



THE CHARTERED ACCOUNTANT JOURNAL

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

Companies Bill, 2009

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Infrastructure

Limited Liability Partnership

Multi Disciplinary Partnership

Networking and Mergers

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“We have hard work ahead. There is no resting for any one of us till we redeem our pledge in full, till we make all the people of India what destiny intended them to be. We are citizens of a great country, on the verge of bold advance, and we have to live up to that high standard. All of us, to whatever religion we may belong, are equally the children of India with equal rights, privileges and obligations.”

(Jawaharlal Nehru, August 14, 1947)

Challenges of Indian Economy and Budget 2011

"Economy is the method by which we prepare today to afford the improvements of tomorrow," so goes the saying, which has been successfully lived by India in the past decade. The \$1.3 trillion Indian economy remains irrefutably robust and roaring despite disturbing economic signals from US, Europe and Egypt. It continues to march ahead on the path of progress even in the face of formidable challenges, including the recent global economic slowdown. According to the Central Statistical Organisation, our economy will probably expand 8.6 per cent in the year ending 31st March. Several recent economic reports glowingly predict that by 2013-2015, India will start outpacing China's annual GDP growth rate. But the instant dream is to take India into 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 Indian growth engine from going full throttle.

There are some immediate concerns to be taken care of—viz to keep growth rate high and inflation rate low. Exorbitant rate of inflation, fuelled by spiraling demand and food costs, tops the list of concerns. Although inflation has cooled down a bit in recent weeks, it remains a major cause of concern for the Government and foreign institutional investors who have withdrawn more than ₹15,000 crore so far this year. To make it worse, India is now bracing for another spurt in oil prices following political unrest in Middle East. At the crossroads, Indian economy will have to walk a tight rope between chasing growth and curbing inflation.

But the main challenges of our economy are to achieve 'Inclusive Growth' and eliminate 'economic inequalities'. As many as 37 per cent of people in India live below the poverty line, according to the Tendulkar Committee report, which has been accepted by the Planning Commission. According to World Bank estimate, 41.6 per cent of India falls below the international poverty line of US\$ 1.25 a day. Our economic progress has not even remotely touched the lives of our rural poor.

High level of illiteracy, with about 47 per cent of Indian women still not able to read or write (2001 census), is another big challenge. Shortage of skills required for sustained growth, is yet another daunting challenge. Only 12 per cent of India's citizens enter higher education. The Indian government has identified a skills gap in between 240 - 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. Over 40 per cent of Indian fruits rot before they reach the market and more than 78 million homes do not have electricity. Shortage of long term funds for the infrastructure projects also needs to be addressed more effectively.

Our one of the largest budget deficits in the developing world, which is about 5.5 per cent of GDP for the current fiscal, limits the scope for increasing investment in public services like health and education. 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.

Deterioration of Balance of Payments is another worrisome factor. The current account deficit is projected to be at 3.5 per cent of GDP in the current fiscal, against 2.9 per cent in the previous financial year. Current account deficit above three per cent is considered to be a dampener for any national economy.

Another major task at hand, as acknowledged by Finance Minister Pranab Mukherjee, is to re-energise governance and improve delivery mechanisms. It is perceived that of late India has witnessed weaknesses in the government systems, structures and institutions at different levels of

governance. Our institutions must provide high quality public services, security and the rule of law to all citizens with transparency and accountability.

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. Indian corporate sector reforms are only half complete. Despite Prime Minister Singh's admirable efforts, the legendary "license raj" is still much in evidence. The government has taken some steps in the right direction like it is actively working to simplify the Byzantine tax code, and has opened many new sectors to foreign direct investment. However, India still ranks a low 134 out of 183 countries on the World Bank's 'Ease of Doing Business Index'.

Meanwhile, agriculture and allied sectors, which contribute about 15 per cent 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. India has failed to achieve complete food security leaving the rural economy in crisis. Rising population, urbanisation, declining crop land, crop production and biodiversity were affecting agriculture.

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 2011 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. Even though Budget 2011 may not be a panacea, it will set the outline for the economy for the near future. The country expects the Budget 2011 to make the impact India needs.

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

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MUMBAI: Spenta Multimedia, Peninsula Spenta, Mathuradas Mill Compound, N. M. Joshi Marg, Lower Parel, Mumbai-400013. Tel: +91 (22) 24811022/24811025, Telefax: -91(22) 24811021.

