Indian accountancy profession on the international front, he has been nominated on the 'Committee on Professional Ethics and Independence' of South Asian Federation of Accountants (SAFA). Besides, he has also been an ICAI nominee on various Committees of SAFA, including Committee for Improvement in Transparency, Accountability and Governance, Committee on Professional Accountants in Business and Committee on Quality Control Review. He has also put forward Indian accountancy profession's views in the meetings of International Ethics Standards Board for Accountants of IFAC at New York and its International Standards Setters meeting at Toronto.

An outstanding facilitator of ICAI and accountancy profession as a leading partner in nation building, he has been nominated on the 'Working Group' constituted by the Competition Commission of India and on 'Committee of Experts' constituted by the Ministry of Corporate Affairs to prepare a fresh Inspection Manual. He also represents ICAI in the 'Standing Committee on Accounting Issues' constituted by Insurance Regulatory and Development Authority and in the 'Committee to review SIDBI's lending to MSME Sector.' Presently, he is also a member of the 'Task Force of Department of Public Enterprises (DPE)' to provide professional and technical support to the DPE in the process of finalisation of MOU documents. Earlier also, in 2008, he was appointed as Task force Member by Department of Public Enterprises for MoU in Mining and Metal Sector and in the year 2009, he was appointed as Task Force Member by Department of Public Enterprises for Petroleum - II. He has also commendably performed as member of Banking and Financial Services Sectional Committee - MSD 7 constituted by Bureau of Indian Standards, Regional Advisory Committee of Central Excise Commissionerate, Technical Group on Institution & Market Structure of the Committee on Financial Sector Assessment constituted by RBI, and member of SEBI Primary Market Advisory Committee. He is also an Independent Director in 'M/s Gujarat NRE Coke Ltd'. and 'Accounting and Research Foundation' (ARF) of the ICAI.

A seasoned professional with a futuristic vision, CA. Subodh Kumar Agrawal, in his illustrious inning in Council, has served the profession holding important positions in both Standing and Non Standing committees of the ICAI. As the Vice President of the ICAI, he is Vice-chariman of all the Standing Committees and also the Member



CA. Subodh Kumar Agrawal
Vice President, ICAI (2012-2013)

ex-officio in all Non-standing Committees of ICAI and Joint Editor of *The Chartered Accountant* journal.

He has made noteworthy contributions in whatever capacities he served the profession, particularly as Chairman 'Committee for Members in Industry (2010-2011), Audit Committee (2008-09), Public Finance Committee (2008 and 2009) and as a member of Executive committee of ICAI (2007). He has also distinctly served as Convenor the group for Satyam Report - High Powered Committee (2010-2012).

During his years in ICAI Council, he has also remarkably contributed as Chairmen of Committee for Member in Industry and Ethical Standard Board and member in various Non-Standing Committees such as Accounting Standards Board, Auditing and Assurance Standards Board, Direct Taxes, Indirect Taxes, International Taxation, etc.

Before his election to the Central Council of the ICAI, CA. Agrawal has also made wide contributions in Eastern India Regional Council as he became the Secretary of the EIRC of ICAI in 2004, Vice Chairman in 2005 and then its Chairman in 2006. It was under his dynamic chairmanship that Eastern India Regional Council was honoured with 'Best Regional Council award' in the year 2006.

Known for his hard work and selfless service to the accountancy profession, CA. Subodh Kumar Agrawal is also a prolific speaker and has addressed various seminars, symposia and conferences at national, regional councils, branches and ICAI Study Circles level across the country on various issues of professional interest. He has also addressed other organisations of national and international repute on topics like Bank Audit, Corporate Governance, Micro Finance, NGO, Derivatives, Right to Information Act, CAAT, CARO, Accounting Standards, Auditing Standards and LLP, etc.

Having been a brilliant student, CA. Subodh Kumar Agrawal secured 10th rank in Final examination of Chartered Accountancy in the year 1988. He did B.Com (Hons) from Kanpur University.

His other areas of interest include sports and reading management and professional books. ■



CA. Jaydeep Narendra Shah, President, ICAI

Dear friends,

The only thing that is never-changing is the change itself. And every change offers a new beginning. This is the eternal phenomenon that encompasses everything — our profession and the ICAI included. As the ICAI enters a new Council Year, the baton of profession's leadership has changed hands too. And at the forefront of this change in the realm of our profession, I humbly salute you as the new President of the ICAI. As the saying goes, a beginning is only the start of a journey to another beginning. As I begin my new role as 60th President of the Institute, I wish that the profession makes a new beginning too — a new beginning with renewed vigour and thrust to reach the pinnacle of global glory. A journey of a thousand miles begins with a single step. So, join me in taking that first step together and rededicate ourselves to promote professional excellence and opportunities to conquer these challenging times.

It is an immense honour to serve as President of ICAI, particularly in view of the long glorious history of our organisation and examples of the distinguished former Presidents. I bow to the Past Presidents for their efforts in bringing the profession to its present stature.

I am particularly indebted to the immediate past-President CA. G. Ramaswamy, whose able guidance greatly boosted my experience and abilities to take on future challenges. I humbly acknowledge that I have learnt a lot from CA. Ramaswamy, who has been truly a 'Friend, Philosopher and Guide' to me all through the last year. Working with him as the Vice-President gave a good exposure to the critical challenges concerning the profession.

I am extremely grateful to all the members, my colleagues in Central Council, my family members and other well-wishers, including those from my hometown Nagpur, for reposing faith in me for leading the glorious forward march of our esteemed profession.

As I carry the baton of presidency, I promise not to let you down, particularly when it comes to upholding the interests of the profession and the nation. Enthused and honoured by the words of praise for our profession by the Minister of Corporate Affairs Dr. M. Veerappa Moily and Padma Shri awardee past-Presidents of the Institute, CA. T. N. Manoharan and CA. Y. H. Malegam at the annual function of the Institute, I commit on behalf of the CA fraternity to play our role as '*trustee of stakeholders' interest*' and to continue to render quality services to the society keeping the larger social and national interests in mind. I promise to provide all out support to the '*reform agenda*' of the Minister of Corporate Affairs and look forward to continue getting his visionary guidance as a friend, philosopher and guide to the accountancy profession in India. I undertake to uphold the enormous trust put in our profession by the founding fathers of the nation, and carry forward our tradition of excellence and partnership in nation-building.

Our New Vice-President

I congratulate CA. Subodh Kumar Agrawal on his election as the Vice-President of ICAI and I am fully confident that his rich experience, professional acumen and abilities will greatly benefit the members at large, and also help me in shouldering my responsibilities. I know CA. Agrawal as a dedicated hard-worker bestowed with exceptional organisational and networking skills, and a futuristic vision which is the need of the hour for all of us.

Action Plan 2012-2013

Being the backbone of financial discipline in India and conscience keeper of national economy for decades, our profession has today come to be known as one of the most vibrant forces of socio-economic growth.

Indeed, we have come a long way... but there are still miles to go. As such, as the torch bearer of the profession in our glorious journey of excellence and selfless service, my motto for the year will be '*Inclusive Growth of Professionals and Exhaustive & Exclusive Growth of the Profession*' for the overall growth of our great country. My goal would be to position Indian accountancy and auditing profession globally, and raise the profile of ICAI and brand 'Indian CA' nationally and internationally. To this effect, I will launch a vigorous branding and awareness campaign to enhance public perception of ICAI and professionals affiliated to ICAI. I will go all out to facilitate global and national partnerships, making ICAI as a hub of valued Thought Leadership. Enhancement and empowerment of SMPs is at the core of my '*inclusive-growth*' agenda for this year. I will dedicate myself to the objective of creating enabling framework for Indian firms and professionals to leverage national and global opportunities. One of my primary goals is to encourage and help Indian firms to form limited liability partnerships and multidisciplinary firms to service clients across the whole spectrum of professional services. I will work to enhance the maturity level of XBRL implementation in India and establish ICAI's leadership position in this space. Ultimately, my aim will be to expedite the process of making CAs matchless professionals in the present as well as future — all in terms of skills, knowledge and analytical ability combined with contemporary professional capabilities, integrity, independence, ethics and above all, right attitude. I wish to give impetus to research in areas of contemporary significance and to bring about greater integration of the profession with global imperatives, including Convergence of our accounting standards with IFRS, XBRL, changes in taxation and regulatory regimes, etc. And to this effect, I would like to not only re-emphasise but also re-invigorate and re-invent the ICAI Mission that is '*The Indian Chartered Accountancy Profession will be the valued Trustees of World Class Financial Competencies, Good Governance and Competitiveness*'.

I will devote all my energies to make ICAI and Indian accountancy profession assume leadership position in national, regional and international accounting fraternity. On the regulatory front, I will adapt the regulatory mechanism to changing times and create an institutional mechanism to not only facilitate closer coordination with other regulatory agencies such as the RBI, C&AG, IRDA and SEBI but to also take necessary steps proactively. Besides, I will leave no stone

turned to strengthen infrastructure and technological capabilities to improve engagement with all stakeholders.

While concentrating on the present, we also have to set our sights on the future of the profession, i.e. the students, whose interests have been very dear to me all along my years in the Council, including as Chairman, Board of Studies. To this effect, I will go all out to align Indian accountancy education with the emerging imperatives, in line with global best practices so that our future generations acquire multi-dimensional abilities to counter any challenge. An all-encompassing and experience-rich education, combined with practical training, value-added soft skills and personality development will be my priority. I promise you to revitalise our education and training systems and establish an enabling ecosystem to produce globally competitive accounting professionals. Remember, the best way to be ready for the future is to invent it.

Taking into account all these broader objectives, I have prepared a detailed Action Plan 2012-2013, which has been published elsewhere in this journal. I request all stakeholders to share their views on this and help me implement this action plan in letter and spirit for the larger benefit of the profession because I believe the more we collaborate, the more we achieve.

Felicitation of CA. Y. H. Malegam and CA. T. N. Manoharan

I, on behalf of entire Indian accounting fraternity, would like to particularly congratulate our past President CA. Y. H. Malegam who has been conferred with Padma Shri by the Government of India. A matter of great honour for the profession, it is the third occasion when a past President of the ICAI has been honoured with this fourth highest civilian award of the country—the first two being CA. R.K. Khanna and CA. T. N. Manoharan.

As a mark of respect, we thought our annual function to be a befitting occasion to felicitate CA. Malegam and CA. Manoharan. I am thankful to them for accepting our invitation and grace the 62nd Annual Function of ICAI held recently. I highly regard them as the doyens of Indian accountancy profession and thank them for raising the profile of our profession nationally and internationally. While CA. Malegam's services to the profession as NACAS Chairman have been particularly noteworthy, CA. Manoharan's role in the revival of once-beleaguered Satyam cannot be forgotten in Indian corporate world.

Promising Times for Chartered Accountants

These are exciting yet challenging times for Indian chartered accountants. The year 2012 will be an eventful year for Indian accountancy profession if both external and internal developments are any indication. World economy is in turmoil and is casting its shadow on India, thereby putting the role of CAs in sharp focus. The resilient Indian economy will surely withstand any trouble.

Meanwhile, Indian accounting standards converged with IFRS are likely to be implemented soon. The eXtensible Business Reporting Language is becoming popular by the day across the globe. Further, major reforms are likely to be unveiled—Companies Bill, Goods and Services Tax regime, Direct Tax Code, the Banking and Insurance Bill, the Public Interest Disclosure and Protection to Persons Making the Disclosures Bill, Accountability Bill, etc., are all waiting in the wings. In fact, there is a likelihood that the bill relating to DTC could be clubbed with the Finance Bill, which too will throw many a challenge at us. All these offer plethora of opportunities to the profession in the garb of challenges.

Particularly, India's transition to a new set of accounting standards fully convergent with IFRS will be the beginning of a new era for Indian accounting profession. This is an opportunity for us to showcase our competence to the world. It will offer vast scope for Indian accountants to offer their services globally and we cannot afford to lose this opportunity. And I will leave no stone unturned to ensure that we don't. Together WE CAN. The profession is upbeat and demand of the Chartered Accountants is at an all time high. In this background, it's time for the emerging CA fraternity to see them in the midst of a new boom; a boom of their own. And it is possible, if the members start looking beyond the traditional number crunching and be at ease with technology environment. Our profession is more a matter of innovation today... it means that we have to manage more dynamic macro-economic forces.

The high status for the CAs and growing expectations from them also mean higher responsibilities and pressures on them. With the calls for private sector and governments to be more accountable and transparent getting louder, modern accountant's role is bound to come under frequent scrutiny. Remember, the future belongs to us. These are times to lead by example.

We have to play a leading role in the economic uplift of the nation. The direct relationship between good accounting practices and better economic outcomes is widely recognised.

Working in Unison with Government

As highlighted during the annual function of the Institute, our various stakeholders, including the Government, have indeed very high regard for us, coupled with far higher expectations. *"Innovation should be the word today... We need to build for the future, think of the future which holds highest promise... Your profession is the most sufficient in the world and you will have to take it forward because we should not be just happy with what we have today but what we ought to be tomorrow,"* so said the Chief Guest of our 62nd Annual Function, Corporate Affairs Minister Dr. M. Veerappa Moily in his eloquent, enlightening and encouraging address to us. He added: *The accounting profession is the noblest profession. You are on the right track of building world-class profession in this country and world over. That requires a lot of perseverance, a lot of training and a lot of capacity building... I am a reformist and want ICAI to support my reform agenda. I want ICAI to work out Corporate Governance Policy and play a greater role in building a corporate citizenship in the country.* I completely agree with the views and vision of Dr. Moily and, on behalf of the Council and the CA fraternity, I assure him to proactively work to translate his vision and reform agenda into reality and live up to Government's expectations. I have placed this objective high on my agenda for this year. Besides further improving relationship with corporate sector, I will work with trade and industry associations as well. I thank him for guiding us to serve better, and look forward to his continued support to us. A detailed report of the annual function has been published elsewhere in the journal.

In line with my intention to work in unison with the Government, I, along with CA. Subodh Kumar Agrawal, recently had meetings with the Rajya Sabha Deputy Chairman Shri K. Rahman Khan and the MCA Minister Dr. M. Veerappa Moily, Secretary Shri Naved Masood and Joint Secretary Shri Manoj Kumar, and discussed matters of interest to the profession and the nation as a whole.

Now let's have a look at some other important developments pertaining to the profession over the last month.

International Initiatives

Seminar and Meetings in Bahrain: I, along with my predecessor CA. G. Ramaswamy, recently attended a seminar on “Emerging Opportunities and Challenges” in Bahrain. Coinciding with the event, we had a meeting with the Minister of Finance Sheikh Ahmed Bin Mohammad Al Khalifa and Minister of Industry & Commerce Dr. Hassan Abdulla Fakro in which we gave an account of the role played by ICAI within and outside India.

IFAC-International Donor Community Meeting: I am happy to inform you that we, jointly with Institute of Cost Accountants of India, recently hosted inaugural Steering Committee meeting of the IFAC-International Donor Community MOSAIC MOU at Jaipur. The meeting was attended by officials of World Bank and other important donor communities.

Initiatives for Members

Empanelment of Statutory Auditors: We recently held an emergent meeting to deliberate upon the proposal of the RBI Working Group on Revision in the Norms for Empanelment of Statutory Auditors and other issues relating to appointment of Statutory Auditors in Public Sector Banks. This was followed with a discussion in the Council. Based on the deliberations, we have prepared a detailed representation and submitted it to the Reserve Bank of India. Subsequently, I also submitted a summarised version of the representation to Shri D. K. Mittal, Secretary, Department of Financial Services, Ministry of Finance.

Professional Courses: We recently successfully conducted *Certificate Course on Forensic Accounting & Fraud Detection* at Centre of Excellence, Hyderabad with 30 candidates, which was very well received by the members. We have also restarted the *SAP Course* for members and students. The 17th & 18th batches of *Certificate Course on International Taxation* started recently in Pune and New Delhi while the new batches of this Course is likely to start in Mumbai, Chennai, Hyderabad and Baroda in March this year. Meanwhile the 10th batch of the *Certificate Course on Valuation* recently commenced at Mumbai. The 3rd batch of *Master of Business Finance Certificate Course* recently started in Delhi, Mumbai, Chennai and Kolkata. A 7-day course on “*Oracle 11i Financials*” will be organised at Delhi from 27th February, 2012. Meanwhile, we are conducting *IFRS Certification Course* batches at Delhi, Kolkata and Mumbai.

IDT Courses and Workshops to Commence: Empowerment of the accounting professionals in employment or practice through knowledge and in depth understanding of indirect taxes has been felt while the same, especially service tax, is gaining importance. This year, we have three indirect tax certificate courses running in Delhi, Chennai and Kolkata, and 15 more have been planned in the year ahead. Focused workshops to empower at least 3,000 more professionals to take up specialisation in service tax, along with increased e-learning initiatives, have been planned and members may grab this opportunity considering the fact that GST is on the anvil.

Members in Entrepreneurship & Public Services: In order to highlight and deliberate upon the issues concerning our members in entrepreneurship & public services, the 2nd conclave of such members was recently organised in Mumbai, which was inaugurated by Deputy Chairman of Rajya Sabha CA. K. Rahman Khan. Many highly respectable members of the profession in public service and entrepreneurship, including former Union Minister CA. Suresh Prabhu, President of Income Tax Appellate Tribunal CA. G.E. Veerabhadrapa, Commissioner of Service Tax-1, Mumbai CA. S.K. Solanki, Chairman of Gencoval Strategic Services Private Limited CA. Deepak Ghaisas and Chief Editor of *Premium Investments* attended the event.

Technical Guidance: Environmental issues are increasingly impacting the bottom line and future prospects of organisations in many industries. Recognising the growing importance of the subject of environmental auditing as the survival and growth mantra for business these days, we have issued a “*Guide on Environmental Audit*”, which explains types of environmental audit and discusses emerging opportunities for professional accountants in the field of environmental audit. We have also issued a “*Technical Guide on Stock and Receivables Audit*” as a one-stop practical guide for performing an effective stock and receivable audit and ensuring the quantity, quality, composition and actual value of the stock and the debtors. We have also come out with a Guidance notes on ‘*Revised Schedule VI to Companies Act, 1956*,’ ‘*Accounting for Rate Regulated Activities*,’ ‘*Accounting for Self-generated Certified Emission Reductions (CERs)*,’ and revised the *Guidance Note on Accounting for Real Estate Transactions*. Further, we have finalised a series of educational materials on Ind AS and the same will be issued shortly.

Partner in Nation-Building

Study for Tamil Nadu Government: We have received a proposal from Finance Department, Government of Tamil Nadu to take up a study on the accounting practices in Tamil Nadu Civil Supplies Corporation Limited and suggest ways and means to streamline the accounting system and for its computerisation in integrating all the units of the organisation so as to help develop an effective Management Information System.

Training Govt. Officials: We have also received a proposal from Employees' State Insurance Corporation, under the Ministry of Labour & Employment, to provide training to their officials on Accrual Based Accounting System in Delhi.

Initiatives for Students

More Student Empowerment Programmes: Strong team at our Board of Studies promises a substantial improvement in the quality of students coming out of our system in terms of their pragmatic and analytical skills. Our enhanced training programmes in technology and GMCS would also help them in becoming a more competent and confident professional. The BoS, this year, would be focusing on e-learning initiatives in order to provide them a facility of real distance learning. Self-assessment measures in the coming examinations are also being increased to reach all students who are interested in getting a status check on where they stand in terms of readiness for the examination.

CPT Classes: We have requested the Regional Councils and Branches to organise CPT Classes for the ensuing CPT Examination in June 2012, and will extend all the support required to the Programme Organising Units, including supply of study material, Power Point presentations and weekly test papers. We will also be creating an Online Group of CPT Faculty Members, subject wise, on All India basis, so that they can share their experience and resources to make the CPT Classes successful.

Helping Physically Challenged Students: In yet another initiative, we have adequately modified the policy with respect to provision of writers to physically challenged students and it would be made effective from May 2012 CA Examinations.

Analysing Quality of Examinations: In order to analyse the qualitative aspect of our examinations, we recently conducted research study by way of conduct

of Examinations with participation of the experts, select examiners involved in valuation of respective subjects, Question Paper setters and Moderators of the respective papers.

Orientation Programme: An orientation programme for GMCS for students was organised recently in Delhi, where Minister of Corporate Affairs Dr. M. Veerappa Moily, as the Chief Guest, encouraged the students to serve the nation with their professional expertise with missionary zeal. Myself and Vice-President CA. Subodh Kumar Agrawal also addressed the students.

I am sure all these developments will strengthen our profession in short as well as long run. Although there is no agreed definition of a profession, I draw your attention to the definition provided by the Australian Council of Professions (Professions Australia). It defines a profession as: *A disciplined group of individuals who adhere to high ethical standards and uphold themselves to, and are accepted by, the public as possessing specialised knowledge and skills in a widely recognised, organised body of learning derived from education and training at a high level and who are prepared to exercise this knowledge and these skills in the interest of others.* Inherent in this definition is the concept that the responsibility for the welfare, health and safety of the community shall take precedence over other considerations. The punch line of our profession too is 'Service Before Self' which draws strength from our profession's motto 'Ya esa suptesu jagarti' (one who is awake among those who sleep). I like this definition because it captures societal expectations from a profession. Sometimes we lose focus on ethics and social responsibility, and emphasise on competence only. I wish that members of our profession re-evaluate their approach to professional accountability in the light of the above definition.

By the time this issue of the Journal reaches you, most of you would be giving final touches to your plans and strategy for performing the statutory audit of bank branches. Best wishes for a timely and effective completion of audit.



CA. Jaydeep Narendra Shah
President, ICAI
New Delhi, 23rd February, 2012



Action Plan

2012-13

CA. Jaydeep Narendra Shah
President, ICAI, New Delhi

- I. Assume Leadership position in national, regional and international accounting fraternity
- II. Adapt the regulatory mechanism to changing times
- III. Create enabling framework for Indian firms and professionals to leverage national and global opportunities
- IV. Revitalize education and training systems and establish an enabling ecosystem to produce globally competitive accounting professionals
- V. Undertake branding and awareness campaign to enhance public perception of ICAI and professionals affiliated to ICAI
- VI. Strengthen infrastructure and technological capabilities to improve engagement with all stakeholders

I. Assume Leadership position in national, regional and international accounting fraternity

i. Collaborate with different stakeholders

- ⇒ Closely work with the Ministry of Corporate Affairs.
- ⇒ Provide assistance to Ministry of Finance, Ministry of Commerce and Industry, Ministry of External Affairs and other institutions of Government in different policy matters.
- ⇒ Collaborative working with the Regulatory Bodies.
- ⇒ Improve relationship with corporate sector.
- ⇒ Work with trade and industry associations.

ii. Global and National Partnerships

Enhance the level of international partnerships

- ⇒ Enter into MRA with accounting bodies in various countries wherever feasible.
- ⇒ Provide Technical Cooperation to countries in Africa (such as Djibouti, Benin, Mauritius etc), Asia (such as Bahrain, Bhutan, Cambodia, Maldives, UAE, Oman, Qatar, etc.) and other countries.
- ⇒ Identify at least 4-5 countries to provide technical cooperation.
- ⇒ Develop plan for each country on areas of Technical Cooperation.
- ⇒ Reach out to country representatives (embassies and / or other relevant institutions) of identified countries to explore technical cooperation opportunities.

iii. ICAI as a hub of valued Thought Leadership

- ⇒ Work with leading universities and educational institutions to encourage PhD courses in Accounting, Assurance and other areas of professional interest.

- ◆ Identify at least 5 leading institutions for conducting research in areas related to Accounting, Assurance, Taxation and Finance.
- ◆ Create a framework for partnering with the identified institutions in terms of resources such as scholarship for PhD program, grants for research, Research chair, etc.
- ◆ Develop a proposal and MoU for partnering with the identified institutions.
- ⇒ Encourage Indian CAs to contribute articles in leading global accounting publications.
 - ◆ Develop and communicate a reward scheme to recognize and reward members for contributions in global accounting publications.
 - ◆ Track opportunities for contributing to articles in global publications.
- ⇒ Undertake different socially relevant initiatives through focused programmes involving students and members.
 - ◆ Education.
 - ◆ Health.
 - ◆ Tree Plantation.
 - ◆ Water conservation, Rain water harvesting.

II. Adapt the regulatory mechanism to changing times

i. Proactive monitoring, close cooperation and coordination with other regulatory agencies to enhance the robustness of existing systems

- ⇒ Create an institutional mechanism to not only facilitate closer coordination with other regulatory agencies such as the RBI, IRDA and SEBI but to also take necessary step proactively.

ii. Subscription to a news agency for periodic reporting of news related to CAs

- ⇒ Retain services of a news agency to centrally monitor any news related to CAs and CA firms.
- ⇒ Mandate regional offices to report any untoward incidents to Headquarters.

III. Create enabling framework for Indian firms and professionals to leverage national and global opportunities

i. Capacity Building of Indian firms and professionals

Encourage and help Indian firms to form Limited Liability Partnerships and Multidisciplinary firms to service clients across the whole spectrum of professional services

- ⇒ Create awareness of Limited Liability Partnerships and Multi-disciplinary firms as a form of organisation amongst members.
- ⇒ Conduct seminars on advantages of collaborating for formation of Limited Liability Partnerships and Multi-disciplinary firms across the country.

Subscribe to world's leading accounting journals and publications so that the members are exposed to the latest practices and thinking in the professional services arena

- ⇒ Identify global accounting journals and publications for member access.
- ⇒ Provide e-library facilities for the members.

Recognize and award the contribution of members to the organisation, profession and society.

To bring out publications on the contemporary topics relevant to the profession.

ii. Enhance Continuing Professional Education program

Develop and empower members for professional development

- ⇒ Conduct survey of members to ensure CPE courses reflect needs of stakeholders.
- ⇒ Publish annual calendar of CPE programs to empower members to plan professional development programs.
- ⇒ Design CPE courses through e-Learning medium.
- ⇒ Design CPE programs to meet needs of members working in industry as well as practicing professionals.
- ⇒ Launch certificate courses on contemporary areas such as XBRL.
- ⇒ Organise seminars, workshops, conferences to disseminate knowledge and skills in contemporary areas. The focus will include the topics in the areas of:
 - ◆ Accounting Standards.
 - ◆ Standards on Audit.
 - ◆ Developments in the area of taxation including Direct Tax Code and Goods & Services Tax.

- ◆ eXtensible Business Reporting Language.
- ◆ Corporate Laws and new legislations.
- ◆ Emerging areas of profession.

iii. Enhance the maturity level of XBRL implementation and establish leadership position in this space

- ⇒ Develop detailed Roadmap for adoption of XBRL in India.
- ⇒ Engage with other regulators such as IRDA, RBI etc. to facilitate implementation of XBRL in reporting requirements through meetings, forums.
- ⇒ Identify and Develop taxonomies for key sectors; Publish plan to review the developed taxonomies for regular revisions and updates.
- ⇒ Facilitate education in XBRL through workshops, seminars and conferences.
- ⇒ Support XBRL International with financial and Human Resource to leverage outsourcing opportunities for Indian firms.

iv. Harness global opportunities for Chartered Accountants

Identify and realize opportunities for Indian professionals and firms to work internationally and develop international partnerships

- ⇒ International Opportunity Identification and Assessment.
- ⇒ Create a desk for Global Opportunities for Chartered Accountants.
- ⇒ Subscribe to an agency to provide updates on opportunities for providing professional services internationally.
- ⇒ Identify top 7-10 countries where Indian CAs and professional services can get opportunities to conduct business.
- ⇒ Develop Opportunity Assessment Reports to understand ICAI's possible role, and create awareness amongst Indian professionals and firms regarding the identified opportunities.
- ⇒ Explore business opportunities through ICAI International Chapters.
- ⇒ Explore business opportunities in countries where ICAI has signed MRA or provided technical cooperation.
- ⇒ Collaborate with the Indian government, Indian embassies abroad and governments/ embassies/ Trade bodies of the identified countries to realize the opportunities.
- ⇒ Plan for inbound and/or outbound delegations to explore opportunities in selected countries.

Strengthen and empower ICAI International chapters with permanent employees wherever possible

- ⇒ Identify roles and responsibilities for additional manpower at International Chapters in consultation with Chapter leads.

- ⇒ Evaluate performance of International Chapters.
- ⇒ Develop criteria (such as member strength, quality of services, new members added, lead opportunities generated) for evaluating International Chapter operations.
- ⇒ Conduct performance assessment of International Chapters; Take steps to rejuvenate International Chapters.

IV. Revitalize education and training systems and establish an enabling ecosystem to produce globally competitive accounting professionals

i. Strengthen education and training initiatives

Update the course curriculum to satisfy the needs of students, employers and society.

- ⇒ Analyze course curriculum of leading accounting bodies.
- ⇒ Conduct survey to reflect requirements of students, industry, government and other regulators to redesign curriculum.
- ⇒ Reinforce theoretical education with application based learning.
- ⇒ Include real life examples and case studies.
 - ◆ Develop annual competition to develop cases to encourage collaboration between practitioner and academicians.
 - ◆ Include relevant multi-disciplinary cases as part of curriculum, particularly dealing with issues such as global marketplace, international standards, blending information technology with financial decision making, strategic and critical thinking, ethical decision making etc.

ii. Improve efficacy of Training

Monitoring of Articleship Training

- ⇒ Introduce e-Diary system to monitor articleship training.
- ⇒ Conduct student surveys to assess quality of articleship training.

Improve quality of Articleship Training through empowerment and incentives

- ⇒ Conduct regular capacity building programs for firms to promote effective articleship training.
- ⇒ Develop capacity building program with modules on effective articleship training.
- ⇒ Develop plan for conducting capacity building programs.

Industrial Training

- ⇒ Conduct visits in banks, industry, regulatory organizations for familiarization with the best practices.
- ⇒ Popularize Industrial Training.

iii. Emphasis on developing the soft-skills

- ⇒ Improve communication skills.
- ⇒ Develop language through establishing language labs at key locations.

V. Undertake branding and awareness campaign to enhance public perception of ICAI and professionals affiliated to ICAI

i. Promotion of ICAI, Indian CAs and professional accounting service firms

- ⇒ Develop a coherent and focused awareness campaign.
- ⇒ Design a coherent advertising campaign for ICAI.
- ⇒ Student Outreach program to attract quality students.
- ⇒ Collaborate with prominent schools and colleges to promote accounting careers.

ii. Safeguard the reputation and brand image of ICAI and its members

- ⇒ Develop Standard Operating Procedures.
- ⇒ Develop Crisis Management Plan.

VI. Strengthen infrastructure and technological capabilities to improve engagement with all stakeholders

i. Strengthen Physical Infrastructure

Develop world class educational institutions

- ⇒ Establish Centers of Excellence at different places.

ii. Strengthen Technology Infrastructure

Leverage computer based learning systems to increase reach economically

- ⇒ Roll out applications and infrastructure under the Parivartan program.
- ⇒ Introduce computer based learning systems for students.
- ⇒ Subscribe to electronic version of world's leading journals.

iii. Strengthen Organizational structure

Conduct organization restructuring

- ⇒ Conduct study to ascertain requirements for number of people and employee skill sets within ICAI to achieve strategic vision.
- ⇒ Build capacity to bridge skills gap.
- ⇒ Decentralization of ICAI to rationalize work across regions.
- ⇒ Develop best human resource development practices for talent acquisition and retention.

Develop a process-oriented culture in the organization

- ⇒ Undertake comprehensive organization-wide risk assessment program.

Establish Vision Implementation Office

- ⇒ Put in place an independent dedicated Vision 2030 Implementation Office. ■

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

MEMBERS OF THE TWENTY-FIRST COUNCIL & THE SECRETARY [as on 12th February, 2012]



1st Row (L to R): CA. Vinod Jain, CA. Bhavna G. Doshi, CA. Amarjit Chopra (Past President), CA. Subodh K. Agrawal (Vice-President), CA. Jaydeep Narendra Shah (President), CA. G. Ramaswamy (Past President), Shri T. Karthikeyan (Secretary), CA. Rajkumar S. Adukia, CA. Abhijit Bandyopdhayay

2nd Row (L to R): CA. Jayant P. Gokhale, CA. V. Murali, CA. Sanjay K. Agarwal, CA. Anuj Goyal, CA. M. Devaraja Reddy, CA. Shiwaji B. Zaware, CA. J. Venkateswarlu, CA. Atul C. Bhedra

3rd Row (L to R): CA. Charanjit Singh Nanda, CA. Manoj Fadnis, CA. S. Santhanakrishnan, CA. Sanjeev K. Maheshwari, CA. K. Reghu, CA. Mahesh P. Sarada, CA. Ravi Holani, CA. Navveen N.D. Gupta

4th Row (L to R): CA. Pankaj I. Jain, CA. Sumantra Guha, CA. Pankaj Tyagee, CA. Nilesh S. Vikamsey, CA. Dhinal A. Shah, CA. Madhukar N. Hiregange, CA. P. Rajendra Kumar, CA. Vijay K. Garg

Not in Picture: Shri Anil K. Agarwal, Shri Ashutosh Dikshit, Shri Deepak Narain, Shri Prithvi Haldea, Shri Sidharth Birla, Shri Manoj Kumar, Smt. Usha Narayanan, Smt. Usha Sankar

Strengthening Ties



Meeting with Dy. Chairman Rajya Sabha

CA. Jaydeep Narendra Shah, President, ICAI and CA. Subodh Kumar Agrawal, Vice President, ICAI greet Hon'ble Shri K. Rahman Khan, Deputy Chairman, Rajya Sabha during a meeting in New Delhi. (19.02.2012)



Meeting with Minister MCA

CA. Jaydeep Narendra Shah, President, ICAI presenting a bouquet to Hon'ble Minister of Corporate Affairs Dr. M. Veerappa Moily during a meeting in New Delhi. (21.02.2012)



Meeting with Secretary MCA

CA. Jaydeep Narendra Shah, President, ICAI and CA. Subodh Kumar Agrawal, Vice President, ICAI presenting a bouquet to Hon'ble Secretary, MCA Shri Naved Masood during a meeting in New Delhi. (13.02.2012)



Meeting with Joint Secretary MCA

CA. Jaydeep Narendra Shah, President, ICAI and CA. Subodh Kumar Agrawal, Vice President, ICAI presenting a bouquet to Hon'ble Joint Secretary, MCA Shri Manoj Kumar during a meeting in New Delhi. (13.02.2012)

Programme/ Inaugurations



2nd CMEPS Conclave

CA. G. Ramaswamy, the then President, ICAI and CA. Jaydeep Narendra Shah, President ICAI (the then Vice President) with Hon'ble CA. K. Rahman Khan, Deputy Chairman, Rajya Sabha and CA. Suresh Prabhu, Former Union Minister at the inauguration of Conclave of ICAI Members in Entrepreneurship & Public Services in Mumbai. (24.01.2012)



India Corporate & Investor Meet 2012

CA. G. Ramaswamy, the then President, ICAI seen with Dr. K. Rosaiah, His Excellency the Governor of Tamil Nadu, Dr. M. Veerappa Moily, Hon'ble Union Minister of Corporate Affairs and Central Council member CA. V. Murali at the India Corporate & Investor Meet 2012 organised in Chennai. (07.02.2012)



GMCS Orientation

Hon'ble Union Minister of Corporate Affairs Dr. M. Veerappa Moily lighting the lamp to inaugurate the GMCS Orientation programme organised by the NIRC in the presence of CA. Jaydeep Narendra Shah, President, ICAI; Central Council members CA. Sanjay Agarwal and CA. Pankaj Tyagee; Chairman NIRC CA. Rajesh Sharma and Vice Chairman NIRC CA. Vishal Garg in New Delhi. (17.02.2012)



Bahrain Visit

CA. G. Ramaswamy, the then President ICAI and CA. Jaydeep Narendra Shah, President ICAI (the then Vice President) along with CA. T. D. Balraj (extreme right), Chairman of the Bahrain Chapter presents a memento to His Excellency Dr. Mohan Kumar, the Indian Ambassador to Bahrain (second from right) during their Bahrain visit. (30.01.2012)



New President Takes Charge

ICAI's Immediate past-President CA. G. Ramaswamy and ICAI Secretary Shri T. Karthikeyan help ICAI President CA. Jaydeep Narendra Shah in taking over the President's Collar. (12.02.2012)



Felicitation at Kolkata

Photograph taken on the occasion of felicitation of the newly elected Vice-President of the ICAI CA. Subodh Kumar Agrawal in Kolkata. (16.02.2012)



NIRC Awards, New Delhi

CA. Subodh Kumar Agrawal, Vice President, ICAI presenting awards during NIRC awards function held in New Delhi. Also seen in the photograph are Central Council members CA. Vinod Jain, CA. Sanjay Agarwal, CA. Pankaj Tyagee and Chairman NIRC CA. Rajesh Sharma. (18.02.2012)



Jammu

CA Subodh Kumar Agrawal, Vice President, ICAI seen with Jenab Abdul Rahim Rather, Hon'ble Finance Minister, J&K Govt. and Jenab J. A. Khan, Economic Advisor, J&K Govt. during foundation stone laying ceremony of the J&K Branch in Jammu. Central Council member CA. Pankaj Tyagee, Chairman NIRC CA. Rajesh Sharma and branch executive committee members are also seen in the photograph. (20.02.2012)



Mathura

CA. G. Ramaswamy, the then President, ICAI; CA. Jaydeep Narendra Shah, President ICAI (the then Vice President) with Central Council members CA. Anuj Goyal, CA. Vijay Kumar Garg, CA. Ravi Holani; Chairman CIRC CA. Vivek Khanna and branch executive members during the Mathura branch building inauguration. (09.02.2012)



Mysore

CA. G. Ramaswamy, the then President, ICAI with Central Council members CA. K. Raghu and CA. Madhukar Hiregange; Chairman SIRC CA. K. Shanmukha Sundaram and branch committee members during the foundation stone laying ceremony for the first floor of the Mysore Branch building. (28.01.2012)

ICAI Convocations



Kanpur

CA. G. Ramaswamy, the then President, ICAI handing over membership certificate at the Convocation Ceremony of ICAI held in Kanpur. Also seen in the photograph are CA. Anuj Goyal, Central Council member and CA. Vivek Khanna, Chairman CIRC of ICAI. (04.02.2012)



Mumbai

Hon'ble CA. K. Rahman Khan, Deputy Chairman, Rajya Sabha inaugurating the Convocation Ceremony of ICAI held in Mumbai in the presence of CA. G. Ramaswamy, the then President, ICAI; CA. Jaydeep Narendra Shah, President ICAI (the then Vice President); CA. V. Murali, Central Council member and CA. Y. Shrinivas Joshi, Chairman WIRC. (24.01.2012)

The Journal is Knowledge Enhancing

> The February 2012 issue of the journal was enlightening as usual. The editorial titled 'Hints of global economic recovery and India' was very well written, informative and revealing. The article titled 'Green Audits: A Boon to World' was particularly informative. There should be more articles on the Green issues and the CAs' role and responsibilities in such issues and concepts. The 'International Taxation' has been a very good feature and both the articles published under this column viz 'Taxability of Technology Related Payments- The Controversy Continues' and 'New Capital Allocation Rules for Permanent Establishments (Article 7 AOA)' were knowledge enhancing and practically useful. It also helped us to update ourselves with the latest on Basel III norms in the article under 'Banking and Finance' column.

CA. S Jain, Indore

'Significant Achievements' Column Noteworthy

> The coverage under 'Significant Achievements' in the February 2012 issue of the journal was very good and provided a bird's eye view of the great strides made by the profession in the year gone by. I congratulate Past President CA. G. Ramswamy and the current President CA. Jaydeep Narendra Shah who have rendered excellent

services to Indian accountancy profession.

-CA. P.V.Vittal, Visakhapatnam

Accounting 'Opinion' is a valuable Feature

> I thank the journal for providing valuable information under the column 'Opinion'. The opinion in February 2012 issue of the journal on 'Accounting Treatment of Success Fee Paid to Financial Advisors' was particularly informative. Further, the significant achievements of the ICAI in the year gone by also provided a valuable update on the developments in the accounting world in the country. It was also nice to see the former president of India Dr. A.P.J Abdul Kalam on the cover of the February 2012 journal.

CA. Anand Raghuvanshi

Journal Highlighted the Competence of Indian Accountancy Profession

> The cover page of February 2012 CA Journal was amazing and as a member of this esteemed organisation, I am really proud when I read the words of Dr. A.P.J Abdul Kalam about the accountancy profession in India like "Sanctioning authorities can seek the help of chartered accountants for simplifying the procedures of fund allocated by government to the intended beneficiaries". These words highlight the competence of Indian accounting profession. This statement enlightens all our colleagues about the trust reposed by the society in the Chartered

Accountants. Professional initiatives like MoU for PhD programmes and representation before CBDT are very appreciable movements of the ICAI. The presentation and coverage of 'Significant Achievements of ICAI (2011-2012)' were good. Further, the article titled "Private Provident Fund Trusts" pointed out the hindrance of maintenance of such trusts and given best possible option. Overall, the journal has been rendering a valuable service to the Indian accounting fraternity.

-CA Jomon C.V, Mumbai

Columns like 'Tech for You' are Need of the Hour

> The article titled Data Analytics-The Tool to Transform Data to Decisions' under the "Tech for You" column by CA. A. Rafeq was very good and informative and this column is the need of the hour. The article rightly tells that instead of doing the stereotype work, CAs can enhance their capabilities by using Data Analytics. Of late the CAs are rightly relying more on the Business Intelligence Tools & Techniques and Data Analysis. This not only reduces the work load of the Auditors but also enhances the clients' confidence as they will be relying more on the auditors for improved business efficiencies and reduction of frauds, misuse & errors. I am sure the Institute journal will have an article on this type of topic every month. I thank the editor for publishing such a good article.

-CA.S.Chakravarthy, Nagpur

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.

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 ebboard@icai.org or write to:

The Editor, The Journal Section, ICAI, A-29, Sector 62, Noida (UP) - 201309

ICAI Celebrates Professional Success & Excellence at its 62nd Annual Function

The Institute of Chartered Accountants of India celebrated yet another year of professional success and excellence at its 62nd Annual Function held on 11th February 2012 in the convention hall of Hotel Ashok, New Delhi. On this occasion, the ICAI not only looked back at its remarkable achievements in the year gone by, but also looked ahead for another year of success for the profession. The Chief Guest on the occasion was the Minister of Corporate Affairs Dr. Veerappa Moily. Two former ICAI Presidents and Padma Shri awardees CA. T. N. Manoharan and CA. Y. H. Malegam were also felicitated on the occasion. The meritorious CA students and outstanding regional councils and branches were also honoured on the occasion. Past Presidents of ICAI, Members of ICAI Council, Regional Councils, office-bearers of the branches, officials of Ministry of Corporate Affairs and CA students were among a large gathering which attended the event. Following is the report of the occasion.



Minister of Corporate Affairs Dr. M. Veerappa Moily inaugurates the annual function as the then ICAI President CA. G. Ramaswamy, ICAI President (the then Vice President) CA. Jaydeep Narendra Shah, Padma Shri awardee Past Presidents CA. T. N. Manoharan and CA. Y. H. Malegam, and NIRC Chairman CA. Rajesh Sharma look on.



CA. G. Ramaswamy

Addressing the gathering, the then ICAI President **CA. G. Ramaswamy**, in his presidential address, gave a brief account of the major milestones achieved and successful initiatives launched by the ICAI during his tenure. Hailing Indian accountancy profession he said: "Former President of India Dr. A. P. J. Abdul Kalam has called us *Partners in Nation Building*. We are also called *Conscience Keepers* of business.

First President of India Dr. Rajendra Prasad has called us "Providers of the first line of defence to the unwary public. Our profession inspires perseverance and responsibility." He said that since the day he became ICAI President, his prime agenda has been to develop and transform the body and spirit of our institution and to create a benevolent and generous culture so that all the stakeholders of the profession including our members and students should come across effectively, empathetic and compassionate Institute and employees.

AD

C A. G Ramaswamy said technology is going to transform the entire accountancy profession with no manual audits and no physical filing of returns. E-filing and e-governance are going to be the order of the day, he said adding that in the year gone by a series of initiatives were taken to harness Information Technology to bring the profession on a higher pedestal. He said ICAI provided the free of cost facility to the CA firms to create their own websites by logging on to ICAI website. ”

Complimenting Dr. M. Veerappa Moily, he described him as “great friend” of Indian accountancy profession, a “great reformer and a public figure in the political life”. Thanking Ministry of Corporate Affairs for the support and guidance to the Institute, he sought continued support of Dr. Moily, Minister of State for Corporate Affairs Shri R. P. N. Singh and Secretary of Corporate Affairs Shri Naved Masood. He congratulated Padma Shri awardees Past Presidents CA. T. N. Manoharan and CA. Y. H. Malegam.

Giving a brief account of the initiatives and achievements of the Institute in the year gone by, he said ICAI has entered into Mutual Recognition Agreements in various countries which now have become fully operational. In a growing recognition to the ICAI, a number of universities have come forward to coordinate with the Institute, recognising our qualification to award the various post-graduate qualifications, he said adding “our members are recommended for the minimum scale of fee to be applied for the purpose of our professional recognition and professional services rendered by them.” Talking about various other initiatives, he mentioned about health insurance scheme launched for the members and the students, formulation of the tender document and model forms, simplification of the Companies Act with efforts of ICAI, ICAI extending support to the various initiatives of the Reserve Bank of India and SEBI, and ICAI helping out the Ministry of HRD in implementation of all accounting standards in educational institutions, universities and other bodies in India.

He said that in the year gone by, the ICAI played a leading role in implementation of XBRL in the country. He said ICAI extended technical guidance to the members of the profession and other stakeholders including through guidance notes on Revised Schedule-VI and Real-estate property. He also referred to various professional courses launched by the Institute during the year, including ‘Master of Business Finance,’ and ‘Indirect Tax Certification Course.’

The then President CA. G. Ramaswamy said the Institute is focussing on globalisation of Indian accountancy profession in cooperation and coordination with Confederation of Asia-Pacific Accountants, South-Asian Federation of Accountants and particularly the IFAC where he has been elected as Board Member.

He said that in the year gone by, enormous efforts and initiatives have been taken to uplift the small and medium practitioners and help them to meet all the challenges and grow bigger and better through networking and forming Limited Liability Partnership firms.

Speaking about the achievement in standard setting process, he said ICAI has brought out all the Ind AS, the Indian version of IFRS and are training and preparing our members and other stakeholders for their implementation.

On the Companies Bill 2011, he said: “The Bill is now before the Parliamentary Standing Committee. We are continuously giving our inputs to the Government especially with regard to constitution of NFRA and the role and responsibilities of the ICAI.”

CA. Ramaswamy said technology is going to transform the entire accountancy profession with no manual audits and no physical filing of returns. E-filing and e-governance are going to be the order of the day, he said adding that in the year gone by a series of initiatives were taken to harness Information Technology to bring the profession on a higher pedestal. In this regard he referred to the initiative of ‘E-learning of all the standards on audit’ through ICAI website. He said that in another major initiative, ICAI provided the free of cost facility to the CA firms to create their own websites by logging on to ICAI website.

CA. Ramaswamy also gave an account of several reforms that are underway, particularly with respect to the ICAI examination system and Project Parivartan, which aims to facilitate many fold increase in the services for members, students and other stakeholders of ICAI.

D r. M. Veerappa Moily said: “This is a combination, which very rarely happens – Saraswati, Laxmi and Durga, the power, which you possess as Chartered Accountants and you function as the conscience keepers of the nation. I must tell you that. I am proud of your profession and the credibility which you have built up in the profession... the domain expertise that you have built up is par excellence. Keep it up.” ”

He said that last year the ICAI has scored on Disciplinary front as well, particularly with regard to Satyam case. He informed that a breakthrough has been achieved in the matters relating to Satyam wherein Disciplinary Committee has concluded the hearings in all the 6 cases. Altogether, the maximum punishment which is provided for in the Act has also been awarded to four out of the six Respondents. Punishments to the remaining two respondents will be decided in due course in the Disciplinary Committee meetings, he added.

He said that the Institute is growing bigger and bigger and is ably performing its duty as a partner in nation building. "We must ensure that Indian accountancy profession gets globalised. There should be networking of Indian chartered accountants. The Indian chartered accountants should grow big and start working outside India as well as they are second to none," he said concluding that he will continue to work for the cause of the profession.



Dr. M. Veerappa Moily

Addressing the gathering, Minister of Corporate Affairs **Dr. M. Veerappa Moily** said that after taking over as a Minister of Corporate Affairs, the maximum functions which he attended were of the Chartered Accountants and this reflects his warm feeling, not only towards the ICAI but also to ICAI President CA. G. Ramaswamy. "I always believe, as a reformer, the principle of creative destruction is also called creative disruption. This is the principal philosophy of all our ten avatars. One avatar doesn't repeat what it has done tomorrow. This is what we need to do. Innovation should be the word today," he said.

Stressing the importance of excellence, he said: "When I joined the profession as a lawyer, my senior told me that there are no vacancies at the mediocre

You (Chartered Accountants) have the scope, potential, canvas, to build yourself because I think you have the potential. The accounting profession is the noblest profession. You are on the right track of building world-class profession in this country and world over. That requires a lot of perseverance, a lot of training and a lot of capacity building," Dr. Moily said.



The then ICAI President CA. G. Ramaswamy greets Minister of Corporate Affairs Dr. M. Veerappa Moily as ICAI President (the then Vice President) CA. Jaydeep Narendra Shah looks on.

level or average level. There is a plenty of vacancy at the level of excellence. We need to target that." Lauding the Chartered Accountants, the minister said: "This is a combination, which very rarely happens – Saraswati, Laxmi and Durga, the power, which you possess as Chartered Accountants and you function as the conscience keepers of the nation. I must tell you that. I am proud of your profession and the credibility which you have built up in the profession... the domain expertise that you have built up is par excellence. Keep it up."

Dr Moily said that as a reformer, he always wants a change. "The past has always a power to put you down, but the future has a power to pull you up. This is what all of us have to do with the experience we gain in our respective professions. We need to build for the future, think of the future which holds highest promise," he said. The minister said he is working all out to make it easy to do business in India by removing all hurdles, including legal and administrative. "I proposed a Bill and it is in the Parliament which will create a Commercial Court in each High Court everything from filing, petition, end of the decree and execution of the decree is handled by one court," he informed adding that one of his priorities is to make India the most attractive destination for international arbitration and, with that aim, he has come out with a comprehensive amendment to the Conciliation and Mediation Act.

Informing about the initiative in the area of corporate governance, Dr. Moily said: "There is a lot of prosperity in India. There is a lot of wealth we can create around. But, we need to sharpen the instruments, not by over-regulation but with the sharp regulations, very conducive, friendly regulations which can create a philosophy of the auto-pilot... and that is why I am coming out with a new initiative of

a National Corporate Governance Policy in next six months." The minister said he wanted ICAI to work out that Corporate Governance Policy. "We will be constituting the committee very shortly," he added.

Speaking about another major initiative of preparing a National Competition Policy, he said: "We have the Competition Law, but that alone is not enough. The Competition Policy will remove dismantle all the anti-competitive forces in the country." "I will continue to have this kind of collaboration with you to take the agenda of the Ministry of Corporate Affairs forward."

Exhorting the profession of accountancy, the minister said: "Your profession is the largest in the world. It is the most sufficient in the world. You take it forward because we should not be just happy with what we have today but what we ought to be tomorrow."

"I must tell you that we have a greater role to play. I am very happy and excited to hear the story of Satyam which is enunciated by Padma Shri awardee CA. T. N. Manoharan. He took up that national duty to perform. This is how you can make your own mark in the country in building the nation in building the integrity of the nation," he added.

He said CAs have a greater role to play in the capital market. "We are the highest domestic

Thankful for the Padma Shri, CA. T.N. Manoharan said: "Let me admit, I could have not been able to do what I could do for the revival of Satyam but for the competency, domain expertise that I could gather as a Chartered Accountant in my tenure as Vice-President and President of ICAI. Therefore, it is not an honour to an individual; it is an honour to the profession as such which makes me what I am. So, it is my proud privilege to dedicate this award to each and every one of you who are members of the profession of chartered accountancy."

saving to the extent of 37-40%. But not even 5% is ploughed back into the capital market," he said adding that a vigorous investor awareness programme is being conducted across the country for the purpose.

The minister sought support of the Chartered Accountants in building a corporate citizenship in the country. The corporate citizenship makes it immaterial whether a government is run by one political party or another, he said adding that in the culture corporate citizenship, the investment profile will not change by any political change.