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

Editor — CA. G. Ramaswamy

Published at ICAI Bhawan, P. O. Box No. 7100, Indraprastha Marg, New Delhi - 110 002 and printed at Spenta Multimedia. Peninsula Spenta, Mathuradas Mill Compound, N. M. Joshi Marg, Lower Parel, Mumbai - 400013
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TOTAL CIRCULATION: 2,03,610

Total No. of Pages: 148 including Covers

Cover image, Inside images and graphics: www.dreamstime.com



VOLUME 59 | No. 9 | MARCH 2011 | ₹100

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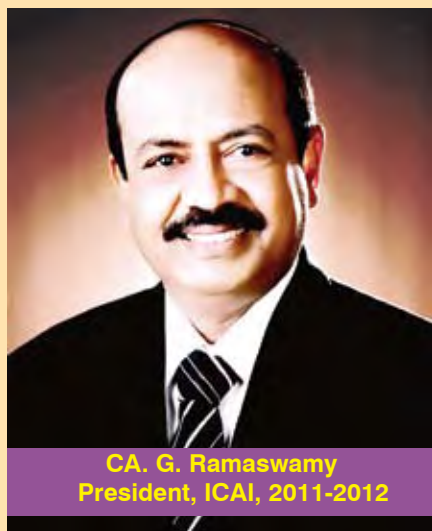
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CA. G. Ramaswamy
President, ICAI, 2011-2012

A combination of erudition, foresight and professional excellence, CA. G. Ramaswamy has become the supreme torch-bearer of Indian accountancy profession as the President of the Institute of Chartered Accountants of India (ICAI). A fellow member of the ICAI with more than 26 years of standing, he has been elected as the President of ICAI for the year 2011-12 by the 21st Council of Institute on 12th February, 2011. Bestowed with exceptional organisational and administrative skills, he was serving as Vice President of the ICAI for 2010-2011. An illustrious and versatile practicing Chartered Accountant since 1984, he is also a fellow member of the Institute of Company Secretaries of India (ICSI).

Hailing from Coimbatore (Tamil Nadu), he has vast experience in the field of taxation, company law matters, statutory audit, internal audit, and management consultancy of more than two decades. Having a penchant for perfection, he has the distinction of being the 1st nominated member of the Quality Review Board, an external body constituted under the Chartered Accountants (Amendment) Act, 2006 to act as an oversight body of the profession. He has also been nominated as Member of the 2nd Quality Review Board constituted by the Government of India.

An ardent advocate and proponent of 'Brand Indian CA' and accountancy profession globally, he has been nominated Technical Advisor to Board of International Federation of Accountants (IFAC) that has 159 members and associates from 124 countries across the world and also Technical Advisor to Professional Accountancy Organisation Development Committee (PAODC) of IFAC. He is also a member of India-UK (Indo-UK) Task Forces on 'Corporate Affairs' and 'Accountancy' respectively constituted by the Ministry of Corporate Affairs. He has also been nominated on the Board of Confederation of Asia Pacific Accountants (CAPA) and also serves on its Strategic Committee. He is also on the Board of South Asian Federation of Accountants (SAFA), which is an Apex Body of the South Asian Association for Regional Co-operation and a Regional Grouping of IFAC. He also played a crucial role as the Institute's Representative to the SAFA Committee on Harmonisation of Fiscal & Tariff Regimes in SAARC Region for the year 2010-2011. He was nominated as Vice Chairman in SAFA Centre of Excellence on Standards and Quality Control and as a member of SAFA task force. He was also the nominated member of SAFA Committee for Improvement in Transparency, Accountability and Governance.

A facilitator of ICAI as 'Partner in Nation Building', he also represents ICAI on a number of Governmental/other stakeholder committees/boards, including as member of National Advisory Committee on Accounting Standards (NACAS) and 'Government Accounting Standards Advisory Board for Union and the States' constituted by C & AG. He has also been nominated to the Standing Committee on TDS for the year 2011 for exchange of ideas on enhancing voluntary TDS/TCS compliance, strengthening partnership

OUR NEW PRESIDENT

with tax practitioners, tax deductors/collectors and third party partners, and promoting education and awareness of TDS/TCS provisions amongst the deductors/collectors & tax payers besides minimising scope for grievances. Some other such committees include '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,' 'Secretarial Standards Board of the Institute of Company Secretaries of India (ICSI),' 'Board of Tariff Advisory Committee and Standing Committee on Accounting Issues constituted by Insurance Regulatory and Development Authority (IRDA),' 'Task Force for Working Groups of G-20 constituted by Reserve Bank of India,' 'SEBI Committee on Disclosures and Accounting Standards (SCODA),' 'Project Implementation Committee to pursue the implementation of Accrual Accounting in the Ministry of Road Transport & Highways constituted by Ministry of Road Transport & Highways and Ministry of Shipping,' 'Working Group constituted by the Competition Commission of India,' 'Committee of Experts to prepare a fresh Inspection Manual constituted by the Ministry of Corporate Affairs,' 'Advisory Committee of Micro, Small and Medium Enterprises of the Ministry of Micro, Small and Medium Enterprises,' 'Audit Board constituted by Comptroller & Auditor General of India for conducting Performance Audit of Corporate Social Responsibility of the PSUs in Steel sector,' and 'Financial Action Task Force (FATF) constituted by Ministry of Finance, Department of Revenue, Government of India'.