“You (Chartered Accountants) have the scope, potential, canvas, to build yourself because I think you have the potential. The accounting profession is the noblest profession. You are on the right track of building world-class profession in this country and world over. That requires a lot of perseverance, a lot of training and a lot of capacity building,” Dr. Moily said, adding: “You must build an empire. Why not? LLP has been provided to you. I want that in other five years’ time, 100 big companies, partnership companies to be built from our own soil.” Concluding, the minister assured that for the purpose his ministry will provide all the necessary logistic support.

Two former President of ICAI, CA. T. N. Manoharan and CA. Y.H. Malegam, who are also Padma Shri awardees, were also specially felicitated on the occasion.



CA. T. N. Manoharan

Replying to his felicitation, **CA. T. N. Manoharan**, Padma Shree awardee, spoke about his role in Satyam turnaround. He said: “Although the occasion arose on 7th January, 2009 when the promoter of Satyam Computers confessed. It was shocking not only for the corporate India but also the whole of India and it was at that juncture when I received a call from the Ministry of Corporate Affairs, whether I will be willing to be a part of the six-member Board to be constituted by the Government to revive Satyam. Only two thoughts came to my mind, as I accepted the assignment. The first thought was that it is a call of the nation and it is the duty of every citizen to undertake whatever is assigned. Secondly, all said and done, whether we like it or not that episode is going to cause some dent in the image of the profession. So, I thought why not make use of the same opportunity to do my best to restore or revive the image of the profession.” CA. T. N. Manoharan added that



CA. T. N. Manoharan being felicitated by Dr. M. Veerappa Moily

“When the Government nominated six-member Board met, it was deliberated as to who will run the show 24x7. Although we decided to meet on a weekly basis, there was a need for one of us to stay there 24x7 to execute the strategy and the decision for revival. It was thanks to the opportunity that was given to me to serve as the Vice-President and the President of ICAI. For 730 days, I could live in Delhi 24x7. So, having done it for two years for the profession, it was not difficult for me to accept that assignment for a few months and that is how the assignment began. The Board unanimously passed a resolution whether it is going to take a few months or few years for revival, we will do it for the nation without any honorarium or even sitting fee. That is how the mission was pursued and accomplished.” “It was the generosity of my esteemed colleagues in the Government nominated Board who recommended my name that I should be conferred this prestigious award (Padma Shree) and that is how the Government awarded this”.

I would be less than honest if I say that I am not pleased to receive this award (Padma Shree) because it does give me a great pleasure, but I would also like to admit that what gives me even greater pleasure is the appreciation and regard which the profession has showered on me for over 56 years that I have been a member of this profession” said CA. Y.H. Malegam. ☺

Thankful for the Padma Shri, CA. T. N. Manoharan said: "Let me admit, I could have not been able to do what I could do for the revival of Satyam but for the competency, domain expertise that I could gather as a Chartered Accountant in my tenure as Vice-President and President of ICAI. Therefore, it is not an honour to an individual; it is an honour to the profession as such which makes me what I am. So, it is my proud privilege to dedicate this award to each and every one of you who are members of the profession of chartered accountancy." "I personally believe that this award, as far as I am concerned, is not for what has been done or what has been contributed, it is what I am expected to do for the society and the nation in the years to come. First 25 years, we learn. Next 25 years or so, we earn. But, the accomplishment in life comes when you share what you have learnt and what you have earned."



CA. Y. H. Malegam being felicitated



CA. Y. H. Malegam

Replying to his felicitation, ICAI Past President and Padma Shri awardee **CA. Y. H. Malegam** said he was extremely grateful for the honour. "I would be less than honest if I say that I am not pleased to receive this award (Padma Shree) because it does give me a great pleasure, but I would also like to admit that what gives me even greater pleasure is the appreciation and regard which the profession has showered on me for over 56 years that I have been a member of this profession."

Hailing the profession of Chartered Accountancy, CA. Malegam said: "We are a profession which has a glorious past and a brilliant future. We represent in a sense an essential condition for the existence of the capital market, and the capital market is the instrument through which the savings of the community are collected and channelised into productive and technological uses. If this productive and technological use had not taken place, we would not be enjoying the significant increase in the value systems and comforts which we are enjoying today, and this would not have been possible, if the capital market had not existed. But, the capital market itself would not have existed, if profession had not existed. Therefore, we have played a significant role in the development of

the economy and in the growth of the economy and for this, we should be proud.” However, on a note of caution, he said: “But, being proud is not enough. We also need to recognise our responsibilities. It is because of this significant role which we are playing, we are, in fact, responsible, to a large extent, to provide the technical expertise, the independence and the integrity which is necessary for us to fulfil that role. I am sure as we have been doing for the last 62 years, we will continue to do so.”

CA. Y. H. Malegam said the origins of the profession really lie in the guild system in England. “The guilds, as you know, were the bodies of master craftsmen. They were bodies which were established by master craftsmen in individual trades. So, you had a guild of nascence. You had a guild of artisans. You had a guild of jewelers and so on. The guild system worked on the basis that there was a master craftsman and he had a body of apprentices, who looked over his shoulder and in that process, acquired the skill which the master craftsman had. That is the genesis of our articleship system.” “But, it is not just enough that the apprentice acquired the skill of the master craftsman; he also acquired his value systems, and that is the great opportunity which we have that we, as members of the profession, we, who have access to this large body of article clerks who are below us, have the opportunity to inculcate in them the value systems which are so important for the future development of the country. I believe this really is the task before our profession.”

Dr. Moily also gave away awards to meritorious CA students and the ICAI Regional Councils and branches which were adjudged outstanding under different categories in the year gone by.



Mr. T. Karthikeyan

Earlier at the beginning of the function, ICAI Secretary **Shri T. Karthikeyan** in his welcome address said that ICAI Annual Function traditionally is seen as an occasion of introspection and reckoning. Welcoming all the guests and huge gathering, he particularly gave an account of the contributions of the

Chief Guest Corporate Affairs Minister Dr. M. Veerappa Moily and Padma Shri awardees Past President CA. T. N. Manoharan and CA. Y. H. Malegam to the profession, society and the nation.

The vote of thanks was proposed by the then Vice President **CA. Jaydeep Narendra Shah**. Thanking Chief guest Dr. Moily, CA. Shah said the words of wisdom by the minister were really inspiring. He assured the Government that ICAI is taking pro-active measures for regulating the profession and coming



CA. Jaydeep Narendra Shah

up to the expectations of the Government and Society for the benefit of society. The then Vice President sought constant guidance and support from the Ministry of Corporate Affairs and said all the suggestions and advises by Dr. Moily have been well taken by the ICAI. He also thanked Padma Shri awardees CA. T. N. Manoharan

and CA. Y. H. Malegam for their inspiring addresses. He also thanked all the Past Presidents, award winner students, regional councils and branches, various Government officials and other dignitaries present on the occasion. ■

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I, Vijay Kapur hereby declare that the particulars given above are true to the best of my knowledge and belief.

Date: sd/-
February 22, 2012 Vijay Kapur
Signature of publisher

Legal Decisions¹

DIRECT TAXES



Income-tax Act

LD/60/91

Delhi Music Society

Vs.

Director General of Income-tax
December 16, 2011 (DEL)

Section 10(23C) of the Income-tax Act, 1961 - Exemption - Religious

Trust / Institution

Where petitioner society was run like any school or educational institution in a systemic manner with regular classes, vacations, attendance requirements, enforcement of discipline and so on without any profit motive, it should be approved as an educational institution; mere fact that it was not recognised by UGC or it did not conduct its own examination or awards degrees of its own, would not disentitle it from being approved as educational institution

The petitioner was registered as a society established with the aims and objects to teach, promote and encourage all forms of Music and Dancing (Western, Indian or any other). In the financial year 2008-09, the gross receipts of the petitioner exceeded ₹1 crore and, therefore, as stipulated in section 10(23C)(vi), the petitioner was obliged to apply to the "prescribed authority" for approval so that it could continue to enjoy the tax exemption.

The prescribed authority, after giving the petitioner an opportunity of being heard, rejected the claim for exemption. He took the objections that (a) the petitioner had to satisfy that it came within the expression "other educational institution", (b) after conclusion of the classes, examinations were conducted by the Trinity College and the Associated Board of the Royal School of Music, London. The petitioner itself did not award any degree/certificate, (c) The petitioner was not an institution recognized by the UGC or any Board constituted by the Government of India, and (d) the petitioner could not be distinguished from any coaching or training institute preparing the students for appearing any examination for obtaining a formal degree by a formally recognised institution. The prescribed authority held that the petitioner was not entitled to be characterized as an "educational institution" within the meaning of section 10(23C) (vi) for the assessment year 2010-11 onwards.

The Delhi High Court held that the petitioner was teaching and promoting all forms of music and dance, western, Indian or any other. In accordance with the object, it was running a music school in Delhi, collecting tuition fee and admission fee from the students. Teachers had been employed and they had been paid salaries.

Expenditure was also incurred on the maintenance of musical instruments. The petitioner had also filed audited account for these years. There are 549 students enrolled with the petitioner who are taught western instruments according to their choice such as Piano, Guitar, Electronic Key Board, Wind Instruments, Drums and Vocal. The school faculty comprises of 30 teachers with 25 of them being Grade 8 and above in western music. There is reference to scholarships that are open to the students including waiver of fees from 25% to 90%. It had been stated that several students of the school have gone on for higher musical studies to places like Moscow, London, New York, Prague and Rome. There are rules and regulations governing the running of the school. The main rules and regulations are that the school works for all seven days a week and remains closed only on national and public holidays; that the school year is divided into four terms of three months each; that students who are attending instrumental music classes would be taught individually by the teachers; that dance students would be taught in groups; that there would be workshops/lecture demonstrations arranged for the benefit of the students from time to time and that attendance in such workshops would be compulsory; that students who report late by more than 20 minutes may be marked absent and so on. There is also a rule that the students who are irregular in attending the classes or absent themselves frequently for long periods without prior intimation, would be removed from the rolls and if any of the students are found lacking in application or discipline, they are liable to be terminated by the Principal.

It is seen from the above that the petitioner is being run like any school or educational institution in a systemic manner with regular classes, vacations, attendance requirements, enforcement of discipline and so on. These provisions in the rules and regulations satisfy the condition laid down in the judgment of the Supreme Court in *Sole Trustee, Loka Shikshana Trust vs. CIT (1975) 101 ITR 234*, that there should be a process of training and developing the knowledge, skill, mind and character of the students by "normal schooling". It cannot be doubted that, having regard to the manner in which the petitioner runs the music school, that there is imparting of systematic instruction, schooling or training given to the students so that they attain proficiency in the field of their choice – vocal or instrumental in western classical music.

The observations of the Supreme Court in *Centre for Policy Research; V.A. Pai Panandiker v. Brahma Chellaney and Others (2010) INDLAW DEL 928*, support the stand

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

of the petitioner that it does not conduct its own examination or awards degrees of its own is not decisive of the question whether it is an educational institution or not. It also lends support to the petitioner's stand before the prescribed authority that it is not a mere coaching centre preparing students for competitive examinations. The coaching centres, as understood, are where candidates are specially prepared to appear in competitive examinations such as civil services, entrance examination for IIMs, IITs and other professional colleges. Profit motive pervades and is the essence of the business activity undertaken by the coaching institutes. The primary object of the coaching institutes is personal or self gain and activity undertaken is with the said objective. Knowledge of education may be imparted but "charity" or philanthropy is missing. No such finding or observation is recorded and stated in the impugned order. The difference between coaching centers and an "educational institution" from section 2(15) or 10(vi) is apparent.

In the petitioner's case, the prescribed authority has not stated that the music school is being run with a profit motive. No objection to the application for approval has been taken by the prescribed authority on this ground.

Thus, the petitioner meets the requirements of an educational institution within the meaning of section 10(23C)(vi). Accordingly, the order passed by the prescribed authority was to be quashed.

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LD/60/92

Vodafone International Holdings B.V.

Vs.

Union of India

January 20, 2012 (SC)

Section 45, read with sections 9, 163 and 195, of the Income-tax Act, 1961 - Capital gains - Chargeable as

Where a non-resident company HTIL entered into off shore transaction of transferring its non-resident subsidiary CGP to another non-resident company VIH by virtue of which CGP's shareholding in its Indian subsidiary HEL is also transferred, such off shore transaction being a bonafide structured FDI investment into India and not a sham or tax avoidant preordained transaction, was not taxable in India

The Cayman Island company HTIL held shares of another Cayman Island company CGP. CGP held through various subsidiaries, the direct and indirect equity and

loan interests in Indian telecom company HEL. HTIL transferred CGP to Dutch Company VIH for consideration of about US \$ 11.08 billion. The Indian tax authorities sought to impose tax on payment made to HTIL on ground that in fact there was transfer of controlling interest in an Indian company.

The Supreme Court held as follows:

International Tax Aspects of Holding Structures

The approach of both the corporate and tax laws, particularly in the matter of corporate taxation, generally is founded on the separate entity principle, i.e., treat a company as a separate person. The Indian Income Tax Act, 1961, in the matter of corporate taxation, is founded on the principle of the independence of companies and other entities subject to income-tax. Companies and other entities are viewed as economic entities with legal independence vis-a-vis their shareholders/participants. It is fairly well accepted that a subsidiary and its parent are totally distinct tax payers. Consequently, the entities subject to income-tax are taxed on profits derived by them on standalone basis, irrespective of their actual degree of economic independence and regardless of whether profits are reserved or distributed to the shareholders/participants. Furthermore, shareholders/participants, that are subject to (personal or corporate) income-tax, are generally taxed on profits derived in consideration of their shareholding/participations, such as capital gains. Now a days, it is fairly well settled that for tax treaty purposes a subsidiary and its parent are also totally separate and distinct tax payers.

It is generally accepted that the group parent company is involved in giving principal guidance to group companies by providing general policy guidelines to group subsidiaries. However, the fact that a parent company exercises shareholder's influence on its subsidiaries does not generally imply that the subsidiaries are to be deemed residents of the State in which the parent company resides. Further, if a company is a parent company, that company's executive director(s) should lead the group and the company's shareholder's influence will generally be employed to that end. This obviously implies a restriction on the autonomy of the subsidiary's executive directors. Such a restriction, which is the inevitable consequences of any group structure, is generally accepted, both in corporate and tax laws. However, where the subsidiary's executive directors' competences are transferred to other persons/bodies or where the subsidiary's executive directors' decision making has become fully subordinate to the Holding Company with the consequence that the subsidiary's executive directors are no more than puppets then the turning point in respect of the subsidiary's place of residence comes about. Similarly, if an actual controlling Non-Resident Enterprise (NRE) makes an indirect transfer through "abuse of



organisation form/legal form and without reasonable business purpose" which results in tax avoidance or avoidance of withholding tax, then the Revenue may disregard the form of the arrangement or the impugned action through use of Non-Resident Holding Company, recharacterize the equity transfer according to its economic substance and impose the tax on the actual controlling Non-Resident Enterprise. Thus, whether a transaction is used principally as a colourable device for the distribution of earnings, profits and gains, is determined by a review of all the facts and circumstances surrounding the transaction. It is in the above cases that the principle of lifting the corporate veil or the doctrine of substance over form or the concept of beneficial ownership or the concept of alter ego arises. There are many circumstances, apart from the one given above, where separate existence of different companies, that are part of the same group, will be totally or partly ignored as a device or a conduit (in the pejorative sense).

The common law jurisdictions do invariably impose taxation against a corporation based on the legal principle that the corporation is "a person" that is separate from its members. It is the decision of the House of Lords in *Salomon v. Salomon* [1897] A.C. 22 that opened the door to the formation of a corporate group. If a "one man" corporation could be incorporated, then it would follow that one corporation could be a subsidiary of another. This legal principle is the basis of Holding Structures. It is a common practice in international law, which is the basis of international taxation, for foreign investors to invest in Indian companies through an interposed foreign holding or operating company, such as Cayman Islands or Mauritius based company for both tax and business purposes. In doing so, foreign investors are able to avoid the lengthy approval and registration processes required for a direct transfer (i.e., without a foreign holding or operating company) of an equity interest in a foreign invested Indian company. However, taxation of such Holding Structures very often gives rise to issues such as double taxation, tax deferrals and tax avoidance. The concept of GAAR is not new to India since India already has a judicial anti-avoidance rule, like some other jurisdictions. Lack of clarity and absence of appropriate provisions in the statute and/or in the treaty regarding the circumstances in which judicial anti-avoidance rules would apply has generated litigation in India. Holding Structures are recognized in corporate as well as tax laws. Special Purpose Vehicles (SPVs) and Holding Companies have a place in legal structures in India, be it in company law, takeover code under SEBI or even under the income tax law. When it comes to taxation of a Holding Structure, at the threshold, the burden is on the Revenue to allege and establish abuse, in the sense of tax avoidance in the creation and/or use of

such structure(s). In the application of a judicial anti-avoidance rule, the Revenue may invoke the "substance over form" principle or "piercing the corporate veil" test only after it is able to establish on the basis of the facts and circumstances surrounding the transaction that the impugned transaction is a sham or tax avoidant. To give an example, if a structure is used for circular trading or round tripping or to pay bribes then such transactions, though having a legal form, should be discarded by applying the test of fiscal nullity. Similarly, in a case where the Revenue finds that in a Holding Structure an entity which has no commercial/business substance has been interposed only to avoid tax then in such cases applying the test of fiscal nullity it would be open to the Revenue to discard such inter-positioning of that entity. However, this has to be done at the threshold. In this connection, the "look at" principle enunciated in *W.T. Ramsay Ltd. V. Inland Revenue Commissioners (1981) 1 All E. R. 865* may be reiterated in which it was held that the Revenue or the Court must look at a document or a transaction in a context to which it properly belongs to. It is the task of the Revenue/Court to ascertain the legal nature of the transaction and while doing so it has to look at the entire transaction as a whole and not to adopt a dissecting approach. The Revenue cannot start with the question as to whether the impugned transaction is a tax deferment/saving device but that it should apply the "look at" test to ascertain its true legal nature.

Applying the above tests, it is to be concluded that every strategic foreign direct investment coming to India, as an investment destination, should be seen in a holistic manner. While doing so, the Revenue/Courts should keep in mind the following factors: the concept of participation in investment, the duration of time during which the Holding Structure exists; the period of business operations in India; the generation of taxable revenues in India; the timing of the exit; the continuity of business on such exit. In short, the onus will be on the Revenue to identify the scheme and its dominant purpose. The corporate business purpose of a transaction is evidence of the fact that the impugned transaction is not undertaken as a colourable or artificial device. The stronger the evidence of a device, the stronger the corporate business purpose must exist to overcome the evidence of a device.

Whether Section 9 is a "look through" provision as submitted on behalf of the Revenue?

Section 9(1)(i) gathers in one place various types of income and directs that income falling under each of the sub-clauses shall be deemed to accrue or arise in India. Broadly there are four items of income. The income dealt with in each sub-clause is distinct and independent of the other and the requirements to bring income within each sub-clause, are separately noted. Hence, it is not necessary that income falling in

one category under any one of the sub-clauses should also satisfy the requirements of the other sub-clauses to bring it within the expression "income deemed to accrue or arise in India" in Section 9(1)(i). In this case, the last sub-clause of Section 9(1)(i) is concerned which refers to income arising from "transfer of a capital asset situate in India". Thus, charge on capital gains arises on transfer of a capital asset situate in India during the previous year. The said sub-clause consists of three elements, namely, transfer, existence of a capital asset, and situation of such asset in India. All three elements should exist in order to make the last sub-clause applicable. Therefore, if such a transfer does not exist in the previous year no charge is attracted. Further, Section 45 enacts that such income shall be deemed to be the income of the previous year in which transfer took place. Consequently, there is no room for doubt that such transfer should exist during the previous year in order to attract the said sub-clause. The fiction created by Section 9(1)(i) applies to the assessment of income of non-residents. In the case of a resident, it is immaterial whether the place of accrual of income is within India or outside India, since, in either event, he is liable to be charged to tax on such income. But, in the case of a non-resident, unless the place of accrual of income is within India, he cannot be subjected to tax. In other words, if any income accrues or arises to a nonresident, directly or indirectly, outside India is fictionally deemed to accrue or arise in India if such income accrues or arises as a sequel to the transfer of a capital asset situate in India. Once the factum of such transfer is established by the Department, then the income of the non-resident arising or accruing from such transfer is made liable to be taxed by reason of Section 5(2)(b) of the Act. This fiction comes into play only when the income is not charged to tax on the basis of receipt in India, as receipt of income in India by itself attracts tax whether the recipient is a resident or nonresident. This fiction is brought in by the legislature to avoid any possible argument on the part of the non-resident vendor that profit accrued or arose outside India by reason of the contract to sell having been executed outside India. Thus, income accruing or arising to a non-resident outside India on transfer of a capital asset situate in India is fictionally deemed to accrue or arise in India, which income is made liable to be taxed by reason of Section 5(2)(b) of the Act. This is the main purpose behind enactment of Section 9(1)(i) of the Act. One has to give effect to the language of the section when it is unambiguous and admits of no doubt regarding its interpretation, particularly when a legal fiction is embedded in that section. A legal fiction has a limited scope. A legal fiction cannot be expanded by giving purposive interpretation particularly if the result of such interpretation is to transform the concept of

chargeability which is also there in Section 9(1) (i), particularly when one reads Section 9(1)(i) with Section 5(2) (b) of the Act. What is contended on behalf of the Revenue is that under Section 9(1)(i) it can "look through" the transfer of shares of a foreign company holding shares in an Indian company and treat the transfer of shares of the foreign company as equivalent to the transfer of the shares of the Indian company on the premise that Section 9(1)(i) covers direct and indirect transfers of capital assets. For the above reasons, Section 9(1)(i) cannot by a process of interpretation be extended to cover indirect transfers of capital assets/property situate in India. To do so, would amount to changing the content and ambit of Section 9(1)(i). The Court cannot re-write Section 9(1)(i). The legislature has not used the words indirect transfer in Section 9(1)(i). If the word indirect is read into Section 9(1)(i), it would render the express statutory requirement of the 4th sub-clause in Section 9(1)(i) nugatory. This is because Section 9(1)(i) applies to transfers of a capital asset situate in India. This is one of the elements in the 4th sub-clause of Section 9(1)(i) and if indirect transfer of a capital asset is read into Section 9(1)(i) then the words capital asset situate in India would be rendered nugatory. Similarly, the words underlying asset do not find place in Section 9(1)(i). Further, "transfer" should be of an asset in respect of which it is possible to compute a capital gain in accordance with the provisions of the Act. Moreover, even Section 163(1)(c) is wide enough to cover the income whether received directly or indirectly. Thus, the words directly or indirectly in Section 9(1)(i) go with the income and not with the transfer of a capital asset (property). Lastly, it may be mentioned that the Direct Tax Code (DTC) Bill, 2010 proposes to tax income from transfer of shares of a foreign company by a non-resident, where at any time during 12 months preceding the transfer, the fair market value of the assets in India, owned directly or indirectly, by the company, represents at least 50% of the fair market value of all assets owned by the company. Thus, the DTC Bill, 2010 proposes taxation of offshore share transactions. This proposal indicates in a way that indirect transfers are not covered by the existing Section 9(1)(i) of the Act. In fact, the DTC Bill, 2009 expressly stated that income accruing even from indirect transfer of a capital asset situate in India would be deemed to accrue in India. These proposals, therefore, show that in the existing Section 9(1)(i) the word indirect cannot be read on the basis of purposive construction. The question of providing "look through" in the statute or in the treaty is a matter of policy. It is to be expressly provided for in the statute or in the treaty. Similarly, limitation of benefits has to be expressly provided for in the treaty. Such clauses cannot be read into the Section by interpretation. For the foregoing reasons it is to

be held that Section 9(1)(i) is not a "look through" provision.

On facts, it may be seen that under the HTIL structure, as it existed in 1994, HTIL occupied only a persuasive position/influence over the downstream companies *qua* manner of voting, nomination of directors and management rights. That, the minority shareholders/investors had participative and protective rights (including Right of First Refusal (RoFR), Tag Along Rights (TARs), call and put options which provided for exit) which flowed from the CGP share. That, the entire investment was sold to the VIH through the investment vehicle (CGP). Consequently, there was no extinguishment of rights as alleged by the Revenue.

Role of CGP in the transaction

On the role of CGP in the transaction, two documents are required to be referred to. One is the Report of the KPMG dated 18.10.2010 in which it is stated that through the acquisition of CGP, VIH had indirectly acquired the rights and obligations of GSPL in the Centrino and NDC Framework Agreements. That, the said two agreements were put in place with a view to provide AG and AS with downside protection while preserving upside value in the growth of HEL. The second document is the Annual Report 2007 of HTIL. Under the caption "Overview", the Report observes that on 11.02.2007, HTIL entered into an agreement to sell its entire interests in CGP, a company which held through various subsidiaries, the direct and indirect equity and loan interests in HEL (renamed VEL) and its subsidiaries to VIH for a cash consideration of HK \$86.6 bn. As a result of the said Transaction, the net debt of the Group which stood at HK \$37,369 mn as on 31.12.2006 became a net cash balance of HK \$25,591 mn as on 31.12.2007. This supports the fact that the sole purpose of CGP was not only to hold shares in subsidiary companies but also to enable a smooth transition of business, which is the basis of the SPA. Therefore, it cannot be said that the intervened entity (CGP) had no business or commercial purpose.

As a general rule, in a case where a transaction involves transfer of shares lock, stock and barrel, such a transaction cannot be broken up into separate individual components, assets or rights such as right to vote, right to participate in company meetings, management rights, controlling rights, control premium, brand licences and so on as shares constitute a bundle of rights. Further, the High Court has failed to examine the nature of the following items, namely, non-compete agreement, control premium, call and put options, consultancy support, customer base, brand licences etc. On facts, the High Court, in the present case, ought to have examined the entire transaction holistically. VIH has rightly contended that the transaction in question should be looked at as an entire package. The items mentioned hereinabove, like, control premium,

non-compete agreement, consultancy support, customer base, brand licences, operating licences etc. were all an integral part of the Holding Subsidiary Structure which existed for almost 13 years, generating huge revenues, as indicated above. Merely because at the time of exit capital gains tax becomes not payable or exigible to tax would not make the entire "share sale" (investment) a sham or a tax avoidant. The High Court has failed to appreciate that the payment of US\$ 11.08 bn was for purchase of the entire investment made by HTIL in India. The payment was for the entire package. The parties to the transaction have not agreed upon a separate price for the CGP share and for what the High Court calls as "other rights and entitlements" (including options, right to non-compete, control premium, customer base etc.). Thus, it was not open to the Revenue to split the payment and consider a part of such payments for each of the above items. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or on the basis that the payment is related to a contingency ('options', in this case), particularly when the transaction does not contemplate such a split up. Where the parties have agreed for a lump sum consideration without placing separate values for each of the above items which go to make up the entire investment in participation, merely because certain values are indicated in the correspondence with FIPB which had raised the query, would not mean that the parties had agreed for the price payable for each of the above items. The transaction remained a contract of outright sale of the entire investment for a lump sum consideration. Thus, one needs to "look at" the entire Ownership Structure set up by Hutchison as a single consolidated bargain and interpret the transactional documents, while examining the Offshore Transaction of the nature involved in this case, in that light.

Summary of Findings

Applying the **look at** test in order to ascertain the true nature and character of the transaction, it is to be held that the Offshore Transaction herein is a *bonafide* structured FDI investment into India which fell outside India's territorial tax jurisdiction, hence not taxable. The Offshore Transaction evidences **participative investment** and not a sham or tax avoidant preordained transaction. The Offshore Transaction was between HTIL (a Cayman Islands company) and VIH (a company incorporated in Netherlands). The subject matter of the Transaction was the transfer of the CGP (a company incorporated in Cayman Islands). Consequently, the Indian Tax Authority had no territorial tax jurisdiction to tax the said Offshore Transaction.

Note: Judgment of Bombay High Court in Writ Petition No 1325 of 2010 dated 8-9-2010 was set aside.

LD/60/93

Commissioner of Income-tax (Central)

Vs.

*Smt. Shaila Agarwal**November 25, 2011 (ALL)**[Assessment Year 2002-03]***Section 153A read with Section 132 of the Income-tax Act, 1961 - Assessment in case of search or requisition***As a consequence of search under Section 132, and notice under section 153A, regular assessment proceedings, which had become final, cannot be abated and restored to file of Assessing Officer*

A plain reading of Section 153A would show that where notice under this Section is issued as result of any search under Section 132, assessment or reassessment if any relating to any assessment year falling within the period of six assessment years referred to under Section 153, pending on the date of initiation of search under Section 132 or requisition under Section 132A shall abate. The words, pending on the date of initiation of search under Section 132, or making of requisition under Section 132A, as the case may be, has to be assigned simple and plain meaning. Where the assessment or reassessment is finalised, there are no pending proceedings to be abated, and restored to the file of the assessing officer. To abate means to diminish or to take away.

The word 'abatement' is referable to something, which is pending alive, or is subject to deduction. The abatement refers to suspension or termination of the proceedings either of the main action, or the proceedings ancillary or collateral to it. The word is commonly used in the legislations, which provide for abatement of action/suit; abatement of legacies; abatement of nuisance; and all actions for such nature, which have the pendency or continuance. The proceedings, which have already terminated are not liable for abatement unless statute expressly provides for such consequence thereof.



The word 'pending' occurring in the second proviso to Section 153A of the Act, is also significant. It is qualified by the words 'on the date of initiation of the search', and makes it abundantly clear that only such assessment or reassessment proceedings are liable to abate.

The pendency of an appeal in the Tribunal against the order of assessment against which an appeal has been decided by CIT (A) is not a continuation of the proceedings of assessment. An appeal under the Income Tax Act lies to the Appellate Tribunal on a question of law. Even if it is pending on the date of search, no such intention has indicated by the Tribunal arises out of the provisions of second proviso to Section 153A, to abate the proceedings, which have been completed, or concluded, and to restore assessment to the file of the Assessing Officer.

There is no force in the submission that where a notice under Section 153A has been given after the search operations under Section 132, for filing assessment for the block period of 6 years, and if such period includes any of the assessment year, the abatement of assessment and re-assessment proceedings, to give way to reassessment considering the additions in the assessment under Section 153A, will also include the assessment or re-assessment, which has been completed. If as a result of search, some undisclosed income is found to have escaped assessment, the Assessing Officer, may initiate steps for reassessment after sanction of competent authority, within the prescribed period of limitation.

A Circular No.7 of 2003 dated 5.9.2003 issued by the Commissioner of Income Tax has clarified the position stating that "The Assessing Officer shall assess or reassess the total income of each of these six assessment years. Assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years pending on the date of initiation of the search under section 132 or requisition under section 132A, as the case may be, shall abate. It is clarified that the appeal, revision or rectification proceedings pending on the date of initiation of search under section 132 or requisition shall not abate. Save as otherwise provided in the proposed section 153A, section 153B and section 153C, all other provisions of this Act shall apply to the assessment or reassessment made under section 153A. It is also clarified that assessment or reassessment made under section 153A shall be subject to interest, penalty and prosecution, if applicable. In the assessment or reassessment made in respect of an assessment year under this section, the tax shall be chargeable at the rate or rates as applicable to such assessment year."

The second proviso to Section 153A, refers to abatement of the pending assessment or re-assessment proceedings. The word 'pending' does not operate any

such interpretation, that wherever the appeal against such assessment or reassessment is pending, the same alongwith assessment or reassessment proceedings is liable to be abated. The principles of interpretation of taxing statutes do not permit the Court to interpret the Second Proviso to Section 153A in a manner that where the assessment or reassessment proceedings are complete, and the matter is pending in appeal in the Tribunal, the entire proceedings will abate.

There is another aspect to the matter, namely that the abatement of any proceedings has serious causes and effect in as much as the abatement of the proceedings, takes away all the consequences that arise thereafter. The material found in the search may be a ground for notice and assessment under Section 153A of the Act but that would not efface or terminate all the consequence, which has arisen out of the regular assessment or reassessment resulting into the demand or proceedings of penalty.

For the aforesaid reasons, the Income Tax Appellate Tribunal erred in law in abating the regular assessment proceedings, which had become final, and restoring them as a consequence of search under Section 132, and notice under Section 153A of the Act to the file of the Assessing Officer.

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LD/60/94

Bhura Exports Ltd.

Vs.

Income-tax Officer (TDS)

August 30, 2011 (CAL)

[Assessment Year 2002-03]

Section 201 of the Income-tax Act, 1961 - Deduction of tax at source - Failure to deduct or pay, consequences of

In applying the provisions contained in Section 201 where the previous bar of limitation was lifted by amendment and there was no period of limitation fixed for exercising such power at the relevant point of time i.e., from 1-4-1989 to 1-4-2010, no question of invoking a reasonable period of limitation arises

The embargo of limitation provided earlier in Section 231 of the Act for taking action under Section 201 had been omitted with effect from April 1, 1989 and the selfsame bar of limitation was re-introduced by way of addition of sub-Section (3) of Section 201 with effect from April 1, 2010 and thus, in between these periods, there was no bar of the period of limitation of taking action under Section 201 of the Act. The time limit prescribed in Section 149 of the Act for taking action under Section 147 by giving notice under Section 148 cannot have any application for taking action under Section 201 as it is not a case of income escaping assessment but a case of inaction of a debtor to deduct tax on interest while making payment of the interest in violation of Section 194A the Circular No. 275/201/95-IT



(B), dated January 29, 1997 issued by the Central Board of Direct Taxes, has put an end to the controversy as regards the extent of liability of the deductor. The circular states that “no demand visualized under Section 201(1) of the Income-tax Act should be enforced after the tax deductor has satisfied the officer-in-charge of TDS, that taxes due have been paid by the deductee-assessee. However, this will not alter the liability to charge interest under Section 201 (1A) of the Act till the date of payment of taxes by the deductee-assessee or the liability for penalty under Section 271C of the Income-tax Act.”

Even if the person to whom interest was paid without deduction of tax had subsequently paid tax on that income, the deductor cannot escape the liability to pay interest under Section 201(1A) of the Act till the date of payment of taxes by the deductee-assessee nor can the deductor avoid the liability of penalty under Section 271C of the Act and the said provision is mandatory in nature. It is a different kind of a situation from the one of “income escaping assessment” and for the above reason, the legislature made a separate provision of bar of limitation as prescribed in Section 231 of the Act in spite of existence of the provision contained in Section 149 being conscious that the said provision cannot have any application in the matter of taking action under Section 201 and again reintroduced the same period of limitation by way of incorporation of sub-section (3) of Section 201. There would be a definite error of law in applying the time limit prescribed in Section 149.

The next question is if in any given Statute, there is no period of limitation prescribed for taking an action under that Statute, whether such action should be taken within a reasonable period. If no period of limitation is prescribed under a Statute for taking action under it and at the same time, the Limitation Act does not apply to such a Statute, there cannot be any prohibition of the period of limitation for taking action under the said Statute unless there is any contrary intention expressed in the said Statute.

A Three-Judge- Bench of the Supreme Court in the case of *Uttam Namdeo Mahale Vs. Vithal Deo and others*, AIR 1997 SC 2695 has held that “In the absence of any specific limitation provided under Mamlatdar’s Court Act,

necessary implication is that the general law of limitation provided in Limitation Act (Act 2 of 1963) stands excluded. Where no limitation has been prescribed, an order can be executed at any time, especially when the law of limitation for the purpose of filing appeal therefore is not there. Where there is statutory rule operating in the field, the implied power of exercise of the right within reasonable limitation does not arise”.

The Supreme Court in the case of *Ishar Singh Vs. Financial Commissioner and others*, AIR 1984 SC 1719 took a similar view and held that no period of limitation would apply to the filing of an application under Section 43 of the Pepsu Tenancy Act of 1955 since no such period was prescribed by that Act and the Limitation Act had also no application to a proceeding under the Pepsu Tenancy Act.

Under the Income-tax Act, there is no scope of applying the provisions of the Limitation Act as would appear from the fact that in Section 260A itself, the power of condonation of delay in filing the appeal has been incorporated by the legislature by introducing sub-section 2A with effect from April 1, 2010 only and if the Limitation Act of its own had the application to such an appeal, there was no necessity of incorporation of such a provision in Section 260A and that too, with effect from April 1, 2010.

Therefore, in applying the provisions contained in Section 201 where the previous bar of limitation was lifted by amendment and there was no period of limitation fixed for exercising such power at the relevant point of time, no question of invoking a reasonable period of limitation arises.

Section 201 of the Income-tax Act, 1961 - Deduction of tax at source - Failure to deduct or pay, consequences of

Where assessee had utilized unspent credit limits of third party for importing goods and interest payable by third party to Bank was paid back to third party and further, assessee paid commission to said third party, payment made by assessee would be liable to TDS under section 194A

The appellant had paid ₹7,54,521 to Globe International Ltd. and the documents were sent through Bank. Since the appellant did not have sufficient Bank Letter of Credit limits (LC) for import of materials from foreign countries, it had utilized the LC limit of Globe International, for which the appellant paid commission @ 1% on utilized LC limits and Bank charges etc. According to the appellant, for utilizing the L.C. limits of Global, interest had been charged by the Bank which was paid by Global to the Bank on behalf of the appellant. Thus, the amount paid by the appellant to those two parties was the reimbursement of interest and consequently, no TDS was liable to be deducted.

On merit, the appellant tried to convince that the appellant did not take any loan from Globe International but utilized its unspent credit limits for importing the goods and thus, interest payable by the Global to the Bank was paid back to Global and as such, the interest was really payable by Globe International to the Bank and in such a circumstance, Section 194A was not attracted.

The Calcutta High Court held that the word “interest” has been defined in Section 2 (28A) of the Act. According to this definition “interest” means *interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.*

Thus, the case of the appellant that it really paid commission to Globe International for utilizing its unspent credit facilities for import clearly comes within the definition of interest as it is a debt incurred by the appellant, which includes an obligation to pay fee or other charges in respect of the unspent credit facility of the Globe International. It appears that the appellant in its book described the amount as interest paid to Globe International and the said Globe International also confirmed the same before the Assessing Officer. The appellant was under the obligation to deduct TDS from the amount paid to Globe International in terms of Section 194A.

LD/60/95

Classic Papers Converters P. Ltd.

Vs.

CIT

September 2, 2011 (DEL)

(Assessment Years 1994-95 & 1995-96)

Section 220 of the Income-tax Act, 1961 read with Section 3 of the Taxation Law (Continuation and Validation of Recovery Proceedings) Act, 1964 - Collection and recovery of tax – When tax payable and when assessee deemed in default

Where (i) addition made by Assessing Officer was deleted by Commissioner (Appeals), but upheld by Tribunal and





(ii) assessee's case was that though demand on addition was in fact paid, still show cause notice was issued for levying interest, matter was to be remanded for fresh adjudication

For the assessment years 1994-95 and 1995-96, additions were made by the Assessing Officer disallowing the foreign tour expenses of one of the directors of the petitioner. The aforesaid addition was deleted by the Commissioner (Appeals), but was confirmed by the Tribunal *vide* orders dated 19th April, 2004 and 29th April, 2004. The petitioner did not challenge the said orders and the additions attained finality.

Penalties under section 271(1)(c) were imposed and were sustained in the first appeal. The petitioner did not file any further appeal and the orders imposing penalty have attained finality. The petitioner had filed an application under section 273A for waiver of penalty, which was dismissed. Therefore, the demands both on account of additional tax and penalty had to be paid by the petitioner. Notices dated 23-12-2005 and 8-12-2006 were issued by the Income Tax Officer, and the rectification order dated 25-1-2007 was also passed by the same officer.

The petitioner claimed that after the assessment orders were passed, notice of demand under section 156 of the Act was issued to the petitioner. Such notice of demand would stand nullified as the Commissioner (Appeals) had deleted the additions. In this connection, reliance was placed on the decision of the *Supreme Court Vikrant Tyres Ltd. v. First Income-Tax Officer*, [2001] 247 ITR 821 (SC).

The respondent, on the other hand, had submitted that the demand would be so nullified in case demand had been paid in full at the initial stage. However, when demand has not been paid in full, in view of section 3 of the Taxation Law (Continuation and Validation of Recovery Proceedings) Act, 1964, the earlier notice under section

156 of the Act would stand revived. In this connection, they have relied on the decision of the Kerala High Court in *Indira Rani (B.) v. Commissioner of Income Tax* [1999] 237 ITR 20 (Ker).

The High Court of Delhi held that the judgments referred to above had not been considered and examined. Further, the petitioner had now contended that the demands were in fact paid. Another question which might arise was whether these demands were fully or partly paid and the effect of part payment, if any. As facts had not been discussed and stated in the order by the ITO, the order of the ITO dated 25-1-2007 was to be set aside and the matter was to be remitted.

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LD/60/96

Poonawalla Aviation Private Limited, In re
December 5, 2011 (AAR)

Section 245Q read with Section 195 of the Income-tax Act, 1961 read with Article 12 of the India-France Double Taxation Avoidance Convention - Advance rulings - Application for

Where French seller provides export credit facility to Indian purchaser and credit insurance premium was to be paid to French authority for extending export credit, interest paid to French seller on installment of loan or interest paid to French bank on endorsement of promissory notes for installment executed in its favour would not be taxable in India

The applicant, a company incorporated in India entered into an agreement for purchase of an aircraft from Dassault, a company incorporated in France. The French body 'COFACE', acting on behalf of French State in the export credit insurance, agreed to ensure the credit facility to be extended by the seller. As per amended agreement, the price payable was \$ 41,000,000. Out of that amount, Dassault, the seller, agreed to provide as export credit facility a sum of \$ 30,010,400. Out of that amount, the credit insurance premium of \$ 5,10,400 was to be paid to COFACE towards insurance premium. The amount loaned, or in respect of which the credit facility was extended was to be repaid in six-monthly instalments. Promissory notes, for installment payable, covering the principal and the interest separately were executed by the applicant in favour of Dassault. All the promissory notes were assigned by Dassault to bank BNP Paribas, France. The application was filed seeking an advance ruling as to whether it had any obligation to withhold tax on the interest payable.

The Authority for Advance Rulings held that insurance is a contract by which one party in consideration of a premium engages to pay an agreed sum on a certain event or indemnify another against a contingent loss. In a wider sense, a contract of insurance will come within

the scope of a contract of indemnity. But a contract of insurance against loss or damage to the subject matter of the insurance would not be a contract of indemnity. Here, the insurance is extended to the creditor, not to the debtor. The contract by the insurer is to indemnify the creditor, on the basis of the insurance contract. The liability is not based on the contract between the debtor and the creditor. COFACE has not extended the insurance facility to the debtor, the applicant. So, the mere fact that COFACE has insured the credit extended by Dassault, and is obliged to pay on the happening of the contingency agreed upon, does not mean that it has endorsed the credit facility extended by Dassault to the applicant.

COFACE has not guaranteed the repayment of the loan by the applicant. It has only engaged itself to pay an agreed sum to Dassault on the happening of a certain event, the event of Dassault incurring a loss on not being able to recover the loan or credit it has extended to the applicant. A contract of guarantee is a tripartite contract. It is only bilateral in this case, between COFACE and the Dassault.

Giving by the Convention between India and France, the mere extending of insurance cover by COFACE does not amount to 'extending or endorsing' the loan or credit by COFACE so as to attract paragraph 3(b) (i) of Article 12 of the DTAC. Further, the benefit of the Most Favoured Nation clause has been extended to Indo-French Convention.

Clause 7 of the Protocol reads that in respect of articles 11 (dividends), 12 (interest) and 13 (royalties, fee for technical services and payments for the use of equipment), if under any Convention, Agreement or Protocol signed after 1.9.1989, between India and a third State which is a member of the OECD, India limits its taxation at source.

In Treaties India had entered into with Canada, Hungary and Ireland exemption from taxation for interest relating to a loan or credit is available not only in respect of loans or credits made, guaranteed or extended, but also in respect of loans insured by institutions corresponding to COFACE in France.

In case of France also the convention covers loans or credits extended or endorsed by two institutions, the Banque Francaise du Commerce Exterieur or COFACE, the benefit is available.

When applying a tax treaty, it is necessary to carefully examine the Protocols and other additional documents. A protocol by itself amends or supports the existing treaty.

Clause 7 of the Protocol speaks of India limiting its taxation at source on interest dealt with in Article 12 of the Convention by providing a lower rate or by providing a scope more restricted than the rate or scope provided for in the Convention, the same rate or scope

shall also apply to the Convention in question.

Clause (b) of paragraph 3 of the India France Convention exempts interest income from tax in the State in which it arises in respect of France, if the loan and credits extended or endorsed by Banque Francaise due Commerce Exterieur or COFACE and any institution in charge of the public financing of external trade and in respect of India, if it is extended or endorsed by Export Import Bank of India or any institution incharge of the public financing of external trade.

If the coverage or protection is understood as extended to loan or credit insured by one of the institutions referred to in the Convention between India and France in the context of the provisions noticed above, it has to be held that a loan or credit insured by COFACE would also come within the purview of Article 12.3(b) of the India-France Convention. Hence, on the argument on behalf of the applicant based on the Most Favoured Nation clause, it is to rule that the interest payable in the case on hand is not taxable in India.

Based on this conclusion, it is ruled that the interest payable to Dassault is not taxable in India under Article 12.3(b) of the India-France Double Taxation Avoidance Convention in view of the Most Favoured Nation Clause in the India-France Protocol which has to be taken as part of the Convention. Further, the interest payable to BNP PARIBAS on endorsement of the promissory notes in its favour is also not taxable in India in view of the Article 12.3 (b) of the DTAC between India and France as modified by the Most Favoured Nation protocol. In view of the above, there will be no obligation on the applicant to withhold tax on the interest paid to Dassault or to BNP PARIBAS on the transaction.

Excise/Customs

INDIRECT TAXES



LD/60/97

Flex Engineering Limited
Vs.

Commissioner of Central Excise
January 13, 2012 (SC)

**Rule 57A of the Central Excise Rules,
1944 - Modvat Credit**

Materials which are not physically used in manufacture of customized machine but used for testing packaging machines would be entitled to Modvat Credit as process of testing customised machines is integrally connected with ultimate production of final product

The appellant-assessee, is engaged in the manufacture of various types of packaging machines, marketed as Automatic form 'fill and seal' machines (F&S machines), classified under chapter heading 8422.00 of the Schedule to the Central Excise Tariff Act, 1985. The assessee has prototype models of F&S machines

with technical details. The machines are 'made to order', inasmuch as all the dimensions of the packaging/sealing pouches, for which the F&S machine is required, are provided by the customer. The purchase order contains the inspection clause.

Flexible Laminated Plastic Film in roll form and Poly Paper which are duty paid, falling under chapter headings 3920.38 and 4811.30 of the Schedule to the Tariff Act, are used for testing, tuning and adjusting various parts of the F&S machine in terms of the purchase order. As the machine ordered is customer specific, if after inspection by the customer it is found deficient in respect of its operations for being used for a particular specified packaging, it cannot be delivered to the customer, till it is re-adjusted and tuned to make it match with the required size of the pouches as per the customer's requirement. On completion of the above process and when the customer is satisfied, an entry is made in the RG 1 register declaring the machine as manufactured, ready for clearance.

The assessee filed declarations and availed of the benefit of Modvat credit in respect of the Flexible Laminated Plastic Film in roll form and Poly Paper used for testing the F&S machine. The benefit of Modvat credit on the above goods was denied, on the ground that they have used the said material for the purpose of testing the final product i.e. the F&S machine which cannot be treated as inputs as stipulated in Rule 57A.

The Supreme Court of India held that the amended Rule itself contemplates that physical presence of the input, in respect of which Modvat credit is claimed, in the final product is not a pre-requisite for such a claim; even otherwise this issue is no longer *res-integra*.

In *CCE v. Rajasthan State Chemical Works (1991) 4 SCC 473 : 1991 (55) E.L.T. 444 (S.C.)*, the Supreme Court had held that any operation which results in the emergence of the manufactured goods would come within the ambit of the term manufacture. This is because of the words used in Rule 57A, namely, goods used in or in relation to the manufacture of final products.

It is trite to state that "manufacture" takes place when the raw materials undergo a series of changes and transformation that result in the formation of a commercially distinct commodity having a different name, character and use. It is equally well settled that physical presence of an input in the final finished excisable goods is not a pre-requisite for claiming Modvat credit under Rule 57A of the Rules. It may very well be indirectly related to manufacture and still be necessary for the completion of the manufacture of the final product. It needs little emphasis that the process of manufacture is complete only when the product is rendered marketable. Thus, manufacture is intrinsically integrated with marketability.

If a product is not saleable, it will not be marketable and consequently the process of manufacture would not

be held to be complete and duty of excise would not be leviable on it. The corollary to the above is that till the time the step of manufacture continues, all the goods used in relation to it will be considered as inputs and thus, entitled to Modvat credit under Rule 57A of the Rules. In the present case, as aforesaid, each machine is tailor made according to the requirements of individual customers. If the results are not in conformity with the order, then the machine loses its marketability and is of no use to any other customer. Thus, the process of manufacture will not be said to be complete till the time the machines meet the contractual specifications and that will not be possible unless the machines are subjected to individual testing. Even though the revenue has alleged that the process of manufacture is complete as soon as the machine is assembled, yet it has not discharged the onus of proving the marketability of the machines thus assembled, prior to the stage of testing.

Thus, the process of testing the customised F&S machines is inextricably connected with the manufacturing process, in as much as, until this process is carried out in terms of the afore-extracted covenant in the purchase order, the manufacturing process is not complete; the machines are not fit for sale and hence not marketable at the factory gate. Therefore, the manufacturing process in the present case gets completed on testing of the said machines and hence, the afore-stated goods viz. the flexible plastic films used for testing the F&S machines are inputs used in relation to the manufacture of the final product and would be eligible for Modvat credit under Rule 57A.

The process of testing the customised machines is integrally connected with the ultimate production of the final product viz. the F&S machines and therefore, that process is one in relation to the manufacture, falling within the sweep of Rule 57A.

Note: Judgments of the Allahabad High Court was set aside.

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LD/60/98

Indian Oil Corporation Ltd.

Vs.

CCE, Vadodara

&

Indian Oil Corporation Ltd.

Vs.

CCE, Lucknow

January 13, 2012 (SC)

Rule 192 read with Rule 8 of the Central Excise Rules, 1944 – Application for Concession

For availing concession from excise duty as per Notification No. 75/84-CE dated 01.03.1984 on excisable goods used in a specified industrial process, a person must obtain a registration certificate from the Collector and that “the concession shall, unless renewed by the Collector, cease on the expiry of the registration certificate”; for period between expiry of registration certificate and granting of fresh certificate, concession would not be available

The appellant produces *inter alia* Reduced Crude Oil (RCO). Under Notification No. 75/84-CE dated 01.03.1984, one of the goods exempted from excise duty by the notification was RCO, if produced only from indigenous crude oil subject to intended use as fuel for generation of electrical energy by electricity undertakings owned or controlled by the Central Government or any State Government or any State Electricity Board or any local authority or any licensee under Part-II of the Indian Electricity Act, 1910 except those who produce electrical energy not for sale but for their own consumption or for supply to their own undertakings. The proviso in the notification stated two conditions subject to which the exemption was granted and one of the conditions was that where the intended use is elsewhere than in the factory of production, it is necessary to obtain an excise registration certificate. Rule 192 further provided that the concession shall, unless renewed by the Collector, cease on the expiry of the registration certificate.

The Ahmedabad Electricity Company Ltd. had obtained a registration certificate in Form CT-2 under Rule 192 of Chapter X of the Rules and on the strength of such registration certificate, purchased RCO from the appellant availing the exemption from excise duty under Notification No. 75/84 dated 01.03.1984. The registration certificate obtained by the Ahmedabad Electricity Company Ltd. expired on 31.12.1995 and a fresh registration was granted in its favour on 26.06.1996. The Assistant Commissioner orders demanding excise duty of ₹32,35,485/- from the appellant for RCO supplied to the Ahmedabad Electricity Company Ltd. during the period 01.01.1996 to 25.06.1996 on the ground that the said company did not have a registration certificate in Form CT-2 under Rule 192 of Chapter X of the Rules during this period and, therefore, the RCO supplied by the appellant to the Ahmedabad Electricity

Company Ltd. during this period was not exempt from excise duty.

The Supreme Court of India held that the proviso to Rule 192 makes it clear that for availing the exemption two conditions must be satisfied: First, that it is proved to the satisfaction of the excise officer that the goods are used for intended use specified in Column (5) of the Table annexed to the exemption notification and second, where such use is elsewhere than in the factory of production, the procedure set out in Chapter X of the Rules is followed. Therefore, none can accept the contention of the appellant that if the first condition is satisfied, i.e. it is proved to the satisfaction of the Central Excise Officer that the goods are used for the intended use, the exemption has to be granted. Unless the second condition is also satisfied, i.e. the procedure set out in Chapter X of the Rules is followed where the use of the goods is elsewhere than in the factory of production, the exemption cannot be granted under the exemption notification.