As President of the ICAI, he is the Member ex-officio in all Non-standing Committees of ICAI and Editor of *The Chartered Accountant* journal. A seasoned professional with a futuristic vision, CA. G. Ramaswamy began his illustrious inning in ICAI Council with his election in 2004, and has served the profession holding important positions in both Standing and Non Standing committees of the ICAI ever since. He served as member of all the standing committees of the ICAI viz. Disciplinary Committee (Old and new mechanism), Examination Committee, Finance Committee and Executive Committee. He has made noteworthy contributions in whatever capacities he served the profession, particularly as Chairman 'Committee on Electoral Reforms,' 'Fiscal Laws Committee,' 'Continuing Professional Education Committee,' Vice Chairman for 'Committee on Accounting Standards for Local Bodies,' 'Audit Committee' and 'Committee on International Taxation,' 'Committee on Information Technology,' 'Committee on Corporate Governance,' 'Fiscal Laws Committee,' and 'Commerce Education and Career Counseling'. He has also distinctly served as Convenor of 'Group for Codification of Regulations, Directions of the Council,' 'Information Technology Initiatives Group,' 'ICAI Study Group to recommend CPE credit requirements to CPEC,' 'ICAI Study group for Guidance Note and Model Code of Conduct for Independent Directors,' 'Professional Development Task Force,' and Dy. Convenor 'Infrastructure Acceleration Group'.

During his Council term 2007-2010, he served as a member in Board of Discipline, ICAI-ICSI-ICWAI Co-ordination Committee, Committee on Ethical Standards, Committee for Members in Industry, HR and Administration Committee, Committees of Direct Taxes and Indirect Taxes, Committee for SMPs, Research Committee, Representation Committee, Committee on Insurance and Pension, etc. He also served as a member in International Affairs Committee, FRRB, Editorial Board, Corporate and Allied Laws Committee, etc. During these two terms, he served as a member of Professional Development Committee, Audit Committee, Continuing Professional Education Committee and AASB. He has also served in various sub-groups of the ICAI on Service Tax, CES, DTC, CA (Amendments) Act of ICAI and worked as Chairman SIRC Audit committee of ICAI.

He had been a member of Southern India Regional Council (SIRC) of ICAI since 1994 and went on to become the Chairman of the SIRC for 1999-2000, during which period the SIRC bagged the best Regional Council award and Best Students Association award on all India basis. He was also the member of Body of Board of Governors of Institute of Internal Auditors, [IIA]-Chennai. Earlier, he was the Chairman of the Coimbatore Branch of the ICAI for 1988-89 and a member of the Managing Committee of the Coimbatore Branch of SIRC of ICAI for the period 1984-1989. During 1994-1995, he also served as Director, The Tamil Nadu Industrial Investment Corporation Ltd, an undertaking of Tamil Nadu Government.

CA. G. Ramaswamy is a prolific speaker and writer. He has addressed various national and international conferences on Accounting and Auditing Standards, Taxation, Company Law matters, Banking and various topics related to the CA profession. He has represented ICAI in various international fora, including CAPA & SAFA, and has addressed a series of international conventions and seminars on the themes related to Governance & IFRS.

A keen golfer, he is a member of various social clubs and organisations. He has widely traveled and visited a number of foreign countries as part of international delegations and study tours. ■



OUR NEW VICE PRESIDENT

A man of efficiency and discipline with a deep-rooted interest in academic discipline of accountancy, CA. Jaydeep N. Shah is new Vice-President of The Institute of Chartered Accountants of India for the term 2011-2012. With a fellowship of the Institute and with more than two decades professional standing and of constant and dedicated service to the cause of accountancy profession, he was elected Vice-President of the Institute by the 21st Council of the Institute on 12th February, 2011. He has always dazzled his fellow members with his brilliant and uninterrupted service to the profession that he has been rendering since 1987 with an inextinguishable enthusiasm.

A resident of Nagpur, Maharashtra, CA. Shah started his 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 in 2004. Since then, he has been actively involved with the functioning of the Central Council of the Institute in various capacities, viz. as Chairman, Vice-Chairman and member of its various Committees.

CA. Shah is currently a Technical Advisor on the Small and Medium Practitioners Committee of the International Federation of Accountants (IFAC) that has 159 members and associates from 124 countries across the world. He has been nominated on the International Innovative Network. He is also a Nominee of the Institute on the Committee to Review SIDBI's lending to Micro Small and Medium Enterprise (MSME) sector. He is Director of the Accounting Research Foundation of the Institute, as well as the Chairman of Audit Committee at the Foundation. He has been nominated as the promoter of XBRL India. He has also been nominated on a sub-committee on the Investors Education and Protection Fund, a constitution of Ministry of Corporate Affairs. He is a member of the ICAI-IFRS Task Force of The Institute of Chartered Accountants of India. As Vice President of the ICAI, he is the Member ex-officio in all Non-standing Committees of ICAI and Joint Editor of *The Chartered Accountant* journal.

CA. Shah has shown his professional skills and acumen in all tasks and responsibilities assigned to him both at national as well as international level. Previously, he had served the International accountancy profession as Chairman of South Asian Federation of Accountants (SAFA) Committee on Education, Training and CPD and also as member of the Task Force for Harmonisation of Fiscal & Tariff Regimes in South Asian Association for Regional Co-operation constituted by SAFA. At home, he had been nominated by the Institute (ICAI) on Education, Education Services and their related services Sectional Committee, MSD 9 of Bureau of Indian Standards as well as on Core Group for SMEs at the National Foundation for Corporate Governance (NFCG) as a representative of ICAI. He had also been a member of the Board of Studies-Accounts & Statistics Board of the Nagpur University for three years.

During his tenure as Central Council member of the Institute, CA. Shah worked for the cause of profession by serving in almost all the Committees of the Institute in various capacities, viz. Chairman, Vice-Chairman and member. Before 2010-2011, he served in the Board of Studies of the Institute as Chairman for four terms proving his passion for the studentship and academics time and again, apart from serving on HR and Administration Committee and Committee for Commerce Education & Career Counseling of the Institute as Chairman. He also contributed as Vice-chairman of Committee for Financial Market and Investors' Protection, Peer Review Board and Committee on Information Technology.

Just before getting elected as the Vice-president of the Institute, he served the Ethical Standards Board (second term)



and Financial Reporting Review Board of the Institute as Chairman, and Capacity Building and Small & Medium Practitioners Committee of the Institute as Vice-chairman. He was member of the Editorial Board, ICAI-ICWAI-ICSI Committee, Continuing Professional Education Committee, Auditing and Assurance Standards Board, Professional Development Committee and Committee for Financial Market and Investors' Protection of the Institute during last year.

Before CA. Shah began his tenure in the Central Council, he served at various Committees of the Western India Regional Council of ICAI for nine years (1995-2004) in various capacities, viz. chairman, convener, etc., including as member of its Executive Committee. He showed his keen interest and worked a lot towards the welfare of CA students in the capacity of the Chairman of the Students Committee for three years in continuity. Later, he also took charge of Professional Development Committee and Continued Professional Education Committee as Chairman and worked for the core issues of the profession.

Under his tenure as Secretary, the Nagpur Branch was adjudged All India Best Branch. In his tenure, Nagpur Branch was declared Best Branch of WIRC twice. Later, he became the Chairman of the Branch and, again, the Branch was declared Best Branch of WIRC third time in continuity. During his stint at Nagpur Branch (1991-94), he served on its 17 committees in the capacity of their Chairman.

As an avid academic, CA. Shah has attended and contributed to numerous national and international seminars and conferences on the issues of professional interest. He has addressed at length on various issues including networking, investment strategies, e-learning, initiatives on education for accountancy showing his passion for the profession and its core concerns.

A student of thorough merit and brilliance, CA. Shah had secured first rank in M. Com. in the Nagpur University. He, therefore, was consequently awarded by the Jawaharlal Nehru Memorial Fund. He was also awarded the P. Satyanarayanan Gold Medal for the same. He was a recipient of Govt. of India Open Merit Scholarship.

Dear friends,

Our first Prime Minister Shri Jawaharlal Nehru had said on the eve of the independence on 14th August, 1947, addressing the Constituent Assembly: *We have hard work ahead. There is no resting for any one of us till we redeem our pledge in full, till we make all the people of India what destiny intended them to be. We are citizens of a great country, on the verge of bold advance, and we have to live up to that high standard. All of us, to whatever religion we may belong, are equally the children of India with equal rights, privileges and obligations.* Certain lines of Robert Frost's poem were found on his notepad and were endorsed by him in spirit: *The woods are lovely, dark and deep. But I have promises to keep. And miles to go before I sleep, And miles to go before I sleep.* I am in complete agreement with those lines and I believe that there is so little time and there is so much to do.

Let me here refer to Lord Buddha who warns: ... *we can make two mistakes while treading the path to success and ethics—not going all the way and not starting at all.* A strong intellectual heritage and a tradition of trust that our profession has, always place a great challenge before us. I acknowledge, it is my honour that I have been entrusted by the Council of the Institute to lead the profession amidst this challenge. I understand that just being on the right track will not be enough. What we require is a certain pace to be in the run while pursuing excellence for the welfare of our society.