In the facts of the present case, the RCO was not to be used in the factory of the appellant but at the place of generation of electricity by the Ahmedabad Electricity Company Ltd. Hence, the second condition laid down in the proviso was also to be complied with.

The language of Rule 192 of Chapter X of the Rules is clear that for availing concession from excise duty as per Notification No. 75/84-CE dated 01.03.1984 on

excisable goods used in a specified industrial process, a person must obtain a registration certificate from the Collector and that "the concession shall, unless renewed by the Collector, cease on the expiry of the registration certificate". Admittedly, the registration certificate of the appellant expired on 31.12.1995. Hence, the exemption granted under the notification ceased on 31.12.1995. The fresh registration certificate in favour of the Ahmedabad Electricity Company Ltd. was issued on 26.06.1996 and the registration certificate was not for any period prior to 26.06.1996. As the procedure laid down in Rule 192 of Chapter X of the Rules has not been complied with, the appellant is not entitled to avail the exemption of excise duty under the exemption notification during the period from 01.01.1996 to 25.06.1996. ■

Rule 3(1) the Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001 read with Section 5A of the Central Excise Act, 1944 – Application by the Manufacturer to obtain the benefit

Where manufacturer of fertilizer had not submitted application in the Form at Annexure-1 for obtaining Naphtha without payment of duty, appellant producer would not be entitled to exemption on provided by Notification No. 3/2001-CE dated 01.03.2001

The appellant produces *inter alia* Naphtha. By

Notification No. 3/2001-CE dated 01.03.2001 Naphtha cleared for the intended use in the manufacture of fertilizers was exempted from excise duty subject to relevant conditions specified in the annexure to the notification. In the annexure to the exemption notification, one of the conditions specified was that where such use is elsewhere than in the factory of production, the exemption shall be allowed if the procedure set out in the Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001 is followed.

Indo Gulf Corporation Limited placed an order on 16.07.2001 on the appellant for supply of Naphtha for the purpose of manufacture of fertilizers and furnished a letter to the appellant saying it has made an application to the Commissioner of Excise for authorization for dispatch of one rake of Naphtha. The appellant supplied 2241.908 MT of Naphtha to Indo Gulf Corporation Limited and while clearing the aforesaid Naphtha from its factory did not make any payment of Central Excise duty. The Commissioner of Central Excise raised the demand of duty and also imposed a penalty.

The Tribunal held that the manufacturer, namely, Indo Gulf Corporation Limited had not submitted application in the Form at Annexure-1 for obtaining Naphtha without payment of duty as the condition of the exemption notification has not been complied with, the appellant was not entitled to clear naphtha without payment of excise duty and accordingly sustained the demand of excise duty.

The Supreme Court held that by the exemption Notification No. 3/2001-CE dated 01.03.2001 the Central Government exempted the excisable goods from duty "subject to the relevant conditions specified in the Annexure" to the exemption notification.

It will be clear from Para 3 of the Annexure to the exemption notification that the exemption shall be allowed if it has been proved to the Central Excise Officer having jurisdiction that the goods are cleared for the intended use specified in column 3 of the table. In addition to this condition, there is a further condition in Para 4 of the Annexure to the exemption notification that where the intended use is elsewhere than the factory of production, the exemption shall be allowed if the procedure set out in the 2001 Rules is followed.

The condition specified in Para 4 in the Annexure to the exemption notification states that where the intend use is elsewhere than in the factory of production, the exemption shall be allowed if the procedure set out in the 2001 Rules is followed. In the facts of this case, the Naphtha produced by the appellant in its factory was to be used for the manufacture of fertilizer elsewhere than in its own factory, i.e. in the factory of Indo Gulf Corporation Limited. Hence, the exemption could be allowed only if the procedure set out in the 2001 Rules was followed.

Rule 3(1) makes it amply clear that the manufacturer, who intends to use subject goods for specified use at concessional rate of duty, shall make an application in quadruplicate in the Form at Annexure-1 to the jurisdictional Assistant Commissioner or Deputy Commissioner of Central Excise, as the case may be. Admittedly, no such application was made by Indo Gulf Corporation Limited in the Form at Annexure-1 to the jurisdictional Assistant Commissioner or Deputy Commissioner of Central Excise. As the procedure set out in the 2001 Rules has not been followed, the appellant was not entitled to exemption on the Naphtha cleared from its factory for supply to Indo Gulf Corporation Limited for manufacture of fertilizer.

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Companies Act

OTHER ACTS



LD/60/99
Sumana Bhasin
Vs.

Eastern Connexion (Exports) Pvt. Ltd.
December 19, 2011 (DEL)

Section 10F of the Companies Act,
1956 – Appeal against the Orders of
the Company Law Board

Where on consent of both parties, chartered accountants was appointed for valuation of shares, said valuation cannot be wriggled out later on unless there is fraud and collusion on part of valuer

The petitioner expressed her willingness to go out of the respondent company if fair consideration was paid for her shares. Both the sides agreed before the CLB that this Board itself would appoint an independent valuer to fix the share price as per the balance sheet as on 31-3-2008. Accordingly, CLB appointed Chartered Accountants to determine the fair price of the shares. The valuer determined the fair price of the share of ₹10 each at ₹174.82 per share and at this fair price, the total consideration for 1000 shares would come to ₹174820. The petitioner desired a sum of ₹10 lakhs. The respondent was agreeable to pay ₹3 lacs which was not acceptable to the petitioner.

The CLB found that the petitioner had not advanced any grounds for challenging the valuation. The valuation done by the company itself, the fair price of the shares came only to ₹157.81 per share. The difference in valuation was not large. The CLB held that once the petitioner had consciously given her consent for the date of valuation being 31.3.2008, the question of change of valuation date did not arise.

Company Law Board passed an order whereby the respondent-company was directed to pay

₹3,00,000 to the appellant as “fair valuation for the 1000 shares held by the appellant”. On receipt of the aforesaid consideration, the appellant was directed to transfer to the respondent her entire shareholding in the respondent company.

The Delhi High Court held that the independent valuer *i.e.* Chartered Accountants had been appointed by the CLB at the instance and with the consent of both the parties. The appellant-petitioner had specifically given her consent for the date of valuation as 31-3-2008. It was not open to the appellant to wriggle out of the consent given by her for appointment of Chartered Accountants as well as for determination of the share price. Hence the conclusion of the CLB that the appellant-petitioner could not go back out on its consent was correct and the same called for no interference.

Trademarks Act

LD/60/100

Tata Sons Limited
Vs.

Hoop Anin

December 16, 2011 (DEL)

Section 29 of the Trademarks Act, 1999 - Infringement of registered trade marks

Using business name 'TATA Diamonds' and web name tatadiamonds.com by a third party, other than TATA Group of company constitutes infringement of trademark 'TATA'

The defendant no.1 was carrying the business under and name and style of “Tata Diamonds” was alleged to be engaged in the business of diamonds and diamond jewellery. He had also registered a domain name “tatadiamonds.com”.

The case of the plaintiff was that by using the word ‘Tata’, which is phonetically, visually and structurally similar to the plaintiff’s registered trademark, the defendant is infringing its trademark. It was also alleged that use of the word ‘Tata’ as part of the trade mark/trade name/web name is likely to cause confusion and deception in the mind of the public, which might be misled to assume that the defendant has a connection with the House of Tatas, in fact there being no connection or affiliation. It was also alleged that these trade activities of defendants under the impugned name are likely to cause injuries in the business, goodwill and reputation, which the mark ‘TATA’ enjoys in a number of activities. The plaintiff has, therefore, sought an injunction restraining the defendant for using any trademark/trade name/web name, of which word ‘TATA’ forms. The plaintiff has also sought an order directing transfer of domain name “tatadiamonds.com” to it.

The Delhi High Court held that the word mark ‘TATA’ is registered in favour of the plaintiff company

and the products covered by registration include jewellery and precious metals. Defendant No.1 has also used the mark ‘TATA’ as a part of the domain name www.tatadiamonds.com and thereby infringed the registered trademark of the plaintiff. The plaintiff is entitled to injunction against use of the mark “TATA” by the defendant for two reasons firstly because of “TATA” being a registered trademark in Class-14 in respect of jewellery and precious metals and secondly because of “TATA” being a well known mark. Defendant No.1 by using the name “TATA DIAMONDS” as his business name and www.tatadiamonds.com as his web name has included the whole of the registered and well known trademark “TATA” as a part of his business name and domain name. Mere suffixing the words “Diamond” with “Tata” would not take the case of defendant No.1 out of purview of sections 29(1), (2) and (5) of the Act. It can hardly be disputed that considering the extent to which the mark ‘TATA’ is known, not only in India but in other countries as well, anyone coming across the business name “Tata Diamonds” and/or domain name www.tatadiamonds.com would assume that defendant No. 2 is a business entity from the House of Tatas, or defendant No.1 has either some business connection with the House of Tatas or that they have licensed him to carry the business which he carries on under the name M/s Tata Diamonds or that there is some kind of a collaboration between him and Tata Sons and that is why name “Tata” is being used by him as a part of his business name and his domain name. Besides diluting the distinctiveness of the trademark “TATA”, this is also likely to cause confusion amongst the persons who come across the aforesaid business name and domain name and as regards source of the goods being sold under the name Tata Diamond, and/or on the website www.tatadiamonds.com, in fact, would amount to causing a deception on them by inducing them to believe that defendant No.1 has some kind of a business connection or association with the House of Tatas.

The defendant No.1 has given a hyperlink to the website of the plaintiff www.tata.com from his website and is also using the device containing the word Tata and ‘t’ in a circle device both of which are registered marks of the plaintiff. The device of the plaintiff, which can be seen on the web site of defendant No.1, is registered in favour of plaintiff in Class-14. Thus, defendant No.1 has gone to the extent of making use of the registered device of the plaintiff without any prefix or suffix to it. Defendant No.1 thus had indulged in, what the plaintiff terms as, “framing”.

Therefore, the defendant No.1 needs to be restrained from using the business name/trademark/symbol akin to ‘TATA’ and also liable to pay damages to the plaintiff. ■

Circulars/Notifications

Given below are the important Circulars and Notifications issued by the CBDT, CBEC, MCA, RBI and SEBI during the last month for information and use of members. Readers are requested to use the citation/website or weblink to access the full text of desired circular/notification. You are requested to please submit your feedback and suggestions on the column at eboard@icai.org.

DIRECT TAXES



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

I. Press Releases

1. Press Release No. 402/92/2006-MC (4 OF 2012) Dated 27-01-2012

The Government of India has signed a Multilateral Convention on Mutual Administrative Assistance in Tax Matters as amended by 2010 Protocol. By signing the Convention, India and the other 31 signatories encourage more countries to join, sending a strong signal that countries are acting together to ensure that individuals and multinational enterprises pay the right amount of tax, at the right time and in the right place. The salient features of the multilateral convention have been given in detail in the said Press release.

2. Press Release No. 402/92/2006-MC (3 OF 2012) Dated 18-01-2012

The Central Board of Direct Taxes has directed the Income Tax department to launch a special drive, from 20th January to 20th March 2012, for verifying high value transactions (investments/deposits/expenditure) from persons who are not assessed to income tax or who have not furnished their PAN while entering into such transactions. In the instruction issued in respect of the same, the CBDT issued proforma for query letters and responses to be issued to the high value investors/depositors/spenders.

The complete details of the text of the above-mentioned press releases can be downloaded from the link: <http://law.incometaxindia.gov.in/DIT/Circulars.aspx>

II. Instruction

1. Instruction No. 01/2012 [F.NO.225/34/2011-ITA.II], Dated 2-2-2012

In order to clear the backlog of returns, the Central Board of Direct Taxes has issued this instruction specifying the following:-

- (i) In all returns (ITR-1 to ITR-6), where the difference between the TDS claim and matching TDS amount reported in AS-26 data does not exceed ₹1 lakh, the TDS claim may be accepted without verification.
- (ii) Where there is zero TDS matching, TDS credit shall be allowed only after due verification. However, in case of returns of ITR-1 and ITR-2, credit may be allowed in full, even if there is zero matching, if the total TDS

claimed is ₹5,000 or lower.

- (iii) Where there are TDS claims with invalid TAN, TDS credit for such claims are not to be allowed.
- (iv) In all other cases, TDS credit shall be allowed after due verification.

The complete details of the text of the above-mentioned press releases can be downloaded from the link:

<http://www.taxmann.com/taxmannflashes/whatsnew.aspx?stype=1&sid=9012>

INDIRECT TAXES



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

A. SERVICE TAX

1. Gross amount does not include value of free-of-cost supplies of goods and services in or in relation

to the execution of Works Contract if execution of works contract has commenced or any payment has been on or before the 7th day of July, 2009 : Circular No. 150/1/2012-ST dated 08-02-2012 has been issued to clarify that in cases where execution of works contract has commenced or where any payment, except payment through credit or debit to any account, has been made towards a works contract, prior to 07-07-2009, meaning of the expression 'gross amount' appearing in Explanation to rule 3(1) of the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 shall not be applicable.

2. Clarification regarding service tax on construction services: Circular No. 151/2/2012-ST dated 10-02-2012 has been issued by the CBEC to clarify various significant issues pertaining to levy and collection of service tax on construction services. The issues have been clarified under the following business models:

- i. Tripartite Business Model
- ii. Redevelopment including slum rehabilitation projects
- iii. Investment model
- iv. Conversion Model
- v. Non requirement of completion certificate/where completion certificate is waived or not prescribed
- vi. Build- Operate - Transfer (BOT) Projects
- vii. Joint Development Agreement Model

B. CENTRAL EXCISE

1. Rule 12 of the CENVAT Credit Rules, 2004 provides that CENVAT credit on specified inputs or capital goods cleared from the factories located in specified areas of North East region, Kutch district of Gujarat, State of Jammu and Kashmir and State of Sikkim shall be admissible as if the duty paid on such inputs or capital goods is not exempted.

Notification No. 01/2012-Central Excise (N.T.) dated 09-02-2012 has amended the said rule to provide that in the aforesaid case, credit of duty paid on inputs or capital goods, on which the benefit of an exemption under Notification No. 1/2011-C.E. dated the 1st March, 2011 is availed, will not be allowed.

The complete text of the above-mentioned notifications and circulars can be downloaded from the following link: www.cbec.gov.in

FEMA



1. Export of Goods and Services - Forwarder's Cargo Receipt

A. P. (DIR Series) Circular No.65 dated 12th January, 2012

Authorised Dealers are allowed to accept Forwarder's Cargo Receipts (FCR) issued by International Air Transport Association (IATA) approved agents, in lieu of bill of lading, for negotiation/collection of shipping documents, in respect of export transactions backed by letters of credit, if the relative letter of credit specifically provides for negotiation of this document in lieu of bill of lading even if the relative sale contract with the overseas buyer does not provide for acceptance of FCR as a shipping document, in lieu of bill of lading.

Further, authorised dealers may, at their discretion, also accept FCR issued by Shipping companies of repute/IATA approved agents (in lieu of bill of



lading), for purchase/discount/collection of shipping documents even in cases, where export transactions are not backed by letters of credit, provided their 'relative sale contract' with overseas buyer provides for acceptance of FCR as a shipping document in lieu of bill of lading. However, the acceptance of such FCR for purchase/discount would purely be the credit decision of the bank concerned who, among others, should satisfy itself about the bona fides of the transaction and the track record of the overseas buyer and the Indian supplier since FCRs are not negotiable documents. It would be advisable for the exporters to ensure due diligence on the overseas buyer, in such cases.

2. Revision in Scheme for Investment by Qualified Foreign Investors (QFIs) in Rupee Denominated Units of Domestic Mutual Funds

A. P. (DIR Series) Circular No.66 dated 13th January, 2012

As per the extant provisions, the funds received from the QFIs into this account shall be remitted to the domestic MF either on the same day of the receipt of the funds from QFIs or by next business day in case money is received after business hours, failing which the funds would be immediately repatriated back to the QFI's overseas bank account. The redemption proceeds of the units shall be repatriated to the overseas bank account of the QFI within two working days of the same having being received in the rupee pool account of the DP.

It has been decided that the time period for which funds (by way of foreign inward remittance through normal banking channels from QFIs as well as by way of credit of redemption proceeds of the units of domestic Mutual Funds by QFIs in India) can be kept in the single rupee pool bank account of the DP under the scheme for investment by QFIs in units of domestic Mutual Funds has been increased to five working days (including the day of credit of funds received by way of foreign inward remittance through normal banking channels from QFIs as well as by way of credit of redemption proceeds of the units of domestic Mutual Funds by QFIs in India).

It has also been decided to allow credit of dividend payments to QFIs on account of units of mutual funds held by them to the single rupee pool bank account subject to the condition that in case dividend payments are credited to the single rupee pool bank account they shall be remitted to the designated overseas bank accounts of the QFIs within five working days (including the day of credit of such funds to the single rupee pool bank account). Within these five working days, the dividend payments can be also utilised for fresh purchases of units of domestic mutual funds under this scheme, if so instructed by the QFI.



3. Review of Foreign Direct Investment (FDI) Policy - liberalisation of the policy in Single Brand Retail Trading

A. P. (DIR Series) Circular No.67 dated 13th January, 2012

Ref.: Press Note No.1 (2012 Series) dated 10th January, 2012 issued by DIPP

DIPP had released a Press Note No.1 (2012 Series) dated 10th January, 2012 wherein the revised FDI policy in relation to Single-Brand Product Retail Trading were elucidated. According to it, GOI decided to allow FDI up to 100%, under the government approval route, in Single-Brand Product Retail Trading, subject to conditions specified in the aforesaid press note.

Accordingly, RBI has, on 13th January, 2012 issued a circular to operationalise the above change.

4. Risk Management and Inter-Bank Dealings - Commodity Hedging

A. P. (DIR Series) Circular No.68 dated 17th January, 2012

Currently, resident entities in India, engaged in import/export trade or as otherwise approved by the RBI from time to time, are permitted to hedge the price risk of permitted commodities in the international commodity exchanges/markets. As per the extant provisions, only AD Category – I banks satisfying certain minimum norms are specifically authorised by the RBI to grant permission to certain specified class of companies to hedge price risk on import/export in respect of specified commodities (except gold, silver, platinum) in the international commodity exchanges/markets.

It has now been decided to permit all Authorised Dealers (AD) Category-I banks to grant permission to companies to hedge the price risk in respect of any commodity (except gold, silver, platinum) in the international commodity exchanges/markets as specified under the delegated route.

Further, AD Category-I banks can also grant permission to unlisted companies to hedge price risk on import/export in respect of any commodity (except gold, silver, platinum) in the international commodity exchanges/markets subject to guidelines as specified in the circular.

Applications from customers to undertake hedge transactions not covered under the delegated route may continue to be forwarded to the RBI by the Authorised Dealers for approval, as hitherto.

The aforesaid circular is available on RBI website at: <http://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=6946&Mode=0>

5. External Commercial Borrowings – Simplification of procedure

As a measure of simplification of the existing procedures relating to ECB, the powers have been delegated to the designated authorised banks to approve the following requests from the ECB borrowers, subject to specified conditions.

A. P. (DIR Series) Circular No.69 dated 25th January, 2012

- a) **Cancellation of Loan Registration Number (LRN):**
The designated authorised banks may directly approach the Department of Statistics and Information Management (DSIM) for cancellation of LRN for ECBs availed, both under the automatic and approval routes, subject to fulfillment the conditions that:
 - (i) no draw down for the said LRN has taken place; and
 - (ii) the monthly ECB-2 returns till date in respect of the LRN have been submitted to DSIM.
- b) **Change in the end-use of ECB proceeds:**
The designated authorised banks may approve requests from ECB borrowers for change in end-use in respect of ECBs availed under the automatic route, subject to the following conditions:
 - (i) the proposed end-use is permissible under the automatic route as per the extant ECB guidelines;
 - (ii) there is no change in the other terms and conditions of the ECB;
 - (iii) the ECB is in compliance with the extant guidelines; and
 - (iv) the monthly ECB-2 returns till date in respect of the LRN have been submitted to DSIM.

A.P. (DIR Series) Circular No. 75 dated 07th February, 2012

a) *Reduction in amount of ECB*

The designated authorised banks may be approved under the automatic route, subject to ensuring the following conditions:

- (i) the consent of the lender for reduction in loan amount has been obtained;
- (ii) the average maturity period of the ECB is maintained;
- (iii) the monthly ECB-2 returns in respect of the LRN have been submitted to the DSIM; and
- (iv) there is no change in the other terms and conditions of the ECB.

b) *Changes/modifications in the drawdown schedule when original average maturity period is not maintained*

It has now been decided that the designated AD Category-I bank may approve requests from ECB borrowers for **changes/modifications in the drawdown schedule** resulting in the original average maturity period undergoing change in respect of ECBs availed both under the **automatic and approval routes**, contrary to the previous condition that the average maturity period, as declared while obtaining the LRN, is maintained subject to ensuring

the following conditions:

- (i) there are no changes/modifications in the repayment schedule of the ECB;
- (ii) the average maturity period of the ECB is reduced as against the original average maturity period stated in the Form 83 at the time of obtaining the LRN;
- (iii) such reduced average maturity period complies with the stipulated minimum average maturity period as per the extant ECB guidelines;
- (iv) the change in all-in-cost is only due to the change in the average maturity period and the ECB complies with the extant guidelines; and
- (v) the monthly ECB-2 returns in respect of the LRN have been submitted to DSIM.

Any elongation/rollover in the repayment, on expiry of the original maturity, of the ECB, would however, continue to require the prior approval of the Reserve Bank.

c) *Reduction in the all-in-cost of ECB*

The designated authorised banks may be approved under the automatic route and approval route, subject to ensuring the following conditions:

- (i) the consent of the lender has been obtained and there are no other changes in the terms and conditions of the ECB; and

(ii) the monthly ECB-2 returns in respect of the LRN have been submitted to DSIM.

The authorised banks should ensure that the ECBs continue to comply with the extant guidelines while exercising their delegated powers and changes are promptly reported to the DSIM, RBI in Form 83.

6. ECB Policy – Infrastructure Finance Companies (IFCs)

A. P. (DIR Series) Circular No.70 dated 25th January, 2012

In case of Non-Banking Finance Companies (NBFCs) categorised as IFCs by the RBI and complying with the prescribed norms, the designated authorised banks should certify the leverage ratio (i.e. outside liabilities/owned funds) of IFCs desirous of availing ECBs under the approval route while forwarding such proposals to the RBI.

7. Memorandum of Instructions governing money changing activities

A. P. (DIR Series) Circular No.71 dated 30th January, 2012

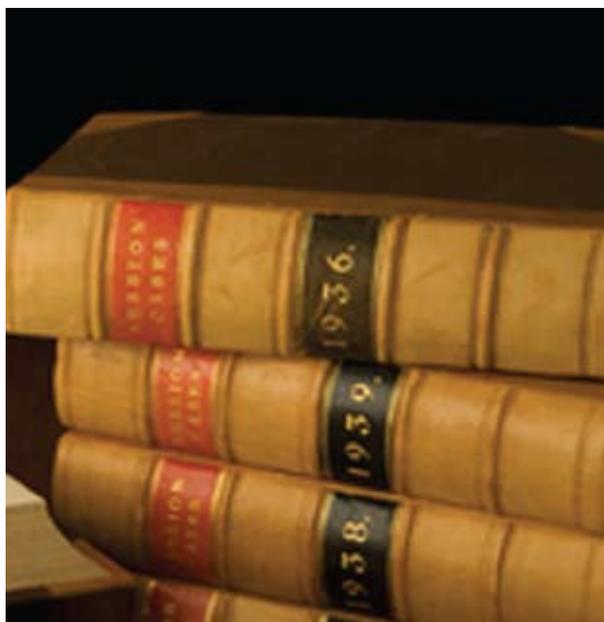
In view of the recent measures adopted to provide more flexibility to the Authorised Persons in selecting the location for their branches, it has been decided to remove the criteria relating to increase in outreach and locational advantage while considering the applications for issuance of fresh licenses for Full Fledged Money Changers.

8. Memorandum of Instructions for Opening and Maintenance of Rupee/Foreign Currency Vostro Accounts of Non-resident Exchange Houses

A. P. (DIR Series) Circular No.72 dated 30th January, 2012

With a view to give more operational leeway to the authorised banks, RBI has decided to dispense with the requirement of prior approval of RBI for opening and maintaining each Rupee Vostro account in India of non-resident Exchange Houses in connection with the Rupee Drawing Arrangements (RDAs) that banks enter into with them. Accordingly, AD banks may take approval of the RBI the first time they enter into the above arrangement with non-resident Exchange Houses from Gulf countries, Hong Kong, Singapore and Malaysia. Subsequently, they may enter into RDAs, subject to the prescribed guidelines and inform RBI immediately.

Once the total number of RDAs reaches 20, the AD bank may cause a detailed external Audit of their internal system to ensure that it is working satisfactorily. Based on the satisfactory report, the Board of AD banks may authorise more such arrangements.



A copy of the Board Note together with Board Resolution in the matter may be filed with RBI and new arrangements informed to RBI as indicated above.

9. Opening of Diamond Dollar Accounts (DDAs)

A. P. (DIR Series) Circular No.73 dated 31st January, 2012

It has now been decided that AD Category - I banks should submit a statement giving the data on the DDA balances maintained by them on a fortnightly basis as per format given in the circular, within seven days of close of the fortnight to which it relates, to the Chief General Manager-in-Charge, Foreign Exchange Department, Reserve Bank of India, Trade Division, Fifth Floor, Amar Building, Mumbai – 400001.

10. Clarification in relation to General Permission to establish a Project Offices in India by Foreign Entities

A.P. (DIR Series) Circular No. 76 dated 09th February, 2012

RBI has clarified that general permission accorded in terms of **A.P. (DIR Series) Circular No. 37 dated 15th November, 2003** [Guidelines regarding general permission to a foreign entity for setting up a Project office in India] is subject to the adherence to the provisions and specified conditions of **Regulation 4 of Notification No. FEMA 22/2000** dated 3rd May, 2000, viz., Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000. In terms of the aforesaid notification, a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran or China requires prior permission of RBI to establish in India a branch/liaison/project

office or any other place of business by whatever name called.

CORPORATE LAWS



MCA

1. Effective date of applicability to CA Act for enabling LLP form of professional organisation

www.mca.gov.in

The MCA has issued Notification No. S.O.190(E) dated 30-01-2012 notifying the effective date for amendments made by the Chartered

Accountants (Amendment) Act, 2011 (No. 3 of 2012) to be 1st February 2012. The amendments were in relation to conversion of existing firms of chartered accountants into an LLP (limited liability partnership) form of organisation or practicing as the LLP. This is apart from enabling multi-disciplinary partnership with members of any other professional body having prescribed qualifications. Similar notifications are issued for notifying the same effective date (ie 1st February, 2012) for the Company Secretaries (Amendment) Act, 2011 (by notification no. S.O.192(E) dated the 30-01-2012) and to the Cost & Works Accountants (Amendment) Act, 2011 (by notification no. S.O.191(E) dated the 30-01-2012) which too contained similar amendments. One may refer to the above citation and website for further details.

2. Filing of conflicting returns by contesting parties

www.mca.gov.in

The MCA has issued General Circular No. 01/2012 dated 10-02-2012 referring to its earlier circular which had laid down a certain procedure to regulate cases in relation to filing of conflicting returns with regard to appointment of directors or change of director (s). These earlier circulars are now withdrawn as it was noticed that in some specific cases either there was lack of consent of the removed/changed director or due process of law was not followed. To avoid such eventualities, wherever there is management dispute, the company is required to mandatorily file the attachment relating to cause of cessation alongwith Form 32 with the RoC concerned irrespective of the ground of cessation, viz (a) retirement; (b) disqualification; (c) death; (d) resignation; (e) vacation of office under Sections 283 or 313 or 260; (f) removal under Section 284; (g) withdrawal of nomination by appointing authority or (h) absence of re-appointment. In case any director is aggrieved with his cessation in the company, he may file complaint in the investor complaint form. The RoC concerned will examine the complaint and mark the company as having 'management dispute'. Also, the RoC will issue a letter to the company and the parties to settle the matter amicably or get an order/interim order from a Court or Tribunal of competent jurisdiction. Till such dispute is settled, the documents filed by the company and



by the contesting groups of directors will not be approved/registered/recorded and will thus not be available in the registry for public viewing. One may refer to the above citation for further details.

SEBI

3. Composition of arbitration committee

www.sebi.gov.in

The SEBI has issued Circular No. CIR/MRD/DSA/04/2012 dated 20-01-2012 stating that the existing mandate to all stock exchanges that not more than twenty percent of the members of the arbitration committee shall be trading members is now decided to do away with. Hence, there would be no representation of trading members on the arbitration committee/panel of all stock exchanges. One may refer to the above citation and website for further details.

4. Investor grievance redressal mechanism at stock exchanges

www.sebi.gov.in

The SEBI has issued Circular No. CIR/MRD/DSA/03/2012 dated 20-01-2012 had earlier mandated all stock exchanges to open/maintain at least one investor service centre for the benefit of the public/investors and that such centres were required to *inter alia* provide counseling service to the investors. Thereafter, some stock exchanges have constituted Investor Grievance Redressal Committees (IGRC) for redressal of investor grievance. Pursuant to concerns expressed by investors and to facilitate early redressal of investor grievances, it has been decided to mandate that stock exchanges

having nationwide terminals (such as NSE, BSE, MCX-SX and USEIL), functional stock exchanges having trading volumes, stock exchanges entering into MOUs with other exchanges and stock exchanges intending to recommence trading operations shall constitute IGRC at every investor service centre. It is provided that the composition of IGRC shall be as follows:

- o The IGRC shall comprise of a single person for claims upto ₹25 lakh, whereas, for claims above ₹25 lakh, the IGRC shall comprise of three persons.
- o The IGRC shall comprise of independent persons with qualifications in the area of law, finance, accounts, economics, management or administration and experience in financial services, including securities market.
- o Further, the three member committee shall comprise of at least one technical expert for handling complaints related to technology issues (such as internet based trading, algorithmic trading, etc).
- o The members of IGRC shall not be associated with a trading member in any manner.

One may refer to the above citation and website for further details.

5. Trade controls in normal trading session IPO and other category of scrips

www.sebi.gov.in

The SEBI has issued Circular No. CIR/MRD/DP/02/2012 dated 20-01-2012 stating that earlier it had prescribed no price bands for scrips on the first day of trading pursuant to IPO as also in case of re-commencement of trading for scrips (hereinafter referred to as Re-listed scrips). In light of high volatility and price movement observed on first day of trading, SEBI has decided to put in place a framework of trade controls for IPO and Re-listed scrips applicable to the normal trading session from the perspective of trade timings, eligible scrips, and price bands in relation to IPO scrips and Re-listed scrips. One may refer to the above citation for further details.

6. Call auction in pre-open session for IPO and other category of scrips

www.sebi.gov.in

The SEBI has issued Circular No. CIR/MRD/DP/01/2012 dated 20-01-2012 stating that earlier it had introduced Call Auction in Pre-open session (hereinafter referred to as "pre-open session") for scrips forming part of Sensex and Nifty and had also clarified with regard to order matching and order level risk management. It has now been decided to extend Call Auction mechanism to IPOs and Re-listed Scrips on the first day

of trading/re-commencement of trading. The duration of session shall be 60 minutes i.e. from 9:00 a.m. to 10:00 a.m., out of which 45 minutes shall be allowed for order entry, order modification and order cancellation, 10 minutes for order matching and trade confirmation and the remaining 5 minutes shall be the buffer period to facilitate the transition from pre-open session to the normal trading session. The session shall close randomly during last one minute of order entry i.e. anytime between 44th and 45th minute of the order entry. Such random closure shall be system driven. One may refer to the above citation for further details.

7. Offer for sale of shares by promoters through the stock exchange mechanism

www.sebi.gov.in

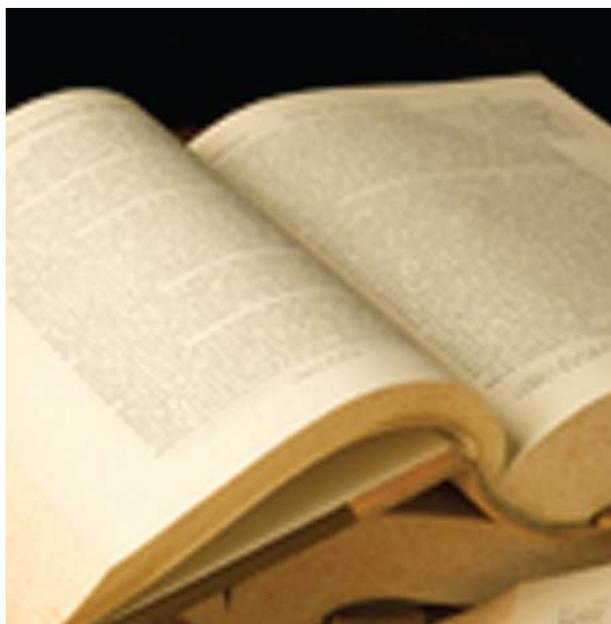
The SEBI has issued Circular No. CIR/MRD/DP/05/2012 dated 01-02-2012 in order to facilitate promoters to dilute/offload their holding in listed companies in a transparent manner with wider participation. SEBI has now decided to allow offer for sale of shares by promoters of such companies through a separate window provided by the stock exchange(s). The guidelines for the same are part of this circular which includes *inter alia* eligibility criteria from the perspective of the exchanges (i.e. the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE)), the sellers and the

buyers. The guidelines are also in relation to size of offer for sale of shares and on advertisement and offer expenses. The guidelines are also in relation to operational requirements like appointment of broker, announcement/notice of the offer for sale of shares, floor price, timelines and order placement. Other guidelines include in relation to risk management, allocation, settlement, issuance of contract notes, withdrawal of offer and for cancellation of offer. One may refer to the above citation for further details.

8. Amendment to issue of capital and disclosure requirements regulations

www.sebi.gov.in

The SEBI has issued Notification No. LAD-NRO/GN/2011-12/34/2499 dated 30-01-2012 amending the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and inserted *inter alia* regulations on issue of warrants along with public issue or rights issue of specified securities subject to the fact that the tenure of such warrants shall not exceed twelve months from their date of allotment in the public/rights issue and that not more than one warrant shall be attached to one specified security. New regulations are introduced for institutional placement programme by inserting new chapter



VIII-A and which broadly covers applicability, some definitions (like eligible securities, eligible seller, institutional placement programme), conditions/procedural requirements for institutional placement programme, appointment of merchant banker, offer document compliance requirements, pricing and allocation/allotment requirements, restrictions on promoters/promoter groups, minimum number of allottees (for each offer of eligible securities made under institutional placement programme), restrictions on size of the offer (aggregate of all the tranches of institutional placement programme made by the eligible seller), period of subscription and display of demand, withdrawal of offer, transferability of eligible securities, etc. One may refer to the above citation for further details.

9. Amendment to buy-back of securities regulations www.sebi.gov.in

The SEBI has issued Notification No. LAD-NRO/GN/2011-12/36/3187 dated 07-02-2012 providing guidelines in respect of disclosures to be made in the letter of offer in respect of buy-back of securities in terms of SEBI (Buy-back of Securities) Regulations, 1998 and the format of standard letter of offer as also the disclosures that are required to be made in the letter of offer. The objective of amending the regulations was to align the regulatory provisions with the principle of equitable treatment to all shareholders and enhancing the efficiency in the buyback process. Now, it is mandatory for companies opting to buyback shares through tender offer route to reserve 15% of the offer for small shareholders. The Regulation also defines small shareholders as those shareholders whose market value of shares on the record date is not more than ₹2 lakh. This is similar to last year's amendment whereby

SEBI had increased the limit of investment by retail investors in initial public issue to ₹2 lakh. It is also provided that the offer for buy-back would remain open for ten working days. Also, the company will have to pay the buy-back amount to the shareholders within seven days of the closure of the offer. The company will need to make a public announcement within two working days from the date of resolution adopted by the board of directors in at least one English national daily, one Hindi national daily and a regional language daily, all having wide circulation, at the place where the registered office of the company is situated. The entire buyback process, through the tender offer route, now can be completed within 41 days of receiving the board of director's/SEBI's approval. The amendment necessitated certain changes in the format of standard letter of offer issued earlier by SEBI and hence the revised format of standard letter of offer is given at Annexure-A to the Circular (No. CIR/CFD/DCR/ 2/2012 dtd. 09-02-2012) issued post this notification. One may refer to the above citation for further details.

10. Amendments to equity listing agreement www.sebi.gov.in

The SEBI has issued Circular No. CIR/CFD/DIL/1/2012 dated 08-02-2012 amending the equity listing agreement entered into by companies. Now, listed entities can achieve the minimum level of public shareholding through the institutional placement programme (IPP) which would not only allow promoters to reduce their holding through stock exchanges but would also allow companies to issue fresh equity shares to institutional investors. Also, listed entities would now have to disclose details of the utilisation of funds raised through warrants, in public or in rights issue of specified securities. One may refer to the above citation for further details.

11. Amendments to portfolio managers regulations www.sebi.gov.in

The SEBI has issued Circular No. LAD-NRO/GN/2011-12/37/3689 dated 10-02-2012 amending the SEBI (Portfolio Managers) Regulations, 1993 pursuant to the decision taken at the SEBI board meeting on 18-01-2012. Now, the minimum investment level under portfolio management schemes is raised to ₹25 lakhs (from the current level of ₹5 lakh) which will apply to new clients and to fresh investment made by existing clients. In this regard, the portfolio manager will need to ensure that each client's holding in unlisted securities will have to be segregated and maintained in a separate account. This will also apply to new clients or to existing clients making fresh investments. One may refer to the above citation for further details. ■

Accounting for sales returns

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

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') has been in the business of manufacture of readymade garments for the last 5 to 6 years. It sells its products to franchisees located across the country.
2. The querist has stated that the sale is said to be completed at the time when risks and rewards of ownership of goods are transferred to the franchisees. Readymade garment industry is subject to change in trends of fashion and as such, some of the goods are returned and the company accepts them back as sales returns. According to the querist, sales returns are said to be completed when the goods have been physically received back in the factory premises and all the risks and rewards of ownership have been transferred to the company. Hence, the company records the sales returns in its books of account on their physical receipt. On the basis of the past trend, sales returns work out to be approximately 20 to 22% of the sales for the year.
3. The querist has further stated that the company has accounted for the sales returns received during the financial year upto the balance sheet date but has not reversed the sales returns likely to be received after the balance sheet date, on the basis of the past trend.
4. During the course of audit for the financial year 2010-11, the auditors have raised an objection regarding booking of revenue from sales. The auditors are of the opinion that since there is a past trend indicating the return of goods sold to franchisees, the company should effect the reversal of sales on 31st March, 2011 to the extent that the goods sold in the year 2010-11 are likely to be returned by the franchisees in the year 2011-12 and subsequent years. Though the company has accounted for sales returns upto the date of the balance sheet, the auditors are of the view that the company should also account for sales returns likely to be received after the balance sheet date on the basis of past trend.
5. The querist has also stated that the auditor proposes to make the following qualification:

“Though the actual sales returns after 31st March, 2011 upto the conclusion of the financial statements have been recognised, the impact of further sales returns, likely to happen based on the past trend of such returns, has not been estimated and recognised in these financial statements. This is not in accordance with Accounting Standard (AS) 9, 'Revenue Recognition'. In the absence of the above estimation and recognition, we are unable to comment in the matter and the consequential effect on the financial statements.”
6. The company is of the view that the stand of the auditors is not correct because of the following reasons:
 - (a) Paragraph 11 of Accounting Standard (AS) 9, 'Revenue Recognition' is reproduced below:

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

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

The querist is of the view that the company has complied with both the above conditions necessary to recognise revenue from the sale of goods in the year. Although there is a probability of some goods being returned by the franchisees, there is no significant uncertainty regarding the amount of consideration that will be derived from the sale of goods. Since the goods are not in the possession of the company and risks and rewards of ownership still lie with the franchisee and he is the one who is responsible for the goods, the company cannot record the sales returns in its books of account in respect of goods likely to be received back after the date of the balance sheet.

- (b) As per the querist, the case of the company is also not covered by paragraph A(2)(c) of the Appendix to AS 9, issued by the Institute of Chartered Accountants of India, which, inter alia, states as below:

"In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a suitable provision for returns based on previous experience."

Although in the company's case, the franchisee has a right to return the goods, the return of goods by the franchisees in subsequent years is entirely contingent upon the situation prevailing in the market at that time.

B. Query

7. On the basis of the above, the querist seeks the opinion of the Expert Advisory Committee on the following issues:
- Whether the present policy of the company regarding recognition of sales returns after the date of the balance sheet in the books of account only upon the physical receipt of goods from the franchisees is correct.
 - If the company records the sales returns received after the date of the balance sheet on estimated basis taking into account the past trend, whether it will be proper accounting to prepare financial statements of the company on estimation basis.

C. Points considered by the Committee

8. The Committee notes that the basic issue raised in the query relates to accounting for sales returns that occur after the date of balance sheet in a situation where the customers (franchisees) have a right to return the goods. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, recognition of revenue as per the principles of AS 9, etc. The Committee presumes from the Facts of the Case that franchisee is neither acting as an agent of the company nor as a consignee as covered under paragraph A(2)(c) of the Appendix to AS 9 which states as given below:

"(c) guaranteed sales i.e. delivery is made giving the buyer an unlimited right of return

Recognition of revenue in such circumstances will depend on the substance of the agreement. In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a suitable provision for returns based on previous experience. In other cases, the substance of the agreement may amount to a sale on consignment..."

9. The Committee notes from paragraph 5 of the Facts of the Case that the auditor proposes to make the qualification that "though the actual sales returns after 31st March, 2011 upto the conclusion of the financial statements have been recognised, the impact of further sales returns, likely to happen based on the past trend of such returns, has not been estimated and recognised in these financial statements", whereas it is also stated in the Facts of the Case that the company has accounted for sales returns upto the date of the balance sheet. Thus, there is an apparent contradiction in the Facts of the Case, although, that does not affect the accounting for the basic issue raised.
10. The Committee notes from the Facts of the Case that the querist has stated in paragraph 6 above that the company has complied with the conditions of paragraph 11 of AS 9 relating to conditions of recognition of revenue in the case of sale of goods. Accordingly, the Committee presumes that the requirements of AS 9 relating to recognition of revenue are fulfilled. The Committee is of the view

that in case conditions relating to recognition of revenue are fulfilled at the time of making sale, it would be correct to recognise revenue in respect of sale of goods at the time of sale itself. However, the Committee notes from the Facts of the Case that in the extant case, there is a right of return by the franchisees (refer paragraph 6 above). The existence of such right would give rise to a present obligation on the company. In this context, the Committee notes the definition of the term 'provision' as defined in paragraph 10 of Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets', notified under the Companies (Accounting Standards) Rules, 2006, which provides as follows:

"A provision is a liability which can be measured only by using a substantial degree of estimation.

A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits."

The Committee is of the view that since obligation in respect of sales return can be estimated reliably on the basis of past experience and other relevant factors, such as, fashion trends, etc., in the extant case, a provision in respect of sales returns should be recognised. The provision should be measured as the best estimate of the loss expected to be incurred by the company in respect of such returns including any estimated incremental cost that would be necessary to resell the goods expected to be returned. The Committee is also of the view that as per paragraph 52 of AS 29, provisions should be reviewed at each balance sheet date and if necessary, should be adjusted to reflect the current best estimate. As far as actual sales returns that occur between the balance sheet date and the date of approval of financial statements are concerned, the Committee is of the view that necessary adjustments should be made in this regard to the amount of the provision.

D. Opinion

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

- (i) No, the present policy of the company regarding recognising sales returns after the date of the balance sheet in the books of account upon the physical receipt of goods from the franchisees is not correct. The company should recognise a provision in respect of sales returns at the best estimate of the loss expected to be incurred by the company in respect of such returns including any estimated incremental cost that would be necessary to resell the goods expected to be returned, on the basis of past experience and other relevant factors as discussed in paragraph 10 above. Necessary adjustments to the provision should be made for actual sales return after the balance sheet date upto the date of approval of financial statements. Such provision should also be reviewed at each balance sheet date and if necessary, should be adjusted to reflect the current best estimate.
- (ii) If the treatment prescribed in (i) above is followed, it will be appropriate accounting treatment for preparing the financial statements of the company.

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. The Committee finalised the Opinion on 10.10.2011. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in twenty nine volumes. A CD of Compendium of Opinions containing twenty nine 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 .

Role of Central Statutory Auditor's in a Bank Audit with Special Reference to Core Banking Environment



The assurance expressed by central auditors through their audit report that they have obtained sufficient and appropriate evidence for the purpose of expressing an opinion is negated by the scope limitation expressed on the nature of engagement. The SAs issued under the clarity project, in particular SA 200, would not support a fundamental scope limitation worded as "Subject to the limitations of audit set out in paragraph 1 to 5 above". The author is of the opinion that current standards do not support AAS-10 - "Using the work of another auditor" and that the responsibility of central auditors is joint and that they have to jointly execute the audit as if it were executed by a single auditor. Central auditors would, therefore, require to assume more responsibilities for the engagement and more so in a core banking environment where there are no books at the branches and all so called branch financial statements are generated from the centralised data base. Much thought would, therefore, have to go into the nature of sign offs to be obtained from branch auditors which could be relied upon by the central auditors.

The Issue

Size, geographic spread, complexity of a business and the regulatory requirements make the audit of any bank a challenge. Though auditing standards were first notified by ICAI in 1985 and subsequently revised/replaced under the clarity project, the approach to audit, particularly bank audit, has seen no change in principle. While standards are adaptations of the International Auditing Standards, the application followed the ground reality. In the case of bank audit, the audit objective in recent years is to verify compliance with income recognition, asset classification and provisioning norms and disclosures required by RBI from time to time as these are the areas which are reviewed in detail by RBI in its Annual financial inspection and any deviation observed by RBI would have a bearing on an auditor's ratings.



CA. H. Anil Kumar

(The author is a member of the Institute. He can be reached at anilkay.rao@gmail.com)

Bank audit has gone through varied approaches in India. Initially the approach was transaction based. When the size of banks increased, the approach was a balance sheet audit approach which continues as of today. Though there is no formal risk analysis, the areas selected for higher substantive testing are on a consideration of risk-based on past experience. However, formal risk-based approach as set out in the current auditing standards in force are not followed. 

While these are practical issues, audit reports¹ of banks contain following averments made by the auditors:

“We conducted our audit in accordance with the auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.”

Therefore, the report creates an expectation in the reader that the auditor has obtained reasonable assurance in terms of the standards and not reasonable assurance based on what is possible as per the practice in vogue. However, the audit report also contains a disclaimer in the opinion paragraph, viz.² *“Subject to the limitations of the audit as indicated in paragraph 1 to 5 above and as required by the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and also subject to the limitations of disclosure required therein”*. Therefore, the assurance is not without reservations on the nature of audit which is contained in the introductory paragraph of the report, viz.:

- It is a joint audit.
- Substantial reliance on the work of branch auditors. Only a small portion of the audit work has been done by the auditors.
- There are branches of the bank which have not been audited.
- The selection of the branches to be audited are made as per RBI guidelines and not based on selection by auditors.

The above reservations are significant and negate the assurance held out by the auditor that the audit has been carried out in terms of the SAs. Otherwise also, the gulf between what the auditor holds out in his audit report and what is actually done in practice has further widened after banks have moved to core banking.

The object of this article is to examine how this gulf should have been addressed.

Approach to Audit: Transaction Based Vs Balance Sheet Approach Vs Risk Based Approach

Bank audit has gone through varied approaches in India. Initially the approach was transaction based. When the size of the banks increased, the approach was a balance sheet audit approach which continues as of today. Though there is no formal risk analysis, the areas selected for higher substantive testing are on a consideration of risk based on past experience. However, formal risk based approach as set out in the current auditing standards in force are not followed. With increase in size and in response to incidents of fraud and error, banks have built up a strong and robust internal control framework. Compliance with these controls is reviewed by the internal audit department of a bank. The auditors place a strong reliance on these internal controls without a formal process of testing the same as required by the standards. This is in part to be blamed on the system of appointment of auditors. Auditors are usually appointed towards the fag end of a financial year and the entire audit process is expected to be completed before the end of April leaving little time for this exercise. A second reason is that the auditors have not received exposure to internal control review during their training as articles and the legacy still continues. Lastly, weaknesses in internal control in an area considered material to the financial statements would require an increase in substantive testing. A major area on which substantive testing is being carried out by auditors is on classification of advances and compliance with IRAC norms. Considering the size of the bank, auditors would not be able to commit further resource to carry out the desired level of substantive procedures. Change in the approach to audit in the banking sector, as in all areas of banking, would probably require to be driven by RBI. In the 1980s, deficiencies in coverage by auditors perceived by RBI was sought to be addressed by requiring the auditors to complete a long form audit report. While RBI has directed banks to adopt a risk-based strategy for internal audit, no such advice has been given to the statutory auditors or branch auditors.

¹ For the recommended format of the report see paragraphs 3, 4 and 5 of the illustrative format of the audit report of a nationalised bank given in Appendix-4 of the Guidance Note on Audit of Banks -2011 Edition)

² Ibid. It is unusual that in the illustrative format of the audit report given in appendix -4 of the Guidance Note on Audit of Banks -2011 Edition, the reservation extends to paragraphs 2 to 5 i.e. the scope paragraphs.

Is the “Whole” a Sum of the “Parts”?

Audit of a bank also continues to be a bottom-up approach based on the model followed when books were maintained manually. The accounts of a bank had to be consolidated from the financial statements of the individual branches and offices. In the manual era, year end and other returns received from the branches were consolidated at head office (H.O.) manually or with the aid of computers. In such a milieu, the branch returns used in the consolidation had to be audited at the branch level with the general ledger and other books maintained at the branch. Opinion on the accounts of a bank was based on the findings in these audit reports. This system of audit also held good when banks moved to computerisation up to the stage of totally automated branches. A major audit issue in that era was the status of reconciliation: between the general ledger and sub-ledger and between the H.O. and the branches.

Today, most if not all banks have moved to core-banking. The financial statements of the bank are drawn up at H.O. based on trial balance for the bank generated from the system and not from consolidation of branch returns. Certain year-end returns such as classification of advances which are generated at branch level are consolidated at H.O. for arriving at the information required to be disclosed in the accounts. In the manual era, the balance sheet and profit and loss account of the branch were prepared only for the purposes of classification of the items and aiding consolidation at H.O. and those were reported upon by the branch auditors. Those financial statements were also incomplete because many year-end entries were passed at H.O. and hence these financial statements never presented a true and fair view of the state of affairs of the branch as on the balance sheet date or the results of its operations. In core banking the data of the branch is already available with the H.O. and the branch balance sheets and profit & loss account are generated from the data base by the system. From the point of view of the financial statements of the bank the branch financial statements are not required and

hence not generated. However, for the purposes of year-end audit, the bank generates the financial statements for each branch and office of which most would be audited and countersigned by the branch auditors. The bank also prepares a report showing each balance in the trial balance branch-wise, against which the reports generated from the core banking software in the form of financial statements of the branches and signed by the branch auditors are verified by the central auditors. Central auditors rely on the branch auditors' reports that these financial statements present a true and fair of the affairs of the branch and its profit for the year subject to the usual adjustments made at H.O. as they used to do when accounts were maintained at the branches. This approach to audit would be valid if the opinion on the “whole” could be based on the sum of the opinions on each of the “parts”.

In the manual era, accounts of an office of the bank were based on books maintained in that office and entries therein could be made by only those who had physical access to the books. Interaction between offices of the bank was only through the inter-branch account. In such a situation, the branch financial statements were based on the books of the branch in which entries were made and approved only by staff of the branch. Branch auditor was not unduly concerned about the controls outside of the branch audited by him. The same held true in the era of totally automated branches. However, in core banking scenario, the reality is different. Data of the bank is stored on a central server. Separate accounts of the branch per se do not exist. Entries in a branch could be initiated and posted from any of three sources: by the branch personnel, by the system or by personnel from another office. Entries could also originate externally from another bank or agency. Financial statements of a branch are a view of the data based on a key relating to the branch. In such a situation, can the audit opinion on the “whole” be based on the sum of the opinions on each of the “parts”? In a core banking scenario whether the central auditor can simply rely upon an unqualified report of the branch auditor on these so called financial statements merely because the said branch auditor is a member of ICAI is a question which has not been asked officially of ICAI and hence does not have an official answer. The answer is in an Exposure Draft of a proposed revision to AAS-10 -“Using the work of another auditor”. The Exposure Draft titled Revised Standard on Auditing (SA) 600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) has not been issued as a standard, though comments have been sought in 2008

In a core banking scenario, whether the central auditor can simply rely upon an unqualified report of the branch auditor on these so called financial statements merely because the said branch auditor is a member of ICAI is a question has not been asked officially of ICAI and hence does not have an official answer. The answer is in an exposure draft of a proposed revision to AAS-10 -“Using the work of another auditor”.

and more than three years have passed since. This standard is most relevant for audit in the core banking environment, where the branch auditor is reporting on “whether proper books of account are maintained at the branch” based on the “books” in the central server i.e. at H.O.