It is always right to begin—irrespective of the constraints of time or space. We can start whenever and wherever. But I believe, if we begin with humility, we will conclude with some sustainable achievement. It is not strange that, with a humble beginning, we always discover an infinite scope of opportunities and possibilities. Let me say if we start with openness, conditions will turn conducive themselves. I still recall vividly the height of optimism of a brave girl called Anne Frank who wrote in her Diary while still surviving the Holocaust: *How wonderful it is that nobody need wait a single moment before beginning to improve the world.* We must begin. Plato had also said: *The beginning is the most important part of the work.* All of us have dreams and power to realise them, but all we need is to begin,

if we want to achieve success.

As I assume the Institute's office as its 59th President, I thank all and stay grateful to them for their help and support. Let me confess that it is my honour to serve as the President of the Institute. To begin with, when the outgoing President of the Institute, CA. Amarjit Chopra, said: '...the Institute will be in abler and safer hands after me...', I can only submit my gratefulness to him for his kind acknowledgement. I was guided and tuned by his sheer professional competence. I got ample opportunities to represent on Institutional matters in particular and professional matters in general at various national and international frontiers in the capacity of the Vice-President. I would like to take this opportunity to congratulate CA. Jaydeep Narendra Shah on his election as the Vice-President of the Institute. I am sure, his professional competence and experience will undoubtedly accelerate our endeavours and, particularly, help me in carrying out my responsibilities in the present capacity.

I wish to record my gratitude to the members of the 21st Council for reposing trust in me by electing me as the Vice-President first and, then, as the President of the Institute. It would be inappropriate if I do not thank the members of my profession for their constant and agreeable support. With your cooperation and support, we will write many success stories for the profession and its stakeholders. Let us bring élan vital to our profession. I assure all stakeholders of the profession that we would take stock of all tasks that have not yet begun, or, have been unfinished or in progress, and then we would bring them to conclusion with our organised cooperation and efforts. Past many a time gives us reasons to march ahead and, at times, asks us to stop, look back and evaluate, and then prepare to march ahead. The list of accomplishments should grow forever, and its impressions on policy, planning and implementation should show. The process of development of the profession should continue. When



I say 'our policy, planning and implementation', I am fundamentally talking about the socio-economic and historical reality of our profession and its gradual empowerment. I am also talking about capacity-building of small and medium practitioners of the profession in particular and about nation-building in general. It is an onerous task and I would like to take it up and continue our march to development.

It is true that our profession is at an enviable height. Number of members has increased and so has the number of Branches and overseas Chapters. Membership is in the process of getting consolidated and empowered. We have been a great help to our Government in contouring their accounting procedures. Our Act is in the process of getting revised. We have added to the infrastructure in the past and will continue to do so as we come across a need. Our initiatives have helped the accounting professionals in creating an efficient space where they would deliver and contribute to the growth of our nation as well as of the world. We have successfully reached our international stake-holder community through a number of MRAs and MoUs with various accounting bodies. Almost all international accounting bodies acknowledge today our role in the growth of profession. We are at the helm in convergence of accounting standards while efficiently preserving our indigenous ones keeping in view the structure and process of our economy.

In the background of these developments, I personally would like to concentrate our efforts to creating a unique *ICAI brand* that would be recognised and treated with respect all over the world, not just in our nation. We will work towards achieving this goal together. I have always believed in the power of togetherness: together, we achieve more. Togetherness is divine—it has the power to bring progress and success to our existence and endeavours respectively. World is full of people who dream and who say that we should act, but there have been very few who actually rise to the occasion and start to act. We need to take a lead, I feel, and move together in unison to substantiate our goals and realise our vision. If we fail or fall, we will start all over again with courage. Entrusted by the Council and committed to the maintenance of integrity and autonomy of my profession, I assure all our stakeholders—members, students and employees of

the Institute on one hand, and society on the other—that we will accomplish all the goals together. In areas where we feel we have reached a standstill, we will explore and strive together to find out an opportunity to turn over a new leaf again. I would like to appeal and call upon my Council colleagues and the staff of the Institute: let us make our endeavours a great success. Let us remember the words of the philosopher king, Dr. Sarvepalli Radhakrishnan: *All our world organisations will prove ineffective if the truth that love is stronger than hate does not inspire them.*

In line with the progress our Institute has been making since inception, I would like to have a look at some of the recent developments that have created an opportunity for the profession in particular and for our society in general:

Action Plan for 2011-2012

I have made public an elaborate Action Plan for the Institute to be implemented during 2011-2012 in the best interests of our profession at large and of the members and students in particular. Our goal primarily will be to uphold public confidence in ICAI and to create global chartered accountants with the help of inducing best international practices in them. To establish the Indian CA brand, I would like to institute awards to our members for their contribution to the profession and the nation at large, and to the highest tax-payer in both individual as well as corporate category. We would try to streamline the tendering procedures and to create awareness about good governance and best accounting practices in cooperatives as well as in NGOs. We would try to hold frequent and focused interactive meetings with CFOs, CEOs and internal auditors to understand and address contemporary issues and needs. I would like to start national study circles at major places and educational services for students in rural and mofussil centres. As part of our international initiatives, I would like to have strategic collaborations with more international accounting bodies so that we could provide a global outlook to our members. Readers may refer to the complete *Action Plan (2011-2012)*, which is printed immediately after this message.

Meeting Shri Murli Deora and Other MCA Dignitaries

I am happy to acknowledge that as Shri Murli Deora

takes charge of the Ministry of Corporate Affairs (MCA) as its Cabinet Minister, Shri R. P. N. Singh and Shri D. K. Mittal have assumed the charge of its Minister of State and Secretary respectively. I am sure that under this new dynamic leadership, the Ministry will usher in a new era of development and growth. I along with the Vice-President of ICAI, CA. Jaydeep N. Shah, and the Secretary of the ICAI, Shri T. Karthikeyan, met and apprised them of the working of the Institute and its contribution to nation-building. Here I also wish to record my gratitude and appreciations to the former Minister of State and the Secretary of the MCA, Shri Salman Khursid and Shri R. Bandyopadhyay respectively for their constant support and encouragement in all our initiatives.

I am sure that they would continue to do so in future as well. To our personal invitation to address the profession at our Annual Function held in New Delhi, Shri D. K. Mittal, Secretary, MCA, came to our Annual Function as the Chief Guest and gave a special address on the occasion.

I along with Vice-President CA. Jaydeep N. Shah and Secretary Shri T. Karthikeyan recently met Shri Murli Deora. Various issues arising out of the Companies Bill, 2009 were discussed, viz. rotation of auditors, implementation of IFRS, compliance for corporate social responsibility as per the Bill and restriction on number of directorship. Issues regarding the role and responsibility and decent remuneration of independent directors, and appointment of people with domain knowledge and professional capabilities as independent directors were also taken up. We expressed our conviction to continue with the empowerment of small and medium practitioners.

International Initiatives

MoU with CICA: It is again a pleasure to inform all of you that we have gone a step further in establishing our Indian CA brand and signed an MoU recently with the Canadian Institute of Chartered Accountants (CICA). It was signed by the President and Chief Executive Officer of CICA, Mr. Kevin Dancey, and myself along with the then President CA. Amarjit Chopra. It was a redefining moment as it allowed our members to be a part of a so-called *Elite Zone* of the Western world.

CAPA Strategic Committee Meeting: This is to inform that I recently attended the Strategic Committee meeting of CAPA held in Manila, Philippines. Strategic Committee is the think tank of the CAPA, which *inter alia* dwelt on wider perspective of promoting the profession regionally and globally by undertaking activities in serving the public interest and tends to take into account a broader integration of various stakeholders in achievement of enhancing the standards and development of the profession. The meeting dwelt on strategic thrust areas namely, role of capacity building and leadership on emerging issues and providing a platform for addressing the commonality of issues which affect the profession's credibility.

PAODC Meeting: I also happened to attend the first meeting of the newly-constituted Professional Accountancy Organisation Development Committee (PAODC) of IFAC recently with the immediate past-President CA. Amarjit Chopra in Singapore, which takes over the reins of the erstwhile Developing Nations Committee of IFAC. The meeting *inter alia* discussed the strategic plan of the Committee and divided the work programme of the Committee into three broad areas, international organisation collaboration programme, ambassador's programme and mentoring facilitation programme.

Indo-UK Task Force on Corporate Affairs: I along with the then President CA. Amarjit Chopra, and Secretary Shri T. Karthikeyan with other officials of the Institute attended the 5th meeting of Indo-UK Task Force on Corporate Affairs recently in New Delhi. The meeting *inter alia* focused on mutual sharing of our respective perspectives of promoting good corporate governance, corporate sustainability issues, promoting audit quality and auditor oversight, collaboration and mobility of professionals and qualifications. We also shared the development with regard to our convergence with IFRS in the context of carve-outs *vis-à-vis* such emulation in the EU context. The two sides with great interest noted the emergence of related corporate social responsibility and best practices including environment getting due leverage in the Director's Report. We cleared our position that we were fully compliant with the system of quality assurance, investigation and penalty, and that our Quality Review Board was quite independent, as more than 50 per cent of its members are from outside the profession, which

gets its administrative and secretarial support through the Indian Institute of Corporate Affairs, Government of India. We further explained that, under new dispensation, the power to discipline our members is with the new Disciplinary Committee and Board of Discipline which are not under our Council's control. Besides, the final authority on punishment to be given to the guilty is the Appellate Authority to be constituted by the Central Government, not our Council. We informed them that while we already have a functional mutual recognition arrangement with ICAEW, the process for similar arrangements with ICA Scotland and ICA Ireland would be soon revived.