The challenge posed to auditors from the core banking could be seen from the following example: In a bank, the employees’ pay and other benefits are maintained on the human resource management service application maintained at H.O. Branches inform the regional office of the attendance of the employees on a monthly basis. The data is keyed into the HRMS package at the ROs. The pay and deductions are worked out by the HRMS software. The HRMS software generates the journal entry for the salary for the bank as a whole, debits various salary and allowances accounts for the expenditure, credits the control accounts for deductions and recoveries and credits the net salary to individual employee SB accounts maintained on the core banking software by a straight through process. Branches would only get an advice of the entries passed without the supporting details. Pay slip reports are not generated because the employee can view the details of his pay directly through the computers maintained at the branch and take a print if he so desires. The salary and allowances related to the employees of the branch would appear in the financial statements generated by the core for the branch. The branch auditor could ask for the details in support of the entry. The information required could perhaps be furnished by the branch from the HRMS package if any such facility is available at the branch level or required reports have to be obtained by the branch from the appropriate office. If the same are not furnished, the branch auditor could issue a disclaimer in his report. In practice, as the entry has been passed under the authority functioning under the controlling office and outside the branch, and in the absence of instructions from the central auditors in this regard, branch auditors will not consider it necessary to verify the payroll with the accounts and consequently salary and other related expense accounts may very well go unaudited though the same are included in the financial statements reported upon by them.

AAS 10 or SA-600 –“Using the work of another auditor”, is based on and explains the following paragraph of AAS-1 “Basic Principles Governing an Audit”:

“When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information.

Auditing a nationalised bank is a greater challenge as the number of central statutory auditors is more than one. ICAI has issued a standard AAS-12 titled “Responsibility of Joint Auditors”. An interesting feature of this standard is that it is not mandated that the objective of the audit be achieved by the joint auditors collectively, i.e. they are not expected to achieve the same audit objective that is required under SA 200, had the audit been carried out by a single firm of auditors. Therefore, this pronouncement helps audit firms arrive at a working arrangement where the “audit work” is divided. 

However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 1956 the auditor's report should expressly state the fact of such reliance.”

AAS-1 is now withdrawn and SA-200 the standard replacing AAS-1 “Basic Principles Governing an Audit” does not have an analogous paragraph.

In the absence of the same, it would not be appropriate for the central auditors to rely on the branch auditors’ reports on the financial statements of the branch, without determining their relevance to the opinion on the financial statements of the bank as a whole. The auditors also cannot claim that they have carried out the audit in accordance with the auditing and assurance standards of ICAI as required by the revised standard SA 700 unless they have satisfied themselves that the work of the branch auditors is reliable.

Challenges of a Joint Audit

Auditing a nationalised bank is a greater challenge as the number of central statutory auditors is more than one. ICAI has issued a standard AAS-12 titled “Responsibility of Joint Auditors”. An interesting feature of this standard is that it is not mandated that the objective of the audit be achieved by the joint auditors collectively, i.e. they are not expected to achieve the same audit objective that is required under SA 200 had the audit been carried out by a single firm of auditors. Therefore, this pronouncement helps audit firms arrive at a working arrangement where the “audit work” is divided. Each audit firm carries out its area of

the audit work allotted without being affected by the quality of work of the other auditors. An audit firm, as one of the joint central statutory auditors, is entitled to rely upon the work of other co-statutory auditors if it is backed by a proper sign off. A grey area is the responsibility for the aspects of "audit work," which are not divided. According to AAS-12, in respect of matters not divided, the responsibility shall be joint.

In practice, as appointment of audit firms as central auditors is only for a period of three years, no audit firm is familiar with all the areas of the bank. Hence, the division of audit work amongst the auditors is usually carried out in many banks by the banks in discussion with the auditors. In making such a division of work, the bank would be guided by past experience and may not consider the changes which have taken place in the business of the bank and the requirements of the engagement standards which are applicable to the auditors. The division of work would usually be by departments at H.O. and regions/divisions/zones for consolidation and not by function or line of business. Division of work also depends on the number of joint auditors. In some banks, to accommodate the auditors, the balance sheet and profit & loss account are allotted to one auditor and another audit firm verifies the consolidation of notes. In such a situation, no audit firm amongst the joint auditors has a sense of the whole. The documentation would indicate the departments and regions allocated. However, the documentation of division of responsibilities may not state which auditor is entrusted with the work of evaluating the financial statements of the bank as a whole and examining the relationships between various components. It appears that in some banks, except for the auditor verifying the consolidation of accounts, other auditors do not see the financial statements till the date of the board meeting. Obviously auditors have to realise that they are collectively responsible for forming an opinion on the financial statements and, therefore, they have to take more responsibility for the allocation of work amongst themselves. Along with the allocation, there should be a clear description of the responsibilities associated with the division so that "the matters not divided" are clearly identified.

Some of the issues which need to be discussed and sorted out jointly so as to address audit risk are:

- Jointly determine the materiality at the financial statement level and component level
- Determine performance materiality for the financial statement level and component level
- The auditor verifying the financial statements including the notes on accounts would be taking upon himself the role of the principal auditor and he

would be responsible to ensure that the division of work is comprehensive and completely addresses all the significant audit areas

- The nature of sign-offs required by each auditor from the other joint auditors in respect of the areas allocated as well as from the branch auditors
- Review the impact of the bank's information system on the respective areas allocated and give their requirements to the central auditor who is auditing the data centre
- Examine the circulars issued by the respective departments for compliance with RBI guidelines as well as for planning their audit
- Review the minutes of the board/audit committee and other committees wherein the notes originating from the departments and matters relevant to the audit areas allocated are considered
- Examine the closing circulars issued by the bank in respect of matters relevant to the areas allocated to them for compliance with RBI guidelines and Accounting Standards
- Identify issues/instructions and audit procedures for advice to co-auditors as well as the branch auditors
- Fixing the limits for errors to be concerned as "trivial"

The joint auditors need to complete the discussions on the above areas well in time to formulate the audit plan and draft the instructions to the branch auditors. The auditors also need to have a discussion amongst themselves to identify possible sources of fraud and error and ensure that the audit plan and procedures address these risks.

Role of Branch Auditors

In the core banking scenario, when the financial information relating to a branch are stored in the central server, they are not components on which the branch auditor could express a true and fair view which could be relied upon by the central auditors. Under the SAs, the branch auditor cannot express a true and fair view unless he has independently carried out a review of the IS and how it affects the financial statements of the branch. Therefore, the work allocated to the branch auditor should be very specific so that the sign off

The secret, therefore, to audit in a core banking environment is for central auditors to accept their joint responsibility for the audit as envisaged under SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing".



by a member of the Institute could be relied upon by the central auditor. In allocating the work, the central auditor should focus on assertions which are material to the financial statements of the bank as a whole and which are best verified at the branch level.

These could be:

- Verification of schedules relating to classification of advances and compliance with IRAC norms;
- Review of balances and accounts in the general ledger and sub-ledger of the branch in accordance with such criteria as may be determined by the central auditor;
- Verification of sample transactions extracted by the central auditor from the core data such as:
 - Transactions in suspense accounts/sundry debtors

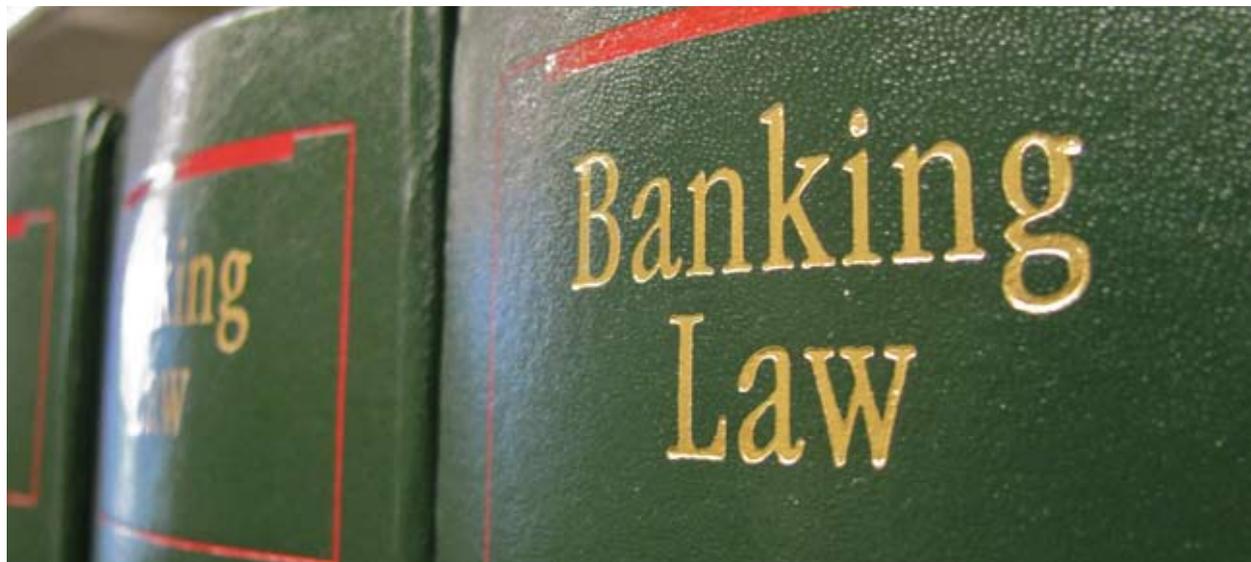
- Acceptance and repayment of deposits
- Entries in interbank reconciliation account
- Entries relating to centralised payroll
- Items of income and expenditure
- Physical verification of cash and security items;
- Review of exception reports identified as relevant by the central auditors.

Though most of the above items are being carried out even now by the branch auditors, the difference would be in the nature of sign offs to be obtained from them and which could be relied upon by the central auditors.

Conclusion

The secret, therefore, to audit in a core banking environment is for central auditors to accept their joint responsibility for the audit as envisaged under SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing". Once that is done, the approach will unfold by itself and, in such an audit, the joint auditors will not find the limitations as now presently expressed through their audit report. A beginning could be said to be made when the auditors jointly issue an engagement letter to the management. ■

Bank Audit — Points to Ponder



Right from the day banks started lending, the rescheduling and restructuring of advances have become part and parcel of banking as the ultimate idea of lenders was to recover such loans under stress with minimum loss. It is in recent times that the RBI came out with a structured approach towards the process of restructuring so as to prevent banks from resorting to ever greening. Nevertheless, sectors do get affected by business cycles and to deny them legitimate support would not be fit and proper. There has been a proposition in some quarters that any nod now by the regulator for a second restructuring would make the banks gloss over virtual NPAs. This line of argument fails to see the impact that would befall the sectors under stress such as telecom, infrastructure, textiles, power, etc. The regulator is surely weighing the pros and cons of advocating relaxation in the number of times an account can be restructured without affecting its performing status. Be that as it may, from the point of view of income recognition and asset classification, restructure has proved to be a bug bear to many. While there are not very many changes over the year with regard to the regulatory guidelines affecting the audit aspects of banks, nevertheless, the feedback received from many fronts suggests that in some areas, audit fraternity has entertained certain doubts. This article aims at discussing these in detail.

A. Restructuring & Infrastructure Advances

General:

One such aspect is of restructuring and rescheduling of advance; for some, the special dispensation provided by the RBI under Circulars dated 8th December, 2008; 2nd, January, 2009, and 4th February, 2009, are still available; for some, all advances restructured post the said circular would become non-performing assets. The truth, as usual, lies in between.

The special dispensation mainly gave the benefit of a second restructure to most advances without affecting their performing status. It also made advances in certain sectors like commercial real estate, to avail the benefits of restructure (if it is for the first time) without any adverse effect on the performing status. This special dispensation has now been done away with.



CA. M. Naganathan & CA. P.S. Narasimhan

(The authors are members of the Institute. They can be reached at m_naganathan@hotmail.com)

All the loans can be rescheduled, renegotiated and restructured, and the effect on restructuring is tabulated below:

S. No	Nature of the Loan	Remarks	Ref. to RBI DBOD circular
1	Industrial Loan	Including projects under implementation: a. Infrastructure Loans b. Non-Infrastructure	No: 37 dtd. August 27, 2008 No: 121 dtd. April 6, 2009 No: 124 dtd. April 17, 2009 No: 125 dtd. April 17, 2009 No: 85 dtd. March 31, 2010 No: 96 dtd. April 23, 2010 No: 49 dtd. October 7, 2010
2	Non-Industrial	Special Regulatory concessions available subject to compliance of norms	No: 37 dtd. August 27, 2008 No: 121 dtd. April 6, 2009
3	Commercial Real Estate	Special Regulatory concession is not available after 1 st July, 2009. To be classified as NPA	No: 93 dtd. December 8, 2008
4	Capital Market	To be classified NPA	No: 37 dtd. August 27, 2008
5	Consumer & Personal	To be classified NPA	No: 37 dtd. August 27, 2008
6	Housing Loans	Can be restructured; AC depends upon compliance of sanction terms	No: 37 dtd. August 27, 2008 Dtd. November 3, 2008
7	Agriculture	Restructuring on account of natural calamities, to be governed by special norms prescribed by RPCD	Master circular on agriculture advances affected by natural calamities and ADWRS circulars

Let us review the norms as per the Regulator, as per its Circular.

DBOD.BP.PC.17/21/048/2009-10 dated 1st July, 2009

S. No		Remarks	Criteria
1	Eligibility	Standard/substandard/doubtful assets; Account can be single/multi banking/syndication or consortium; Corporates or non-corporates engaged in any activity; consumer and personal advances excluded; Capital market exposure with funded and non-funded outstanding of above ₹10 crore	a) Financial viability to be established; b) Retrospective rescheduling/restructuring/renegotiation not allowed; c) Accounts tainted with fraud/malfeasance and loss assets to be excluded; d) Accounts of willful defaulters may be entertained with board's approval;
2	Performing Status	Not to be downgraded if certain conditions are met	Package to be implemented within 120 days of its approval by the appropriate authority;

S. No		Remarks	Criteria
3	Condition 1 Security	To be fully secured with tangible security	Tangible security to include primary/collateral/bank guarantee/government guarantee; Exceptions: SSI accounts with outstanding of ₹25 lakh and below: Infrastructure projects provided the cash flows are adequate for repayment, escrow mechanism in place and bank to have a clear and legal first claim on the cash flows
4	Condition 2 Viability	It should be viable over a period of seven years	For infrastructure projects, a 10-year period can be considered
5	Condition 3 Repayment Period	Not to exceed 10 years including period of moratorium	For infrastructure projects, a 15-year term may be considered
6	Condition 4 Promoters Contribution	Promoters sacrifice and additional funds should at least be 15% of bank's sacrifice	
7	Condition 5 Personal Guarantee	Personal guarantee of the promoters should be available.	Exception would be only for units affected by external factors relating to the economy and the industry
8	Condition 6 Repeated Restructure	Account should not have been restructured earlier; restructure would include modification in terms of advance/securities such as repayment period, repayable amount, number of installments, rate of interest (other than due to competitive reasons)	Extension of repayment tenor of a floating rate loan so as to keep the EMI's same if made applicable to a class of loans, will not amount to restructure

As per the above, one of the conditions is that promoters should bring additional funds to a minimum of 15% of the bank's sacrifice. This requirement has been modified in the Circular 49 dated 7th October, 2010, in that the promoters can bring in upfront one-half (50%) of the said 15% and the balance within a period of one year. If no additional funds are brought in, i.e. upfront or within one year, the asset classification would revert back to the position on the date of reference. The above circular also stipulates that the promoter need not necessarily bring their contribution in cash and they can be brought in the form of de-rating of equity, conversion of unsecured loan into equity or as interest free loans.

One should keep in mind that the core of the restructure is establishment of viability through cash flow. If cash flow includes promoters' fund which is critical for viability and if it is not brought in, the entire exercise of restructuring would turn out to be ineffective, futile and infructuous. Similarly, conversion of existing unsecured loan into equity, if was not envisaged in the original sanction, the same also would affect the cash flow and perhaps its viability as well. Any change in the cash flow affecting the viability and repayment should be commented. The modification in terms even if it is as per the regulator's circular cannot be at the cost the proposed cash flows.

On the conditionality of the account being fully secured, a partial modification was introduced with

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reference to waiver of security for WCTL as per para 5 of the Circular 124 dated 17th April 2009, but has been done away with, thereby making the full security cover essential for WCTL accounts as well.

By the Circular 125 dated 17th April, 2009, for project loans, rights, licenses, authorisations, etc., charged to banks as collaterals were not to be reckoned as tangible securities.

However, vide the Circular 96 dated 23rd April, 2010, for infrastructure projects, banks may treat the annuities under the BOT model in respect of road/highway projects and toll collection rights (where there are provisions to compensate the project sponsor), which are legally enforceable and irrevocable and which operate through a mechanism of escrow accounts, as tangible securities.

B. Project under Implementation

For all project loans, the date of commencement of commercial operations (DCCO) is to be fixed at the time of financial closure and is to be mentioned in the sanction order. As per the RBI norms, any delay by a period of two years for infrastructure and six months for non-infrastructure projects beyond the DCCP fixed in the original sanction renders the account NPA. RBI Circular DBOD No: BP BC 85 dated 31st March 2010, introduced certain modifications in this regard. The circular outlines the following steps to be taken before calling such an account non-performing:

1. First step is to classify the loans into Infrastructure and non-infrastructure categories.
2. Both the infrastructure and non infrastructure loans will be classified NPA if there are arrears of interest/ installments beyond 90 days.
3. An infrastructure loan will be classified NPA, if it does not commence operations, two years beyond the DCCP mentioned in the original sanction unless an extension is granted.

4. The non-performing status would befall on the loan even if there are no arrears beyond 90 days.
5. A non-infrastructure loan will be classified NPA, if it does not commence operation six months beyond the DCCP mentioned in the original sanction unless an extension of period is granted.
6. An extension of time for the DCCP amounts to restructuring.
7. In addition to mere extension, the existing terms and conditions can be restructured and rescheduled.
8. Also, the installment amount and schedule of the loan can be modified, if there is an increase in scope and size of the project (and this modification is not treated as an exercise in restructuring) provided:
 - (a) The rise in cost is due to increased scope and the quantum is 25% or more of the original project cost;
 - (b) The project is viable;
 - (c) The new rating is not below the previous rating by more than one notch; and
 - (d) The increase in scope and size of the project takes place before the commencement of commercial operation of the existing project. (Here the word "existing" means original.)
9. For infrastructure projects, the additional period of extension for fresh DCCP can be given:
 - (a) If the delay is attributed to reasons involving court/arbitration cases, the additional period can go up by another two years, i.e. total of four years from the DCCP mentioned in the original sanction; and
 - (b) For all other reasons, additional period of extension is one year, i.e., a period of three years in all.
10. For non-infrastructure projects, the additional period of extension can be given another six months, i.e. a total period of 12 months from the original DCCP.
11. Since an extension of additional time would amount to restructuring, all the usual conditions of the restructuring circulars have to be complied with, as described under Para A (3) above.
12. If moratorium is given for payment of interest, bank cannot account interest income on accrual basis for the extended period of DCCP.
13. For a list of approved categories of infrastructure projects, one may refer to the master circular on loans and advances.

C. Treasury

Settlement date accounting:

By the Circular 58 dated 4th November, 2010, the accounting procedure for investment in securities has been modified to settlement date for recording

purchase and sale. Interestingly, *this modification is available for government securities and not for other investments like equity and other instruments.*

Exposures in Derivative contracts:

By the Circular 48 dated 1st October, 2010, bilateral netting of counter party credit exposures in derivative contracts are not permitted on MTM valuations, for the purpose of capital adequacy and exposure norms.

Sale of HTM investments:

As per the Circular 34 dated 6th August 2010, if the value of sale and transfer of securities to/from HTM category exceeds 5% of the book value of investments held in HTM category at the beginning of the year, bank should disclose the market value of the investments held under HTM and indicate the excess of book value over market value for which provision is not made.

By the Circular 56 dated 1st November, 2010, it was clarified that the one time transfer of securities to/from HTM at the beginning of the year and sale to RBI under pre announced OMO auctions will be excluded from the 5% cap. Further, banks are permitted to undertake repos from HFT, AFS and HTM categories

Zero Coupon bonds:

By the Circular 44 dated 29th September, 2010, banks have been prohibited from investing in zero coupon bonds issued by corporate and NBFCs unless the issuer builds up sinking funds for all accrued interest and invests the fund in liquid securities. Such investments normally form part of restructure proposals involving conversion of FITL. (Refer also to the master circular on the valuation of zero coupon bonds.)

Investments in bonds issued by infrastructure companies:

By the Circular 97 dated 23rd April 2010, investment by banks in long term bonds issued by companies engaged in executing infrastructure projects and having a minimum residual maturity of seven years may be classified under HTM. While reckoning this seven-year term, the regulator has clarified that the minimum residual period of seven years is relevant only at the time of investment in bonds. Banks can continue to classify them under HTM even if the residual period falls below seven years after the initial investment.

Investments in unrated non-SLR securities:

Bank's investment in unlisted non-SLR securities has been restricted to 10% of its total investments in non-SLR securities as on the previous March figure. Banks are allowed to invest in unrated bonds issued

By the Circular 58 dated 4th November, 2010, the accounting procedure for investment in securities has been modified to Settlement date for recording purchase and sale. Interestingly, this modification is available for government securities and not for other investments like equity and other instruments. ☺

by companies engaged in infrastructure activities up to 10% within the ceiling of unlisted non-SLR securities. By the Circular 98 dated 23rd April, 2010, it is stated that during the time lag between issuance and listing of such securities with exchanges, such investment is considered as listed. However, if such a security is not listed within the specified period, the same will have to conform to the ceiling of 10% and no further investment would be allowed until the cap is reduced to 10%.

D. Provisioning Requirements

1. Provision on Standard assets:

By the Circular 58 dated 5th November, 2009, the provision requirements for standard assets were given as under:

(a) Direct advances to agriculture and SME sector: (reduced from 0.40 to 0.25)	0.25%
(b) Commercial real estate sector	1.00%
(c) All other advances	0.40%

The regulator has since clarified that the reduction to 0.25% is applicable to micro industries and not to medium enterprise and letters SME means small and micro enterprise, not medium enterprises.

Provision with respect to sacrifice on applying present value in restructured accounts:

Detailed guidelines are given in the Circular 121 dated 9th April 2009, on the computation of diminishing in fair value of a restructured loan and provision required to be made in this regard. With the adoption of base rate system from 1st July 2010, it is possible that the sacrifice may have to recomputed and provided in the years when the base rate undergoes a change. It is also stated in the RBI circulars that interest rate reduction due to market forces may not necessitate the re-calculation of sacrifice and provisions.

Provision on Project Loans where extension given for DCCP:

As stated earlier by the Circular 85 dated 31st March, 2009, additional provision on standard restructured accounts where extension is given to the DCCP both

for infrastructure and non-infrastructure accounts:

S. No	Percentage	Infrastructure	Non infrastructure
1	0.40%	Until two years from the original DCCO	Until the first six months from the original DCCO
2	1.00	During the third & fourth year after the original DCCO	During the next six months

Provision for housing loans on teaser rates:

Apart from specifying 'loan to value' caps on housing loans and identifying the risk weights to be adopted for such loans, the regulator has also stipulated a provision of 2% on such loans which are in standard asset category. Once they move into higher rates, a year after they maintain their performance on such higher rates, a lower provision of 0.40% is made applicable to them.

It is mandatory for banks to reimburse its customers on account of failed ATM transactions within 12 working days, failing which the banks shall pay a penalty of ₹100 per day. Banks will have to furnish to the regulator every quarter details of such penalties, reasons for delays and details of action taken.

Banks shall make 100 % provisioning for all unreconciled debit entries outstanding for a period exceeding two years in their Nostro accounts, which originated on or after 1st April, 2002.

All credit entries which originated after 1st April, 2002 and which are outstanding for more than three years, should be transferred to a blocked account and shown as outstanding liabilities. They should be reckoned for CRR/SLR purposes.

Disclosures:

Base Rate: By the Circular 88 dated 9th April, 2010, banks are required to disclose the Base Rate transparently.

HTM investments: By the Circular 56 dated 1st November, 2010, bank should disclose the market value of HTM investments over the book value where the transfer to/from HTM exceeds 5% of the book value of HTM at the beginning of the year.

Bank's investment in unlisted non-SLR securities has been restricted to 10% of its total investments in non-SLR securities as on the previous March figure. Banks are allowed to invest in unrated bonds issued by companies engaged in infrastructure activities up to 10% within the ceiling of unlisted non-SLR securities. By the Circular 98 dated 23rd April, 2010, it is stated that during the time lag between issuance and listing of such securities with exchanges, such investment is considered as listed. ☺

E. A Few of Important Circulars Issued By Regulator in Last One Year

1. Prudential coverage ratio- DBOD BP BC 87- 21/04/2011
2. Enhancement of rates of provisioning for NPAs and restructured accounts-DBOD BP BC 94 -18/05/2011
 - On substandard secured advances - Provisioning to be 15% of the outstandings
 - On substandard unsecured advances - Provisioning to be at 25% of the outstandings
 - Unsecured infrastructure advances with escrow safeguards - Provisioning to be 20% of the outstandings
 - On doubtful assets (up to one year) category - 25 % of the secured portion
 - On doubtful (in one to three year) category - 40% of the secured portion
 - On doubtful assets of three years and beyond - 100% of the outstandings to be provided
 - The unsecured part of doubtful assets will continue to get provided at 100%
 - Restructured standard assets to be provided at 2%
 - Restructured assets which get upgraded will have to be provided at 2% up to a period of one year from the date of upgradation
3. Maintenance of SLR- DBOD Ret BC 92- 09-05-2011
4. Accounting for repo/reverse repo transactions- clarification - IDMD 29-30/05/2011
5. Investments in units of domestic mutual funds - A.P. (Dir) 8 – 09/08/2011
6. Prudential norms for off balance sheet exposures - DBOD BP BC 28 -11/08/2011
7. Inclusion of credit under KCC under direct financing for agriculture -13/10/2011
8. Comprehensive guidelines on derivatives: Modifications - DBOD BP BC 27- 02/08/2011
9. Comprehensive guidelines on derivatives: Modifications - DBOD BP BC 44 – 02/11/2011
10. Reduction in CRR- DBOD Ret BC 74- 24/01/2012

(Note: This article aims to provide a snapshot of the recent pronouncements from the Regulator (RBI) and by no means can it be called complete). ■

Statutory Bank Branch Audit: Strengthening Audit Plan



Auditors are expected to report to Reserve Bank of India anything fraud, any act of excess power or foul play in economic transactions. Paragraph 8 of Standards on Auditing SA 240 (Revised) *Auditor's Responsibilities Relating to Fraud In an Audit of Financial Statements* of ICAI requires an auditor to be responsible for *maintaining an attitude of professional skepticism throughout the audit* while obtaining reasonable assurance, and prescribes him to consider the *potential for management override of controls* and to remember that audit processes, which empower the auditors in evaluating and verifying the financial statements of various enterprises, may not help them effectively *in detecting fraud*. Regulations today bind them to apply heightened professional skepticism considering the potential for management override of controls. This article attempts to identify some of such potential areas exposing the risk of or causing material misstatements, which would help the branch auditors in strengthening their audit plans. It aims to identify some potential areas, not equally applicable to all branches, of management override of controls while not suggesting an audit approach or procedures. The author advises that auditors, while planning their audits, should identify all such potential areas, considering the type and size of the branch.



CA. Ishwar Chandra

(The author is a member of the Institute and he may be contacted at ishwar_c1002@rediffmail.com.)

Technology-enabled business processes and products, and varied platforms/applications at banks, demand for enhanced auditors' understanding of financial reporting process and relevant controls in place. Making auditing exception-based and pressing time-lines to submit plethora of audit reports and certificates with a lack of visible audit-trails make auditing complex and challenging. Above all, sometimes, intentional manipulative practices add to these auditing complexities.

Auditors are required to report to Reserve Bank of India anything susceptible to fraud, fraudulent activity, any act of excess power or any foul play in any transaction. According to Paragraph 8 of Standards on Auditing SA 240 (Revised) *Auditor's Responsibilities Relating to Fraud In an Audit of Financial Statements* of ICAI, "When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit, considering the potential for management override of controls and recognising the fact that audit procedures

that are effective for detecting error may not be effective in detecting fraud..." Today, regulations force auditors to apply heightened professional skepticism, considering the potential for management override of controls. Following is a discussion on some of such potential areas exposing the risk of or causing material misstatements, which would help the bank-branch auditors in strengthening their audit plans:

1. Business Figures

Pressures-to-perform and related incentives many a time conduce the organisational management to incur accounting manipulations and window dressing of business figures, which not only misstates the financial data, but causes some loss to the concerned banks too, e.g. increased SLR (statutory liquidity ratio) and CRR (cash reserve ratio) costs on inflated business figures. Generally, window dressing entries are made at year- or quarter-end to achieve performance and regulatory targets and are not supported with any business transactions. Some of the common ways of incurring window dressing in industry include:

- Transfer entries, not supported with cheque/debit authority from customers, from unutilised credit limits to deposit accounts before near year-/quarter-end and reversing immediate after year-/quarter-end. And, also allowing loans against such term deposits
- Transfer of funds from unutilised credit limits to other bank accounts of borrowers and getting reversed immediate after year-/quarter-end
- Scheme manipulations, such as classifying non-priority sector advances into priority sector advances

Following first-hand procedures, applied at planning stage itself and revealing sudden spurt/down fall, would help indicating such window dressing:

- Comparing quarter-end figures of advances and deposits with that of immediate previous Friday and of immediate next Friday
- Comparing last fortnight volume of advances with that of immediate previous fortnights of the year
- Comparing monthly average rates of interest on advances with that of average rate of interest on year-/quarter-end

If abnormal variances remain unexplained or are not explained satisfactorily, auditors should investigate towards the reasons thereof.

2. Rushed Sanctions and Deposits

To achieve budget and regulatory/government targets, practice of, sometimes, rushed sanctions at

banks near year-/quarter-end, tend to result not only in procedural lapses and deviations of laid down controls relating to appraisal, sanction, disbursement and documentation, e.g. not obtaining complete application forms, non-execution/non-registration of charge and other non-compliances, but in business also beyond delegated powers at times. For example, allowing excess/ad hoc amount in a newly sanctioned account without first getting confirmed the branch action from higher authorities, as per bank's guidelines.

Comparing volume of advances for last fortnight of the year with that of previous fortnights would help indicating such rushed sanctions for evaluation of compliance of laid down controls.

Also, to meet the year-/quarter-end deposit targets, particularly of low-cost CASA (current account savings account), accounts of bodies/organisations are opened as SB accounts, which are prohibited to be opened as SB accounts in terms of paragraph 9.1.3 of Manual of Instructions (June 1998) of the RBI Department of Banking Operations and Development. List of such certain prohibited bodies/organisations can be referred to in the said manual or at the IBA (Indian Banks' Association) website.

Collecting the scheme-wise list of SB accounts, particularly of government offices, would indicate such accounts and would help identifying instances of violations of the RBI directives, causing huge interest loss to the bank and misstating the financial statements.

3. Transactions in Excess of Powers

Pressures also sometimes lead management acting in excess of powers, and lack of default checks in the computer systems, not restricting unauthorised acts, could be one of the facilitating factors for such acts. Identifying such instances becomes difficult when such acts are omitted from record, e.g. allowing

Review of system-generated exceptions, e.g. override default check, particularly at the year-quarter-end, would also help evaluating such transactions.

Auditors should consider examining the ad hoc allowances during the period, irrespective of the year/quarter-end adjustments for compliance of laid-down guidelines. Auditors, while relying upon the legitimate sounding judicious business decisions, should examine into such transactions in excess of powers, drilling down on the facts to see whether more such transactions have taken place. ☞

Generally in CBS (core banking solutions) environment, balancing of subsidiary ledgers is taken assumed and the entries in impersonal accounts, e.g. suspense, sundry credits, special debits, intermediaries, proxy, clearing adjustment, sundry creditors, etc., are pruned and zeroed at balance sheet dates, skipping the audit scrutiny for errors and irregularities. Layering of entries/inappropriate grouping of impersonal account heads into GL (general ledger) heads at the year-/quarter-end in impersonal accounts, expose the risk of potential material misstatement. 

a fresh ad hoc amount, without first adjusting the existing overdue ad hoc amount, for that no authority is authorised in the bank, and omitting to record in ad hoc register.

Auditors' reviews should consider including the accounts regularised at near year-end, and showing financial pressures, e.g. ad hoc not regularised timely, frequent request for excess/ad hoc, and frequent cheques returned. Periodic monitoring information on large accounts submitted to the controllers can give first-hand idea of adverse features in such large accounts. Review of system-generated exceptions, e.g. override default check, particularly at the year-/quarter-end, would also help evaluating such transactions. Auditors should consider examining the ad hoc allowances during the period, irrespective of the year-/quarter-end adjustments for compliance of laid-down guidelines. Auditors, while relying upon the legitimate sounding judicious business decisions, should examine into such transactions in excess of powers, drilling down on the facts to see whether more such transactions have taken place.

4. Non-Performing Assets (NPA)

System classified NPA slippages and provisioning burden, sometimes, tempt management to resort unfair practices at branches. Such practices make branch auditing complex and auditors struggle to find the best way to audit NPAs. In view of this, auditors should consider following while planning the audit of NPAs:

- Restructuring of loan accounts having no financial viability/reasonable certainty of repayment, or taking into account the cash-flows based on unrealistic assumptions
- Repeated rescheduling of highly overdue accounts, such as in housing and educational loan schemes
- Irregular bulk reviews of credit limits at the near

year-/quarter-end, not supported with current financial information and pending for other compliances

- Regularising accounts at the near year-/quarter-end by transfer entries not supported with business transactions, from group borrowal accounts or by extending unauthorised credit facilities too
- Valuing securities in sub-standard and doubtful assets, not supported with current independent valuation and inspection reports.
- Converting the credit facilities, in which securities are lost/depleted, into clean facilities

Review of system-generated log of changes in asset classification would help evaluating whether all manual changes made in asset classification are in order. Going through the periodic statements submitted to controllers on potential NPAs, and on accounts overdue for review/renewal, particularly at the quarter-end immediate before the year-end, would also help indicating such features.

5. Incomes and Expenses

Inappropriate recognition including non-recognition, advance recognition or delayed recognition, or inappropriate measurement of incomes/expenses, can misstate the financial statements materially. Following are some of the suggested audit procedures which auditors should consider while auditing incomes and expenses:

- Reviewing reconciliation of INC (interest not collected) and URIPY (unrealised interest of previous year) with NPA accounts would help locating omissions to derecognise INC and URIPY in NPAs.
- Review of system-generated manual interest report would help identifying instances of manual entries made and reversed, if any, immediately after the year-/quarter-end, e.g. incomes recognised erroneously in the current period and reversed subsequently after the year-end.
- Comparison of non-interest incomes with that of previous corresponding year revealing wide variances, if any, would help indicating instances of inappropriate recognition of incomes, e.g. recognising NPA cash recoveries in sundry incomes.

Provisions and contingent liabilities in terms of Accounting Standard-29 "Provisions, Contingent Liabilities and Contingent Assets" of ICAI is one of such areas of management's judgments/assumptions, exposing the risk of potential subjectivity and over/understatement of expenses, e.g. penalty notice

received for non-registration of lease deed, suit filed by the landlord for payment of enhanced rent and unsettled customer complaints, etc. Auditors should inquire into all such events and should evaluate the appropriateness of management's judgments and underlying assumptions for recognition and measurement of expenses/disclosure of provisions.

6. Impersonal (Sensitive) Accounts

Generally in CBS (core banking solutions) environment, balancing of subsidiary ledgers is taken assumed and the entries in impersonal accounts, e.g. suspense, sundry credits, special debits, intermediaries, proxy, clearing adjustment, sundry creditors, etc., are pruned off and zeroed at balance sheet dates, skipping the audit scrutiny for errors and irregularities. Layering of entries/inappropriate grouping of impersonal account heads into GL (general ledger) heads at the year-/quarter-end in impersonal accounts, expose the risk of potential material misstatement.

Auditors, having determined the reconciliation of subsidiary ledgers, should consider scrutinising the full ledger, particularly of zeroed impersonal accounts, to check and determine whether all significant entries pruned off, are supported with substance/business transactions.

7. Monitoring of Large Borrowal Accounts

Besides the potential management override of controls, unscrupulous borrowers sometimes also expose risk of/cause material misstatements. Following are activities of borrowers tantamount to frauds, in terms of the paragraph 3.2 of the RBI Circular No. DBS.FrMC. BC.No. 1/23.04.001/2011-12 dated 1st July, 2011, auditors should consider in their audit plans:

- *Diversion of funds outside the borrowing units:* Laxity in effective supervision over operations in borrowal accounts or lack of effective monitoring of the end-use of funds can lead to diversion of funds outside the borrowing units. Especially, credit facilities disbursed in cash, instead of directly to suppliers; and also the borrowers having group accounts showing financial pressures, should be considered as more exposed to the risk of potential diversion of funds. To this, auditors should consider having a cursory look on, particularly, at the near year-/quarter-end transfer entries in few of such large borrowal accounts. This simple exercise would throw significant light on substance of transaction/end-use of funds and would help identifying indications of potential diversion of funds in personal SB accounts of promoters/loan accounts of group concerns.
- *Fraudulent removal of pledged stocks/disposing*

of hypothecated stocks/inflating the value of stocks in stock statements and drawing excess bank finance: Experience lessons that accounts with multiple banking arrangements and showing financial pressures/indiscipline features should be considered as one of such areas exposing the risk of such fraudulent activities. At first, auditors are suggested to collect the information on large multiple banking borrowers at planning stage, and to check whether multiple banking information has been shared among the banks in accordance with the RBI guidelines, meticulously. To evaluate compliance of the RBI Circular No. DBOD No. BP.BC.46/08.12.001/2008-09 dated 19th September, 2008, auditors should collect information on large multiple banking borrowers availing sanction limits ₹5 crore and above, and should check and determine whether

- information has been exchanged among the banks, at least, at quarterly intervals,
- regular professional certification for compliance of various statutory prescriptions have been obtained, and
- CIBIL reports have been used.

Lack of transparency in stock statements, e.g. not furnishing information on quantities, method and basis of valuation, aging of debtors and creditors, are also few of the first-hand warning indicators, auditors should consider while examining appropriateness of valuation of stocks.

Heightened Professional Scepticism: Pressing Need with Multiple Benefits

A careful consideration of the above-said potential areas may help in strengthening the audit plan. However, traditionally, management override has not been a focus of statutory bank branch audit plan. With the growing financial statement frauds and forcing regulatory mandates, it has become a pressing need to consider such potential situations while planning a bank branch audit.

Although statutory bank branch auditing can neither be relied for detecting all frauds nor be aimed to discover the planned fraud-schemes, it does play a key deterrent role in prevention of financial-statement frauds. Performing audits with heightened professional scepticism demands vehement cooperation from management. On enabling side, auditing with heightened professional scepticism, detecting the material misstatements and playing a proactive role in fraud prevention would improve governance besides supporting the management's efforts of managing the fraud-risk. ■

Financing the Future of Indian Infrastructure



The task of a finance professional in an infrastructure company is probably the toughest of all finance jobs because of the constant regulatory changes in this sector, along with concerns like increasing inflation and rise in the cost of raw material. Most banks, therefore, do not want to look beyond the five to seven year horizon when they are lending to an infrastructure company. Additionally, there are a series of legal, environmental, and labour related issues. True, the infrastructure sector is a challenging sector anywhere across the globe. However, in India the challenges are quite unique because of a range of factors. However, a competent Chartered Accountant (CA) can convert these challenges into opportunities. CFOs and CAs have their job cut out as the country gears up for an unprecedented level of infrastructure spending. Read on to know more...



CA. Prasad Devatha

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

In India, escalating infrastructure spending is inevitable. The rapid growth of the economy has put a lot of strain on infrastructure areas like power, railways, roads, ports, airports, irrigation and urban/rural water supply. The pattern of inclusive economic growth projected for the 11th plan, with GDP growth averaging 9% per year, can be achieved only if this infrastructure deficit is overcome and adequate investments are in

place to support the growth. What we also need is an improved quality of life for both our urban and rural populace. Let us look where we are at, as a nation with our infrastructure targets.

11th Plan Targets

In the 11th plan up to FY10, approximately ₹11 trillion has been spent on infrastructure, with the remaining ₹9 trillion estimated to be spent in FY11-FY12.

Target and Achievement in the Eleventh Five Year Plan:

Sector	Target	Actual achievement in 2009-2010	Likely Achievement	Gap	Gap as % of target
Power (MW)	78,700	19,092	62,374	16,326	20.75
Roads (NHDP) (km)	54,454	17,528	33,454	21,000	38.56
Ports (mt)	1,016.55	112	511.8	505	49.65
Water supply (% coverage)	100	40	70	30	30.00

Source: India Infrastructure Research 2011

Delay in Completing Projects in 11th Plan

Award and execution of projects in the 11th Plan has been slow mainly because of the issues related to land acquisition, environmental clearance, restrictive regulations and consequent litigation, as well as restrictions on the issue of visas, especially in Ports sector.

The major delays in the Roads sector stemmed from frequent management changes, capacity constraints at NHAI, finalisation of MCA, restrictive policy frameworks, instances of single-bid projects not being awarded, conflicts of interest, termination clauses, and caps on the number of bidders that led to considerable litigation. The law and order problem in certain eastern and north-eastern states also contributed to the delays.

Rise in Infrastructure Spending Inevitable

With the Government of India proposing to invest in infrastructure projects worth ₹41 trillion in the 12th Plan period, growth prospects are strong for EPC players. However, to turn promise into reality, we will need access to equity capital, improvement

• 11th plan infrastructure investments lagging targets.

- Originally envisaged investments of ₹20.6trillion as against investments worth only ₹7.8trillion (38%) had been channeled in the sector till March 2010.
- There has been an 11% -23% downward revision in planned investments in sectors such as roads, railways, and water supply with a sharp and 53% cut in outlay for ports.
- Planned investments in electricity and irrigation sectors have been largely maintained and that in airports raised by 16.7%.
- Overall, there has been 10.6% downward revision in planned investments in infrastructure — storage and oil & gas.

in liquidity and focused efforts from the Government to channel long-term investments to the sector.

Spate of Reforms Across Infrastructure Sectors

Road sector: India has one of the largest road networks in the world. The national highways, though shorter in cumulative length than state, district and rural roads, carry the bulk of the traffic in the country. However, most of our roads are in deplorable condition and suffer from under-capacity.

Indian Road Network

	Length (In Km)
National Highways	70,548
State Highways	131,899
Major District Roads	467,763
Rural and Other Roads	2,650,000

The government has brought about substantial reforms in the Roads sector to make projects attractive to bidders.

The BK Chaturvedi Committee has suggested major reforms in the Roads sector, recommending on all the three modes of delivery: BOT (Toll), BOT (Annuity) and EPC (item rate contract) concurrently rather than sequentially. A road project not found *prima facie* suitable for BOT (Toll) can be implemented directly on BOT (Annuity) subject to the overall cap as envisaged in the work plan. And if BOT (Annuity) bids are unacceptable, then only the project can be awarded on EPC basis.

Typically, Annuity bids translate to an Equity IRR of up to 18%. However, in the event of bids exceeding the equity IRR of 18%, the same will be bid out on EPC. In sensitive areas with law and order problems, or affected by inhospitable terrain, a bid working out to an Equity IRR of up to 21% will be acceptable considering a risk premium of 3% on a case-to-case basis.

Additionally, lenders should be allowed to create a charge on the project escrow account so that they have greater security. The recommendations also suggest that developers to be paid the entire grant amount (40% of project cost) during the construction period. Concessionaires will be allowed to completely exit projects two years after COD and the conflict of interest threshold will be increased to 25% from 5% earlier. Also, prequalification must be made an annual exercise and not be conducted for each project separately.

These measures were aimed at attracting investments to the Roads sector, cutting down on procedural delays, doing away with the need for rebidding for projects. This will enhance the equity

IRR's of developers. Bidders can access to debt and marginally lower interest rates. For bidders and developers, this boosts participation, encourages healthy competition and saves considerable time and effort.

PMGSY instituted for upgrading rural roads: The Pradhan Mantri Gram Sadak Yojna (PMGSY) was instituted to provide all-weather access in rural areas, thus promoting access to economic and social services, and generating increased agricultural incomes and productive employment opportunities. About 2,80,000 kms of projects have been completed while about 1,20,000 kms of projects worth about ₹460 billion are either in the implementation stage or yet to be given out for construction.

Metro rail projects: The government has undertaken development of rail-based Mass Rapid Transit System (MRTS) in major cities like Mumbai, Bangalore, Hyderabad, Chennai, Kolkata (expansion) and Delhi (Phase II). The total investment outlay towards rail based MRTS in the 11th plan is likely to be \$4 billion. In the near future, we see the Kolkata East – West Metro Corridor project, Hyderabad Metro Rail project and the Bangalore High Speed Rail Link project as potential opportunities for EPC and Infra developers.

Ports sector: Ports play a vital role in the overall economic development of the country. There are 12 major ports and about 200 non-major ports along India's coastline. The 12 major ports are under the direct administrative control of the Central Government while the non-major ports are under the jurisdiction of the maritime boards under the respective State Governments.

The National Maritime Development Programme (NMDP) envisaged investments of ₹870 billion in the 11th plan period to increase capacity of major ports to 1,016 MMTPA. However, projects worth only ₹57 billion have been completed till recently and projects worth ₹165 billion are under construction. It is a known fact that delays in awarding projects were caused mainly because of restrictive regulations and consequent litigation.

The FII limit for investment in corporate bonds, with residual maturity of over five years issued by companies in infrastructure sector, has been raised by an additional limit of \$20 billion taking the limit to \$25 billion. This has raised the total limit available to the FIIs for investment in corporate bonds to \$40 billion. ”

As a result of these delays, there has been a sharp 53% revision in the planned outlay in the ports sector — to ₹460 billion. Major domestic ports are currently operating at more than 90% utilisation; their poor rail-road connectivity to the rest of the country has led to congestion. Also, unavailability of storage infrastructure has led to capacity shortage at most of the major Indian ports. At the 12 major ports that are under Central Government jurisdiction, the government has undertaken projects worth ₹288 billion. Another ₹206 billion worth of projects are currently in the pipeline. Most of these projects will involve improving capacity by building new berths, improving productivity by replacing old equipment, improving draft and developing associated infrastructure.

Going forward, we expect the pace of awarding projects in the Ports sector to pick up, attributable to policy reforms, such as easing of restrictive clauses in the bidding process and formalisation of the MCA for the Ports sector. Already, several large projects have been cleared by the apex bodies — the Private Partnership Advisory Committee and Cabinet Committee on Infrastructure — and they have entered the bidding stage. In FY11, the Ministry of Shipping aims to award 21 projects that will add a capacity of 200 million tonnes and will require an estimated capital investment of ₹140 billion.

Airports sector: The development of airports is vital to support the growth in air travel. Passenger traffic in airlines has grown from 73 million in FY06 to 124 million in FY10. With rising incomes and the declining cost of air travel, we can expect a larger number of people using air transport for travelling around the country and overseas. Air cargo traffic, too, has risen from 1.4 MT in FY06 to 1.9MT in FY10. With a view to create world-class airport infrastructure to support this rise in traffic, Airport Authority of India (AAI) has undertaken up gradation/modernisation of a number of metro and non-metro airports in association with joint venture companies in some cases.

Airport modernisation programme: Of the 35 non-metro airports, the government spent ₹15 billion on the development and modernisation work in 12 airports (Vizag, Mangalore, Trivandrum, Aurangabad,

Investments in the 12th plan period are likely to be equally shared between the government and private sources. While Central and State governments are expected to fund 22.5% and 27.5%, respectively, the private sector is expected to pump in the remaining 50%. ”

Withholding tax rate has been reduced to 5% instead of the current rate of 20% on interest payment on borrowing infrastructure debt funds and also exempt the income of the fund from the tax. To promote savings and raise funds for infrastructure, an additional deduction of ₹20,000 for investment in long-term infrastructure bonds extended by one more year. ”

Nagpur, Amritsar, Jaipur, Udaipur, Agra and Dehradun) in FY10. Of the remaining 23 airports, work at 14 other airports (Raipur, Ahmedabad, Ranchi, Bhopal, Indore, Khanjuraho, Pune, Imphal, Dimapur, Coimbatore, Madurai, Lucknow, Varanasi and Chandigarh) are nearing completion. The modernisation projects at five airports (Port Blair, Goa, Bhubaneshwar, Jammu and Vadodara) are in the offing; AAI has already started the detailed planning and engineering.

Power sector – Shedding the lethargy: In the revised 11th Plan, power generation capacity is likely to increase by 62,374 MW with planned investment of ₹6.6 trillion (42% of total investment) in the power sector. So far, 21,221 MW of capacity has been commissioned as part of the 11th plan. Apart from this, 100,000 MW additional capacity is targeted in the 12th plan though ordering is yet to commence for 53,000 MW of power projects. To keep pace with the capacity addition in the generation sector, investments in the transmission and distribution sector too are expected to accelerate. PGCIL (Power Grid Corporation of India Limited) is likely to incur capex of ₹220 billion over FY11 and FY12. The government plan to undertake large transmission projects through the PPP mode will add to opportunities like ultra-mega transmission projects.

PGCIL spending to rise in FY2011-12: PGCIL is the central nodal agency for maintaining the national/regional transmission grids and adding new transmission capacity. PGCIL has a capex plan of ₹550 billion that needs to be spent over the 11th Plan. PGCIL has awarded projects worth ₹277 billion in the first three years of the 11th Plan. Historically, PGCIL has accelerated its capex spending in the last two years of the Plan.

Trends in Infrastructure Financing

Over the five year period between 2005-2006 and 2009-2010, the infrastructure segment has seen funds pouring in from the debt and equity markets, as well as FDI.

Infrastructure Funding in India through Debt and Equity Markets (in ₹ billion)

	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
FDI (\$ millions)	955.10	1902.10	6600.60	6665.40	8030.40
Debt					
Commercial Banks	338.54	302.86	622.20	646.36	1099.16
NBFC's	321.82	440.31	551.07	652.37	845.18
International Development Funding Institutions	144.91	135.62	574.45	244.58	371.27
ECB's	286.04	585.16	696.83	561.05	523.57
LIC	93.87	133.28	128.30	150.41	167.74
IIFCL			16.84	34.70	24.15
Equity					
IPO	50.61	203.58	219.72	8.31	179.31
FPO	2.16	4.67			118.50
QIP		10.22	94.08		66.07
Private Equity	61.65	101.88	193.62	108.05	86.53
Project Equity	0.47	0.97	5.32	7.46	9.42

Budgetary Reforms

In the last budget, our Finance Minister has announced major policies to enhance the flow of funds into the Infrastructure Sector:

- The FII limit for investment in corporate bonds, with residual maturity of over five years issued by companies in infrastructure sector, has been raised by an additional limit of \$20 billion taking the limit to \$25 billion. This has raised the total limit available to the FIIs for investment in corporate bonds to \$40 billion.
- For 2011-2012, an allocation of over ₹2,14,000 crore was made for this sector, which is 23.3% higher than the allocations in 2010. This amounts to 48.5 % of the gross budgetary support to Plan expenditure.
- Allowed tax free bonds of ₹30,000 crore to be issued by various government undertakings in FY2011-12, like IRFC, NHAI, HUDCO and Ports.
- To attract foreign funds for the infrastructure financing, SPV's in the form of notified infrastructure debt funds.
- Withholding tax rate has been reduced to 5% instead of the current rate of 20% on interest

Budgetary support accounts for nearly 30% to 40% of the total infrastructure investment. Of the total non-budgetary investment in infrastructure, nearly 70% is in the form of debt. Lending is typically provided in the form of term loans, ECB's, bonds, debentures or private placement issues. Loan products are structured to suit the needs of both customer and lender. ☞

payment on borrowing infrastructure debt funds and also exempt the income of the fund from the tax.

- To promote savings and raise funds for infrastructure, an additional deduction of ₹20,000 for investment in long-term infrastructure bonds extended by one more year.

With improved access to long-term capital and reduction in borrowing rates, bankers have started lending to infrastructure projects.

Investment Requirements

Investments in the 12th plan period are likely to be equally shared between the government and private sources. While Central and State governments are expected to fund 22.5% and 27.5%, respectively, the private sector is expected to pump in the remaining 50%.