Representation to Parliamentary Standing Committee

As you know, I along with my Central Council colleague CA. Jayant Gokhale, the then Chairman, Direct Taxes Committee had appeared before the Parliamentary Standing Committee on 19th January, 2011 for an oral hearing regarding the Direct Taxes Code Bill, 2010, and our views were favorably considered. However, certain questions were raised by the Chairman and the members of the Parliamentary Standing Committee with regard to our suggestions. We have recently submitted a detailed written reply to the Committee.

Development in Convergence of Accounting Standards

In accordance with the decision of the Council and the suggestions of NACAS, the Indian Accounting Standard on Agriculture is being redrafted. We decided to make amendment in existing AS 11 on the lines of Indian Accounting Standard (Ind AS 21), '*The Effects of Changes in Foreign Exchange Rates*' to provide an option to defer the exchange differences arising on translation of long-term foreign currency items and recognise the same in profit or loss over the life of such items instead of its immediate recognition, to be followed by the companies after paragraph 46 of AS 11 ceases to be effective, i.e., from 1st April, 2011. It is a matter of immense satisfaction to share that we have



completed the task of formulating Indian Accounting Standards converged with IFRS which were submitted and cleared by National Advisory Committee on Accounting Standards (NACAS) for recommendation thereof to the Ministry of Corporate Affairs (MCA) for the purpose of their notification. We have been able to fulfil the commitment that we had made to the Ministry and have been able to adhere to the stipulated timeline.

IFRS Certification Course: To meet the varying requirements of different stakeholders, we have taken all necessary steps to create mass awareness about the preparedness with regard to the convergence. I am pleased to inform that so far 2,607 members have been successfully trained through 100-hour Intensive Training Programme of the IFRS Certification Course across the nation. New batches have been started in Bangalore, Chennai, and Hyderabad.

Training Programme for C&AG: I am pleased to inform that a three-day training programme on IFRS was organised recently in Delhi for the officials of Comptroller & Auditor General (C&AG) of India. Chief Guest Shri Sunil Verma, Deputy C&AG, along with Ms. Ila Singh, Principal Director, C&AG, Chairman-ASB, and the undersigned, addressed the participants on the occasion. Around 50 participants from C&AG participated in the programme. Chairman and Secretary of ASB CA. Manoj Fadnis and Dr. Avinash Chander respectively must be congratulated for their relentless efforts in this regard.

Five New Committees in the Institute

Public Interest Advisory Committee: The role and responsibility of the Committee is to understand the need of the public and their requirements with reference to our profession. It will also extend professional advice to the Government and corporates, and to the common man. It will also identify proper projects with regard to CSR for the corporate and advise them to implement those projects in the interest of the society. It will cater to the needs of the corporates and guide and support them in newer areas of concerns with an understanding about the impact on the nation's wealth. Apart from this, social audit and welfare schemes of the Government would be carried out with the help of C&AG and other agencies.

Committee for Members in Entrepreneurship & Public Services: This committee will take care of the members in business and trade, who, in large number, have acquired professional skills following the standard set by the Institute and doing their own business in service, manufacturing and trade sector. This Committee will guide them in moving forward in business and motivate many more to enter this entrepreneurship. Apart from this, the Committee will also take care of our members who are working in the judiciary and other government administration.

IFRS Implementation Committee: Considering the current developments in India and in majority of other countries, which require to prepare their financial statements either in compliance with the IFRS or converged IFRS, and considering the globalisation of profession, this Committee will provide support to the member corporate, chief executives, CFOs, etc. While focusing on IFRS, this Committee will enhance the knowledge of our members and users of our services, and organise seminars, conferences and workshops in a more consistent manner.

Committee for Co-operatives and NGO Sectors: This Committee will support and guide the cooperative sector in streamlining their audit and raising the level of their governance, and in bringing out their financial statements in uniform manner in compliance with appropriate accounting standards. NGOs are receiving huge donations within and outside India, which need to be deployed in a manner required under the law. The Committee will also help the NGOs in

providing support and guidance towards preparation of uniform financial statements and disclosures.

Disciplinary Committee — Satyam Bench: There is a need to speed up the disciplinary proceedings specifically in Satyam-related cases. This Bench will consider only these specific cases and follow up with the legal authorities towards conclusion of such cases within the set time frame.