Funding Sources and Structures

Budgetary support accounts for nearly 30% to 40% of the total infrastructure investment. Of the total non-budgetary investment in infrastructure, nearly 70% is in the form of debt.

Lending is typically provided in the form of term loans, ECB's, bonds, debentures or private placement issues. Loan products are structured to suit the needs of both customer and lender.

Commercial banks, for instance, lend in the form of term loans and working capital finance. NBFCs finance infrastructure projects through loans, subordinated debt, mezzanine finance and equity, and also providing leasing and hire purchase loans for equipment purchases.

Debt financiers are facing a risk due to the non-recourse or limited recourse nature of infrastructure financing and the lack of tangible security. Reserve Bank of India now allows bankers to treat toll receipts and annuities from road projects as tangible securities. ”

Risks and Challenges

Infrastructure projects are highly capital intensive and have a huge requirement in terms of labour, material, machinery and land. Any infrastructure project, therefore, takes three to five years before generating revenues. Banks have been the largest source of funding for this sector, but they have faced problems like asset-liability mismatch, flexible interest rates and shorter tenors.

- In the global market, insurance and pension funds are the major sources of long-term debt for infrastructure projects. However, in India, insurance and pension funds have had limited presence in infrastructure financing because of regulatory restrictions as well as its own inherent drawbacks.
- ECB (External Commercial Borrowings) flows are also restricted in tenor and by the government's foreign exchange management policies.
- Bonds are a good source of low-cost, long-tenor funds and are most suitable for financing infrastructure projects. However, the Indian bond markets are underdeveloped and illiquid.
- It is very difficult to structure financing proposals because of regulatory issues, restrictions, transparency in documentation; many projects are suffering from clear-cut implementation schedules and targets. Most projects are delayed and frequent cost overruns increase project costs significantly.
- Debt financiers are facing a risk due to the non-recourse or limited recourse nature of infrastructure financing and the lack of tangible security. Reserve Bank of India now allows bankers to treat toll receipts and annuities from road projects as tangible securities.
- Infrastructure projects may consist of financing from domestic or foreign sources, or both. Given the

CFOs and CAs in public and private companies have been playing a crucial role in developing financing structures that are better suited to the long-term nature of infrastructure projects. Some of these, like subordinated debt and convertible debt instruments, are being used to fund key infrastructure projects in India. ”



long-term nature of the projects, risks like interest rate fluctuation as well as currency exchange rate risk abound. At the same time, one needs to consider hedging cost as well.

- Over the lifetime of a project, regulatory changes, alteration in the tax regime, monetary and economic developments may also affect the revenues and returns.

Infrastructure financing trends show that most of private funding has gone to the power, roads and telecom sectors. Investment in other sectors will start flowing only after significant reform of the policy framework.

At the same time, funding requirement in other sectors, like power, roads, ports and airports, will continue to increase because of the investment deficit in these areas.

CFOs and CAs in public and private companies have been playing a crucial role in developing financing structures that are better suited to the long-term nature of infrastructure projects. Some of these, like subordinated debt and convertible debt instruments, are being used to fund key infrastructure projects in India.

(Source; information collected from India Infrastructure Research — Infrastructure Finance in India - 2011) ■

XBRL: XBRL for Reporting in Government



XBRL based reporting systems have found wide application internationally as well as in India in the corporate sector. The advantage of XBRL in making the reported data 'analytics ready' is well recognised. This article explores the application of XBRL for internal reporting in the context of Government departments, projects and schemes. It begins with the complexities of reporting in Government. A framework for XBRL based reporting in Government has been presented. The article also explains how the framework can be applied taking two real life examples of reporting situations in Government. The broad steps in implementation of the XBRL based reporting framework have also been explained. Certain issues that one can expect in a typical implementation exercise are also highlighted.

What is XBRL?

XBRL or eXtensible Business Reporting Language is an application of XML to business information. It uses tags to describe the data, making it immediately reusable, interactive and intelligent. XBRL is also "extensible" making it customisable for unique reporting situations.

The possibility of using XML (eXtensible Markup Language) for electronic reporting of financial information was first explored in April, 1998. XBRL International today is a consortium of more than 650 companies and other agencies worldwide working to promote the adoption of XBRL. XBRL International is governed by a Board of Directors. It has produced a number of specifications and taxonomies so far. XBRL India is a Section 25 company incorporated for managing the affairs of Indian jurisdiction of XBRL International.



CA. Ashok Rao* Uma Shankar Mohanty**

(*The author is a member of the Institute. **The Author is Consultant, NCR Consultants Limited, Bangalore. They can be reached at eboard@icai.org)

Tagging

In XBRL, each piece of data whether numbers or text, is given a unique ID based on standardised lists of terms known as taxonomies. This unique ID is called a 'Tag' in XBRL terminology.

For example, a data point of 2,00,000 might be linked to the following terms:

- Currency in Rupees
- Accounting item as Net Profit
- Time period as the second quarter of 2011

Once data is tagged, it becomes computer-readable. The tags remain connected to the data, so even when the data is used in other software, it can still be understood in its original context. A machine reading this data point now understands it as the net profit of ₹2 lakh for the second quarter of 2011.

Benefits of XBRL

Usage of XBRL has increased over the past few years. XBRL brings in huge cost savings by avoiding duplication in reporting and improves process efficiencies at the same time making the data more reliable and accurate. This has resulted in availability of better quality information for decision making and analysis. Specific benefits of XBRL include:

- XBRL enables analysts to shift focus from organising and re-entering of data to actual analysis of tagged data with the aid of a software tool;
- XBRL has ushered in standardisation of reporting. Data which was earlier being reported in varied forms like spreadsheets, PDF, html pages and so on is being reported in a standard XML format;
- Anybody whose job involves collection of data and its reuse for analysis stands to benefit from XBRL since it makes the data seamlessly move from one software to another;
- Its extensible nature means that it can be adjusted to meet particular business requirements, even at the individual organisation level.



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BRL can help Government agencies bring in the required standardisation and discipline in regular reporting. XBRL to a large extent can insulate the quality

of the information generated by the reporting system from the complexities discussed above. XBRL can also make the job of consolidation at different project monitoring levels easier due to its structure. XBRL makes the data 'Analytics Ready.'

XBRL and the Government Sector in India

XBRL *per se* is not new to the Government sector in India. The Ministry of Finance and the Ministry of Corporate Affairs (MCA) have been the front runners in usage of XBRL in India. E-filing of income tax returns is in XML which is the language used for XBRL. Filing of returns to RBI by Indian banks is progressively shifting to XBRL mode. The MCA has introduced XBRL for filing of annual financial statements by companies.

This article discusses a hitherto unexplored area of usage of XBRL in Government, i.e. for internal reporting and control. The potential for process efficiencies and better monitoring when XBRL is applied for internal reporting is immense.

The complexities of Reporting in Government

The number of Government schemes implemented at various levels (Central, State and Local) run into thousands with large budget allocations. As of February 2008, there were 515 active projects in implementation across India costing ₹100 crore or more each. Each scheme has multiple projects undertaken by different implementing agencies. Every scheme has to be monitored in terms of the physical progress, resource utilisation, timelines, costs and outcomes.

For example, the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGA) with an outlay of ₹40,000 crore in FY2010-11 has over the past five years completed about 7.3 million works, providing employment to about 55 million households, in the process generating about 250 crore person days of work. Revamping of MIS has been identified as one of the key challenges in project implementation in MGNREGA. The scenario for other Government projects is no different. The complexities of reporting in Government arise as a result of one or more of the following:

- **Complex project structures** – a number of Government projects (particularly externally aided projects) now include administrative reforms, civil works and capacity building initiatives all bundled into one project;

- **Diverse implementing agencies** – such as the Central Government, State Governments, local bodies, special purpose vehicles, and NGOs;
- **Involvement of a number of external agencies** – such as vendors, contractors, consultants and so on, both national and international;
- **Capacity issues** – lack of training amongst staff in project monitoring and reporting;
- **Data quality** – Re-presentation and consolidation of reports at multiple levels affect the authenticity of the data thereby adversely impacting the decisions made.

discussed above, it can help Government agencies bring in the required standardisation and discipline in regular reporting. XBRL to a large extent can insulate the quality of the information generated by the reporting system from the complexities discussed above.

XBRL can also make the job of consolidation at different project monitoring levels easier due to its structure. XBRL makes the data 'Analytics Ready' if we may call it so. A lot of the analysis done by humans can now be transferred to the machine without fear of losing reliability due to poor data quality.

As a result of these factors, information generated at the grassroots level by the time it reaches the ultimate decision makers at the other end of the pipeline loses its utility for decision making.

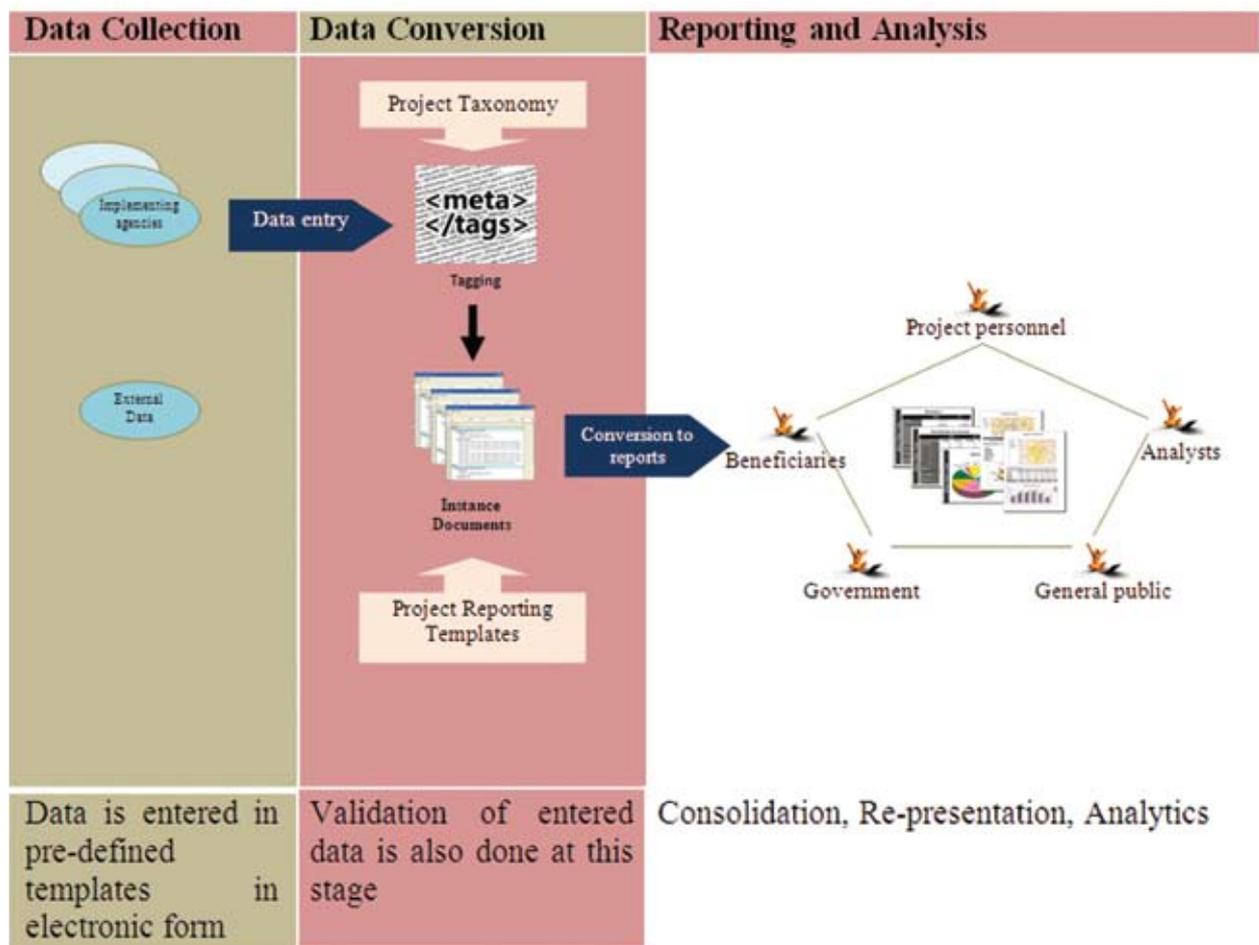
How can XBRL help?

While XBRL is not the tool to address all the complexities

A Framework for XBRL based Reporting in Government

A framework for XBRL based reporting for Government projects is shown in Exhibit 1. While the framework generally applies to all kinds of reporting environments that use XBRL, the specific factors to be considered in each phase are discussed here.

Exhibit 1: Framework for XBRL based reporting in Government



Data Collection

This is the most crucial phase since the inputs for the reporting system are captured here. Most of the data quality issues originate in this phase. Necessary system controls and process controls need to be in place to ensure that the data entered is authentic. An important point to note with regard to the data collection phase is that it need not necessarily be the first point of data recording. The data is generally collected from existing sources of project data, electronic or manual.

For a Government project, the primary source of data is from the field generated by the implementing agencies. This data mainly pertains to the status of awarding contracts, physical progress of project activities and expenditure incurred. Data on results achieved as against project outcomes also comes from the field. External data pertaining to budgetary allocations, Government orders and approvals, clearances from other agencies and so on are also important inputs captured in this phase. Different modes of collecting data may be adopted:

- i. From a transaction processing system like the project management system or the accounting system – real time or in batches. Data already entered is pulled electronically;
- ii. Manual data entry – perhaps the easiest to setup but prone to errors. The risk of errors can be mitigated by using pre-defined templates with in-built validations. Typically, spreadsheets are used for this;
- iii. Smart devices like smart cards or handheld devices like barcode and Quick Response code readers.

The first round of validation happens at this stage itself. The extent and the robustness of the validation are dependent on whether the validation is manual or automated using a validation tool. The validation throws out errors in the collected data which need to be corrected before the conversion to XBRL format can happen.

Data Conversion

Data conversion phase is all about applying the necessary tags (electronic) to the data collected and generating the instance documents (xml files). Tagging is done by the XBRL software and requires no human intervention if the data collected is fully validated. The output of this phase is one or more xml files which don't make any sense to the human eye. This phase is driven by two fundamental factors, namely the Project Taxonomy and the Project Reporting Templates.

The **Project Taxonomy** is a dictionary of all the types of data elements that are used in the project. It is defined at the project conceptualisation stage itself by

The Project Taxonomy is a dictionary of all the types of data elements that are used in the project. It is defined at the project conceptualisation stage itself by the agency responsible for the project implementation. The project taxonomy provides the tags that are applied to the data in this phase. ”



the agency responsible for the project implementation. The project taxonomy provides the tags that are applied to the data in this phase. For instance, the item <<Date of commencement>> will be defined in the taxonomy as a date field in the dd/mm/yyyy format with validations like 'it cannot precede the contract date (which is another data item), it cannot exceed the project completion date and so on.

The **Project Reporting Templates** which in turn are governed by the project reporting parameters are a set of report templates covering different aspects of the project. The project reporting templates are developed around:

- **Physical reporting** – Progress and status of project activities, status of contract awards, completion of civil works and so on;
- **Financial reporting** – expenditure, budget variances, debt servicing and so on;
- **Outcome evaluation** – Project impact *vis-à-vis* desired outcomes.

Once the tagging is done, the software generates one xml file corresponding to each project reporting template.

Reporting and Analysis

Different user groups might need different reports depending on their information needs. The key

The Ministry of Corporate Affairs has initiated filing of financial statements in XBRL format for Indian companies. A similar initiative for the ULBs would make available a wealth of information at the State and Central Government levels. This can give valuable insights into urban local body finances and help in better policy formulation. Inter-ULB, inter state comparison become possible when financial statements are available in XBRL format. ☺☺

stakeholders in a Government project and their reporting needs are:

- The project personnel interested in reports showing the status of the project on different parameters;
- Beneficiaries interested in the status of completion of different activities;
- Government interested in the overall project

progress, fund utilisation and the outcomes achieved;

- Analysts interested in inter-project, inter-agency, time series comparisons;
- General public interested in the status and outcomes of Government projects.

Each report template has a corresponding instance document as explained earlier. The instance documents can be converted to a human readable form using a software tool. The reports can then be printed or circulated just like a normal document.

The data conversion (tagging) process renders the data ready for further analysis. Apart from the standard reporting templates, the tagged data can be used for analysis by different user groups. Generation of consolidated reports at various levels of the project implementation structure also becomes easy with tagged data. The same report can be presented in different forms without the risk of losing credibility of the report.

Application of XBRL in reporting for Externally Aided Government Projects: The Case of KMRP

The Karnataka Municipal Reforms Project (KMRP) is a World Bank funded project aiming to help improve the delivery of urban services in Karnataka by enhancing urban infrastructure and improving the institutional and financial frameworks at the Urban Local Body (ULB) and State level. It is a \$310 million project with the total investment expected to go up to \$450 million. The project involves 37 implementing agencies executing more than 100 contracts across the state of Karnataka. There are at least five distinct levels of project monitoring and reporting.

The existing reporting framework

KMRP follows a monthly review cycle wherein the physical progress and financial progress of all components are reviewed by the nodal agency. The nodal agency in turn submits monthly and quarterly reports to the State and Central Government and to the funding agency. In addition to this, adhoc reports are generated whenever required. Periodic and exception reports like compliance reports are prepared whenever required. For the monthly review itself each implementing agency prepares around

fourteen reports covering physical parameters and five reports covering financial parameters. At a conservative estimate, the average number of reports prepared per month is around 750.

Needless to say, the exercise involves a lot of duplication of efforts and is error prone. The reports prepared are not uniform either in format or in content. There is a lot of subjectivity in interpretation of the information provided by the reports. Consolidation and analysis of the information provided by the reports is not possible in such a scenario.

XBRL based reporting framework for KMRP

The first step would be to define a taxonomy for the project. The project taxonomy will provide a global set of metadata tags applicable to KMRP. For example, for the item 'Status of work' the taxonomy will prescribe that it can be only one of 'to be started', 'in progress' or 'completed'. This will automatically prevent an implementing agency from furnishing a report with the status of work as 'tenders called for' since that is not defined in the taxonomy.

Exhibit 2 on the next page shows the three phases of the XBRL framework discussed earlier as applied to the case of KMRP.

Exhibit 2: Framework for XBRL based reporting in Government

Phase	Implementing agency	XBRL software	End users
Data Collection	Each implementing agency uploads data on the physical and financial progress of its activities in electronic form. The data undergoes one round of validation at the entry stage itself		
Data Conversion		The data uploaded by the implementing agencies is tagged using the project taxonomy. Any inconsistency in the data submitted is pointed out at this stage, ensuring that the output xml files are reliable. Based on the pre-defined report templates, instance documents are generated as xml files	
Reporting and Analysis			The instance documents can be read using a reading tool by the end users. Custom reports can also be built with the tagged data

The benefits

The human effort in the entire reporting exercise is reduced to the initial data collection. All errors in data capture are eliminated either in the data collection phase through validations or during data conversion if they do not correspond to the

project taxonomy. The taxonomy introduces the discipline in reporting and ensures that different terms are interpreted in a uniform way across the project hierarchy. Electronic data makes it very easy to generate custom reports as and when situation demands.

Application of XBRL in Government Reporting: The Case of Urban Local Bodies

Another potential area of application of XBRL for reporting in Government is in preparation of financial statements by ULBs. With migration to double entry accrual based accounting, more and more ULBs across the country are preparing financial statements. However, this has generally remained an academic exercise with no consolidation or analysis being done. Consolidation and analysis as we now

understand require standardisation in reporting.

The Ministry of Corporate Affairs has initiated filing of financial statements in XBRL format for Indian companies. A similar initiative for the ULBs would make available a wealth of information at the State and Central Government levels. This can give valuable insights into urban local body finances and help in better policy formulation. Inter-ULB, inter state comparison become possible when financial statements are available in XBRL format.



Steps in Implementation

XBRL implementation involves a series of activities covering IT as well as non-IT aspects. A typical implementation cycle would consist of the following stages:

- Definition of the project taxonomy;
- Definition of the project reporting templates;
- Mapping of data sources to the project reporting templates;
- Procurement and configuration of a suitable software tool;
- Establishment of data collection processes;
- Pilot runs with sample data;
- Training – conceptual, software and procedural;
- Steady state – regular project reporting in an XBRL environment.

Implementation Issues in Usage of XBRL for Government Reporting

While the financial benefits of a well implemented XBRL based reporting system are unquestionable, implementation of XBRL in Government has its

own unique challenges. Failure to take cognizance of these issues at the planning stage itself would make the implementation a harrowing experience for the stakeholders. Below are given certain key considerations in this regard.

- It is crucial to get the taxonomy right. An improperly defined taxonomy will adversely affect the quality of the information generated;
- Like it or not, there is a certain amount of technical knowledge required to implement XBRL projects. This has to be planned for in the initial stages itself. A model which has proved successful in implementation of e-Governance projects in India is to institutionalise the technical knowledge into special purpose vehicles at the Central or State Government levels;
- Project management and internalisation issues, which have spelt the doom for many e-Governance projects in the past apply equally to XBRL implementations as well;
- It is very important to put in place processes and controls to ensure timely and accurate data capture;
- Factors having a bearing on data quality like the chart of accounts in the case of financial data, measurements in the case of civil works data have to be addressed along with implementation of XBRL.

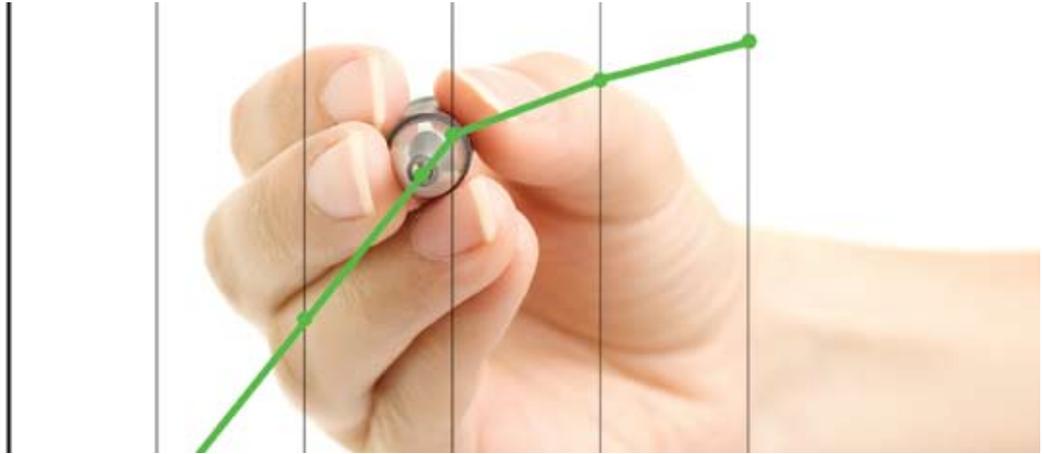
XBRL or XGRL?

It needs no further emphasis that the potential in the coming years for XBRL to revolutionise the reporting scenario across all functions of the Government is immense. The Indian Governments both at the central and state levels have been at the forefront in implementing e-Governance reforms and some of the reforms have been of a path breaking type. Should XBRL not be the next big reform that the Government must immediately initiate? Or to come back to the title, should it not be called XGRL – eXtensible Government Reporting Language?

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Observations on Some Exponential Smoothing Forecasting Methods



Forecasting is an important function in business management and other fields. From demands of products, stock market prices, economic trends, technological changes, weather – accurate forecasts would be of immense use in many situations. Like forecasting arises in many real life purposes, there are many methods available for the purpose of forecasting. The author in this article considers forecasting methods as the single, double and triple exponential smoothing methods in which additive trend and seasonality may be included. These are compared among themselves and also with last-value forecasting. This is done using a theoretical model and with data from an actual time series. It is observed that, single exponential smoothing method does not give consistent results. Last-value forecasting, like single exponential smoothing method, is not much accurate often. From the empirical evidence, among the methods considered, triple exponential smoothing method appears to be the most suitable for practical application.

Introduction

Forecasting is an important function in business management and other fields. From demands of products, stock market prices, economic trends, technological changes, weather – accurate forecasts would be of immense use in many situations. Like forecasting arises in many real life purposes, there are many methods available for the purpose of forecasting. We may refer to Brown (1959), Box et al. (1994), Fildes et al. (2008) and others for discussions on the topic.

It is important that, given the situations, the forecasting method is selected correctly by the planners and the decision-makers. Forecasting methods may be broadly categorised as – (a) Experiential/Judgmental Methods; (b) Causal Methods; (c) Time Series Methods. Experiential or judgmental methods are based on experience and perception. With such methods, forecasts may be subjective and inconsistent. In a causal method, factors (synonymously, input/independent/control variables) which physically or economically affect the variable(s) (output/dependent variable) to be forecast are identified. Functional relationships, exact or approximate, are established among the independent and dependent variables. Such independent causal variables could be rainfall



Pritibhushan Sinha

(The author is Consultant (Operations Management & Research) based in Kolkata. He can be reached at p_sinha@live.com)

during the period considered, population, average *per capita* income in the population, etc. The relationships may be statistical, involving random deviations. We may, for instance, use a statistical linear regression equation between the independent and dependent variables. The relationship may also be a deterministic one, such as a neural network regression equation. In a causal method, we have to forecast future values of the independent variables mostly unless such future values are known in advance or we see present value of such a variable as causal to the future values of the dependent variable. In a time series method, a relationship is assumed, implicitly or explicitly, only between time and the dependent variable. The inherent assumption is that, each causal variable changes with time in a particular manner and this leads to a predictable pattern of change of the dependent variable with time. A time series method is the well-known autoregressive integrated moving average (ARIMA) (see, Box et al. 1994) technique. Many computer routines are available for forecasting.

Some oft-used time series methods of forecasting are exponential smoothing (ES) type of methods. Relatively well-known of such methods are single (also called as, simple) ES (Brown 1959), double and triple ES (Holt 1957, Winters 1960). Such methods have comparatively less number of parameters, satisfying the principle of parsimony, valued for forecasting methods. These are easy to implement and are suitable for automated forecasting in system consisting of a large number of items, for example, a large retail store. There has been a substantial amount of research on the ES methods, as indicated by Gardner (1985) earlier and more recently (Gardner 2006). ES methods have been surprisingly successful in many actual applications and also in forecasting competitions, as described by Makridakis and Hibon (1979), Makridakis

et al. (1982), Makridakis and Hibon (2000). Yet opinion is divided about the accuracy, practical usefulness and theoretical correctness of such methods. There is no conclusive answer to this till now.

Another forecasting method that also finds frequent application is the last-value forecasting or naïve forecasting (see, for example, Hillier and Hillier 2005). In this method, the most immediate preceding value of the time series is used as the forecast. This article compares the three ES methods as mentioned and last-value forecasting using two test data sets. We offer an explanation and describe some conditions when single ES method would be the same as last-value forecasting. Of the test data sets one is obtained from an assumed model. Data for another are from a real-life situation. As far as we are aware, such comparisons and analysis have not been reported in the literature for these methods. The implications of the observations from the study are discussed.

Exponential Smoothing Forecasting Methods and Measurement of Accuracy

Let's talk about the three ES methods and usual ways to measure the accuracy of a forecasting method on the basis of related literature.

ES Methods:

In the single exponential smoothing method, a forecast, following the notation as used by Gardner (2006), is given as,

$$S_t = \alpha X_t + (1 - \alpha)S_{t-1}, \tag{1}$$

$$\bar{X}_t(m) = S_t, \tag{2}$$

where X_t is the observed (actual) value of the time series, S_t is the smoothed value of the series, computed after X_t is observed, in period $t = 1, 2, \dots$. A suitable value for S_0 is used; usually $S_0 = X_1$, yielding $S_1 = X_1$. $\bar{X}_t(m)$ is the forecast given for a period, m periods later from the t -th period; α ($0 \leq \alpha \leq 1$) is a non-negative multiplier, the smoothing constant. To illustrate, suppose actual values (say, weekly demand of an item) of a time series are as: $X_1 = 100, X_2 = 78, X_3 = 92, \dots$, Take $\alpha = 0.9$. With $S_0 = X_1, S_1 = X_1 = 100$. If forecasts are made two periods ahead (i.e., $m = 2$), then this is the forecast for the third period. $S_2 = 0.9 \times 78 + 0.1 \times 100 = 80.2, S_3 = 0.9 \times 92 + 0.1 \times 80.2 = 90.8$ are the forecasts for the fourth and the fifth week respectively.

The equations for double ES, which takes in account an additive trend component, are as follows.

$$S_t = \alpha X_t + (1 - \alpha)(S_{t-1} + T_{t-1}) \tag{3}$$

$$T_t = \gamma(S_t - S_{t-1}) + (1 - \gamma)T_{t-1} \tag{4}$$

From the observations in the numerical experiments, we may write that, single ES method may give good results sometimes, but the performance is not consistent. Last-value forecasting also should be avoided. Among the methods discussed, the best choice in most of the cases would be triple exponential smoothing method. If there is a marked seasonality pattern, period of which has been identified relatively precisely, and forecasts are for short terms, this method can give a forecasting accuracy adequate for practical purposes. At the same time, other methods may also be explored. ☺

$$\bar{X}_t(m) = S_t + mT_t, \quad (5)$$

The smoothed trend component being represented with T_t and γ ($0 \leq \gamma \leq 1$) being another parameter in the model – the smoothing constant for trend. We may take $T_0 = 0$, or any other suitable initial value, S_0 being as before.

For triple ES, considering additive trend and seasonal component, the equations are as:

$$S_t = \alpha(X_t - I_{t-p}) + (1 - \alpha)S_{t-1} \quad (6)$$

$$T_t = \gamma(S_t - S_{t-1}) + (1 - \gamma)T_{t-1} \quad (7)$$

$$I_t = \delta(X_t - S_t) + (1 - \delta)I_{t-p} \quad (8)$$

$$\bar{X}_t(m) = S_t + mT_t + I_{t-p-m} \quad (9)$$

where I_t represents smoothed seasonal component for period t , p is the period of seasonal cycles and δ ($0 \leq \delta \leq 1$) is the smoothing constant for the seasonal component. I_0 and earlier seasonal component values may be initialised with 0, other initialising values may be as before.

Forecasting Accuracy Criteria

The parameters in the above methods are often fixed by optimising some criterion, using past data. Commonly used criteria are sum of squared errors (SSE) (equivalently, root of the mean of sum of squared errors (RMSE)), mean of absolute error percentages (MAEP), etc. Let, F_i be the (proxy) forecast for the i -th period, X_i is the actual value for this period. Then SSE is $\sum(X_i - F_i)^2$, taking the sum over the periods considered. RMSE is its square root. MAEP is the average of the values $(|X_i - F_i| / |X_i|) \times 100\%$ ($X_i \neq 0$). These are indicators of the fitness of the model for the past data. Accuracy of a method would be measured for forecasts for future periods in the same manner, using such indicators.

A Comparison of the Methods

Let's discuss some theoretical points and present some experimental observations now.

• Last-Value Forecasting vis-à-vis Single ES Forecasting

First we note a relationship, relevant to our discussions, between single ES method and last-value forecasting. From equations (1) – (3), the m -periods ahead forecast for the $(t+m)$ -th period with single ES method is given as:

$$F_{t+m} = \bar{X}_t(m) = S_t = \alpha X_t + \alpha(1 - \alpha)X_{t-1} + \dots + \alpha(1 - \alpha)^{t-1}X_1 + (1 - \alpha)^t S_0. \quad (10)$$



Suppose, the actual values in the time series are either increasing ($X_1 \leq X_2 \leq \dots$) or decreasing ($X_1 \geq X_2 \geq \dots$) and we take $S_0 = X_1$, which is a reasonable initialising value, particularly when the values of the parameters would not be changed for forecasting for a few periods. The value of the constant α is fixed optimising a criterion, based on past observations, as $\sum f((X_i - F_i)^2)$, where f is an increasing function. It is not difficult to see that, in such a situation, optimal value of α would be 1, implying that single ES method would give the same forecasts as last-value forecasting. Such a case may happen when there is a strong trend in the data, or time span as covered by the data is small, so that the observations are either increasing or decreasing.

• Experimental Observations

The experiments have been done in the following manner. For two sets of test data, data for 20 consecutive periods are considered. We consider 1-period and 2-periods ahead forecasts. The parameters (α , γ , δ) in the methods are determined minimising RMSE, based on data for first a few periods, i.e., minimising $\sqrt{\sum(X_i - F_i)^2}$ for these periods. Forecasting accuracy in terms of RMSE and MAEP is then noted for the last 3 periods. For initialisation we use, $S_0 = X_1$, $T_0 = 0$, $I_t = 0$, for $t = 0$, or negative. For 1-period ahead forecasts, proxy forecasts are considered for 2nd to 17th period. This is done for 3rd to 17th period for 2-periods ahead forecasts. The experiments have been done in *MS Excel*, solving the optimisation problems with the *Solver* utility.

3.2.1. Data Set with an Assumed Model

Let $X_t = 52 + 10t + 5\sin(1.5t) + \varepsilon$, $t = 1, 2, \dots$. We assume that, the random error ε follows independent, uniform distribution in $(-2, 2)$, with average zero. It may be seen that, the series is increasing, even though there is seasonality and random error. So, single ES method would be only last-value forecasting. A particular realisation (Table 1) of the series is considered. Double and triple ES methods are applied to see the accuracy. For triple ES method we take period of seasonal

cycles, $p = 4$, approximately equal to the period of the sine component. The results are shown in Table 2. As anticipated, single ES method gives last-value forecasting. Triple ES method gives the best result both in terms of model fitness and predictive accuracy. In two-periods ahead forecasts, single ES method performance is not satisfactory.

Table 1: Time Series Values for a Realisation of the Theoretical Model

Obs. No.	Value						
1	65.572	6	114.519	11	156.865	16	209.155
2	72.340	7	115.651	12	167.666	17	223.680
3	78.626	8	128.443	13	184.724	18	237.740
4	89.812	9	145.376	14	196.632	19	241.291
5	106.183	10	153.451	15	199.771	20	245.422

Table 2: Forecasting Accuracy for Theoretical Model Data

Obs. No.	Method	Optimal Parameter Values	RMSE (Model Fitness)	RMSE (Last 3 Periods)	MAEP (%) (Last 3 Periods)
1-Period Ahead Forecasts					
1	Single ES	$\alpha = 1.0$	11.01	8.71	3.02
2	Double ES	$\alpha = 1.0, \gamma = 0.342$	6.35	5.94	2.28
3	Triple ES	$\alpha = 0.638, \gamma = 0.388, \delta = 1.0$	6.03	4.31	1.5
2-Periods Ahead Forecasts					
1	Single ES	$\alpha = 1.0$	20.91	19.89	7.48
2	Double ES	$\alpha = 0.5, \gamma = 0.64$	10.93	9.03	3.07
3	Triple ES	$\alpha = 0.4, \gamma = 0.335, \delta = 1.0$	10.61	7.05	2.76

• **Actual Time Series Data**

The series represents the closing share price of an energy organisation in the National Stock Exchange (www.nseindia.com), India. Share prices of 20 consecutive working days (in 15-03-2011 to 11-04-2011) are considered. Table 3 shows the prices on different days, which are also shown in a plot in Fig. 1, for better visualisation. Here also we take $p = 4$ (as a trial value) for triple ES method, although no seasonality is apparent. We may note that, for $p = \infty$, with the initialisation as here, triple ES method would be identical to double ES method. The results are given in Table 4. Single ES method, overall, gives the most satisfactory result. But, performance of triple ES method is comparable.

Table 3: Share Prices of a Company

Obs. No.	Value	Obs. No.	Value
1	304.8	11	311.3
2	304.15	12	314.5
3	310.65	13	310.3
4	303.55	14	316.7
5	297.25	15	318.95
6	299.25	16	320.1
7	306.25	17	321.7
8	308.15	18	318
9	309.85	19	307.85
10	310.1	20	313.5



Figure 1: Plot of the Share Prices

Table 4: Forecasting Accuracy for Share Prices Data

Obs. No.	Method	Optimal Parameter Values	RMSE (Model Fitness)	RMSE (Last 3 Periods)	MAEP (%) (Last 3 Periods)
1-Period Ahead Forecasts					
1	Single ES	$\alpha = 0.969$	4.12	7	2.06
2	Double ES	$\alpha = 0.935, \gamma = 0.018$	4.12	7.12	2.08
3	Triple ES	$\alpha = 0.0, \gamma = 0.008, \delta = 0.461$	4.05	7.2	2.11
2-Periods Ahead Forecasts					
1	Single ES	$\alpha = 0.969$	5.93	8.48	2.2
2	Double ES	$\alpha = 0.24, \gamma = 0.395$	5.44	13	3.85
3	Triple ES	$\alpha = 0.0, \gamma = 0.0016, \delta = 1.0$	5.85	8.61	2.21

Concluding Remarks

The three exponential smoothing forecasting methods, namely, single ES, double ES and triple ES methods have been compared with additive trend and seasonality. These are also compared with last-value forecasting, often resorted to by practitioners. Two test data sets are used, and for each case one-period and two-periods ahead forecasts are noted. For the first set, a theoretical model, which has a strong trend component, is used. As anticipated, single ES method gives last-value forecasting for the data. Use of double and triple ES method improves forecasting accuracy, particularly for two-periods ahead forecasts. The methods are also applied for an actual time series, share prices of an organisation. Single ES method again is near to last-value forecasting, but shows the most satisfactory results. Performance of triple ES method, although, is comparable.



From the observations in the numerical experiments, we may write that, single ES method may give good results sometimes, but the performance is not consistent. Last-value forecasting also should be avoided. Among the methods discussed, the best choice in most of the cases would be triple exponential smoothing method. If there is a marked seasonality pattern, period of which has been identified relatively precisely, and forecasts are for short terms, this method can give a forecasting accuracy adequate for practical purposes. At the same time, other methods may also be explored.

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Transfer Pricing Regulation and Practical Issues and Updates



Introduction of Transfer Pricing Regulation is one of the best internal controls to ensure that the Indian entity having associate enterprise (as defined in Act) outside India is not paying low taxes by manipulating the prices paid or received for transaction encounter with AE. Indian Government has introduced Rules and Sections in Finance Act 2001 to regulate this activity. This article tries to summaries the important aspects of transfer pricing study and some practical issues co-related with the same. As in the process of globalisation, Indian entities now have too many international transactions with Associated Enterprise (AE) so its scope is very wide. There was a news in Economic Times dated 5th December 2011 that “More than ₹40,000 crore demand is raised in Mumbai from assessment of MNCs which “mispriced” their cross border transactions”. So this article tries to focus on whether determining the ALP by applying the Transfer Pricing Regulations is either not easy because of practical issues discussed or assesseees need to take care while entering into transaction with AE. The idea behind to have discussion on these issues is to find out the ways or to know the solutions available to tackle the same.



CA. Kaustubh P Deshpande

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

Introduction of Transfer Pricing Provisions

The Finance Act 2001 has introduced the Transfer Pricing Regulation (TPR) in the Income-tax Act, 1961 by enacting new Section 92 to 92 F in the Income-tax Act, 1961 (IT Act) in substitution of the earlier Section 92. Hence, TPR are effective from Assessment Year 2002 to 2003 and would be applicable to “International transactions”, which take place on or after 1st April 2001.

These new provisions apply to “International Transactions” that take place between “Associated Enterprises”. It is relevant to notice that, as per these new provisions, where an Assessing Officer is of the opinion that the transactions between Associated Enterprises are not at an arm’s length, he can compute profits from such transactions at an arm’s length price.

Further, it has been provided that where the total income of an Associated Enterprise is so varied on account of applicability of TPR, the other enterprise may not be permitted to make correlative adjustments. There is no threshold limit for Transfer Pricing Audit and its compliance. Therefore, any Indian entity having signal transaction of any amount is required to submit Transfer Pricing Audit Report in 3CEB format and documentation is compulsory only if transaction value is more than ₹1 crore. Therefore, practicing Chartered Accountants have a lot of scope in this activity as now-a-days cross border transactions are necessary to expand the business.

Gist: By applying the provisions and rules introduced by Revenue authorities, assessee has to prove that his transactions with Associated Enterprise are at Arm's Length.

Transfer Pricing - Documentation

Transfer Pricing Study Report plays an important role. It is one of the documents which are required to be maintained as per Rule 10D of Income Tax Act. OECD (Organisation for Economic Co-Operation and Development) Guidelines also define documentation process and its role in transfer pricing study.

The decision of the Special Bench of Bangalore Tribunal in the case of *Aztech Software and Technology Services Ltd Vs. ACIT (2007) 107 ITD 141 ITAT* held that when the primary responsibility is discharged by the taxpayer by conducting the appropriate transfer pricing study, then responsibility shifts to revenue and the tax authorities are required to prove that the said comparables are not in fact comparables. Tax authorities cannot exclude the comparable cases given by the assessee as per their opinion or selection

AND

Extracted para from Bear Text of Circular 12/2001

"721. Clarification on provisions governing transfer price in an international transaction

The Finance Act, 2001, has substituted the existing Section 92 of the Income-tax Act by new Sections 92 and 92A to 92F. These new provisions lay down that income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price. The term "associated enterprise" has been defined in Section 92A. Section 92B defines an "international transaction" between two or more associated enterprises. The provisions contained in Section 92C provide for methods to determine the arm's length price in relation to an international transaction, and the most appropriate method to be followed out of the specified methods. While the primary responsibility of determining and

Transfer Pricing Study Report is the base document which helps to understand how the Arms Length Price is determined. Preparation of Study Report includes the following many steps, including: Understanding of Business profile of the tasted party and Associated Enterprise, and, Identification and analysis of International transactions with AEs. 🗨️

applying an arm's length price is on the assessee, sub-section (3) of Section 92C empowers the Assessing Officer to determine the arm's length price and compute the total income of the assessee accordingly, subject to the conditions provided therein. Section 92D provides for certain information and documents required to be maintained by persons entering into international transactions, and Section 92E provides for a report of an accountant to be furnished along with the return of income."

Therefore, accuracy in Transfer Pricing Study report can relieve the assessee from controversies with tax authorities and addition in total income.

Let's understand the process and other details in relation to Transfer Pricing Study Report after knowing the importance of the same.

Transfer Pricing Study Report is the base document which helps to understand how the Arms Length Price (ALP) is determined. Preparation of Study Report includes the following steps:

- Understanding of Business profile of the tasted party and Associated Enterprise (AE)
- Identification and analysis of international transactions with AEs

- Industry and Market analysis**
- Functional, Asset and Risk analysis
- Selection and Characterisation of entities
- Economic Analysis
- Selection and application of most appropriate method**

Methods are prescribed in Rule 10B. The prescribed Methods are (a) Cost Plus Method; (b) Transactional Net Margin Method; (c) Profit Split Method; (d) Resale Price Method; (e) Comparable uncontrolled Method. Assessee has to select an appropriate method, while selecting the most appropriate method as specified in sub-rule (1) of Rule 10C, the following factors shall be taken into account, namely:—

- (a) the nature and class of the international transaction;
- (b) the class or classes of associated enterprises entering into the transaction and the functions performed by them taking into

- account assets employed or to be employed and risks assumed by such enterprises;
- (c) the availability, coverage and reliability of data necessary for application of the method;
 - (d) the degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
 - (e) the extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;
 - (f) the nature, extent and reliability of assumptions required to be made in application of a method.

Selecting appropriate method after considering the above factors, the required data and information for carrying out the real analysis be obtained and thereafter following two steps can be carried.

- Data Analysis and Market research
- Final list of comparable companies

Functional, Asset and Risk Analysis

Having reference to above steps, in transfer pricing study, analysis of functions, risk and asset (FAR) is of prime importance. Rule 10D clause (e), which also requires the taxpayer to document a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the Associated Enterprises involved in the international transaction.

This helps to

- provide the blue print of business model between Assessee and AE
- provide the risk assumed by Assessee and AE
- select the comparable companies from data available in public domain

In transfer pricing study, analysis of functions, risk and asset (FAR) is of prime importance. Rule 10D clause (e), which requires the taxpayer to document a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the Associated Enterprises involved in the international transaction. This helps to provide the blue print of business model between Assessee and AE, and, provide the risk assumed by Assessee and AE.

The OECD also emphasises the importance of the functional analysis in determining the arm's length price and identifying suitable entities for comparison purpose as under:

Therefore, after carrying out the FAR analysis, assessee should select the comparable companies considering the functions, risks and assets assumed by tested party. In this process first assessee will require to obtain data of all companies falling in his industry e.g. software, automobile, infrastructure. Then applying the filter of function, risk and asset it will select the comparable companies. However, it is rare possibility to available identical comparable companies like tested party, hence there will be always difference in functions, risk and asset employed by comparable companies and tested party. Therefore, there is a need to make adjustment for difference in functions, risk and asset to determine the ALP. Rule 10B also allows making adjustment for difference in FAR. However, it asks to make adjustment to comparable companies instead of tested party. Quantification of risk adjustment is the biggest challenge in this respect. And in most of the cases TPO rejects adjustment to tested party because Rule 10B does not allow. However, assesses have difficulty to obtain data in public domain about comparable companies to make adjustment to their margin or price to determine ALP.

Summary of Case laws where adjustment made to margin of tested party is accepted:

- **Pune Tribunal (ITAT) in the case of Skoda Auto India** ITA No. 202/PN/07 where the Tribunal allowed adjustment to the assessee's PLI
- **ITO Vs CRM Services India (p) Ltd** decided by **Delhi ITAT ITA No. 4796(Del)/2010** where Claim for capacity utilisation adjustments allowed for additional capacity of building created on behalf of the AE, but not used.

To date only few tribunal rulings have ventured into the quantification of risk adjustment. Risk adjustment is more important in case of captive companies, because in case of captive units most of the functions like identifying the business, marketing, debtors collection, handling customer complaints, proving after sale service are handled by AE instead of tested party which is captive unit. However the comparable companies selected from Public domain are exposed to all the above functions and risk. Therefore they expect high returns as they assume high risk, but as captive units assume less risk, therefore, they will earn return consistent with risk assumed.

Another issue faced by small and medium assessee is to get comparable companies in public domain.

The transfer pricing rules apply when one of the parties to the transaction is a non-resident, even if the transaction takes place within India. There is no need to find out the legislative intent behind the transfer pricing provision when the provisions were unambiguous. The existence of actual cross border transactions or motive to shift profits outside India or to evade taxes is not a pre-condition for transfer pricing provisions to apply. ☺

Because mainly these small and medium assessee have turnover ranging from ₹5 crore to ₹25 crore. Companies available in public domain mainly are having large economics of scale, so the availability of pool of companies is very less, so sometimes study can be lopsided.

Example:

ABC Pvt Ltd (tested party) is subsidiary of PQR LLC (AE). ABC Pvt Ltd is captive unit, therefore PQR LLC has assumed most of the functions and risks, i.e. identification of business, business planning, billing to end customer, collection from end customer, after sale service, handling customer complaints. Therefore, ABC Pvt Ltd is only required to execute the business by deploying the required resources.

Price Mechanism: Agreement with AE is Cost Plus 10% mark-up, Cost should exclude Direct tax and foreign exchange gain/loss.

In my opinion as the Subsidiary is going to charge for the services with cost plus, then the risk of idle capacity, risk of incurring business/cash loss is transferred to AE. However, in transfer pricing study we are unable to identify the price mechanism of comparable companies. Now while selecting comparable companies, care is taken that there should be less or nil transactions with AE so that our study will be based on uncontrolled transactions. Hence comparable companies having transactions with third party (i.e. Non-AE entities) will be factoring in, this cost in the sale price for risk of idle capacity, risk of marketing, risk of collection, because risk and reward go hand in hand (high risk high reward).

Also these comparable companies will have wide variable results in different financial years, but as in case of tested party the risk of business/cash loss is avoided by AE. Stability in net results also play an important role in selection of comparable companies.

- Practical Issues:**
- 1) Availability of data or basis for adjustment of functions and risk
 - 2) Selection of comparable companies with same risk and functions
 - 3) Adjustment for stability of result and un-even result of comparable companies

Also where assessee make adjustment for risk, the tax officials may not agree on working or basis, so it is becoming more judgmental. Hence some rules or guidelines for making these adjustments should be designed so that these adjustments can be carried out which will make it easy to determine the Arm's Length Price.

Lower Profitability of AE and Its Impact on Indian Entity

It has been observed that the argument that our AE is earning lower profits hence margin in Indian entity are also low is not accepted.

The transfer pricing rules apply when one of the parties to the transaction is a non-resident, even if the transaction takes place within India. There is no need to find out the legislative intent behind the transfer pricing provision when the provisions were unambiguous. The existence of actual cross border transactions or motive to shift profits outside India or to evade taxes is not a pre-condition for transfer pricing provisions to apply.

Intention of introducing the regulation has been clarified. Let's go through the same.

The Revenue authorities have issued Circular No. 14 of 2001 ('Circular 14') containing the notes explaining the provisions of the Finance Act, 2001, whereby Para 55 of the said Circular lays down the rationale for introduction of TPR.

Bear text "55.5A The new provision is intended to ensure that profits taxable in India are not understated (or losses are not overstated) by declaring lower receipts or higher outgoings than those which would have been declared by persons entering into similar transactions with unrelated parties in the same or similar circumstances. The basic intention underlying the new transfer pricing regulations is to prevent shifting out of profits by manipulating prices charged or paid in international transactions, thereby eroding the country's tax base. The new Section 92 is, therefore, not intended to be applied in cases where the adoption of the arm's length price determined under the regulations would result in a decrease in the overall tax incidence in India in respect of the parties involved in the international transaction."

Therefore, entities earning lower profit are facing problem to prove that their low margin is not because of shifting of profits but real commercial terms depicting ALP.

So here we have to clear the thin line of difference, i.e. we accept that transfer pricing regulation will be applicable to every Indian entity having cross-border transaction but it is able to demonstrate that no profits are shifted outside India then whether authorities adding in total income as per ALP determined by selecting comparable companies will be within the intention of the law.

The reason to raise this point is to clarify whether entities earning low profits should not carry on its business in India or should demonstrate that they have not shifted profits from India to outside India to evade taxes.

Possibility of Amendment in Methods or Introduction of New Methods be Explored

(A) Available Option

Profit Split Method is best to work out the profit on overall group level and to ensure that no profit is shifted from India to any other countries. But the practical difficulty is that Rule specify the conditions when this method can be applied, therefore, assessee which does not fall into those criteria can not apply the same and demonstrate that prices determined are not with intention of shifting the profits from India to other country.

Rule 10B has specifically spelt out the methods out of which one appropriate method should be selected to calculate the ALP. However, considering above issues, the Finance Department should either introduce few more methods or assessee be given some free hand to demonstrate the ALP by method other than given in Rule 10B.

(B) Available Options:

Consolidated Financial statement of Group:

Assessee can prepare the consolidated financial statements to present true and fair result of group, so that tax authorities can compare the result of Indian companies with Group to ensure that there is no shifting of profits. For applying this method, the necessity is that the accounting policy followed by all group companies should be same. This method will be more beneficial for small groups where low economies of scale and business model play an important role to determine profitability. Getting comparable companies for such tested party becomes difficult. These consolidated financial statements can be audited or certified by management.

This method could be based on non-arms length approach: Global formulary apportionment defined in

Finance Act 2009, proposed to introduce “Safe Harbor” rules to Income-tax Act 1961. The Finance Minister in his budget speech stated the objective “to reduce the impact of judgmental errors n determining transfer price in international transaction”. The conditions for qualifying for the safe harbour with reference to transfer pricing will be different i.e. total relief to certain identified taxpayers from compliance with country specific transfer pricing laws and regulations or, at the least, the obligation to comply with country specific procedural rules. ☞

OECD. However, this approach has been rejected by members of OECD because of difficulty of implementing the system in a manner that both protects against double taxation and ensures single taxation.

However, at least this method can ensure the tax authorities that transaction with associated enterprise are not designed to shift the profits from India. Limitation is that this could not be applied in case of large group where preparing the financial statement with similar accounting policies is difficult. Here we can think to make adjustment to consolidated financials to the extent of difference in accounting policies applied by companies group, because getting the data for this adjustment in group companies can be easier than calculating the adjustment for risk and functions in case of comparable companies. These consolidated results can have disclosure of segmental results.

Safe Harbour Rules:

Finance Act 2009, proposed to introduce “Safe Harbour” rules to Income-tax Act, 1961. The Finance Minister in his budget speech stated the objective “to reduce the impact of judgmental errors n determining transfer price in international transaction”. The conditions for qualifying for the safe harbour with reference to transfer pricing will be different i.e. total relief to certain identified taxpayers from compliance with country specific transfer pricing laws and regulations or, at the least, the obligation to comply with country specific procedural rules. Some examples of the rules for availing of safe harbour are: (1) establishing transfer prices by a simplified method provided by the tax administration, (2) complying with specific information reporting and record maintenance provisions, with regard to the intra-group transactions. Further, these rules require substantial involvement of the tax administration to monitor the taxpayers’ adherence to the procedural rules.

The Guidelines clearly differentiate the 'safe harbour' provisions from 'advance pricing arrangements', the latter are decided in advance by the taxpayer and the tax administration.

Pros and Cons of Safe harbour provisions:

Some of the factors in favour of having safe harbour provisions to the taxpayers are simplified compliance with arm's length principle, affords flexibility in cases where there are no matching or comparable companies or transactions, advance information or knowledge about the range of profits or prices to qualify for the safe harbour helps in better planning of intra-group transactions, substantial reduction in time and efforts involved in search for comparables in external databases, reduction in cost in terms of simplified procedures for compliance and record maintenance. Certainty about acceptance of the transfer prices by tax authorities in transfer pricing assessments or even the taxpayer may be spared of a detailed scrutiny, if the transfer prices fall meet the specified mark-up or pricing. For the tax authorities, the safe harbour provisions substantially reduce the administrative burden involved in terms of minimal examination (or limited number of companies being picked up for detailed scrutiny) of the transfer pricing compliance by the taxpayers. They can choose to concentrate their time and resources on larger taxpayers, transactions or issues and be more lenient to the small taxpayers.

Hence, the structure of safe harbour provisions can give relief to assessee requiring compliance with transfer pricing regulations. Therefore, all assesses are waiting for blue print of these rules.

TPR Can Enhance to Domestic Transactions

Recently, in the case of *Commissioner of Income Tax & Anr. Vs. Glaxo Smithkline Asia (P) Ltd. (2010) 236 CTR (SC) 113 : (2010) 195 Taxman 35 : 47 DTR 65*, the Supreme Court took up the issue as to whether transfer pricing regulations should be limited to cross-border transactions or whether the transfer pricing regulations be extended to domestic transactions too? The Court observed that in the case of domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily would be revenue neutral except in two circumstances involving 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 bases incentives, nature of activity, etc.) and if profit is diverted towards the unit on the lower side of tax arbitrage.

The Apex Court suggested amendments for consideration by the Finance Ministry in certain provisions like Sections 40a(2) and 80-IA(10) to empower the AO to apply any of the generally accepted methods of determination of arm's length price, including the methods provided under the transfer pricing regulations to domestic transactions between related entities. The court also capitulated on maintenance of books of accounts and other documents reflecting transactions between such entities and audit of such transactions by chartered accountants. The court has reiterated the legal position regarding non-applicability of transfer pricing provisions to domestic transactions. The court has also accepted that domestic transactions are by its nature revenue neutral. Therefore, the burden of proof would lay on the department to draw any conclusion on the contrary. The intent of the Supreme Court behind making this suggestion is to decrease the litigation relating to allowance and disallowance of expenditures and adjustment of incomes by providing a well defined price determination regime and bringing in objectivity to domestic transactions. However, experience relating to transfer pricing regulations in international transactions indicates to the contrary. The lack of comparables and uniqueness in the business of each company would only make the matter more complex and perhaps a rise in transfer pricing litigations relating to domestic transactions would become inevitable. In addition, it would also increase the compliance cost for the assessee and oversight cost for the department. The matter, therefore, requires a cost-benefit-analysis before taking any further steps. However, considering so many tax arbitrage avenues available to domestic units, one would be surprised why provisions similar to transfer pricing adjustments have not been put in place till date. From the Department's point of view, this would provide level playing field to both domestic and transnational units and would also plug the leak of revenues from domestic entities.

Conclusion

Transfer Pricing Regulations are vital for Indian tax kitty. However, can we have some mechanism for entities which are earning lower profits but have not either understated or overstated their prices to shift the profits from Indian to overseas, so that the intention of the law, tax authorities and assessee all should have win-win situation. Now in case of this mechanism the prime responsibility will be on assessee to prove because it should be able to extract the information and data required from AE to assure tax authorities that the price is genuine and not misleading to avoid taxes in India. ■

Vodafone Ruling – Key Tax Principles



Last month the Supreme Court (SC) pronounced its verdict in the case of Vodafone and pulled a lid over the most debated tax controversy of the recent history. The bone of contention was whether transfer of shares of a foreign company which indirectly held shares of an Indian company was taxable in India. The matter took 26 days of final hearing, battery of ‘Superstar’ lawyers assembled by either side, hundreds of paralegals assisting the lawyers and thousands of pages of briefs to culminate in this widely awaited ruling. For those 26 days, Senior Counsel Harish Salve, representing Vodafone and Solicitor General of India, Rohinton Nariman representing the Revenue Department set the courtroom alight with their reasoned and exhaustive arguments and counter-arguments; the Supreme Court’s courtroom became the battleground for the two gladiators.

The three member bench of Supreme Court led by the Chief Justice of India himself eventually ruled that the transaction of transfer of one share of a Cayman Island company which indirectly held shares in Indian company by Hutchison group to Vodafone group was not taxable in India. Therefore, no tax was recoverable from Vodafone for failure on its part to deduct tax at source while making payment to Hutchison. In the process, the Supreme Court reiterated the well-established principle - tax planning within the framework of law is permissible as well as provided some new concepts for consideration viz. the ‘look at’ test,

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

situs of shares, 'participative' *vis-à-vis* 'persuasive' interest etc.

In this article, we have tried to shed some light on the key principles emanating from the Supreme Court's ruling.

'Timeline' of Vodafone Ruling

- 1992 – Hong Kong based Hutchison group ('to be called as Hutch') acquired interest in Indian mobile telecommunication business through a joint venture, Hutchison Max Telecom Limited ('HMTL') which was subsequently renamed as Hutchison Essar Limited ('HEL').
- 1998 – Hutch group, through Hutchison Telecommunications Ltd., Hong Kong ('HTL') incorporated CGP Investments (Holding) Ltd. ('CGP') in Cayman Islands with a single share equity capital.
- 2004 – Hutchison Telecommunication International Limited (CI), ('HTIL') was incorporated and listed on New York and Hong Kong stock exchanges.
– HTL transferred the single equity share of CGP to HTI (BVI) Holdings Limited ('HTI BVI') which was a wholly owned subsidiary of HTIL.
- 2005 – Consolidation of Hutch's Indian telecom business under a single entity, HEL.
– Ownership of HEL was consolidated under tier I companies based in Mauritius which were held by CGP. Thus, CGP became the indirect owner of HTIL's share of approx. 52% interest in HEL.
– Out of the balance 48%, 15% interest was held by companies headed by Asim Ghosh ('AG') & Analjit Singh ('AS') and remaining 33% was held by the Essar group.
- 2006 – In December 2006, HTIL issued a press statement stating that it had been approached by various interested parties for acquisition of its equity interest in HEL.
– On the same date, an open offer was made by Vodafone Group Plc on behalf of Vodafone group for a non-binding bid of \$ 11.055 billion for the enterprise value of HTIL's 67% interest in HEL by acquiring the one share equity of CGP. 67% represented HTIL's direct and indirect interest in HEL of 52% and call options to acquire the remaining stake in the companies headed by AG & AS which would allow Vodafone to control another 15% stake in HEL.
- 2007 – In February 2007, Vodafone group submitted a revised offer of \$ 11.076 billion for HTIL's interest in HEL.
– In May, FIPB consents to Vodafone-Hutch deal under the extant FDI regulations subject

to other applicable laws. Accordingly, Vodafone acquired the one share of CGP which entitled it to 52% direct and indirect controlling interest in HEL and an option to acquire shares in the companies headed by AG and AS. The same is depicted by way of a diagram as Exhibit 1 and Exhibit 2.

- In August, the revenue department issued a show-cause notice to Vodafone Essar Limited ('VEL'), prior to acquisition called as HEL, seeking to treat it as representative assessee for Hutch.
- In September, another show-cause notice issued to VEL for failure to deduct taxes at source while making payment to Hutch and therefore, considering it to be an 'assessee-in-default'.
- VEL and Vodafone challenged the said notices by filing writ petition in the Bombay High Court.
- 2008 – The Bombay High Court dismisses the petition filed by Vodafone. The Bombay High Court held that the transaction of sale of one share of CGP can be picked up for scrutiny by the revenue department as the inherent intention behind the transaction was to acquire the controlling interest in HEL. The High Court additionally commented that as all the relevant papers were not filed before it, it was not in position to analyse the nature of the transaction and hence, not comment on it.
- 2009 – January. Vodafone files Special Leave Petition against the Bombay High Court's order which is dismissed by the Supreme Court. Further, the Supreme Court directed the tax authority to first determine whether the revenue department has jurisdiction over the said transaction. If the same was found to be prejudicial to Vodafone, Vodafone could directly appeal before the Bombay High Court.
- 2010 – May. Order passed by the revenue authorities asserting their jurisdiction to tax the said transaction in the hands of Vodafone as a 'taxpayer in default'.
– September. Vodafone filed an appeal with the Bombay High Court against the revenue authorities' decision. The Bombay High Court

The control of a company resides in the voting power of its shareholders and shares represent an interest of shareholder which is made up of various rights contained in the contract embedded in the Articles of Association. ”

dismissed Vodafone's writ and confirmed the order of the revenue authorities.

- October & November. Vodafone files SLP before the Supreme Court against the Bombay High Court's decision. Supreme Court orders Vodafone to deposit ₹2,500 crores and balance

2011
2012

tax amount involved of ₹8,500 crores by way of a bank guarantee.

- August to October. Hearings took place over a period of 28 days.
- 20th January 2012. Supreme Court delivers its verdict.

Exhibit 1

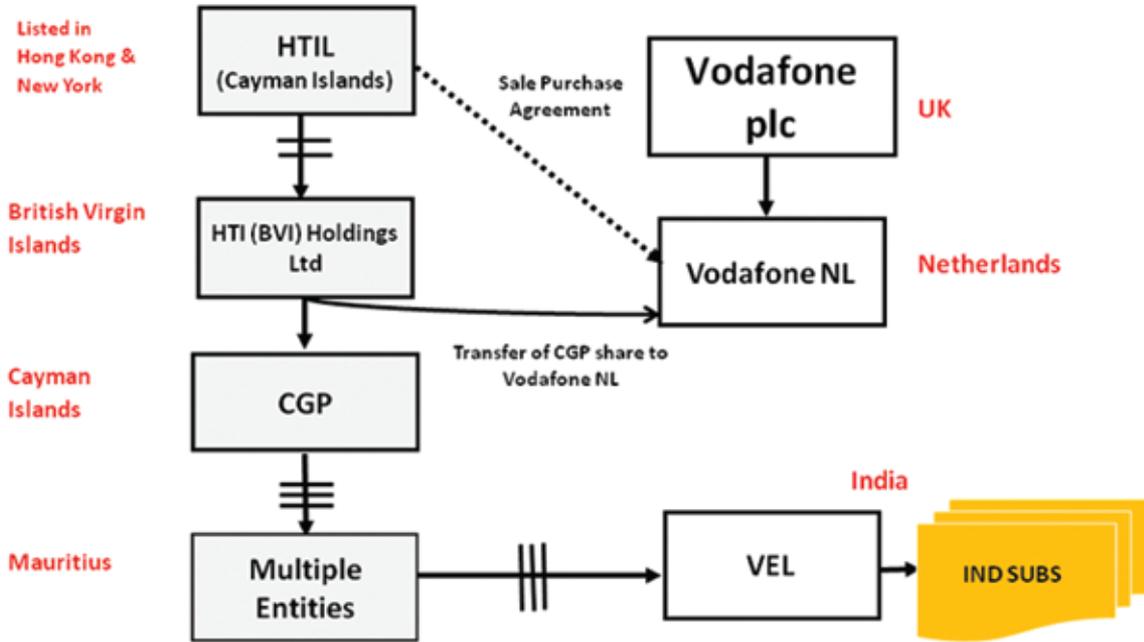
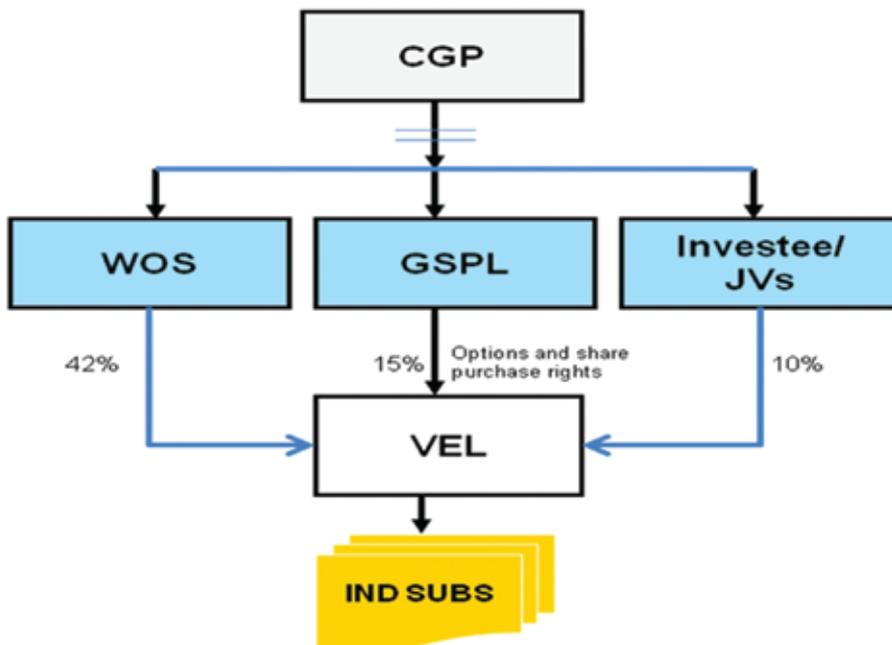


Exhibit 2



Key Principles Emanating from Supreme Court Ruling

1. *McDowell Vs. Azadi Bachao Andolan*

- It was the contention of the Revenue authorities that SC decision in the case of *Azadi Bachao Andolan* [263 ITR 706] needed to be overruled as it had adopted a divergent view from the principles laid down by the five member bench in the case of *McDowell* [154 ITR 148].
- The Supreme Court dismissing the contention of the revenue authorities held that the majority ruling (four member ruling) in *McDowell* had clearly laid down that legitimate tax planning within the framework of law was permissible. However, resorting to colorable devices to avoid tax cannot be considered to be a part of tax planning.

The Supreme Court further went on to explain that separate ruling given by Justice Chinnappa Reddy in *McDowell's* case was in relation to tax evasion through use of colorable devices and by resorting to dubious methods and subterfuges. However, Justice Reddy has not mentioned that tax planning is illegitimate or impermissible. Further, it was to be noted that Justice Reddy himself agreed with the four member ruling.

- The Supreme Court further explained the *McDowell's* ruling and the context in which Justice Reddy held that the principle laid down in the case of *Duke of Westminster* was not applicable and that the subsequent ruling in the case of *Ramsay* was to be considered as way forward.

The Supreme Court explained that as per the principle laid down by House of Lords in the case of *CIR Vs. Duke of Westminster* [1935 All E.R. 259], a taxpayer can arrange his affairs so as to reduce the liability of tax and the fact that the motive for a transaction is to avoid tax does not invalidate it unless a particular enactment so provides.

However, in a subsequent ruling in the case of *WT Ramsay* [1981 1 All E.R. 865], a new approach to artificial tax avoidance schemes was laid down wherein an assessee could be held liable to tax only if there was a clear intention of tax avoidance. Further, the intention to evade taxes ought to be proved based on facts and the same should not be concluded on a mere literal interpretation.

The Supreme Court further explained that ruling in the case of *Ramsay* did not overrule the principle laid down in the case of *Westminster* but merely provided a proper context as per which any arrangement which was colorable in nature and intended primarily to evade taxes had to be ignored. Thus, the *Ramsay* ruling only lays down the principle of statutory interpretation rather than

providing an anti-avoidance mechanism in the interpretation of tax laws.

- The Supreme Court further relied on the ruling of House of Lords in the case of *Craven Vs. White* [1988 3 All E.R. 495], wherein it was held that the Tax Authority cannot question every transaction as to whether it is a tax deferment/or tax avoiding device but the Tax Authority should apply the 'look at' test to ascertain its true legal nature. If the arrangement is a genuine tax planning, then the taxpayer cannot be refused benefit of the same.

Applying the Westminster principle in the said case, it was held that the Tax Authority cannot tax a subject without a specific provision to support and every tax payer is entitled to arrange his affairs so that his taxes shall be as low as possible and that he is not bound to choose that pattern which will replenish the treasury.

- Given the same, the Supreme Court explained that there is no conflict between principles laid down in the ruling of *McDowell* and in the case of *Azadi Bachao* and that there was no requirement to reconsider the decision of *Azadi Bachao Andolan*.

2. Separate Entity Principle and 'Look At' Test

- The Supreme Court quoting Pope Innocent IV explained the principle of separate entity applicable to companies. In nutshell, the separate entity principle states that the company is to be treated as a person separate from its shareholders. The said principle is also reflected in the both Indian corporate and tax laws. Companies and other entities are viewed as economic entities with legal independence *vis-à-vis* their shareholders/participants.
- Further, generally as well as for the purposes of tax treaties, a subsidiary and its parent are considered as totally distinct tax payers. Also, given the fact that parent company exercises shareholder's influence on its subsidiaries does not generally imply that the subsidiaries are to be deemed to be resident of the country in which the parent company resides.
- However, if the controlling foreign enterprise makes an indirect transfer through "abuse of organisation form/legal form and without reasonable business purpose" resulting in tax avoidance, then the revenue authorities can disregard the form of the arrangement, re-characterise the equity transfer according to the economic substance and impose tax on the actual controlling foreign enterprise. This would need to be determined by review of all facts and circumstances surrounding the transaction.
- However, when it comes to taxation of a holding structure, at the threshold, the burden is on the

The Supreme Court explained that under the “look at” test, the Revenue authorities need to ascertain the true legal nature of the transaction by looking at the entire transaction holistically and not by adopting the dissecting approach. ”

Revenue authorities to allege and establish the abuse, in the sense of tax avoidance in the creation/ and or use of such structures. The Revenue may invoke “substance over form” principle or “piercing the corporate veil test” only after it is able to establish on the basis of facts and circumstances surrounding the transaction that the transaction is sham or tax avoidant. One of such example could be a structure for circular trading or round tripping or to pay bribes which should be disregarded applying the principle of fiscal nullity.

- Thus, if revenue authorities finds that in a holding structure that an entity has not commercial/business substance and has been interposed only to avoid tax then in such cases, applying the test of fiscal nullity it would be open to the Revenue to discard such inter-positioning of that entity.
- The SC reiterated the “look at” principle enunciated in Ramsay (supra) and Craven Vs. White in which it was held that the Revenue or the Court must look at a document or a transaction in a context to which it properly belongs to. It is the task of the Revenue/Court to ascertain the legal nature of the transaction and while doing so it has to look at the entire transaction as a whole and not to adopt a dissecting approach. The Revenue cannot start with the question as to whether the impugned transaction is a tax deferment/saving device but that it should apply the “look at” test to ascertain its true legal nature.
- The SC further observed that every strategic foreign direct investment coming to India, as an investment destination, should be seen in a holistic manner. While doing so, the Revenue/Courts should keep in mind the following factors:
 - o the concept of participation in investment,
 - o the duration of time during which the Holding Structure exists;
 - o the period of business operations in India;
 - o the generation of taxable revenues in India;
 - o the timing of the exit;
 - o the continuity of business on such exit.

In short, the onus will be on the Revenue to identify the scheme and its dominant purpose.

The SC also held that merely because at the time of exit, capital gains tax does not become

payable, the entire share sale transaction would not become sham or tax avoidant.

3. Scope of Section 9 – Whether a Look Through Provision so as to Cover Indirect Transfer of Capital Assets?

- The Revenue authorities primarily contended that any gain arising to a foreign company in consequence of indirect transfer of capital asset situated in India would be taxable under Section 9 in India. Thus, in the instant case, even if control over HEL were to get transferred in consequence of transfer of the CGP Share outside India, it would yet be covered by Section 9.
- The Supreme Court while explaining the scope of provisions of Section 9(1)(i) of the Act explained that income dealt with in each sub-clause is distinct and independent of the other. In the instant case, the applicable clause is last sub-clause of Section 9(1)(i) which refers to income arising from “transfer of a capital asset situate in India”.
- The said sub-clause consists of three elements, namely,
 - o transfer,
 - o existence of a capital asset, and
 - o situation of such asset in India.

All above three elements should exist in order to make the last sub-clause applicable. Therefore, if such a transfer does not exist in the previous year no charge is attracted. Further, Section 45 also states that such income shall be deemed to be the income of the previous year in which transfer took place. Hence, transfer in the previous year should exist in order to attract the said sub-clause.

Thus, income accruing or arising to a nonresident outside India on transfer of a capital asset situate in India is fictionally deemed to accrue or arise in India by virtue of above sub-clause of Section 9(1)(i) of the Act.

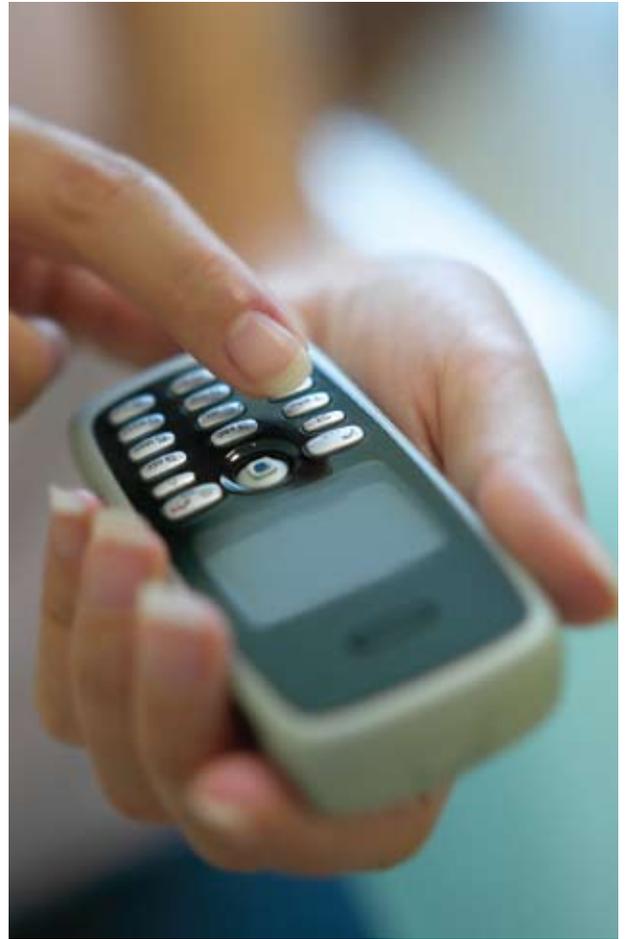
- The Revenue authorities contended that under Section 9(1)(i) it can “look through” the transfer of shares of a foreign company holding shares in an Indian company and treat the transfer of shares of the foreign company as equivalent to the transfer of the shares of the Indian company on the premise that Section 9(1)(i) covers direct and indirect transfers of capital assets.
- However, based on unambiguous language of Section 9(1)(i) of the Act and the fact that the legislature has not used the words indirect transfer in Section 9(1)(i), the SC held that Section 9(1)(i) cannot be extended to cover indirect transfers of capital assets/property situate in India. It further

held that the words directly or indirectly in Section 9(1)(i) go with the income and not with the transfer of a capital asset (property).

- Further, the SC also relied on the provisions of proposed Direct Taxes Code Bill which expressly proposes to tax indirect transfers. This proposal indicates that indirect transfers are not covered by the existing Section 9(1)(i) of the Act. The question of providing “look through” in the statute or in the treaty is a matter of policy. It is to be expressly provided for in the statute or in the treaty. Similarly, limitation of benefits has to be expressly provided for in the treaty. Such clauses cannot be read into the section by interpretation. Thus, the SC held that that Section 9(1)(i) is not a “look through” provision.

4. Other Property Rights – Whether Constitute a Separate Asset?

- The revenue authorities contended that HTIL had certain rights like rights of control and management over HEL and its subsidiaries, which were extinguished under the share purchase agreement entered with Vodafone for transfer of share of CGP. Thus, the defacto control over subsidiaries which was extinguished amounted to transfer of capital asset situated in India.
- The Supreme Court based on the facts held that the instant case involved selling shares of CGP and not with sale of assets, item-wise. The Supreme Court explained that under the “look at” test, the Revenue authorities need to ascertain the true legal nature of the transaction by looking at the entire transaction holistically and not by adopting the dissecting approach.
- Accordingly, SC observed that if one applies the “look at” test, they would find that the entire Hutchison structure had been in place since 1994 to 2007. Hence, it could not be said that the structure was created or used as a sham or tax avoidant. Hence, applying the “look at” test and without invoking the dissecting approach, the SC held that extinguishment of above mentioned rights occurred because of the transfer of CGP share and not by virtue of various clauses of SPA.
- Further, the SC also held rights such as right to control a subsidiary or to appoint a director or to direct a downstream subsidiary to vote in a particular manner fall within the category of persuasive position/influence. Hence, as these rights cannot be enforced in the court of law, they cannot be construed as a right in the legal sense.
- With regards, to call and put options to buy additional shares, the SC held that these are



contractual rights and in absence of any statutory stipulation, they cannot be considered as capital assets. At best, they may be regarded as potential shares till they are exercised.

5. Role of CGP and Situs of Shares of CGP

- The Supreme Court also made interesting observations on efficiencies of a holding structure. It observed that subsidiaries are often created for tax or regulatory reasons. Further, based on facts of the case, it held that it cannot be said that the intervened entity CGP had no business or commercial purpose.
- Also, the Revenue authorities contended that as CGP was a mere holding company, situs of CGP's shares existed where its underlying assets were situated, which was India. However, the SC held that under the Indian Companies Act, 1956, the situs of the shares is where the company is incorporated and the place, where shares can be transferred.
- In the instant case, as transfer of the CGP shares were recorded in the register of members kept in Cayman Island, the situs of the shares was in

Cayman and not in India were underlying assets are situated.

6. Transfer of Controlling Interest – Whether A Separate Capital Asset ?

- The Supreme Court held that controlling interest is an incident of ownership of shares in a company and it flows from holding of shares. Controlling interest is not an identifiable or distinct capital asset independent of holding of shares. The control of a company resides in the voting power of its shareholders and shares represent an interest of shareholder which is made up of various rights contained in the contract embedded in the Articles of Association.
- Shares, and the rights which emanate from them, flow together and cannot be dissected. Thus, it held that control and management is facet of holding of the shares. Thus, the instant case covered only a straight forward share sale which Vodafone purchased along with various rights flowing from the CGP share, including the right to gain control over three layers of companies.
- The SC also as a general rule held that where a transaction involved transfer of shares it transaction cannot be broken up into separate individual components, assets or rights such as right to vote, right to participate in company meetings, management rights, controlling rights, control premium, brand licences and so on as shares constitute a bundle of rights.
- The SC also held that it was not open for the revenue authorities to split the payment for share sale into variety of different rights transferred due to share sale.
- The essential character of the transaction cannot be altered by the form of the consideration, the payment or the basis of consideration. The transaction in the instant case remained a contract of outright sale of the entire investment for a lump sum consideration.

7. Scope and Applicability of Sections 195 and 163 of the Act

- The SC held that withholding provisions under Section 195 of the Act would apply only if the transaction is subject to tax in India. In the present case, the transaction was of transfer of capital assets between two non-resident entities on a principal to principal basis, through a contract situated outside India and for which consideration was also paid outside India. Hence, as the transaction was not taxable in India, no liability to deduct tax at source arose on Vodafone.

Applying the Westminster principle in the said case, it was held that the Tax Authority cannot tax a subject without a specific provision to support and every tax payer is entitled to arrange his affairs so that his taxes shall be as low as possible and that he is not bound to choose that pattern which will replenish the treasury. ☺

- Further, tax presence in India has to be viewed in context of the transaction and hence, Vodafone's investment in Bharti Airtel cannot make all entities of Vodafone group subject to the Indian Income-tax Act, 1961. Tax presence has to be construed in a manner that brings the non-resident assessee under jurisdiction of Indian tax authorities.
- With regards to applicability of provisions of Section 163 of the Act pertaining to representative assessee, the SC held that Section 163 of the Act does not relate to deduction of tax. Further, Section 163(1)(c) as well as Section 9(1)(i) of the Act state that income should be deemed to accrue or arise in India. In the instant case, as there is no transfer of capital asset situated in India, Section 163(1)(c) of the Act is not attracted and hence, no proceedings can be initiated on Vodafone as representative assessee even under provisions of Section 163 of the Act.

Conclusion

While concluding, the SC made some interesting observations on the legal and judicial system. It observed that Certainty is integral to rule of law. Certainty and stability form the basic foundation of any fiscal system. Tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner.

Further, legal doctrines like "Limitation of Benefits" and "look through" are matters of policy. It is for the Government to have them incorporated in the Treaties and in the laws so as to avoid conflicting views. This would help both investors as well as the tax administration in enforcing the provisions of the taxing laws.

Thus, the judgment of SC in Vodafone case has given many key principles for interpretation of legal statutes and tax treaties and which would serve as a guiding principle in all future cases.

The revenue authorities have recently filed a review petition against the above judgment with the Supreme Court, so it seems that the Vodafone controversy has not yet been laid down to rest. ■



CAATs: The Essential Tools to Audit Digital Data¹

Chartered accountants deal with information in myriad ways encompassing the areas of accounting, assurance, consulting and compliance, and most of this information is now available in electronic form. This is true not only in case of large and medium enterprises but also in case of small enterprises. In case there are enterprises that have still not adopted the digital way, it is an opportunity for CAs to help such enterprises to ride the digital wave. Hence, it has become critical for CAs to understand and use information technology as relevant for the services we provide. It is rightly said: “one cannot audit data which is flying in bits and bytes by using the ancient method of riding on a horse back”. We are living in a knowledge era where the skill sets are key to harnessing the power of technology to be effective as knowledge workers. Computer Assisted Audit Techniques (CAATs) refers to using technology for increasing the effectiveness and efficiency of auditing. CAATs enable auditors to do more with less and add value through the assurance process which is more robust and comprehensive. This article provides an overview of the process, approach and techniques which could be used across various technology platforms and in diverse enterprises.

The All-Encompassing Electronic Data

A great blessing in ancient times was: “May you live in exciting times”. Indeed, we are living in exciting times without even being aware of it. We are experiencing how technology innovations are making our life and living simpler by bridging global boundaries and bringing global information on our finger tips. For enterprises as well as professionals, the question is no longer what technology can do for us but what we can do with the technology. The question “do I need to use technology” is no longer relevant and instead the relevant decision is about “how do I use technology to remain relevant”. Information technology is all pervasive and more so as the government and regulatory agencies are also using technology platforms to provide services to citizens and compelling information to be filed in electronic form. The government at all levels has drawn up ambitious plans to implement e-Governance initiatives to improve speed, access and transparency of services. The Information Technology (IT) Act 2000 with IT Amendment Act 2008 and IT rules 2011 provide the regulatory framework and mechanism for recognising electronic records and electronic transactions thereby facilitating ecommerce and also identifying cybercrimes and providing penalties and compensation for them. Hence, we can expect IT usage to only keep growing in the near future impacting all areas of life more so our work as professionals.

CAs and CAATs

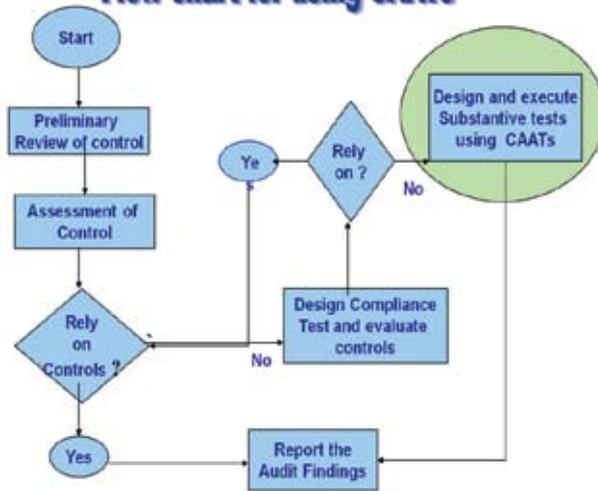
As a chartered accountant, we come across computers

and communication technology as the most common denominator among our clients, both large and small. Further, we use computers and communication technology for providing services to our clients. In today’s complex and rapidly changing technology environment, it is important to master the right techniques which could be used across enterprises and across various technology platforms. Typical of a IT environment are the speed of processing, large capacity of storage, lack of the paper based trails, the radically different way of information processing, the ease of information access, internal controls being imbedded and the ever-present risk of failure of IT and loss of data. All these factors make it imperative for auditors to harness power of technology to audit technology environment by taking into consideration the risks, benefits and advantages. CAATs empower CAs with the key survival techniques which effective used in any IT environment. CAATs are not specialist tools designed for use by specialist IT auditors but these are

**Any electronic information
that is auditable
is a potential candidate
for applying CAATs**

¹ CA A. Rafeq: The author is a member of the Institute and can be reached at rafeq@vsnl.com.

Flow chart for using CAATs



common techniques which can be easily mastered to audit in a computerised environment for statutory audit, tax audit and internal audit as also for providing consulting services.

CA + IT = CAATs

CAATs are tools for drawing inferences and gathering relevant and reliable evidence as per requirements of the assignment. CAATs provide direct access to electronic information and empower auditors not only to perform their existing audits more efficiently and effectively but also facilitate them in knowing how to create and execute new types of IT related audit assignments. CAATs provide a mechanism to gain access and to analyse data as per audit objective and report the audit findings with greater emphasis on the reliability of electronic information maintained in the computer system. There is higher reliability on the audit process as the source of the information used provides and greater assurance on audit findings and opinion. CAATs are available in specific general audit software designed for this purpose but the techniques of CAATs can be applied even by using commonly used software such as MS Excel and by using query/reporting features of commonly used application software. CAATs can be used to perform routine functions or activities which can be done using computers, allowing the auditors to spend more time on analysis and reporting. A good understanding of CAATs and the knowledge as to where and when to apply them is the key to success. ICAI has published a guidance note on CAAT and publication titled "Data Analysis for Auditors" which may be referred for more details.

Need for CAATs

In a diverse digital world of clients' enterprises, the greatest challenges for an Auditor is to use technology

to access, analyse and audit this maze of electronic data. CAATs enable auditors to move from the era of ticks using pencil or pen to the era of clicks by using a mouse. CAATs will help auditors to change focus from time-consuming manual audit procedures to intelligent analysis of data so as to provide better assurance to clients and also manage audit risks. Some of the key reasons for using CAATs are:

1. Absence of input documents or lack of a visible paper trail may require the use of CAATs in the application of compliance and substantive procedures.
2. Need for obtaining sufficient, relevant and useful evidence from the IT applications or database as per audit objectives.
3. Ensuring audit findings and conclusions are supported by appropriate analysis and interpretation of the evidence.
4. Need to access information from systems having different hardware and software environments, different data structure, record formats, processing functions in a commonly usable format.
5. Need to increased audit quality and comply with auditing standards.
6. Need to identify materiality, risk and significance in an IT environment.
7. Improving the efficiency and effectiveness of the audit process.
8. Ensuring better audit planning and management of audit resources.

Key Capabilities of CAATs

CAATs refer to using computer for auditing data as per audit objectives. This requires understanding of the IT environment and most critically the core applications and the relevant database and database structure. CAATs could be used by using the relevant functionalities available in general audit software, spreadsheet software or the business application software. However, broadly the key capabilities of CAATs could be categorised as follows:

1. *File access*: This refers to the capability of reading of different record formats and file structures. These include common formats of data such as database, text formats, excel files. This is generally done using the import/ODBC function.
2. *File reorganisation*: This refers to the features of indexing, sorting, merging, linking with other identified files. These functions provide auditor with an instant view of the data from different perspectives.
3. *Data selection*: This involves using of global filter conditions to select required data based on specified criteria.
4. *Statistical functions*: This refers to the features of sampling, stratification and frequency analysis. These functions enable intelligent analysis of data.

5. *Arithmetical functions*: This refers to the functions involving use of arithmetic operators. These functions enable performing re-computations and re-performance of results.

Step by Step Methodology for Using CAATs

CAATs are very critical tools for Auditors. Hence, it is important to formulate appropriate strategies to ensure their effective use. Some of the key strategies for using CAATs are:

1. Identify the scope and objectives of the audit. Based on this, auditor can decide about the need and the extent to which CAAT could be used.
2. Identify the critical data which is being audited as per audit scope and objectives.
3. Identify the sources of data from the enterprise information system/application software. These could be relating to general ledger, inventory, payroll, sundry debtors and sundry creditors.
4. Identify the relevant personnel responsible for the data and information system. These personnel could be from the IT department, vendors, managers, etc.
5. Obtain and review documents relating to data/information systems. This should provide information about data types/data structures and data flow of the system.
6. Understand the software by having a walk-through right from user creation, grant of user access, configuration settings, data entry, query and reporting features.
7. Decide what techniques of CAATs could be used as relevant to the environment by using relevant CAAT software as required.
8. Prepare a detailed plan for analysing the data. This includes all the above steps.
9. Perform relevant tests on audit data as required and prepare audit findings which will be used for forming audit report/opinion as required.

Steps for Obtaining Audit Data

In most cases where CAATs are used, it becomes necessary to obtain copy of data in their original format for independent analysis. The data has to be obtained in commonly accepted format. It is important to understand the format in which the data is stored in the application which is being audited. If the data is a native format which is not readable by audit software, then it is necessary to use the reporting feature of application software and export this data to commonly recognisable format of audit software. For example, auditor may not be aware of the data structure/tables of a software developed through a vendor by the client. In such case, auditor may have to study the reporting features and use the export feature to get the data in the required format. It is very important to educate the client about the need to obtain copy of the data as required for audit. Based on the audit scope and relevant audit

Where we are Today?



Where We Need to be?



environment, auditor may have to finalise the required approach for getting the data for audit. This may include installing audit software on client system or using the application software for audit as feasible. Broadly, some of the key steps for obtaining data are:

1. Discuss with client about the requirement of raw data for audit and issue a request letter for getting the requested data in specified form as per the audit objectives.
2. Discuss with the IT personnel responsible for maintaining data/application software and obtain copies of record layout and definitions of all fields and ensure that you have an overall understanding of the data. The record layout should describe each field and provide information about the starting and ending positions and the data type (numeric, alphanumeric, character, etc.).
3. Print sample list of the first 100 records in the data file and compare this to a printout of the obtained data to confirm they are correct.
4. Verify data for completeness and accuracy by checking the field types and formats, such as identifying all records with an invalid date in a date field.
5. Obtain control totals of all the key data and compare

with totals from the raw data to ensure all records have been properly obtained. This can be performed by importing the data in audit software and reviewing the statistics of all the key fields.

Tests Performed Using CAATs

CAATs can be used for compliance or substantive tests. As per the audit plan, compliance tests are performed first as per risk assessment and based on the results of the compliance tests, detailed compliance tests could be performed. Some examples of tests which can be performed using CAATs are given below:

1. *Identify exceptions:* Identify exceptional transactions based on set criteria. For example, cash transactions above ₹20,000.
2. *Analysis of controls:* Identify whether controls as set have been working as prescribed. For example, transactions are entered as per authorised limits for specified users.
3. *Identify errors:* Identify data, which is inconsistent or erroneous. For e.g.: account number which is not numeric.
4. *Statistical sampling:* Perform various types of statistical analysis to identify samples as required.
5. *Detect frauds:* Identify potential areas of fraud. For example, transactions entered on week-days or purchases from vendors who are not approved.
6. *Verify calculations:* Re-perform various computations in audit software to confirm the results from application software confirm with the audit software. For e.g. TDS rate applied as per criteria.
7. *Existence of records:* Identify fields, which have null values. For example, invoices which do not have vendor name.
8. *Data completeness:* Identify whether all fields have valid data. For example, null values in any key field such as date, invoice number or value or name.
9. *Data consistency:* Identify data, which are not consistent with the regular format. For example, invoices which are not in the required sequence.
10. *Duplicate payments:* Establish relationship between two or more tables as required. For example, duplicate payment for same invoice.
11. *Inventory obsolescence:* Sort inventory based on data of purchase or categorise as per specified aging criteria or period and identify inventory which has become obsolete.
12. *Accounts exceeding authorised limit:* Identify data beyond specified limit. For example, transactions entered by user beyond their authorised limit or payment to vendor beyond amount due or overdraft allowed beyond limit.

CAATs and Auditing Standards

The various standards on auditing highlight the need for acquiring the required skill-sets to audit in an IT

environment and using relevant techniques. Many of the requirements of the auditing standards can be complied by adopting them for use in an IT environment as required. For example, Standard on Auditing (SA) 520 Analytical Procedures states: "**A1. Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:**

- *Comparable information for prior periods.*
- *Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.*
- *Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.*

A2. Analytical procedures also include consideration of relationships, for example:

- *Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.*
- *Between financial information and relevant non-financial information, such as payroll costs to number of employees.*

A3. Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, components and individual elements of information."

Most of the analytical procedures can be performed in an IT environment using CAATs which makes the audit process much more effective and efficient.

Conclusion

CAATs enable auditors to use computers as a tool to audit electronic data. CAATs provide auditors access to data in the medium in which it is stored, eliminating the boundaries of how the data can be audited. As auditors start using CAATs, they will be in a better position to have a considerable impact on their audit and auditee as more time is spent on analysis and less time on routine verification. It is important to understand the client IT environment and chart out which techniques of CAAT could be used. Initially, time needs to be invested in this endeavour but once the audit plan is prepared based on the IT environment as per audit scope, re-use becomes easier. However, the audit plan and tests need to be updated based on changes in the IT environment as relevant. Using CAATs provides greater assurance of audit process to the auditor and also to the auditee. The key to using CAAT is recognising the need, learning how to use CAATs and using them in practical situations. ■

Government Concerned over Rising Subsidy Burden

Union Finance Minister Pranab Mukherjee has said he is losing sleep over the government's ballooning subsidy bill, a rare expression of candour on a sensitive economic subject from an otherwise restrained finance minister triggering talk the upcoming budget could be harsh on subsidies. "As the finance minister when I think of enormity of the subsidies to be provided, I lose my sleep. There is no doubt," Mukherjee said recently in his address to a conference on Public Distribution System and Storage. It was Mukherjee's second broad hint in recent weeks that the budget for 2012-2013 will be less about tax giveaways and more about fiscal consolidation, an area considered as a major blemish on his ministry's performance and about which it has been facing much criticism. On another occasion recently, Mukherjee told a gathering in Kolkata that industry needs to brace for higher taxes, which has been interpreted to mean that the government could roll back remnants of the 2008-2009 fiscal stimulus by raising excise duty and service taxes. In the winter session of Parliament that ended in December, Mukherjee had said he expected the subsidy bill, pegged at ₹1.4 lakh crore in the budget, to overshoot the target by ₹1 lakh crore.

(Source: Press Trust of India)

Companies for No Change in Tax Rates in Budget 2012-2013

Reeling under the impact of global slowdown and a high interest rate regime, India Inc has demanded that tax rates be retained at existing levels even as finance minister Pranab Mukherjee expressed concerns about challenges facing the economy. In their customary pre-Budget meeting with Mukherjee, industry leaders also demanded that healthcare services be kept outside service tax ambit, and privatise coal mines. There are various challenges before us, including keeping inflation and fiscal and revenue deficit to manageable levels... which we all have to address collectively, Mukherjee said in his address to the industry leaders. At the meeting, business leaders suggested that service tax base may be widened with a negative list, besides exempting infrastructure companies and SEZ units from MAT.

(Source: <http://www.economictimes.com>)

MPs Want I-T Exemption Limit Hiked to ₹5 Lakh

Ahead of the Budget, some members of a Parliamentary panel scrutinising the Direct Taxes Code (DTC) Bill recently pressed for raising the income tax exemption limit to ₹5 lakh per annum. The Standing Committee on Finance, which met recently

has decided to finalise its report soon, enabling Parliament to consider the ambitious reforms in direct tax regime. Some members, they said, "wanted the IT exemption limit to be increased to ₹5 lakh per annum in view of inflation and erosion in purchasing power of rupee." The Government is hoping for approval of the DTC Bill by Parliament in the next fiscal. Pending Parliamentary nod, the government may include some of the provisions of the bill in the Budget 2012-2013. The Committee, in its draft report, has suggested that the income tax exemption threshold be enhanced to ₹3 lakh per annum from ₹1.8 lakh at present. The Bill proposes the limit of ₹2 lakh and provides for revising the tax slabs for all the three categories. Currently income of ₹1.80 to ₹5 lakh attracts 10% tax, ₹5 to ₹8 lakh 20% and above ₹8 lakh, 30%. It has also proposed retaining the corporate tax rate at the existing 30%.

(Source: <http://www.thehindubusinessline.com/>)

Tax Rebate on Three Year Bank FDs Likely

Following concerted pressure from banks, the finance ministry has agreed to consider a proposal to reduce the lock-in period for bank deposit eligible for tax rebate to three years from five years, even though it goes against the spirit of the Direct Tax Code. If this proposal finds its way into next this year's budget, it will make bank fixed deposits, which currently fetch an annual return more than 9%, an attractive savings option for individuals, and bring them on par with equity-linked tax saving schemes of mutual funds and tax-free bonds. "Among the list of demands submitted by the banks and financial institutions in their pre-budget meeting with the Finance Minister, some proposals have been short listed for further deliberations, this is one of them," said a senior finance ministry.

(Source: <http://www.hindustantimes.com>)

Service Tax is Payable on Flats Allotted to Landowner, clarifies Finance Ministry

When the landowner is given flats in lieu of cash, such flats become liable to service tax, the Finance Ministry clarified recently among other things. Suppose, the landowner invites a builder to demolish his bungalow and construct 10 flats thereon, with two flats being allotted to him as sale consideration, the two flats, though for non-cash consideration, would attract service tax immediately on signing of the building agreement. The taxable value would be the amount for which similar flats have been booked by the other buyers on the date of such agreement. It boils down to this: if on the date of the agreement with the builder, there are two buyers who have booked their flats that are similar to those allotted to

the landowner at ₹40 lakh each, the allotment of the two flats to the landowner would be a taxable event, liable to service tax. With abatement allowed being 75% towards the goods used in the construction, which obviously cannot be subjected to service tax, ₹10 lakh would be liable to service tax, which currently is 10.3%. If the flats are not comparable on account of difference in the area, the rate per square foot charged from buyers must be taken into account.

(Source: <http://www.cainindia.org>)

Centre Not to Compensate States against CST Loss

The Government has decided to phase out compensation given to states against Central Sales Tax (CST) loss from 2011-2012, a move that is perceived to queer the pitch for roll out of the proposed Goods and Service Tax (GST). The overall compensation for all state governments was worked out at ₹15,000 crore for 2011-2012. With economic growth projections on the downside amid global macroeconomic uncertainties, the Centre is not keen on straining its resources by doling out compensation to states. The Union finance secretary has informed Sushil Modi, the chairman of the empowered committee of finance ministers on GST that from 2011-2012 onwards, the Centre will not be compensating states against CST loss. This is going to set a wrong signal to all states that have been vehemently demanding full compensation against CST loss. In a way, it is set to pose a huge bottleneck for GST roll out as there was consensus among all states that the Centre would offset CST loss fully till the Integral GST Mechanism is well established, a senior state government official told Business Standard. Of the total CST loss to the tune of ₹12,000 crore incurred by all states, the Centre has disbursed only ₹6,394 crore. It has also categorically stated that the matter is settled for 2010-2011 and the left over loss of states that have not raised base VAT (value added tax) from four to five per cent will not be compensated.

(Source: <http://www.business-standard.com/india/>)

Government eases Telco Merger Rules; Defers Spectrum Pricing

The telecoms ministry will allow mergers and acquisitions between operators that create a combined market share of up to 35% through a "simple and quick" process, the telecoms minister said, easing rules that were seen restricting deals in the sector. The ministry, which approved many proposals as part of a new telecoms policy, has deferred a decision on 2G radio spectrum pricing and on a one-time levy on carriers holding spectrum beyond 6.2 mega hertz

following a recent Supreme Court order asking the government to sell spectrum through auction. The policy is likely to be announced in April this year.

(Source: <http://www.financialexpress.com/news>)

Income Tax for Charitable Entities May be Tightened

Non-profit organisations set up for charitable purposes may see a tightening of income tax provisions applicable to them in the coming budget. According to a senior finance ministry official, the department has made significant progress in streamlining its administrative set-up to handle such organisations during this financial year, keeping in mind the provisions of the proposed Direct Taxes Code (DTC). He added that Finance Minister Pranab Mukherjee was expected to either announce steps to take the tax provisions handling non-profits either closer to DTC or their implementation from 2012-2013 itself, rather than waiting till April 2013. DTC is now expected to come in 2013-2014, instead of the earlier deadline of 2012-2013. The finance ministry is expected to push at least those provisions of the new regime in the next financial year which are associated with enhancing compliance and may also help in collecting more money. In the DTC, the income of non-profits whose activities are for public religious purposes are proposed to be exempt. On those set up for charitable purposes, it is proposed to levy a tax on their surplus at the rate of 15%.

(Source: <http://www.hindustantimes.com>)

PAN to be Most Potent Tool against Tax Evasion: Income Tax Department

Come next financial year, the PAN card is likely to become the most potent tool for the Income Tax Department to unearth black money, tax evasion and instances of criminal financing in the country. A recent directive of the Central Board of Direct Taxes (CBDT) to the I-T Dept has asked its officials to launch a special drive against those who have "not furnished their PAN (Permanent Account Number)" while entering into high value transactions. The drive will end on 20th March, eleven days before the current fiscal closes. The measure has been taken on the recommendations of a high-level committee appointed by the CBDT last year to find those taxpayers who have gone missing without paying taxes, pegged at ₹1,01,836 crore at present. The Committee under I-T Director General (Administrative) was set up to examine pending cases on I-T demands under the categories "assesses not traceable" and "non assets/inadequate assets for recovery".

(Source: <http://www.economictimes.com>)

Global Accountancy Leaders Identify Key Issues for 2012

The International Federation of Accountants (IFAC) recently released the results of its *2011 IFAC Global Leadership Survey of the Accounting Profession*. Respondents identified three issues of particular concern to the profession in 2012: the Difficult global financial climate, Enhancing the reputation/credibility of the profession, and Addressing the needs of SMPs and SMEs. Additional concerns for this year include: Issues related to EU draft legislation, Public sector/sovereign debt issues, Increased regulation, Global regulatory convergence, Role of the professional accountant in business, and Auditor independence. Accountancy leaders around the world said that the difficult financial climate was a key concern in this year's survey addressing the needs of SMPs and SMEs, important engines of economic growth and development that could be instrumental in improving the world's economies. Continued global regulatory convergence—which can help promote growth and development, reduce economic uncertainty, and enhance international financial stability—was also highlighted as a significant issue. Addressing the ongoing sovereign debt issues, which are impacting growth and contributing to economic uncertainty, were also highlighted as key concerns for 2012.

(Source: <http://www.ifac.org/>)

Year-End SMP Quick Poll Reveals Burden of Regulation and Economic Uncertainty as Top Challenges

Regulatory burdens and economic woes continue to top the list of challenges faced by small and medium-sized accountancy practices (SMPs) and their clients, according to the fourth quarter SMP Quick Poll results released recently by IFAC. Burden of regulation and economic uncertainty were tied for the top challenge faced by practitioners' SME clients, with nearly 30% of respondents choosing each. Difficulties accessing finance followed closely behind with 25%. Similarly, for accountants within small practices, keeping up with new standards and regulations (41%) ranked as the top challenge, followed by attracting and retaining clients (25%). As a whole, pessimism increased since the August-September 2011 poll was conducted, which may be due in part to the high European response rate in the fourth quarter and deepening debt crisis across the region. Overall, in the fourth quarter poll, only 29% reported that business was better in 2011 than 2010, while nearly 50% of those from North and South America said that business was better. Looking forward, over one-third of respondents expect an improvement in business performance in 2012 over 2011, while 44% expect no change, showing that respondents are slightly more optimistic about the year to come. When asked about the main driver of growth for their practice, revenue from new clients (38%) came out on top with nearly twice the number of responses as revenue from existing clients (20%).

(Source: <http://www.ifac.org/>)

'Professional Accountants Need to Respond to Increasing Demands from Investors for ESG Information'

The Professional Accountants in Business

(PAIB) Committee of the International Federation of Accountants (IFAC) has published a report on *Investor Demand for Environmental, Social, and Governance Disclosures: Implications for Professional Accountants in Business*. The report considers trends in investor demand for and use of environmental, social, and governance (ESG) information, and recommends how professional accountants can better support their organisations in responding to these demands, and ultimately improve the management and reporting of ESG performance. The report highlights an evolving trend toward greater interest in ESG factors, and integration of these factors and ESG performance information into investment processes and decisions. It also reviews investor approaches to acquire information on ESG factors, including positive and negative screening, engagement, and ESG integration. To alert professional accountants to essential ESG metrics and indicators sought by investors, the report provides a sector-neutral list of core performance indicators most frequently used by investors to evaluate ESG performance, and a review of how investors might consider the financial implications and monetisation of these factors. In response to the challenges of ESG integration, the report recommends five actions for the accountancy profession and professional accountants in business *viz* engaging investors effectively to understand their information needs and communicate performance, incorporating ESG factors and non-financial performance information into governance and accountability arrangements to improve information and disclosure quality, linking financial and non-financial performance and outcomes to improve understanding of sustainable value creation, ensuring that ESG disclosures meet investor needs by being material, timely, consistent, and comparable in order to improve usefulness of reporting and greater transparency and bringing together data that may be dispersed in different parts of the organisation or its supply chain to support internal and external decision making.

(Source: <http://www.ifac.org/>)

Exposure Draft of the IFRS Taxonomy 2012

The IFRS Foundation has published for public comment an exposure draft of the International Financial Reporting Standards (IFRS) Taxonomy 2012. The proposed Taxonomy is a translation of IFRSs and interpretations as issued in January 2012 into XBRL (eXtensible Business Reporting Language). The 2012 Taxonomy consolidates all IFRS Taxonomy interim releases that were published in 2011. In addition, the proposed IFRS Taxonomy 2012 will be the first IFRS Taxonomy to include common practice extensions to the IFRS XBRL Taxonomy. These extensions were derived from an analysis of approximately 200 IFRS financial statements and will diminish the need for preparers to customise the taxonomy to fit their individual business when filing IFRS compliant financial statements online. The exposure draft IFRS Taxonomy 2012 is open for comment until 17th March 2012. IFRSs issued by the International Accounting Standards Board (IASB) from 1st January 2012 onwards will be published as interim releases to the Taxonomy.

(Source: <http://www.ifrs.org/>)

□ IIA Report: How Internal Auditors Can Provide More Insight into Their Organisations

The Institute of Internal Auditors Research Foundation (IIARF) has released a report examining the prospect for internal auditors to make meaningful contributions to the organisations they serve by providing insight into organisational risks and opportunities. Based on a 2011 survey of 358 chief audit executives (CAEs), board members, and senior management from organisations in 39 countries, as well as in-depth follow-up interviews, *Insight: Delivering Value to Stakeholders* provides a global snapshot of stakeholders' views on whether internal audit should and is delivering insight, and with what regularity. The IIARF commissioned research to gain an understanding of how CAEs and key stakeholders view the current state of insight delivery. Researchers also explored key enablers or hindrances to insight delivery and provide suggestions for CAEs eager to enhance the delivery of insight by internal audit.

(Source: <http://www.accountingeducation.com/>)

□ AAA Publishes Study on Disclosure Tone and Shareholder Lawsuits

The American Accounting Association (AAA) has published a study that indicates that an optimistic tone in earnings statements "...makes a major difference in whether or not shareholders initiate lawsuits against companies." The study concludes that managers "can reduce litigation risk by dampening the tone of their earnings announcements either by decreasing their use of positive language or by tempering their optimism with statements that are less favorable. The study titled "Disclosure Tone and Shareholder Litigation," appears in the November/December 2011 issue of *The Accounting Review*. The research focuses on 165 companies sued in federal court for alleged fraud involving the price of their common stock and a matching group of 165 firms similar to the defendant companies but not the targets of lawsuits. In all, 628 earnings announcements from the sued firms were analysed along with 625 from non-sued firms. The authors conclude "Disclosure tone is certainly not the sole determinant of litigation risk. What we view as important, however, is that disclosure tone is both associated with litigation risk and under the discretion of management.

(Source: <http://www.accountingeducation.com/>)

□ IPSASB Publishes International Public Sector Conceptual Framework Consultation Paper for Comment

The International Public Sector Accounting Standards Board (IPSASB) has released for comment a consultation paper as part of 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 from 2010 through 2012, and is of fundamental importance to the future of global public sector standard setting for at least the next 10 to 15 years. The Consultation Paper, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Presentation in*

General Purpose Financial Reports" (CF-CP4), explores concepts applicable to the presentation of information in the general purpose financial reports of public sector entities. It is not limited to the financial statements. The Paper describes what is meant by presentation of information, and explains that presentation covers both display and disclosure. It reviews an approach to presentation of information that involves: presentation objectives based on user needs; application of the qualitative characteristics to presentation decisions; and three presentation concepts. The three presentation concepts are: select information that meets user needs, satisfies the cost-benefit test, and is sufficiently timely; locate information in a way that meets user needs; and organize information to make important relationships clear and to support comparability.

(Source: <http://www.accountingeducation.com/>)

□ IASB and FASB to Host a Series of Outreach Meetings on Revised Revenue Recognition Proposals

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) will host a series of outreach meetings in March, April and May 2012 on their revised joint proposals for the recognition of revenue that were published in November 2011. The meetings form an important part of the boards' programme of outreach activities on this second set of the revenue recognition proposals and they reflect the importance of revenue to all companies. To date, the boards have already hosted a number of workshops, webcasts and conferences on the topic and have held a number of meetings with auditors, preparers, regulators and users. The roundtable meetings will be held in public and will provide an opportunity for those that have submitted a comment letter, or who still intend to submit a comment letter, to discuss the proposals with the boards in further detail. An audio recording of the roundtable discussions will be made available shortly after each round table on www.ifrs.org and www.fasb.org.

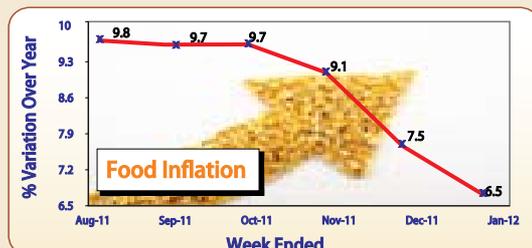
(Source: <http://www.ifrs.org/>)

□ IFAC Announces Seminar to Address Lessons from the Sovereign Debt Crisis and Steps Needed for Reform

The International Federation of Accountants is hosting *The Sovereign Debt Crisis, a Matter of Urgency—From Lessons to Reform*, a seminar to take place 19th to 20th March, 2012 in Vienna. In this seminar, IFAC will convene key decision makers, politicians and public finance management leaders to gain a comprehensive understanding of the causes contributing to the international sovereign debt crisis and the steps needed now for meaningful reform. The seminar's speakers will include influential financial and accounting leaders. Seminar attendees will have the opportunity to network with speakers and their fellow professionals. Registration for the conference is open to the public. For more information about the conference and to register, visit <http://sovereigndebt.ifac.org/>.

(Source: <http://www.ifac.org/>)

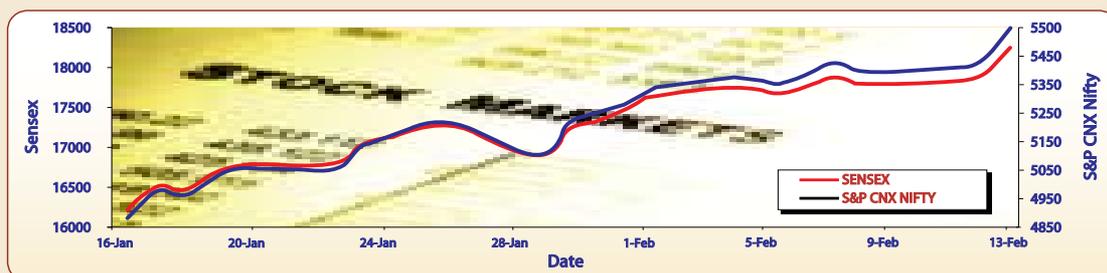
Economic Indicators



Indian Rupee vs. Major Foreign Currencies (January 16, 2012 to February 15, 2012)



Stock Markets



Selected Indicators

(per cent per annum)

Item	2011		2012				
	Feb. 4	Dec. 30	Jan. 6	Jan. 13	Jan. 20	Jan. 27	Feb. 3
Cash Reserve Ratio ⁽¹⁾	6.00	6.00	6.00	6.00	6.00	6.00	5.50
Bank Rate	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Base Rate ⁽²⁾	8.00/9.50	10.00/10.75	10.00/10.75	10.00/10.75	10.00/10.75	10.00/10.75	10.00/10.75
Deposit Rate ⁽³⁾	8.25/9.50	8.50/9.25	8.50/9.25	8.50/9.25	8.50/9.25	8.50/9.25	8.50/9.25
Call Money Rate (Weighted Average) ⁽⁴⁾	6.74	9.11	8.80	8.69	9.11	8.97	8.99

Notes: (1) Cash Reserve Ratio relates to Scheduled Commercial Banks (excluding Regional Rural Banks).

(2) Base Rate relates to five major banks since 1st July, 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.

(4) Data cover 90-95 per cent of total transactions reported by participants. Call Money Rate (Weighted Average) is volume-weighted average of daily call money rate for the week (Saturday to Friday).

Readers are invited to contribute write-ups or any relevant and interesting piece of information for this feature at eboard@ical.org.

ACCOUNTANT'S BROWSER

'PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE'

Index of some useful articles taken from Periodicals/Newspapers received during January-February, 2012 for the reference of Faculty/Students & Members of the Institute.

1. ACCOUNTING

Accounting Standards: gaps in Gaap – amortization of leasehold improvements by Dolphy D'Souza. *BCAJ*, Jan.2012, pp.93-94.

Carbon Accounting challenges in India – Some practical issues by Sujit Dutta & Ranjan Dasgupta. *The Management Accountant*, Jan. 2012, pp.91-94+108.

Challenges to the Accounting profession: some reflections by Duvvuri Subbarao. *RBI Bulletin*, Jan.12, pp.15-20.

Changing role of Management Accounting practices in Business Valuation – an Accountant's perspective by Mahesha V. & Sachindra G.R. *The Management Accountant*, Dec. 11, pp.1141-45.

Cost & Management Accountants & IAS 41: Agriculture by Sharad K. Marathe. *The Management Accountant*, Dec. 11, pp.1180-81.

CPA horizons 2025 : A road map for the future. *Journal of Accountancy*, Dec. 11, pp.44-47.

'Deprival value' vs. 'fair value' measurement for contract liabilities: how to resolve the 'revenue recognition' conundrum? by Joanne Horton etc. *Accounting & Business Research*, Dec. 11, pp.491-514.

Fair value measurement under international financial reporting standard 13 by Gautam Mitra & Sumita Chakraborty. *The Management Accountant*, Dec. 11, pp.1133-35.

2. AUDITING

Banking Frauds – Role of professionals/customers in detection & prevention by Naveen Kumar. *Chartered Secretary*, Dec. 11, pp.1724-26.

Big ideas for small Audit shops by Will mcmillan & C. Miller. *Internal Auditor*, Dec. 2011, pp.52-57.

Continuous Audit: aligning IA with ERM by Malay Paul. *The Management Accountant*, Jan.12, pp.95-97.

External assessments as tactical tools by A. Manchanda & C.B. Macdonald. *Internal Auditor*, Dec. 2011, pp.47-50.

Finding frauds in Financial statements – 10 commandments for Auditors by Sriraman Parthasarathy. *BCAJ*, Jan.12, pp.9-14.

Raising Internal Audit's potential by Nel Baker. *Internal Auditor*, Dec. 2011, pp.30-35.

Special Audit by a cost accountant under section 14A & 14AA of central Excise Act, 1944 by M. Govindarajan. *The Management Accountant*, Dec. 11, pp.1152-54.

The Strategy Audit by Gerry H. Grant etc. *Internal Auditor*, Dec. 2011, pp.37-40.

3. ECONOMICS

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C. Other Committees

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Secretary: CA. Vandana Nagpal

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Disciplinary Committee - Satyam Bench (Under Section 21B)

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CA. G. Ramaswamy	Coimbatore
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Ms. Ila Singh (Nominee of Central Government)	New Delhi
Shri S. K. Ghosh (Nominee of Central Government)	Kolkata

Secretary: CA. Vandana Nagpal

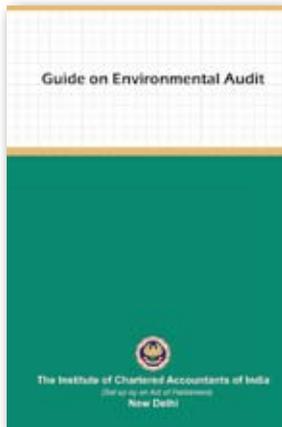


New Publications

Guide on Environmental Audit

(Pages: 94 pages + 19 Initial pages+ 2 Cover pages)
Price: ₹ 150/- (including CD)

Environmental issues are increasingly impacting the bottom line and future prospects of organizations in many industries. Recognising the growing importance of the subject of environmental auditing as the survival and growth mantra for business these days, the Internal Audit Standards Board has issued this "**Guide on Environmental Audit**". The main objective of this guide is to provide a general overview of the concept of environmental auditing as an emerging area.



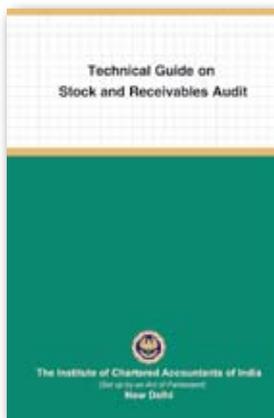
Significant Features of the Guide are:

- Covers concepts such as, environmental management system, environmental accounting, reporting, etc.
- Explains evolution, features, objectives and benefits of environmental auditing.

Technical Guide on Stock and Receivables Audit

(Pages: 137 pages + 20 Initial pages+ 2 Cover pages)
Price: ₹ 150/- (including CD)

The auditor of the bank today, be it at branch level or the head office level, is faced with challenges of the growing complexities in the operating environment of banks, attributable not only to the transactional, customer, regional spread of the activities of the bank but also to frequent regulatory directions issued by the banking regulator coupled with increasing use of sophisticated technology. Considering this, the Internal Audit Standards Board of the ICAI is issuing "**Technical Guide on Stock and Receivables Audit**" to provide extensive knowledge to the members restricted not only to circulars issued by the Reserve Bank of India but extends to knowledge of the industry, regulatory and other external factors, including financial reporting framework, nature of the client, etc.,. This publication a comprehensive, self contained and



- Describe stages of the environmental audit process, contents of environmental audit report, tools and techniques used in environmental audit, provides guidance on international standards on green audit.
- Explains types of environmental audit viz:
 - Environmental Compliance Audit.
 - Environmental Performance Audit.
 - Environmental Financial Audit.
- Provides knowledge about the emerging trends of the environmental auditing and emerging opportunities for professional accountants in the field of environmental audit and describes the role of a Chartered Accountant as:
 - CA as Environmental Accountant.
 - CA's role in Environmental Management Accounting.
 - CA's role in Compliance and Certification Audits.
 - CA's role in Environmental Information Audit.
 - CAs as Environmental Consultants.
 - CA's Role in Sustainable Development.
- Contains an illustrative checklist in respect of environmental management system, environmental compliance audit and also sample environmental audit report.
- Includes environment related glossary of terms and abbreviations.
- The guide comes with a CD of the entire guide to ensure ease of reference and reusability.

touching upon almost all critical aspects in stock and receivable audit of banks.

Significant Features of the Technical Guide are:

- Covers concepts such as, inventories and receivable audit, valuation of inventories, verification of securities, etc.
- Explains objective, scope, purpose and need of Stock Audit.
- Provides knowledge about the following:
 - Analytical Review Procedures.
 - Planning of Physical Inventory.
 - Stocktaking.
 - Significant Observations in Cash-Credit Accounts.
- Contains an illustrative checklist in respect of stock and receivable audit and various specimen letters.
- Includes banking related glossary of terms and abbreviations.
- The guide comes with a CD of the entire guide to ensure ease of reference and reusability.

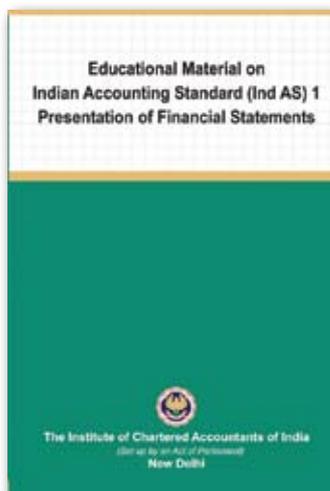
The Publication (s) can be obtained from the sales counters at the Head Office or at the Regional Office of the Institute. To order by post, requisition may be sent to the Postal Sales Department of the ICAI at postalsales@icai.org or postalsales@icai.in.



New Publications

Educational Material on Indian Accounting Standard (Ind AS) 1, Presentation of Financial Statements

In accordance with the objective to provide necessary support and guidance to members and other stakeholders for proper implementation of IFRS-converged Indian Accounting Standards, the **Ind AS (IFRS) Implementation Committee** has brought out Educational Material on Indian Accounting Standard (Ind AS) 1, *Presentation of Financial Statements*.



Ind AS 1 prescribes the overall requirement for the presentation of financial statements and guidelines for their structure. This publication contains summary of Ind AS 1 discussing the key requirements of the Standard in brief and Frequently Asked Questions (FAQs) on issues which are expected to be encountered while implementing this Standard. The text of Indian Accounting Standard (Ind AS) 1, *Presentation of Financial Statements*, has also been included as an Appendix to make this publication comprehensive.

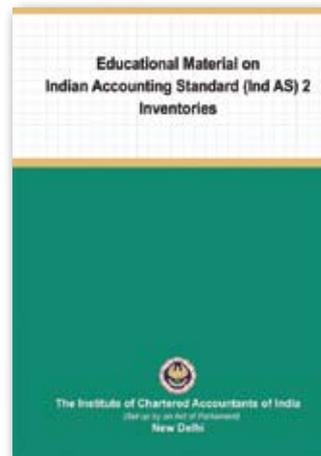
Price: ₹ 100/-

Ordering information

The publication can be purchased directly from the Sales Counters at the ICAI's Regional Offices or at the Head Office. To order by post, requisition may be sent to the Postal Sales Department of ICAI at postalsales@icai.org or postalsales@icai.in

Educational Material on Indian Accounting Standard (Ind AS) 2, Inventories

The **Ind AS (IFRS) Implementation Committee** of the Institute of Chartered Accountants of India has issued Educational Material on Indian Accounting Standard (Ind AS) 2, *Inventories* to provide guidance on the Standard for its proper implementation. Ind AS 2 prescribes the accounting treatment for inventories, such as, measurement of inventories, recognition of inventories as



expense and disclosures etc. The purpose of this Educational Material is to provide guidance for proper implementation of the Standard by way of Frequently Asked Questions (FAQs). This Educational Material contains summary of Ind AS 2 and the Frequently Asked Questions (FAQs) on Ind AS 2. The text of Indian Accounting Standard (Ind AS) 2, *Inventories*, and differences between Ind AS 2, *Inventories* and AS 2, *Valuation of Inventories* have been included to make this publication comprehensive.

Price: ₹ 50/-

Ordering information

The publication can be purchased directly from the Sales Counters at the ICAI's Regional Offices or at the Head Office. To order by post, requisition may be sent to the Postal Sales Department of ICAI at postalsales@icai.org or postalsales@icai.in



New Publications

Fiscal Responsibility and Budget Management Act: A Review of the Performance of Enacted States

The Fiscal Responsibility and Budget Management Act-2003 is in place for around eight years now. The objective of the Act is to ensure inter-generational equity in fiscal management, long run macroeconomic stability, better coordination between fiscal and monetary policy and transparency in fiscal operation of the Government. The Committee on Public Finance & Government Accounting of ICAI has prepared a publication on “**Fiscal Responsibility and Budget Management Act: A Review of the Performance of Enacted States**” with a view to highlight Fiscal



Responsibility and Budget Management Rules and performance of various States with regard to FRBM.

Price : ₹100/-

Ordering Information

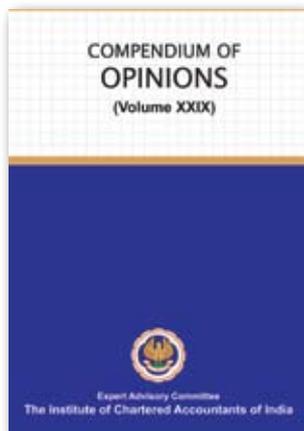
The Publication can be purchased directly from the Sales Counter at the ICAI's Head Office or at the Regional Offices of the Institute. To order by post please send a demand draft for the amount of price of the publication (plus postage charges as per the desired mode of delivery) in favour of “**The Secretary, The Institute of Chartered Accountants of India, New Delhi**”, payable at new Delhi to the Postal Sales Department, The Institute of Chartered Accountants of India, ICAI Bhawan, A-29, Sector-62, Noida-201 309.

Postal Charges

- Courier (NCR): ₹8/-
- Courier (Rest of India): ₹16/-
- Registered Post: ₹36/-
- Unregistered Post: ₹19/-

Compendium of Opinions - Volume XXIX (February 2009 – January 2010)

The Expert Advisory Committee of the Institute of Chartered Accountants of India has published Compendium of Opinions, Volume XXIX including a CD of Compendium of Opinions. This Volume of Compendium of Opinions contains opinions finalised by the Expert Advisory Committee during the period February 2009 to January 2010 and the CD contains opinions finalised by the Expert Advisory Committee upto January 2010 as contained in Volume I to Volume XXIX.



- Treatment of preliminary expenses incurred on incorporation of a company
- Provision for sick leave benefit
- Accounting for insurance claim

The salient features of the CD are as follows:

- User-friendly features with search facility for locating opinions on the desired subject(s).
- Contains around 1200 opinions on diverse subjects related to accounting and/or auditing principles and allied matters, issued by the Committee since its inception.
- Contains Advisory Service Rules, in accordance with which the Committee answers the queries received from the members of the Institute.

The opinions are based on the facts and circumstances of each case as presented to the Committee, and the accounting/auditing principles and practices and the relevant laws applicable on the dates the Committee finalised the respective opinions.

Price: ₹300/-

Ordering Information

The publication can be purchased directly from the sales counters at ICAI's Regional Offices or at Head Office. To order by post, requisition may be sent to the Postal Sales Department of ICAI at postalsales@icai.org or postalsales@icai.in

The subjects of the opinions contained in this volume include:

- Transfer price for the purpose of segment reporting
- Accounting treatment of licence fee and technical know-how fee
- Treatment of exchange effects (gains/losses) from foreign currency transactions
- Revenue recognition
- Deferred tax assets
- Capitalisation of expenditures in respect of projects under construction



Invitation for Contribution of Questions for ISA-AT Question Bank

The Information Systems Audit Assessment Test (ISA-AT) is an objective type test having multiple choices and contains 200 questions carrying 200 marks. The time allowed for answering 200 questions is four hours. The aforesaid Test is meant for the members of the Institute to enable them to develop understanding in the field of Information Systems Audit.

With a view to develop the Question Bank for the various Modules spread over the Syllabus of the ISA-AT, it has been decided to invite questions from Chartered Accountants/experts working in various organisations/institutions. The titles of these Modules prescribed in the Syllabus are given hereunder:

Module No.	Module Title
1.	Information Technology Infrastructure & Communication/Networking Technology
2.	Protecting Information Assets
3.	Systems Development. Life Cycle & Application Details
4.	Business Continuity Planning
5.	Information Systems Organisation & Management
6.	Information Systems Control & Audit Process

The contributor can contribute as many questions as he/she can, but in a lot of minimum of 50 questions on the aforesaid modules in the following manner:-

Name of the module:

Q.No.	Question and answer options	Answer (For example)
01	Question description..... A) Option A B) Option B C) Option C D) Option D	C
02		
.....		
50		

While framing the questions, the contributors have to prepare the questions for individual modules in separate files/documents. The questions should cover all the sub chapters or aspects of the syllabus and be free from any ambiguity, doubt etc. The question should convey the same meaning which you intend to convey. It is also essential that proper care is taken in framing the questions and options (answers) provided below the questions. The solution (correct answer) to each option (answer) given as per the above format.

The copyrights of the questions as well as answers so submitted shall vest with the Council of the Institute. The contributor of the questions shall ensure that the questions so submitted to the Institute are not parted with by him/her to any other Body/Person and shall be meant only for the exclusive use by the Council of the Institute.

It may please be noted that the questions framed by you should be original and not already published in some books or journals or study material of the Institute or reference/text books available in the market or also from question papers of any other examinations or material distributed by any coaching institution. The requirement is the questions that are original and framed with the meticulous care and genuinely.

For each question framed and forwarded and accepted by the Council of the Institute for developing a Question Bank of ISA-AT, ₹500/- per question selected/accepted will be paid as honorarium. In addition to honorarium payable towards questions selected, ₹100/- (fixed) will be paid for other services also. The questions may be sent in a sealed envelope superscribed "Question Bank – ISA-AT" to Shri G. Somasekhar, Additional Secretary (Exams), The Institute of Chartered Accountants of India, "ICAI Bhawan", Indraprastha Marg, New Delhi – 110002 by name or by e-mail to exam.development@icai.in. While sending the questions by post/mail, please mention your name and complete postal address alongwith contact details including mobile number. All correspondence on the subject should be treated as secret.

Interested persons may kindly contribute to the Question Bank of ISA-AT.

(G. Somasekhar)
Additional Secretary (Exams.)





Contribution to the Question Bank of CPT

The Common Proficiency Test (CPT) is an entry level test meant for 10+2 students to the Chartered Accountancy Profession having multiple choice objective questions. The level of knowledge expected is basic knowledge with the objective to develop conceptual understanding of the subject concerned.

With a view to augment the Question Bank in the Subjects of Accounting/Mercantile Laws/General Economics/Quantitative Aptitude of Common Proficiency Test, it has been decided to invite questions from Chartered Accountants/Subject experts working in various Colleges/Universities/Public/Students pursuing Chartered Accountancy Course etc.

The contributor can contribute as many questions as he/she can, but in a lot of minimum of 20 questions in the subjects of Accounting/Mercantile Laws/General Economics/Quantitative Aptitude in the following manner:-

- The questions should be of objective with four probable answers for each question. The correct answer for each question is also required to be given.
- Fill in the blanks having four alternative answers.
- Small paragraph containing two to three lines followed by a question having four alternative answers.
- Numerical having four alternative answers (in Fundamentals of Accounting, Mathematics and Statistics).
- Simply worded Case studies involving multiple concepts be also prepared. The case study could be something like a practical situation described in 3 to 4 lines in simple language with application of single/multiple concepts and requiring students to choose one answer from amongst four answers whereby the analytical/

logical ability and intelligence of the students is tested.

Since the CPT is an entry level Test meant for 10+2 students, the level of knowledge expected is basic knowledge and the questions should be aimed at testing the conceptual understanding and fundamentals of the subject than merely testing the memory of candidates. The difficulty level of the questions should be of 10+2 level and capable of being answered/solved in less than one minute.

While framing the questions, the questions be framed in such a manner that each one of the four answers given for a particular question, per se, appear to be the right answer thereby requiring the candidate to use his analytical ability to find the correct answer.

- The language of the questions to be sent should be English only and is clear, correct, unambiguous and free from any doubt. The language conveys the same meaning as was intended by you.
- The copyrights of the questions so submitted shall vest with the Council of the Institute. The contributor of the questions shall ensure that the questions so submitted to the Institute are not parted with by him/her to any other Body/Person and shall be meant only for the exclusive use by the Council of the Institute.
- **It may please be noted that the questions framed by you should be original and not already published in some books or journals or study material of the Institute or reference/**

text books available in the market or also from question papers of any other examinations or material distributed by any coaching institution. The requirement is the questions that are original and framed with the meticulous care and genuinely.

- For each question framed and forwarded and accepted by the Council of the Institute for augmentation of the Question Bank of CPT, ₹250/- per question selected/accepted will be paid as honorarium. In addition to honorarium payable towards questions selected, ₹100/- (fixed) will be paid for other services also. The questions may be sent in a sealed envelope superscribed "Question Bank – CPT" to Shri G. Somasekhar, Additional Secretary (Exams), The Institute of Chartered Accountants of India, Indraprastha Marg, New Delhi – 110002 by name or by e-mail to exam.development@icai.in. While sending the questions by post/mail, please mention your name and complete postal address alongwith contact details including mobile number. All correspondence on the subject should be treated as secret.

Interested persons may kindly contribute to the Question Bank of CPT.

(G. Somasekhar)
Additional Secretary (Exams)



Setting up of WICASA Branch at Navi Mumbai

In pursuance of Regulation 81(5) of the Chartered Accountants Regulations, 1988, read with Rule 4 of the Chartered Accountants Students' Association Rules (as contained in Appendix No. (5) to the Chartered Accountants Regulation 1988), the Council of the Institute of Chartered Accountants of India is pleased to announce the setting up of Branch of Western India Chartered Accountants Students' Association (WICASA) at Navi Mumbai with effect from February 1, 2012.

The Branch shall be known as Navi Mumbai Branch of WICASA.

As prescribed under Rule 4(b), of the Chartered Accountants Students' Association Rules, the Branch

shall, at all time function subject to the control, supervision and direction of the Central Council, exercised through the Regional Council or the Regional Students' Association and shall be governed by the directions issued by the Central Council from time to time, for the functioning of the Branches of Students' Association or such other directions that may be issued from time to time.

Sd/-

(T. Karthikeyan)
Secretary





Classifieds

- 4897 Kochi based firm of Chartered Accountants with corporate audits require young/experienced CAs. Selected candidates will have excellent exposure to Company/Tax/IS Audit and Consultancy and be groomed to eventually become partners of the firm. Please mail your proposals to: babuakallivayalil@gmail.com
- 4898 Required partners to open branch preferably in Odisha. Retired members can apply. Contact to S. Kanungo, Flat No-24, Shila Mansion, Ratha Road, Bhubaneswar- 751002 or E-mail: ssahoo8998@gmail.com
- 4899 Chartered Accountant, 20 years experience in Indirect Tax at a senior position is now available to set up/ lead indirect tax practice in a mid size CA firm. Apply Box: 4899, C/o The Institute of Chartered Accountants of India, ICAI Bhawan, A-29, Sector-62, Noida-201309
- 4900 Available experienced CA partnership firm for conducting Bank Branches/Zonal offices and consolidations of current year at reasonable and confidential terms. Contact: glen.office@gmail.com/9920317933/9322249414/26845318/26845319.
- 4901 A 49 year old CA, CS with 24 years industry experience wishes to enter the profession. Firms desirous of engaging a partner or equivalent based at Kolkata are requested to call 9831611600 or write to dk_g@rediffmail.com
- 4902 Guwahati based CA Firm seeks assignments in sales tax/income tax/service tax/audit/other professional services for mutual benefit. Contact: 9864857565, mohanagarwalca@gmail.com
- 4903 Recently qualified CA with C.I.S.A. qualification intends to work on assignment /subcontract basis with the existing CA/CA firm at Hyderabad. Contact: 07299076836.
- 4904 FCA, PGDBMA (XLRI) DISA with 35 years experience in Industry and Profession interested in joining as partner in a firm in Jaipur or partnership. firm planning to open an office here having experience in Internal Audit Corporate Audit, Bank Audit and Consultancy in Steel Industry. Contact R. Khandelwal at randhirkhandelwal@gmail.com Mob No 919950997700.





Invitation to Join Panel of Examiners

The Institute is in the process of strengthening its panel of examiners with professionals/academicians/resource persons for all the papers in CA IPCE and Final (New Course) Examinations in general and for the following subjects in particular:

- 1.Strategic Financial Management
- 2.Advanced Auditing and Professional Ethics
- 3.Advanced Management Accounting
- 4.Information Systems Control and Audit
- 5.Direct Tax Laws
- 6.Indirect Tax Laws
- 7.Taxation
- 8.Business Law, Communication and Ethics

9.Information Technology

Persons who have the requisite proficiency in the above subjects, inclination for evaluation of answer books and who can spare time may send in the Empanelment Form duly filled in to the Sr. Deputy Director (Exams), The Institute of Chartered Accountants of India, ICAI Bhawan, Indraprastha Marg, New Delhi – 110002. The form may be obtained by sending a request letter or in the alternative, downloaded by clicking on to link <http://220.227.161.86/15857ExaminersEmpanelmentForm.pdf>



Non-Receipt of Journal

This is for the information of Members/students/subscribers who fail to receive *The Chartered Accountant* journal despatched to them either due to unanticipated change of address or postal problems. Please inform the respective Regional Office immediately after you change the address to ensure

regular and timely delivery of journals to you. Other queries and complaints in this regard can also be sent by email at journal@icai.org (for members), eb@icai.org (for students) or contact at 0120-3045921.



Invitation for Empanelment of Resource Persons for Investor Awareness Programmes

The Committee on Financial Markets and Investor's Protection (CFM&IP) is one of the Non-Standing Committees of the Institute. The functions of the Committee include spreading awareness among the investor about their rights and responsibilities besides preparing suggestions on various Regulations/Circulars relating to Financial Markets for submission to the Government/Regulators.

We are pleased and proud to state that the Institute of Chartered Accountants of India has been designated as the nodal authority by the Ministry of Corporate Affairs, Government of India to organise 4000 Investor Awareness Programmes across India through the Institute's vast network of Regional Councils and Branches during the year 2011-2012.

The Committee invites proposals from Chartered Accountants, Bankers, Capital Market experts, MBAs, professors and teachers having a flair of capital market and public speaking skills for acting as Resource Persons for conducting the aforesaid programmes.

The resource persons have to plan and organise

such programmes of two hours duration in small towns (other than district headquarters) at their own initiative. Arranging venue, assembling at least 50 participants per programme and disseminating financial literacy will be their key responsibilities. For this, MCA will pay a lump sum amount of ₹5,000/- per programme inclusive of TA/DA and honorarium of the Resource Person.

Interested persons are requested to send their detailed profile along with name of the towns where they can conduct programmes to the following address:

The Chairman,
Committee on Financial Markets and Investors' Protection
The Institute of Chartered Accountants of India,
A-29, Sector 62,
Noida 201309
Ph: 09350799912, 0120-3045905/945
E-Mail: cfmip_rp@icai.org

Guidance Note on Accounting for Real Estate Transactions (Revised 2012)

(The following is the text of the Guidance Note on Accounting for Real Estate Transactions, issued by the Council of the Institute of Chartered Accountants of India.)

1. Objective and Scope

Objective

1.1. The objective of this Guidance Note is to recommend the accounting treatment by enterprises dealing in 'Real Estate' as sellers or developers. The term 'real estate' refers to land as well as buildings and rights in relation thereto. Enterprises who undertake such activity are generally referred to by different terms such as 'real estate developers', 'builders' or 'property developers'.

Scope

1.2. This Guidance Note covers all forms of transactions in real estate. An illustrative list of transactions which are covered by this Guidance Note is as under:

- (a) Sale of plots of land (including long term sale type leases) without any development.
- (b) Sale of plots of land (including long term sale type leases) with development in the form of common facilities like laying of roads, drainage lines and water pipelines, electrical lines, sewage tanks, water storage tanks, sports facilities, gymnasium, club house, landscaping etc.
- (c) Development and sale of residential and commercial units, row houses, independent houses, with or without an undivided share in land.
- (d) Acquisition, utilisation and transfer of development rights.
- (e) Redevelopment of existing buildings and structures.
- (f) Joint development agreements for any of the above activities.

1.3 The Guidance Note primarily provides guidance on application of percentage of completion method where it is appropriate to apply this method as explained in subsequent paragraphs as such transactions and activities of real estate have the same economic substance as construction contracts. For this purpose, the Guidance Note draws upon the principles enunciated in Accounting Standard (AS) 7, *Construction Contracts*. In respect of transactions of real estate which are in substance similar to delivery of goods principles enunciated in Accounting Standard (AS) 9, *Revenue Recognition*, are applied.

1.4 Real estate transactions of the nature covered by Accounting Standard (AS) 10, *Accounting for Fixed Assets*, Accounting Standard (AS) 12, *Accounting for Government Grants*, Accounting Standard (AS) 19, *Leases*, and Accounting Standard (AS) 26, *Intangible Assets*, are outside the scope of this Guidance Note.

1.5 This Guidance Note should be applied to all projects in real estate which are commenced on or after April 1, 2012

and also to projects which have already commenced but where revenue is being recognised for the first time on or after April 1, 2012. An enterprise may choose to apply this Guidance Note from an earlier date provided it applies this Guidance Note to all transactions which commenced or were entered into on or after such earlier date. This Guidance Note supersedes the Guidance Note on Recognition of Revenue by Real Estate Developers, issued by the Institute of Chartered Accountants of India in 2006, when this Guidance Note is applied as above.

2. Definitions

2.1 Project – Project is the smallest group of units/plots/saleable spaces which are linked with a common set of amenities in such a manner that unless the common amenities are made available and functional, these units/plots / saleable spaces cannot be put to their intended effective use.

A larger venture can be split into smaller projects if the basic conditions as set out above are fulfilled. For example, a project may comprise a cluster of towers or each tower can also be designated as a project. Similarly, a complete township can be a project or it can be broken down into smaller projects.

2.2 Project Costs – Project costs in relation to a project ordinarily comprise

- (a) *Cost of land and cost of development rights* -All costs related to the acquisition of land, development rights in the land or property including cost of land, cost of development rights, rehabilitation costs, registration charges, stamp duty, brokerage costs and incidental expenses.
- (b) *Borrowing Costs* – In accordance with Accounting Standard (AS) 16, *Borrowing Costs* which are incurred directly in relation to a project or which are apportioned to a project.
- (c) *Construction and development costs* – These would include costs that relate directly to the specific project and costs that may be attributable to project activity in general and can be allocated to the project.

2.3 Construction costs and development costs that relate directly to a specific project include

- (a) land conversion costs, betterment charges, municipal sanction fee and other charges for obtaining building permissions;
- (b) site labour costs, including site supervision;
- (c) costs of materials used in construction or development of property;
- (d) depreciation of plant and equipment used for the project;
- (e) costs of moving plant, equipment and materials to and from the project site;
- (f) costs of hiring plant and equipment;

- (g) costs of design and technical assistance that is directly related to the project;
 - (h) estimated costs of rectification and guarantee work, including expected warranty costs; and
 - (i) claims from third parties.
- 2.4 The following costs should not be considered part of construction costs and development costs if they are material:
- (a) General administration costs;
 - (b) selling costs;
 - (c) research and development costs;
 - (d) depreciation of idle plant and equipment;
 - (e) cost of unconsumed or uninstalled material delivered at site; and
 - (f) payments made to sub-contractors in advance of work performed.
- 2.5 Costs that may be attributable to project activity in general and can be allocated to specific projects include:
- (a) insurance;
 - (b) costs of design and technical assistance that is not directly related to a specific project;
 - (c) construction or development overheads; and
 - (d) borrowing costs.

Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of project activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll.

- 2.6 **Project revenues** – Project revenues include revenue on sale of plots, undivided share in land, sale of finished and semi-finished structures, consideration for construction, consideration for amenities and interiors, consideration for parking spaces and sale of development rights. Project revenues are measured as the consideration received or receivable. The measurement of project revenues is affected by a variety of uncertainties that depend on the outcome of future events. The estimates often need revision as events occur and uncertainties are resolved. Therefore, the amount of project revenue may increase or decrease from one reporting period to the next.

3. Accounting for Real Estate Transactions

- 3.1 Real estate activities and transactions take diverse forms. While some are for sale of land (developed or undeveloped), others are for construction, development or sale of units that are not complete at the time of entering into agreements for construction, development or sale.
- 3.2 The typical features of most construction/development of commercial and residential units have all features of a construction contract – land development, structural engineering, architectural design and construction are all present. The natures of these activities are such that often the date when the activity is commenced and the date when the activity is completed usually fall into different accounting periods. It is not unusual for such activities to spread over two or more accounting periods.
- 3.3 For recognition of revenue in case of real estate sales,

it is necessary that all the conditions specified in paragraphs 10 and 11 of Accounting Standard (AS) 9, *Revenue Recognition*, are satisfied. As stated above, real estate sales take place in a variety of ways and may be subject to different terms and conditions as specified in the agreement for sale. Accordingly, the point of time at which all significant risks and rewards of ownership can be considered as transferred, is required to be determined on the basis of the terms and conditions of the agreement for sale. In case of real estate sales, the seller usually enters into an agreement for sale with the buyer at initial stages of construction. This agreement for sale is also considered to have the effect of transferring all significant risks and rewards of ownership to the buyer provided the agreement is legally enforceable and subject to the satisfaction of conditions which signify transferring of significant risks and rewards even though the legal title is not transferred or the possession of the real estate is not given to the buyer. Once the seller has transferred all the significant risks and rewards to the buyer, any acts on the real estate performed by the seller are, in substance, performed on behalf of the buyer in the manner similar to a contractor. Accordingly, revenue in such cases is recognised by applying the percentage of completion method on the basis of the methodology explained in AS 7, *Construction Contracts*. Further, where individual contracts are part of a single project, although risks and rewards may have been transferred on signing of a legally enforceable individual contract but significant performance in respect of remaining components of the project is pending, revenue in respect of such an individual contract should not be recognised until the performance on the remaining components is considered to be completed on the basis of the aforesaid principles. This Guidance Note, thus, provides guidance in the application of:

- Principles of AS 9 in respect of sale of goods for recognising revenue, costs and profits from transactions of real estate which are in substance similar to delivery of goods where the revenues, costs and profits are recognised when the revenue recognition process is completed; and
 - Percentage completion method for recognising revenue, costs and profits from transactions and activities of real estate which have the same economic substance as construction contracts.
- 3.4 The application of the methods described in paragraph 3.3 above requires a careful analysis of the elements of the transaction, agreement, understanding and conduct of the parties to the transaction to determine the economic substance of the transaction. The economic substance of the transaction is not influenced or affected by the structure and/or legal form of the transaction or agreement.

4. Application of principles of AS 9 in respect of sale of goods to a real estate project

- 4.1 The application of principles of AS 9 in respect of sale of goods requires recognition of revenues on completion

of the transaction/activity when the revenue recognition process in respect of a real estate project is completed as explained in paragraph 4.2 below.

- 4.2 The completion of the revenue recognition process is usually identified when the following conditions are satisfied:
- The seller has transferred to the buyer all significant risks and rewards of ownership and the seller retains no effective control of the real estate to a degree usually associated with ownership;
 - The seller has effectively handed over possession of the real estate unit to the buyer forming part of the transaction;
 - No significant uncertainty exists regarding the amount of consideration that will be derived from the real estate sales; and
 - It is not unreasonable to expect ultimate collection of revenue from buyers.
- 4.3 Where transfer of legal title is a condition precedent to the buyer taking on the significant risks and rewards of ownership and accepting significant completion of the seller's obligation, revenue should not be recognised till such time legal title is validly transferred to the buyer

5. Application of Percentage Completion Method

- 5.1 The percentage completion method should be applied in the accounting of all real estate transactions/activities in the situations described in paragraph 3.3 above, i.e., where the economic substance is similar to construction contracts. Some further indicators of such transactions/activities are:
- The duration of such projects is beyond 12 months and the project commencement date and project completion date fall into different accounting periods.
 - Most features of the project are common to construction contracts, viz., land development, structural engineering, architectural design, construction, etc.
 - While individual units of the project are contracted to be delivered to different buyers these are interdependent upon or interrelated to completion of a number of common activities and/or provision of common amenities.
 - The construction or development activities form a significant proportion of the project activity.
- 5.2 This method is applied when the outcome of a real estate project can be estimated reliably and when all the following conditions are satisfied:
- total project revenues can be estimated reliably;
 - it is probable that the economic benefits associated with the project will flow to the enterprise;
 - the project costs to complete the project and the stage of project completion at the reporting date can be measured reliably; and
 - the project costs attributable to the project can be clearly identified and measured reliably so that actual project costs incurred can be compared with prior estimates.

When the outcome of a project can be estimated reliably, project revenues and project costs associated with the project should be recognised as revenue and expenses respectively applying the percentage of completion method in the manner detailed in paragraphs 5.3 to 5.8 below.

- 5.3 Further to the conditions in paragraph 5.2 there is a rebuttable presumption that the outcome of a real estate project can be estimated reliably and that revenue should be recognised under the percentage completion method only when the events in (a) to (d) below are completed.
- All critical approvals necessary for commencement of the project have been obtained. These include, wherever applicable:
 - Environmental and other clearances.
 - Approval of plans, designs, etc.
 - Title to land or other rights to development/construction.
 - Change in land use
 - When the stage of completion of the project reaches a reasonable level of development. A reasonable level of development is not achieved if the expenditure incurred on construction and development costs is less than 25 % of the construction and development costs as defined in paragraph 2.2 (c) read with paragraphs 2.3 to 2.5.
 - At least 25% of the saleable project area is secured by contracts or agreements with buyers.
 - At least 10 % of the total revenue as per the agreements of sale or any other legally enforceable documents are realised at the reporting date in respect of each of the contracts and it is reasonable to expect that the parties to such contracts will comply with the payment terms as defined in the contracts. To illustrate - If there are 10 Agreements of sale and 10 % of gross amount is realised in case of 8 agreements, revenue can be recognised with respect to these 8 agreements.
- 5.4 When the outcome of a real estate project can be estimated reliably and the conditions stipulated in paragraphs 5.2 and 5.3 are satisfied, project revenue and project costs associated with the real estate project should be recognised as revenue and expenses by reference to the stage of completion of the project activity at the reporting date. For computation of revenue the stage of completion is arrived at with reference to the entire project costs incurred including land costs, borrowing costs and construction and development costs as defined in paragraph 2.2. Whilst the method of determination of stage of completion with reference to project costs incurred is the preferred method, this Guidance Note does not prohibit other methods of determination of stage of completion, e.g., surveys of work done, technical estimation, etc. However, computation of revenue with reference to other methods of determination of stage of completion should not, in any case, exceed the revenue computed with reference to the 'project costs incurred' method. Illustration appended to this Guidance Note clarifies the method of computation of revenue.

- 5.5 The project costs which are recognised in the statement of profit and loss by reference to the stage of completion of the project activity are matched with the revenues recognised resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed. Costs incurred that relate to future activity on the project and payments made to sub-contractors in advance of work performed under the sub-contract are excluded and matched with revenues when the activity or work is performed. This method provides useful information to the extent of contract activity and performance during a period.
- 5.6 The recognition of project revenue by reference to the stage of completion of the project activity should not at any point exceed the estimated total revenues from 'eligible contracts'/other legally enforceable agreements for sale. 'Eligible contracts' means contracts/agreements specified in paragraph 5.3 where at least 10% of the contracted amounts have been realised and there are no outstanding defaults of the payment terms in such contracts.
- 5.7 When it is probable that total project costs will exceed total eligible project revenues, the expected loss should be recognised as an expense immediately. The amount of such a loss is determined irrespective of:
- commencement of project work; or
 - the stage of completion of project activity.
- 5.8 The percentage of completion method is applied on a cumulative basis in each reporting period to the current estimates of project revenues and project costs. Therefore, the effect of a change in the estimate of project costs, or the effect of a change in the estimate of the outcome of a project, is accounted for as a change in accounting estimate. The changed estimates are used in determination of the amount of revenue and expenses recognised in the statement of profit and loss in the period in which the change is made and in subsequent periods.
- 5.9 The changes to estimates referred to in paragraph 5.8 above also include changes arising out of cancellation of contracts and cases where the property or part thereof is subsequently earmarked for own use or for rental purposes. In such cases any revenues attributable to such contracts previously recognised should be reversed and the costs in relation thereto shall be carried forward and accounted in accordance with AS 10, *Accounting for Fixed Assets*.

6. Accounting for sale of land or plots

A. Sale of plots of land without any development

Revenue from sale of land or plots should be recognised when all the conditions in paragraph 4.2 above are met.

B. Sale of developed plots

Where the development activity is significant and if the projects meet the criteria specified in paragraphs 3.3 and 5.1 above, the percentage completion method is used to account for such sales.

7. Transferable Development Rights

7.1 Transferable Development Rights (TDRs) are generally acquired in different ways as mentioned hereunder:

- Direct purchase.
- Development and construction of built-up area.
- Giving up of rights over existing structures or open land.

7.2 When development rights are acquired by way of direct purchase or on development or construction of built-up area, cost of acquisition would be the cost of purchases or amount spent on development or construction of built-up area, respectively. Where development rights are acquired by way of giving up of rights over existing structures or open land, the development rights should be recorded either at fair market value or at the net book value of the portion of the asset given up whichever is less. For this purpose, fair market value may be determined by reference either to the asset or portion thereof given up or to the fair market value of the rights acquired whichever is more clearly evident.

7.3 When development rights are utilised in a real estate project by an enterprise, the cost of acquisition should be added to the project costs.

7.4 When development rights are sold or transferred, revenue should be recognised when both the following conditions are fulfilled:

- title to the development rights is transferred to the buyer; and
- it is not unreasonable to expect ultimate realisation of revenue.

8. Transactions with multiple elements

8.1 An enterprise may contract with a buyer to deliver goods or services in addition to the construction/development of real estate [e.g. property management services, sale of decorative fittings (excluding fittings which are an integral part of the unit to be delivered), rental in lieu of unoccupied premises, etc.]. In such cases, the contract consideration should be split into separately identifiable components including one for the construction and delivery of real estate units.

8.2 The consideration received or receivable for the contract should be allocated to each component on the basis of the fair market value of each component.

8.3 The accounting of each of the components should be in accordance with paragraph 3.3 above.

9. Disclosure

9.1 An enterprise should disclose:

- the amount of project revenue recognised as revenue in the reporting period;
- the methods used to determine the project revenue recognised in the reporting period; and
- the method used to determine the stage of completion of the project.

9.2 An enterprise should also disclose each of the following for projects in progress at the end of the reporting period:

- the aggregate amount of costs incurred and profits recognised (less recognised losses) to date;

- the amount of advances received;
- the amount of work in progress and the value of inventories; and
- Excess of revenue recognised over actual bills raised (unbilled revenue).

Illustration on application of percentage completion method

Total saleable area	20,000 Sq. ft.
Estimated Project Costs (This comprises land cost of ₹300 Lakhs and construction costs of ₹300 Lakhs)	₹ 600 lakhs
Cost incurred till end of reporting period (This includes land cost of ₹300 Lakhs and construction cost of ₹60 Lakhs)	₹360 Lakhs
Total Area Sold till the date of reporting period	5,000 Sq. ft.
Total Sale Consideration as per Agreements of Sale executed	₹200 Lakhs
Amount realised till the end of the reporting period	₹50 Lakhs
Percentage of completion of work	60% of total project cost including land cost or 20% of total construction cost

At the end of the reporting period the enterprise will not be able to recognise any revenue as reasonable level of construction, which is 25% of the total construction cost, has not been achieved, though 10% of the agreement amount has been realised.

Continuing the illustration

If the work completed till end of reporting period is (This includes land cost of ₹300 Lakhs and construction cost of ₹90 Lakhs)	₹390 Lakhs
Percentage of completion of work would be	65% of total project cost including land cost or 30% of construction cost

The enterprise would be able to recognise revenues at the end of the accounting period. The revenue recognition and profits would be as under:

Revenue recognised (65 % of ₹200 Lakhs as per Agreement of Sale)	₹ 130 Lakhs
Proportionate cost (5000 sq.ft./20,000 sq.ft.) X 390	₹97.50 Lakhs
Income from the project	₹32.50 Lakhs
Work in progress to be carried forward	₹292.50 Lakhs

Guidance Note on Accounting for Rate Regulated Activities

(The National Advisory Committee on Accounting Standards (NACAS) constituted under the Companies Act, 1956, by the Ministry of Corporate Affairs, while considering Indian Accounting Standards converged with IFRS, suggested that the Institute of Chartered Accountants of India (ICAI) may issue a Guidance Note to address accounting issues for rate regulated entities. Since, accounting for rate regulated activities would be relevant in the context of the existing notified Accounting Standards also, the following text of the Guidance Note has been formulated by the Council of ICAI in that context. The Guidance Note will be considered by the NACAS as it may require modification in the relevant Accounting Standards where and to extent the accounting treatment of such activities is affected by this Guidance Note. Accordingly, the Guidance note will be effective from a date to be announced later.)

Introduction Background

1. Regulation of different economic activities through bodies established under statute or otherwise can be found in many countries. The object of regulation is typically to promote the orderly growth and development of the regulated industry, protect the interests of consumers, regulate competition, monitor social and environmental issues within the industry etc. Regulation of utilities like telecommunication, electricity and water often aims to control prices, ensure service quality, protect the environment and establish an investment environment capable of attracting capital at reasonable cost. In India we have different bodies such as the Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Central Electricity Regulatory Commission, State Electricity Regulatory Commissions, Directorate General of Hydrocarbons (DGH), Telecom Regulatory Authority of India etc., for regulating different sectors.
2. Regulation can take many forms depending upon the industry and objectives to be achieved. Rate regulation is one of the main forms of regulation often found in the utility sector or in sectors dealing with 'public goods' or other important goods and services. For example, in India, electricity prices are regulated by the CERC/SERCs, fertilizer prices and highway tolls are regulated by the Government.

Framework for Rate Regulation

3. A key aspect of rate regulation is that the regulator is empowered to determine prices that bind the entity's customers under a statute or otherwise. Regulatory authorities are usually set up under a legislation which stipulates their constitution, functions, powers etc. While such legislation may provide the general guidelines and considerations for determination of tariffs, the regulatory authority decides the particular methodology to be adopted for tariff setting which is notified through regulations or rules. The regulator from time to time issues orders for tariff setting in individual cases which provide further guidance on the implementation of the

notified regulations and rules. The legislation, regulations, rules and tariff orders provide the entity with the framework for charging the customers for the regulated goods and services.

4. Entities subject to price regulation are not allowed to charge prices for regulated goods or services other than those approved by the regulatory authority. In those circumstances, the regulator acts on behalf of the customers who individually would have no bargaining power with the entity. The regulator also acts on behalf of the entity. Agreements between a rate-regulated entity and its customers cannot be understood without reference to the regulation in place. Therefore, it can be said that such agreements are different from the agreements between an entity and its customers in a non-regulated environment.

Methods and Process of Rate Regulation

5. There are several basic methods for rate regulation and in each case, the application of a particular methodology may vary with the regulator, the entity being regulated and the circumstances faced. Some of the forms of rate regulation are cost of service regulation, price-cap mechanisms or a hybrid methodology featuring combinations of price cap and cost-of-service approaches.
6. Under the cost-of-service regulation (also referred to as return-on-rate-base regulation) rates are set to give the entity the opportunity to recover its costs of providing the good or service plus a fair return. Under price cap regulation, the regulator caps the rates at which the entity can charge for the goods or services. In such cases, while the initial rates may reflect the cost of service, subsequent increases or decreases may be made in accordance with a formula.
7. The regulators may adopt several approaches for cost-of-service regulation. The regulator may stipulate the various costs which can be covered under the tariff, the admissible rate of return and the mechanism for recovery of the tariffs. Alternatively, the regulator establishes the revenues required to cover the expected cost of providing the regulated service, including a fair return on the investment in the regulated operations. This amount is called the "revenue requirements". The regulator then sets rates that will provide the entity with a reasonable opportunity to recover its revenue requirement.
8. Not all costs that an entity incurs are automatically recoverable from its customers. Regulators typically review entities' costs to ensure that they were appropriately incurred to provide the regulated service and were 'prudent'. When a regulator decides that a cost was not prudently incurred, it may disallow all or part of the cost, thereby reducing (or eliminating) any future recovery of that cost. Consequently, a cost must be permitted by the regulator to be included in the determination of rates. In cost-of-service regulation, such costs are the actual

or estimated costs for which revenue is intended to provide recovery and include costs of debt and a reasonable return on shareholders' investments.

9. Cost-of-service rate-making does not necessarily equal a one-for-one pass-through of all costs. Regulations enable for rate fixation which provides that the entity will recover its costs using reasonable assumptions regarding demand as well as normal expenditures. The regulator to promote efficiencies may stipulate performance norms for recovery of some costs or may provide recovery of some elements of cost as per norms while other elements are recovered at actuals. For example, tariff regulations issued by many of the SERCs in the electricity sector in India classify costs into 'controllable' and 'uncontrollable' costs and provide for adjustment of tariffs for the 'uncontrollable costs' during 'truing up' process while variations in the 'controllable costs' are to be borne by the entity. In some cases, the regulators also prescribe a formula for sharing efficiency gains between the entity and the customers, such as the gains on account of reduction in distribution losses etc.
10. The regulatory mechanism provides for a rate review or 'truing up' exercise at periodic intervals to adjust the rates, downward or upward, to ensure recovery of costs and a reasonable return on investment. For 'truing up' of the initially determined rates, the entity provides the regulator with details of actual costs, capital expenditure etc., based on audited accounts and other supporting evidence. The regulator reviews the details of actual costs provided by the entity and may also provide opportunity to other stakeholders to submit their comments on the entity's application for rate review. Upon such review, the regulator determines the additional costs which can be recovered by the entity or amounts which need to be refunded to the customers.
11. Following the truing up exercise, the regulator usually adjusts the rates to be charged from customers so as to ensure recovery of additional costs or refund of amounts, as the case may be. The regulators may also decide not to immediately adjust the rates due to various considerations, for example, to avoid rate fluctuations or to smooth out an increase in rates, and require the regulated entity to defer the recovery or refund of the difference between the expected and actual amount of those costs. This results in a portion of the costs (or cost savings) of one period being included or adjusted in the revenue of another period.

Objectives

12. This Guidance Note deals with the effects on an entity's financial statements of its operating activities that provide goods or services whose prices are subject to cost-of-service regulation.
13. The objectives of this Guidance Note are to recommend:
 - (i) the recognition of a regulatory asset or regulatory liability if the regulator permits the entity to recover specific previously incurred costs or requires it to refund previously collected amounts and to earn a specified return on its regulated activities by adjusting the prices it charges to its customers;
 - (ii) the measurement basis of a regulatory asset or regulatory liability both on initial recognition and at the end of each subsequent reporting period; and
 - (iii) the disclosures that identify and explain the amounts recognised in the entity's financial statements arising from a regulatory asset or regulatory liability and assist users of those financial statements to understand the nature and financial effects of its rate-regulated activities.

Scope

14. An entity should apply this 'Guidance Note' to its operating activities that meet the following criteria:
 - i. the regulator establishes the price the entity must charge its customers for the goods or services the entity provides, and that price binds the customers; and
 - ii. the price established by regulation (the 'rate') is designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specified return. The specified return could be a minimum or range and need not be a fixed or guaranteed return.
15. If regulation establishes different rates for different categories, such as different classes of customers or volumes purchased, the related operating activities of an entity are within the scope of this 'Guidance Note' provided that the regulator approves the definition and the rate for each of those categories and that all customers of the same category are bound by the same rate.
16. Activities of an entity which are subject to other forms of regulation are not covered by this Guidance Note. For example, the telecom sector in India, though regulated by the Telecom Regulatory Authority of India (TRAI), is not subject to price regulation which provides for recovery of entity specific costs plus a specified return. Similarly, some regulations determine rates based on targeted or assumed costs, for example industry averages, rather than the actual costs incurred or expected to be incurred by the entity. Activities regulated in this way are not within the scope of this Guidance Note.
17. Where the prices an entity charges its customers for the goods or services it provides are regulated according to a 'price cap', the entity cannot charge more than the set prices. Under such regulation the buyer is assured of the result while the supplier takes the risk and receives the rewards from additional effort or from the implementation of cost-reducing innovations. Though the prices are regulated and bind customers, this Guidance Note does not cover such activities because prices are not designed to recover the entity's specific costs to provide the goods or services.
18. Regulators may require a regulated entity to maintain its accounts in a form that permits the regulator to obtain the information needed for regulatory purposes. This Guidance Note does not address an entity's accounting for reporting to regulators (regulatory accounting).

19. Rate regulation may be applied to all or only a portion of an entity's activities. In some cases, an entity may have both regulated and non-regulated activities. In others, the entity may be permitted to negotiate rates individually with some customers. This Guidance Note applies only to the activities of an entity that meet the criteria set out in paragraph 14.
20. The entity should determine at the end of each reporting period whether its operating activities during the reporting period meet the criteria in paragraph 14 for application of this Guidance Note.

Definitions

21. The following terms are used in this Guidance Note with the meanings specified:
 - i. A **regulator** is an authorised body empowered by statute or by any government or any authorised agency of a government to set rates that binds an entity's customers.
 - ii. **Cost of Service** regulation is a form of regulation for setting an entity's prices (rates) in which there is a cause-and-effect relationship between the entity's specific costs and its revenues.
 - iii. A **regulatory asset** is an entity's right to recover fixed or determinable amounts of money towards incurred costs as a result of the actual or expected actions of its regulator under the applicable regulatory framework.
 - iv. A **regulatory liability** is an entity's obligation to refund or adjust fixed or determinable amounts of money as a result of actual or expected action of its regulator under the applicable regulatory framework.

Accounting issues arising from Rate Regulation

22. Rate regulation of an entity's business activities creates operational and accounting situations that would not have arisen in the absence of such regulation. With cost-of-service regulation, there is a direct link between the costs that an entity is expected to incur and its expected revenue as the rates are set to allow the entity to recover its expected costs. However, there could be a significant time lag between incurrence of costs by the entity and their recovery through tariffs. Recovery of certain costs may be provided for by regulation either before or after the costs are incurred. Rate regulations are enforceable and can create legal rights and obligations for the entity.
23. An issue therefore arises as to whether an entity should recognise in its financial statements the right to recover incurred costs or the obligation to refund amounts received for which costs have not been incurred through future tariff adjustments. Recognition of the right to recover incurred costs in the future or the obligation to refund amounts received in the financial statements of the entity would arise if they meet the definition of assets and liabilities as provided in the *Framework for the Preparation and Presentation of Financial Statements* issued by the Institute of Chartered Accountants of India.

Regulatory assets

24. The Framework, defines an 'asset' as follows:

"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."

In a cost-of-service regulation, the resource is the right conferred by the regulator whereby the costs incurred by the entity result in future cash flows. In such cases, incurrence of costs creates an enforceable right to set rates at a level that permits the entity to recover those costs, plus a specified return, from an aggregate customer base. For example, if the regulator has approved certain additions to be made by the entity in its assets base during the tariff period, which would be added to the asset base for tariff setting, the entity upon making such additions obtains the right to recover the costs and return as provided in the regulatory framework though the actual recovery through rates may take place in the future. While adjustment of future rates is the mechanism the regulator uses to implement its regulation, the right in itself is a resource arising as a result of past events and from which future cash inflows are expected.

25. The cause-and-effect relationship between an entity's costs and its rate-based revenue demonstrates that an asset exists. In this case, the entity's right that arises as a result of regulation relates to identifiable future cash flows linked to costs it previously incurred, rather than a general expectation of future cash flows based on the existence of predictable demand. The binding regulations/orders of the regulator for recovery of incurred costs together with the actual incurrence of costs by the entity would satisfy the definition of asset as per the Framework since the entity's right (to recover amounts through future rate adjustments) constitutes a resource arising as a result of past events (incurrence of costs permitted by the regulator for recovery from customers) from which future economic benefits are expected to flow (increased cash flows through rate adjustments).
26. As regards the 'control' criterion in the definition of an asset as per the Framework, it may be argued that though the entity has a right to recover the costs incurred, it does not control the same since it cannot force individual customers to purchase goods or services in future. In this regard, it may be mentioned that the rate regulation governs the entity's relationship with its customer base as a whole and therefore creates a present right to recover the costs incurred from an aggregate customer base. Although the individual members of that group may change over time, the relationship the regulator oversees is between the entity and the group. The regulator has the authority to permit the entity to set rates at a level that will ensure that the entity receives the expected cash flows from the customers' base as a whole. Further, the Framework states that control over the future economic benefits is sufficient for an asset to exist, even in the absence of legal rights. The key notion is that the entity has access to

a resource and can limit others' access to that resource which is satisfied in case of the right provided by the regulator to recover incurred costs through future rate adjustments. Any issues regarding recoverability of the amounts should not affect the recognition of the right in the financial statements though they certainly merit consideration in its measurement.

Regulatory liabilities

27. The Framework defines a liability as 'a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits'. In cost-of-service regulation, an obligation arises because of a requirement to refund to customers excess amounts collected in previous periods. In such cases, collecting amounts in excess of costs and the allowed return creates an obligation to return the excess collection to the aggregate customer base. For example, if the tariffs initially set assume a certain level of costs towards energy purchased but the actual costs incurred by the entity are less than such assumed levels, the entity would be obliged to make a refund following the 'truing up' exercise by the regulator. Such obligation is a present obligation relating to amounts the entity has already collected from customers owed to the entity's customer base as a whole, not to individual customers. It is not a possible future obligation because the regulator has the authority to ensure that future cash flows from the customer base as a whole would be reduced to refund amounts previously collected. The obligation exists even though its amount may be uncertain. An economic obligation is something that results in reduced cash inflows, directly or indirectly, as well as something that results in increased cash outflows. Obligations link the entity with what it has to do because obligations are enforceable against the entity by legal or equivalent means.

Nature of regulatory assets and regulatory liabilities

28. Regulatory assets and regulatory liabilities that would be recognised as a result of application of this Guidance Note are not financial instruments since the entity does not have the right to request reimbursement from, or the obligation to make payments to, individual customers for fixed or determinable amounts under a contract.

29. The regulatory assets are also not intangible assets as per AS 26, *Intangible Assets* since they are not 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. Accordingly, it would be appropriate to classify the assets and liabilities arising out of rate regulation separately from other assets and liabilities.

Recognition

30. A regulatory asset should be recognised when it is probable that the future economic benefits associated with it will flow to the entity as a result of the actual or

expected actions of the regulator under the applicable regulatory framework and the amount can be measured reliably.

31. Probability refers to the degree of uncertainty that future economic benefits associated with the regulatory asset will flow to the entity. Therefore, the probability criterion is said to be met when there is a reasonable assurance that future economic benefits will flow from the regulatory asset to the entity. A regulatory asset can be recognised when the regulatory framework provides for the recovery of the incurred costs and the entity has incurred such costs. If the recovery of the incurred costs is at the discretion of the regulator, the right can at best be said to be a contingent asset as per Accounting Standard (AS) 29, *Provisions, Contingent Liabilities and Contingent Assets*. In such case it would not be appropriate to recognise an asset till the approval of the regulator is received. For example, if any additions to the rate base are subject to the approval of the regulator, the entity should not recognise a regulatory asset on account of costs incurred on capital additions before approval of the regulator since the recovery of additional amounts through tariffs is contingent upon approval by the regulator.
32. In some cases, a regulator permits an entity to include in the rate base, as part of the cost of self-constructed (tangible) fixed assets or internally generated intangible assets, amounts that would otherwise be recognised as expense in the statement of profit and loss in accordance with Accounting Standards. After the construction or generation is completed, the resulting cost is the basis for depreciation or amortisation and unrecovered investment for rate determination. A regulatory asset should be recognised by the entity in respect of such costs since the same is recoverable from the customers in future through tariffs.
33. As regards the criterion for reliable measurement, since the recoverable amount is linked to the specific costs incurred which are permitted to be recovered by the regulatory framework, meeting the same may not present much difficulty for regulatory assets.
34. A regulatory liability should be recognised
- when an entity has a present obligation as a result of a past event;
 - it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
 - a reliable estimate can be made of the amount of the obligation.
35. Since in a cost-of-service regulation, the tariffs are subjected to 'truing up' based on actual costs incurred and prudence checks by the regulator, if the costs incurred by the entity are lower than those initially considered for rate determination, the entity has no realistic alternative to making a refund to the customers. Similarly, if the tariffs are set assuming certain level of additions to the asset base and the actual additions by the entity are lower, the entity would be required to refund a portion of the tariffs collected due to the lower

additions to the asset base. The regulatory framework may also provide for other circumstances which would warrant a refund of the amounts collected to the customers directly or indirectly through a downward adjustment of rates. For example a electricity distribution entity may have an obligation to share gains from reduction of distribution losses with the consumers in a specified ratio which would be passed on to consumers through an adjustment in future tariffs. Such amounts should be recognised as a liability if on the balance sheet date it is probable that the entity would be required to make refund upon review by the regulator and a reliable estimate can be made of the amount of refund.

36. Regulated entities should comply with the requirements of the Accounting Standards in the same way as other entities.¹ Therefore, if the criteria in paragraph 14 are satisfied, the entity should recognise regulatory assets and regulatory liabilities in accordance with this Guidance Note in addition to the assets and liabilities recognised in accordance with the Accounting Standards in the normal course.

Measurement

37. On initial recognition and at the end of each subsequent reporting period, an entity should measure a regulatory asset or regulatory liability at the best estimate of the amount expected to be recovered or refunded or adjusted as future cash flows under the regulatory framework. A regulatory asset or regulatory liability should not be discounted to its present value.
38. Estimates of the amount expected to be recovered, refunded or adjusted are determined by the judgment of the management of the entity considering various factors such as:
- statutes or regulations that specifically provide for the recovery of the cost in rates;
 - formal approvals from the regulator specifically authorising recovery of the cost in rates;
 - previous formal approvals from the regulator allowing recovery for substantially similar costs (precedents) for a specific entity or other entities in the same jurisdiction;
 - written approval from the regulator (although not a formal approval) approving future recovery in rates;
 - uniform regulatory guidance providing for the treatment of various costs that the regulator typically follows in setting rates;
 - opinions of independent experts regarding recoverability of the cost on the basis of regulations and past practice.
 - any additional evidence provided by events after the balance sheet date, where appropriate as per the applicable Accounting Standard.

Impairment

39. An entity should review the estimates of the amount expected to be recovered, refunded or adjusted at least at the end of each reporting period to reflect the current best estimate. If expectation differs from previous estimates, the changes should be accounted for as a

change in an accounting estimate in accordance with relevant requirements of the applicable Accounting Standard. If an entity concludes that it is not reasonable to assume that it will be able to collect sufficient revenues from its customers to recover its costs, this is an indication that the cash-generating unit in which the regulatory assets and regulatory liabilities are included may be impaired. Accordingly, the entity shall test that cash-generating unit for impairment in accordance with AS 28 *Impairment of Assets*.

De-recognition

40. An entity should derecognise the entire carrying amount of regulatory assets and regulatory liabilities when the underlying activities fail to meet the criteria in paragraph 14 and any resulting loss/gain should be recognised in the statement of profit and loss.
41. If it is no longer probable that the future economic benefits associated with a regulatory asset will flow to the entity or an outflow of resources embodying economic benefits will be required to settle a regulatory liability, the regulatory asset or liability, as the case may be, should be de-recognised and any resulting loss/gain should be recognised in the statement of profit and loss.

Presentation

42. An entity should present regulatory assets and regulatory liabilities as current/non-current, as the case may be, in the balance sheet, separately from other assets and liabilities.
43. An entity should offset rate regulated assets and liabilities pertaining to the same regulator.

Disclosures

44. An entity should disclose information that:
- enables users of the financial statements to understand the nature and the financial effects of rate regulation on its activities; and
 - identifies and explains the amounts of regulatory assets and regulatory liabilities, and related income and expenses, recognised in its financial statements.
45. An entity should disclose the fact that some or all of its operating activities are subject to rate regulation, including a description of their nature and extent.
46. An entity should disclose the break-up of regulated assets and regulated liabilities into major components of the respective balances in the notes to accounts.
47. For each set of operating activities subject to a different regulator, an entity should disclose the following information:
- an explanation of the approval process for the rate subject to regulation (including the rate of return), including information about how that process affects both the underlying operating activities and the specified rate of return;
 - the indicators that management considered in concluding that such operating activities are within the scope of this 'Guidance Note', if that conclusion requires significant judgement;

¹ For rate regulated activities, the relevant Accounting Standards will be modified where and to extent the accounting treatment of such activities would be affected by this Guidance Note.

iii. significant assumptions used in measurement of regulatory assets and regulatory liabilities including:

- (a) the supporting regulatory action, for example, the issue of a formal approval for costs to be recovered pending a final ruling at a later date and that date, when known, or
- (b) the entity's assessment of the expected future regulatory actions.

An entity should disclose the above information for each category of regulatory asset and regulatory liability that is subject to a different regulator.

48. A disclosure should be made of reconciliation from the beginning to the end of the period, in tabular format unless another format is more appropriate, of the carrying amount in the balance sheet of the regulatory asset and regulatory liability, including at least the following elements:
- i. the amount recognised in the statement of profit and loss relating to balances from prior periods collected or refunded in the current period.
 - ii. the amount of costs incurred in the current period that were recognised in the balance sheet as regulatory assets and regulatory liabilities to be recovered or refunded in future periods.
 - iii. other amounts that affected the regulatory asset and regulatory liability, such as items acquired or assumed in amalgamation etc., or the effects of changes in foreign exchange rates or estimated cash

flows. If a single cause has a significant effect on the regulatory asset and regulatory liability, the entity should disclose it separately.

49. When an entity derecognises regulatory assets and regulatory liabilities in accordance with paragraphs 41 and 42 because the related operating activities fail to meet the criteria in paragraph 14, it should disclose a statement to that effect, the reasons for the conclusion that the criteria in paragraph 14 are not met, a description of the operating activities affected and the amount of regulatory assets and regulatory liabilities derecognised.
50. If the disclosures required by paragraphs 46 - 49 of this Guidance Note do not meet the objectives set out in paragraph 45, the entity should disclose whatever additional information is necessary to meet those objectives.

Effective date

51. An entity shall apply this Guidance Note for accounting periods beginning on or after the date (to be announced separately).

Transition

52. On the first occasion this Guidance Note is applied, the entity should recognise in the financial statements regulatory assets and liabilities as on that date with corresponding credit/charge to opening balance of revenue reserves. ■

Guidance Note on Accounting for Self-generated Certified Emission Reductions (CERs) (Issued 2012)

(The following is the text of the Guidance Note on Accounting for Self-generated Certified Emission Reductions (CERs), issued by the Council of the Institute of Chartered Accountants of India.)

Introduction

- One challenge facing the human race is that of global warming. To address the issue of global warming, the United Nations Framework Convention on Climate Change (UNFCCC) was adopted in 1992, with the objective of limiting the concentration of Green House Gases (GHGs¹) in the atmosphere. Subsequently, to supplement the Convention, the Kyoto Protocol came into force in February 2005, which sets limits to the maximum amount of emission of GHGs by countries. The Kyoto Protocol at present commits 41 developed countries (known as Annex I countries) to reduce their GHG emissions by at least 5% below their 1990 baseline emission by the commitment period of 2008-2012. As per the Kyoto Protocol, at present, developing and least-developed countries are not bound by the amount of GHG emissions that they can release in the atmosphere, though they too generate GHG emissions.
- Under the Kyoto Protocol, countries with binding emission reduction targets (which at present are applicable to developed countries) in order to meet the assigned reduction targets are issued allowances (carbon credits) equal to the amount of emissions allowed. An allowance (carbon credit) represents an allowance to emit one metric tonne of carbon dioxide equivalent. To meet the emission reduction targets, binding countries in turn set limits on the GHG emissions by their local businesses and entities. Further, in order to enable the developed countries to meet their emission reduction targets, Kyoto Protocol provides three market-based mechanisms – Joint Implementation (JI), Clean Development Mechanism (CDM), and International Emission Trading (IET).
- Under JI, a developed country with a relatively high cost of domestic GHG reduction can set up a project in another developed country that has a relatively low cost and earn carbon credits that may be applied to their emission targets. Under CDM, a developed country can take up a GHG reduction project activity in a developing country where the cost of GHG reduction is usually much lower and the developed country would be given carbon credits for meeting its emission reduction targets. Examples of projects include reforestation schemes and investment in clean technologies. In case of CDM, entities in developing/least developed countries can set up a GHG reduction project, get it approved by UNFCCC and earn carbon credits. Such carbon credits generated can be bought by entities of developed countries with emission reduction targets. The unit associated with CDM is Certified Emission Reduction (CER) where one CER is equal to one metric tonne of carbon dioxide equivalent. Under IET, developed countries with emission reduction targets can simply trade in the international carbon credit market. This implies that entities of developed countries exceeding their emission limits can buy carbon credits from those whose actual emissions are below their set limits. Carbon credits can be exchanged between businesses/entities or bought and sold in international market at the prevailing market price.
- These mechanisms serve the objective of both the developed countries with emission reduction targets, who are the buyers of carbon credits as well as of the developing and least developed countries with no emission targets (at present), who are the sellers/suppliers of carbon credits. The non-polluting companies from less developed countries can sell the quantity of carbon dioxide emissions they have reduced (carbon credits) and earn extra money in the process. This mechanism of buying and selling carbon credits is known as carbon trading.

Clean Development Mechanism and CERs

- The Clean Development Mechanism is a flexible mechanism to enable countries with GHG emission reduction commitments, i.e., Annex I countries to meet their commitments by paying for GHG emission reductions in developing countries (non- Annex I countries). Such CDM projects earn saleable Certified Emission Reduction (CER) units, each equal to one metric tonne of carbon dioxide equivalent, which can be counted towards meeting Kyoto targets (given in Annexure B of Kyoto Protocol). This mechanism encourages the non-Annex I countries, i.e., developing and least developed countries which at present are not bound by Kyoto Protocol to reduce GHG emissions. India, being a non-Annex I country, has emerged to be a beneficiary as Indian entities can set up CDM projects which reduce GHG emissions and thereby generate CERs which can be sold to Annex I countries and used by the latter to meet their binding emission reductions.
- To be eligible for CDM benefits, the proposed project must have the feature of additionality, i.e., the CDM project must provide reductions in emissions that are additional to that would occur in the absence of the project. For example, an entity can generate CERs under

¹ GHGs refer to polluting gases including carbon dioxide which cause global warming.

CDM, if it installs a waste heat boiler that saves energy. This is because reduced fuel use reduces the amount of carbon dioxide emitted. However, if an entity has to undertake the project activity because of law, for example, if the industry is legally mandated to have a waste-heat recovery boiler, such a project is generally not eligible for CDM benefits.

7. An entity desirous of undertaking a CDM project activity, generate carbon credits there from, and earn revenue needs to go through several stages. These are described below:

(i) *Registration/Accreditation of the project*

As a first step, an entity desirous of setting up a CDM project needs to get the project registered with the CDM Executive Board of the UNFCCC. To do so, it needs to develop a Project Design Document (PDD) which contains the description of the proposed CDM project. The entity also needs an approval from the Designated National Authority (DNA) which is an office, ministry or other official entity appointed by a Party to the Kyoto Protocol to review and give national approval to projects proposed under the CDM. India's DNA is the National CDM Authority (NCDMA). Once approved by the DNA, the proposed project is required to be validated by a Designated Operational Entity (DOE). A DOE is a company/organisation accredited by the CDM Executive Board that checks whether the project meets the CDM criteria. The DOE checks the PDD and hosts the same on UNFCCC's website for public comments for a period of 30 days. Upon the expiry of this period, the DOE makes a determination as to whether on the basis of the information provided and taking into consideration the comments received, the project should be validated. Once satisfied, the DOE submits the validation report and all the other necessary documents to the CDM Executive Board along with the request for project registration, and all these documents are hosted on UNFCCC's website. If within 8 weeks no request for review of the proposed CDM project is received by UNFCCC, the project is automatically registered.

(ii) *Monitoring, Verification and Issuance of CERs*

Once the project is registered and becomes operational, the performance of the CDM project is monitored and verified periodically (usually once a year) to determine whether emission reductions have taken place before the CDM Executive Board can issue CERs. For this, the entity having got itself successfully registered appoints a DOE which is different from the one involved in the first stage. The DOE assesses the quality/quantity of GHG emission reductions

and compliance with all CDM criteria. After successful verification, the DOE submits the verification report and other relevant documents to the Executive Board and requests for issuance of CERs. UNFCCC hosts all these documents on its website and if within 15 days from the date of making the request for issuance no request for review is received, CERs are certified and issued to the entity. Certification is a written assurance by UNFCCC that a project activity achieved the emission reductions as verified.

(iii) *Sale/Trade*

The CERs obtained by the entity may be sold to those who need it.

8. From the above, it follows that there are various parties involved in the carbon trading process. These include (i) Generating entity/generator, i.e., the entity which undertakes CDM project activity to generate CERs; (ii) CDM Executive Board of UNFCCC which approves the CDM projects and issues CERs; (iii) Designated National Authority as defined above and in India it refers to National CDM Authority; (iv) Designated Operational Entities as defined above which validate and verify the CDM project and its operations; and (v) the buying entity/buyer which buys the CERs generated by the generator and for the purpose of this Guidance Note it refers to the entity of a developed country which is bound by the Kyoto Protocol emission reduction targets.

Objective

9. With large number of entities in India generating carbon credits and the carbon credits being a relatively new area, a need was felt to provide guidance on accounting in this area. There is no specific Accounting Standard or interpretation provided by the International Accounting Standard Board (IASB) in relation to the accounting for Certified Emissions Reductions (CERs). The debate is still on for an appropriate treatment for Carbon Emission Reductions (CERs) in the international forum. There are, however, existing Accounting Standards (AS) that deal with the principles that should govern accounting for Certified Emissions Reductions (CERs). But the lack of specific guidance furthers the scope for judgement and results in varying treatments.

Scope

10. Kyoto Protocol provides three market-based mechanisms – Joint Implementation (JI), Clean Development Mechanism (CDM), and International Emission Trading (IET). The accounting issues and the consequent accounting treatment involved in the three different mechanisms may be different. However, since at present the Clean Development Mechanism is the relevant mechanism in India and with India currently not being under the obligation to reduce its GHG emissions as

per the Kyoto Protocol, this Guidance Note provides guidance on accounting for carbon credits, i.e., CERs generated under the Clean Development Mechanism. This Guidance Note provides guidance on matters of applying accounting principles relating to recognition, measurement and disclosures of CERs generated by the entity that has obtained the same under the Clean Development Mechanism (hereinafter referred to as 'self-generated CERs').

This Guidance Note does not address the accounting issues involved in carbon credits under Joint Implementation and International Emission Trading the other two mechanisms under the Kyoto Protocol.

This Guidance Note also does not deal with purchased CERs or with the use of CERs in own business.

Accounting Treatment

Whether CER is an 'asset'

11. An issue that arises in accounting for carbon credits is that whether the carbon credits generated under the Clean Development Mechanism, i.e., CERs, can be considered as assets of the generating entity.
12. The 'Framework for the Preparation and Presentation of Financial Statements', issued by the Institute of Chartered Accountants of India, defines an 'asset' as follows:

"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."

CER is an 'asset' as per the definition given in the Framework

13. From the above-mentioned definition of 'asset' it follows that for a CER to be considered as an asset of the generating entity, it should be a resource controlled by the generating entity arising as a result of past events, and from which future economic benefits are expected to flow to the generating entity.
14. In order to generate CERs, an entity undertakes a CDM project activity and thereby reduces carbon emissions. It is mentioned in paragraph 9 above that various stages are involved in a CDM project activity to generate CERs. After a successful registration, as the CDM project is operated, carbon emission reductions are generated and these continue to be generated over the course of the project. However, at this stage, i.e., when the emission reductions are taking place, CERs do not arise. It may be argued that as soon as emission reductions take place these should be considered as assets since certification thereof subsequently in the form of CERs is a procedural aspect. In this regard, it is noted that issuance of CERs is subject to the verification process, i.e., CERs are applied for and on the expiry of 15 days having received no request for review and after having satisfied all requirements, a communication is received from UNFCCC thereby crediting CERs to the generating entity. It is, thus, possible that emission reductions may

not eventually result in to creation of CERs. Accordingly, at this stage when emission reductions are taking place, CERs can, at best, be said to be contingent assets as per Accounting Standard (AS) 29, *Provisions, Contingent Liabilities and Contingent Assets*, which defines a contingent asset as "**a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise**". This is because when the generating entity reduces carbon emissions by way of a CDM project, the generating entity becomes eligible to receive CERs from UNFCCC. However, whether CERs will actually arise and be received by the generating entity or not will depend on a future uncertain event, i.e., certification of the same by UNFCCC.

15. It follows from the above that a CER comes into existence and meets the definition of an asset only when the communication of credit of CERs is received by the generating entity. This is because only at this stage the CER becomes a resource controlled by the generating entity and therefore leads to expected future economic benefits in the form of cash and cash equivalents which would arise on the future sale of CERs. As stated above, at other earlier stages of the CDM project activity, there is no resource in existence for the generating entity, and hence the question of 'resource controlled' and 'expected future economic benefits' therefore do not arise. Accordingly, CER is an 'asset', when it comes into existence as stated aforesaid.

Recognition of CERs

16. According to the 'Framework for the Preparation and Presentation of Financial Statements', once an item meets the definition of the term 'asset', it has to meet the criteria for recognition of an asset as laid down in the Framework so that it may be recognised in the financial statements. In other words, it has to be seen when the CERs should be recognised in the financial statements. As per paragraph 88 of the Framework, the criteria for recognition of an asset are as follows:

"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."
17. From paragraph 15 it follows that CERs come into existence when these are credited by UNFCCC in a manner to be unconditionally available to the generating entity. Therefore, CERs should not be recognised before that stage. Further, from the above it follows that for CERs to be recognised in the financial statements of the generating entity as assets, the two criteria with regard to probable future economic benefits flowing from the CERs and CERs possessing a cost or

value that can be measured with reliability should be met as follows:

- (a) As regards the probability criterion for recognition of CERs, it may be mentioned that the concept of probability refers to the degree of certainty that future economic benefits associated with CERs will flow to the entity. Therefore, the probability criterion is said to be met when there is a reasonable assurance that future economic benefits will flow from the CERs to the entity. As the market for CERs is relatively new, the future economic benefits may not always be assured. Thus, an entity needs to make an assessment for the probability of future economic benefits. Accordingly, if there is a probable market for the self-generated CERs ensuring flow of economic benefits in the future, CERs should be recognised.
- (b) As regards the criterion for measurement of cost or value, there are certain costs which are incurred to generate CERs, and therefore the cost of CERs can be measured reliably. The value at which CERs are to be measured is discussed in later paragraphs.

For reasons stated above, the recognition of CERs as an asset at any earlier or later stage than when they are credited by UNFCCC is not justified in the following cases:

- (a) CERs are recognised upon execution of a firm sale contract for the eligible credits
- (b) CERs are recognised on an entitlement basis based on reasonable certainty after making adjustments for expected deductions.

What type of asset is a CER

18. Having agreed that a CER is an asset as per the 'Framework for the Preparation and Presentation of Financial Statements' and also having determined when a CER meets the recognition criteria, its nature is to be examined. Keeping in view the non-physical form of CERs, the definition of 'intangible asset', as per Accounting Standard (AS) 26, *Intangible Assets*, is noted as follows:

"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."

19. From the above, it is noted that though CERs are non-monetary assets without a physical form, they do not strictly fall within the meaning of 'intangible asset' as per AS 26. The reason is that CERs are not held for use in the production or supply of goods or services, and neither are CERs used for administrative purposes nor are they used for the purpose of renting to others. Instead, CERs generated by the generating entity are held for the purpose of sale.

However, it may be mentioned that though the definition of 'intangible asset' does not mention assets held for sale, the other requirements of AS 26, such as the following, indicate that intangible assets include assets which are developed by an entity for sale:

"44. An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:

- (a) ***the technical feasibility of completing the intangible asset so that it will be available for use or sale;***
- (b) ***its intention to complete the intangible asset and use or sell it;***
- (c) ***its ability to use or sell the intangible assets;***
- (d) ***...***
- (e) ***the availability of adequate technical, financial and other resources to complete the development and use or sell the intangible asset; and***
- (f) ***..."*** [Emphasis supplied]

20. Further, though CERs are intangible assets as mentioned above, AS 26² scopes out those intangible assets from its purview which are specifically dealt with in another Accounting Standard and requires them to be accounted for in accordance with that Standard. For instance, intangible assets held for the purpose of sale in the ordinary course of business are excluded from the scope of AS 26 (paragraph 2) and, therefore, are to be accounted for as per Accounting Standard (AS) 2, *Valuation of Inventories*. In this context, the definition of the term 'inventories' as given in AS 2 is noted below:

"Inventories are assets:

- (a) ***held for sale in the ordinary course of business;***
- (b) ***in the process of production for such sale;***
- (c) ***in the form of materials or supplies to be consumed in the production process or in the rendering of services."***

21. From the above, it follows that CERs are inventories of the generating entity as they are generated and held for the purpose of sale in the ordinary course of business. Therefore, even though CERs are intangible assets these should be accounted for as per the requirements of AS 2.

Measurement

Measurement of CERs

22. As stated above, CERs are inventories for an entity which generates the CERs. Therefore, the valuation principles as prescribed in AS 2 should be followed for CERs. As per AS 2, inventories should be valued at the lower of cost and net realisable value. Accordingly, CERs should be measured at cost or net realisable value, whichever is lower.

² Reference may be made to paragraph 2 of AS 26.

Cost of Inventories

23. AS 2 prescribes the composition of cost of inventories as follows:

“6. The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.”

24. Various costs are incurred by the generating entity to set up a CDM project activity, operate the CDM project and generate CERs. These may include the following:
- (i) research costs arising from exploring alternative ways to reduce emissions;
 - (ii) costs incurred in developing the selected alternative as a process/device to reduce emissions;
 - (iii) costs incurred to prepare the Project Design Documents;
 - (iv) fees paid to DOEs for validation and verification and to the National Authority for approval;
 - (v) fees of registering with UNFCCC;
 - (vi) costs incurred for monitoring the reductions of emissions;
 - (vii) costs incurred for certification of CERs; and
 - (viii) operating costs incurred to run the CDM project.
25. As already mentioned earlier, CERs do not come into existence and, therefore, do not become the assets of the generating entity till the UNFCCC certifies and credits the same to the generating entity. Accordingly, not all costs incurred by the generating entity give rise to CERs and therefore not all costs can be considered as the costs of bringing the CERs to existence (i.e., their present location and condition). For example, the research and development costs as mentioned above are the pre-implementation costs of the CDM projects which do not result in CERs. Accordingly, these should be treated as per Accounting Standard (AS) 26, *Intangible Assets* (refer also to paragraph 30 below) when they bring into existence a separate intangible asset such as a patent of a process to reduce carbon emissions. Similarly, the other costs such as those incurred for preparation of PDD and registration of the CDM project with UNFCCC, etc., do not result in CERs coming into existence, and therefore these costs cannot be inventorised. It is only the costs incurred for the certification of CERs by UNFCCC which bring the CERs into existence by way of credit of the same by UNFCCC to the generating entity. Thus, the costs incurred by the generating entity for certification of CERs, are the costs of inventories of CERs.
26. In order to certify and issue CERs, UNFCCC imposes two types of levies on the generating entity. The first type of levy is in kind whereby a specified percentage of the CERs earned are deducted at the point of issuance by the UNFCCC. In other words, the generating entity is issued CERs net of this levy. For example, if this levy is 2% and if 1000 CERs are to be issued, then after deducting 20 CERs, 980 CERs will be credited. This levy is applied

to all projects other than those of the Least Developed Countries. The second type of levy imposed is in the form of a cash payment which is charged by the UNFCCC towards meeting administrative costs of UNFCCC. In this levy, a fixed payment per unit of CER is charged for the total CERs credited to the generating entity. Taking the above example further, if USD 0.10 per CER is charged towards the second levy, then the generating entity will need to make a payment at this rate for the 980 CERs credited to it, i.e., USD 98. Apart from these two levies, the generating entity normally pays a fee to the consultant for the services rendered to obtain the certification of CERs by UNFCCC.

27. From the above, it follows that the ‘costs incurred for certification of CERs’ at which the inventory of CERs should be valued include the consultant’s fee and the cash payment made under the second levy to the UNFCCC for obtaining the credit of CERs. The deduction of CERs by UNFCCC under the first levy is in kind which increases the per unit cost of the CERs credited to the generating entity.

Net Realisable Value

28. AS 2 defines net realisable value as follows:

“Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.”

29. In the determination of the net realisable value of CERs, paragraph 22 of AS 2 reproduced below should be used as guidance:

“22. Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the balance sheet date to the extent that such events confirm the conditions existing at the balance sheet date.”

Income Recognition

30. Since CERs are recognised as inventories, the entity should apply AS 9 to recognise revenue in respect of sales of CERs .

Measurement of underlying assets related to CERs

31. For the generation of CERs, the generating entity may create certain intangible and tangible assets. For example, for reducing emissions, an entity may carry out some research and development which may result into creation of an intangible asset. Insofar as expenditure on research and development is concerned, the entity should apply AS 26, *Intangible Assets*.
32. In some cases, an entity may use a tangible asset to reduce emissions. For example, an entity may use incinerators for the purpose of reducing carbon

emissions. In respect of such equipments/devices, the provisions of the Accounting Standard (AS) 10, (Revised) *Tangible Fixed Assets*³ will apply, as is evident from the following paragraph thereof:

“8.1A. Items of tangible fixed assets may be acquired for safety or environmental reasons. The acquisition of such tangible fixed assets, although not directly increasing the future economic benefits of any particular existing item of tangible fixed asset, may be necessary for an enterprise to obtain the future economic benefits from its other assets. Such items of tangible fixed assets qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the enterprise is unable to manufacture and sell chemicals. However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with AS 28, *Impairment of Assets*.”

33. From the above, it is clear that any pollution control/ emission reduction devices installed by the generating entity for the purpose of generating CERs are fixed assets and therefore they shall be accounted for as per AS 10 (Revised).

Presentation

34. An entity should present certified emission rights as part of Inventories, in the balance sheet, separately from other categories of Inventories such as Raw Materials, Work-in-process, Finished goods and others.

Disclosure

35. An entity should disclose the following information relating to certified emission rights in the financial statements:
- No. of CERs held as inventory and the basis of valuation.
 - No. of CERs under certification.
 - Depreciation and operating and maintenance costs of Emission Reduction equipment expensed during the year.

Effective date

36. An entity should apply this Guidance Note for accounting periods beginning on or after April 01, 2012.

Transition

37. On the first occasion this Guidance Note is applied, the entity should recognise in the financial statements certified emission rights earned as on that date with corresponding credit to revenue reserves. ■

³ AS 10 (revised), *Tangible Fixed Assets* is being formulated.

Exposure Draft of the Standard on Internal Audit (SIA), *Related Parties* (Last Date for Comments is April 30, 2012)

Invitation to Comments:

The Internal Audit Standards Board of the Institute of Chartered Accountants of India invites comments on the Exposure Draft of the Standard on Internal Audit (SIA), *Related Parties*. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Internal Audit Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, A-29, Sector-62, NOIDA - 201 309 so as to be received not later than **April 30, 2012**. Comments can also be sent by e-mail at cia@icai.org.

Introduction

1. The purpose of this Standard on Internal Audit is to establish standard and provide guidance on the procedures to be followed by the internal auditor in ensuring that related party activities of the entity are properly captured through internal controls; and that related party activities are consistent with the entity's code of conduct and conflict of interest policy, applicable laws and regulations and disclosure requirements.

2. Management is responsible for the identification and disclosure of related parties and accounting for the related party transactions. This responsibility requires management to implement adequate internal control to ensure that transactions with related parties are appropriately identified, recorded and disclosed in the financial statements. The internal auditor is the appropriate resource for assessing what management has implemented with regard to related party information by evaluating relevant internal controls and inform the management about the deficiencies detected.

Related Party

3. Related party is either:

- (i) A related party as defined in the applicable laws or regulations; or
- (ii) Where the applicable laws or regulations establish minimal or no related party requirements:
 - (a) A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;

- (b) Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
- (c) Another entity that is under common control with the reporting entity through having common controlling ownership, or owners who are closely family members or common key management.

However, entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

4. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities and significant influence (which may be gained by share ownership, statute or agreement) is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies.

The existence of the following relationships may indicate the presence of control or significant influence:

- (a) Direct or indirect equity holdings or other financial interests in the entity.
- (b) The entity's holding of direct or indirect equity or other financial interests in other entities.
- (c) Being part of those charged with governance or key management (i.e., those members of management who have authority and responsibility for planning, directing, and controlling the activities of the entity).

- (d) Being a close family member of any person referred to in sub-paragraph (c).
- (e) Having a significant business relationship with any person referred to in sub-paragraph (c).
- (b) The nature of the relationships between the entity and these related parties; and
- (c) Whether the entity entered into any transactions with these related parties during the period and, if so, the nature and the purpose of the transactions.

Related Party Transactions

5. A related party transaction is a transfer of resources, services or obligations between an entity and a related party, regardless of whether a price is charged. Transactions that because of their nature may be indicative of the existence of related parties include:

- (a) Borrowing or lending on an interest-free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction.
- (b) Buying/selling transactions at a price that differs significantly from its appraised value.
- (c) Exchanging property for similar property in a non-monetary transaction.
- (d) Making loans with no scheduled terms of repayment.
- (e) Granting of a guarantee without adequate compensation.

6. Related party transactions may not be conducted under normal market terms and conditions at all times. There may be possibility that transactions with related parties may have been motivated solely, or in large measure, by conditions similar to the following:

- (a) Lack of sufficient working capital or credit to continue the business;
- (b) An urgent desire for a continued favorable earnings record in the hope of supporting the price of the company's share;
- (c) An overly optimistic earnings forecast;
- (d) Depending on a single or relatively few products, customers, or transactions for the continuing success of the venture;
- (e) Excess capacity;
- (f) Significant litigation, especially, litigation between shareholders and management;
- (g) A declining industry characterized by a large number of business failures;
- (h) Significant technology obsolescence.

Internal Audit Procedures

7. The internal auditor shall perform the internal audit procedures and related activities to obtain information relevant to evaluating internal controls associated with related party relationships and transactions. The internal auditor shall gather the following information pertaining to related party relationships and transactions:

- (a) The identity of the entity's related parties including changes from the prior period;

8. The following may be considered by the internal auditor while understanding the entity's related party relationships and transactions:

- (a) The nature and extent of the entity's relationships and transactions with related parties.
- (b) An emphasis on the importance of maintaining due professional care throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
- (c) The circumstances or conditions of the entity that they indicate the existence of related party relationships or transactions that management has not identified or disclosed to the internal auditor (for example, a complex organizational structure, use of special-purpose entities for off-balance sheet transactions, or an inadequate information system).
- (d) The records or documents that may indicate the existence of related party relationships or transactions.
- (e) The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions, and the related risk of management override of relevant controls.

9. The internal auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed:

- (a) Bank and legal confirmations obtained as part of the internal auditor's procedures;
- (b) Minutes of the meetings of the shareholders and of those charged with governance; and
- (c) Such other records or documents as the internal auditor considers necessary in the circumstances of the entity, for example:
 - Entity income tax returns.
 - Information supplied by the entity to regulatory authorities.
 - Shareholder registers to identify the entity's principal shareholders.
 - Statements of conflicts of interest from management and those charged with governance.
 - Records of the entity's investments and those of its pension plans.

- Contracts and agreements with key management or those charged with governance.
- Significant contracts and agreements not in the entity's ordinary course of business.
- Specific invoices and correspondence from the entity's professional advisors.
- Life insurance policies acquired by the entity.
- Significant contracts re-negotiated by the entity during the period.
- Documents associated with the entity's filings with a securities regulator (e.g., prospectuses).

If the internal auditor identifies significant transactions outside the entity's normal course of business then the internal auditor shall obtain information about the nature of these transactions and whether the related parties are involved.

10. In smaller entities, the identification of related party transactions can often be difficult. If the entity uses a standard software package to record transactions, consider obtaining an electronic copy of the transactions and importing them into an electronic spreadsheet. By using the sort feature and configuring the selection criteria, it may be possible to obtain information about customers/suppliers with only a few, but large, transactions, or those with significant transactions of a size or nature that is unusual.

11. In responding to the identified risks of material misstatement associated with related party relationships and transactions, the internal auditor would consider the following:

- (a) Determine whether underlying circumstances confirm their existence;
- (b) Promptly communicate the information to the engagement team;
- (c) Request management to identify all the transactions with the related party;
- (d) If related party was not previously identified, consider:
 - failure of any related party identification controls, and
 - fraud (non-disclosure by management appears intentional);
- (e) Reconsider the risk that the other undisclosed related parties or significant related party transactions may exist, and perform additional internal audit procedures as necessary; and
- (f) Perform appropriate substantive internal audit procedures.

12. With regard to significant related party transactions outside normal course of business, the internal auditor should inspect underlying contracts or agreements, if any, and evaluate whether:

- (a) **Rationale suggests possible fraudulent financial reporting or concealment of misappropriated assets,**
- (b) **Terms are consistent with management's explanations, and**
- (c) **Transactions are accounted for and disclosed in accordance with the generally accepted accounting principles,**
- (d) **Ensure transactions have been appropriately authorized and approved.**

13. The internal auditor should obtain sufficient appropriate audit evidence about management's assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction. Evaluating management's support for this assertion may involve one or more of the following:

- (a) Considering the appropriateness of management's process for supporting the assertion.
- (b) Verifying the source of the internal or external data supporting the assertion, and testing the data to determine their accuracy, completeness and relevance.
- (c) Evaluating the reasonableness of any significant assumptions on which the assertion is based.

14. The internal auditor should consider the following matters:

- (a) **Document the names of the identified related parties and the nature of the related party relationships; and**
- (b) **Communicate with those charged with governance, or relevant Committee thereof, such as, audit committee, any significant matters arising during the internal audit in connection with related parties.**

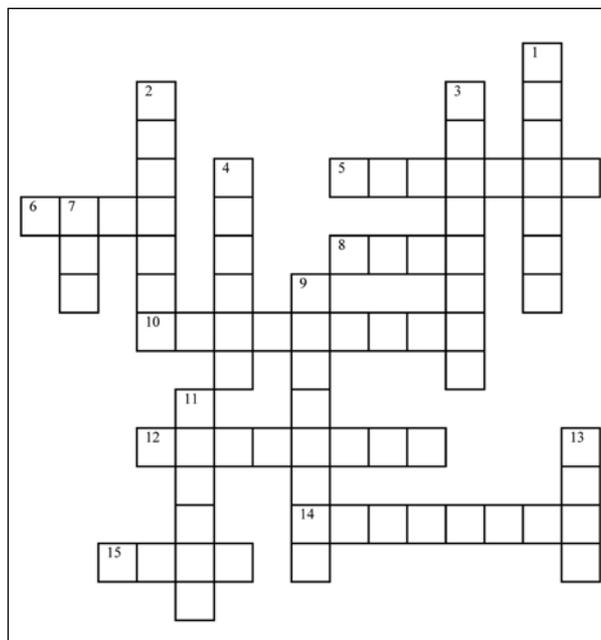
15. The internal auditor would consider the impact on the internal audit report if it is not possible to obtain sufficient appropriate audit evidence concerning related parties and transactions.

Effective Date

16. This Standard on Internal Audit will apply to all internal audits commencing on or after Earlier application of the SIA is encouraged. ■

CROSSWORD

069



ACROSS

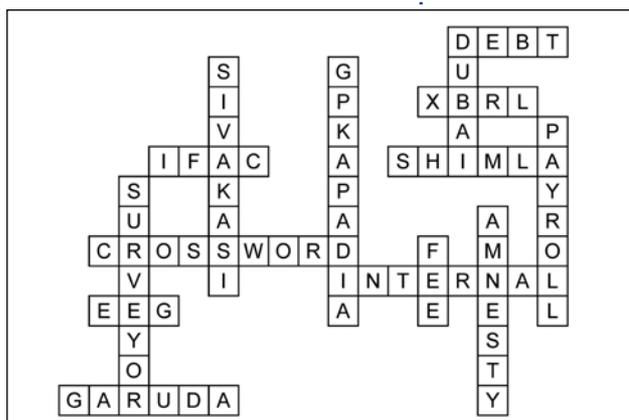
- 5 Short term capital gain on shares taxed at _____ per cent. (7)
- 6 One of the softwares recently launched by the ICAI is related to _____.
- 8 As per SEBI IPO Grading, Grade 1 signifies _____ fundamentals. (4)
- 10 A _____ equity share is a financial instruments or other contract that entitles or may entitle, its holder to equity shares. (9)
- 12 One of the stages of the Money Laundering. (8)
- 14 One of the methods prescribed under Transfer Pricing Rules to determine profits. (4,4)
- 15 Six Sigma's acceptance level of defects per million. (4)

DOWN

- 1 _____ Mortgage Loan offers an option to senior citizens to earn a steady income by pledging their homes. (7)
- 2 Six Sigma name coined by _____ Crosby. (7)
- 3 Six Sigma was initially developed at this company. (8)
- 4 QFIs are now allowed to invest directly in the Indian _____ markets. (6)

- 7 The _____ is a comprehensive method to evaluate organisational performance to better understand the customer requirements and performance gaps.
- 9 Securities Transaction Tax is a _____ tax. (8)
- 11 One of the newly set up branches of the ICAI. (6)
- 13 IFRSs are issued by this organization.

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 068



Economics astrology

An economist and an astrologer are arguing about their subjects.

The astrologer says, "Astrology is more scientific. My predictions come out right half the time. Yours can't even reach that proportion".

The economist replies, "That's because of external shocks. Stars don't have those".