Infrastructural Initiatives

Foundation Stone Laying at Patna, Ahmedabad and Saharanpur Branches: I am delighted to inform that foundation stone for the Patna Branch building was laid, where Hon'ble Chief Minister of Bihar Shri Nitish Kumar was the Chief Guest. I along with the then President CA. Amarjit Chopra and my Central Council colleague CA. Anuj Goyal attended the occasion. We also visited Saharanpur for the foundation stone laying ceremony of its ICAI Bhawan. I also visited Ahmedabad Branch for the foundation stone laying ceremony of its new ICAI Bhawan along with the then President CA. Amarjit Chopra.

Management and Maintenance of Hardayal Library: I am happy to inform that the Institute as a part of its social responsibility and to provide library facilities to CA students has undertaken to manage and maintain Hardayal Library at six locations in collaboration with the Municipal Corporation of Delhi. The Library at Chandni Chowk was inaugurated by Shri Prithvi Raj Sawhney, Mayor of Delhi, in the presence of Smt. Aarti Mehra, Former Mayor and, Shri Yogesh Chandolia, Chairman, Standing Committee. I also attended the inauguration along with the then President CA. Amarjit Chopra, my Central Council colleagues CA. Vinod Jain and the then NIRC Chairman CA. Atul Kumar Gupta among others. Facilities made available at the well-equipped Library include an air-conditioned hall with a spacious reading area. I am sure that this facility would help our students in achieving their goals.

Initiatives for Members

MoU for Insurance against Professional Indemnity: I am indeed pleased to inform our members that we have recently signed an MoU with New India Assurance Co. Ltd. extending facility for insurance against professional indemnity for members and CA firms. This MoU will provide cushioned insurance scheme

to our members at a heavily discounted premium and would provide indemnity insurance to them covering a risk of ₹10 lakh with an extension of allied professional colleagues and for CA Firms including partners with coverage of ₹1 crore to ₹2 crore. It is a renewable scheme for a year applicable to all members and CA firms registered with the Institute.

Agreement with CCH Wolters Kluwer Pvt. Ltd.:

We have entered into an agreement with CCH Wolters Kluwer Pvt. Ltd. under which they would offer mailer and free subscription of the tracker to all our members for one year and, thereafter, for the immediately succeeding year, a discount of 25 per cent would be offered at the rate of ₹3,550/-. Members can use this benefit by referring to the ICAI website.

Joint Seminar with University of Madras: I am happy to inform that we organised a joint seminar with the University of Madras recently on *Convergence of Indian Accounting Standards with IFRS*. Col. Dr. G. Thiruvassagam, Vice Chancellor of the University, inaugurated the seminar. I along with my Central Council colleague CA. S. Santhanakrishnan delivered special address in the inaugural session.

ICAI Channel: We are planning to start *ICAI Channel* as well as Web TV to provide support to both our members and students towards continuing professional education as well as Live Virtual classes.

Initiatives for Students

GMCS and Orientation Programmes to be Conducted Twice: To improve the quality of our delivery to our newly-qualified members, we have taken a decision to conduct the GMCS course twice in future during the practical training. We have also decided to bring further qualitative improvements in the GMCS course/Orientation Programmes by making it more practical-oriented with an emphasis on technical aspects of the chartered accountancy course. Board of Studies will finalise the syllabus and bring out the revised study material at the earliest.

e-Diary: To make practical training of the articled assistants more effective, we have decided in principle to introduce e-Diary system for them in a phased manner, so that training undergone by them could be monitored. It will facilitate us to analyse and ascertain

the direction in which the profession is moving and the nature of services which are being provided by our members to our students, apart from monitoring students and curb dummy training. The data so collected will be kept confidential.

Launch of Student Registration Centres: Students registration centres will be launched very soon across the nation in the offices of chartered accountants. We are also planning to set up more Study Centres by providing infrastructure to all our Branches.

Revolutionary saint-poet Thiruvalluvar, also known by names like Theiva Pulavar, Valluvar and Poyyamozhi Pulavar, says in his *Thirukkural* (Sacred Couplets), a work of ethics: *Learning is excellence of wealth that none destroy; to man nought else affords reality of joy*. He goes on to say: *Those who can agreeably set forth their acquirements before the learned will be regarded as the most learned among the learned*. I firmly believe in avoiding those actions at all times, which bring fame but no real benefit. I agree absolutely if we cannot live in harmony with the world, despite having learnt many things, we will still be called ignorant. I would love to receive your feedback and suggestions during my tenure as President, as this may help us in investing and channelising our efforts in the right direction in improving our strategy and its effectiveness, and, thereby, changing the image and identity of the profession for betterment. A feedback form in this regards has been printed elsewhere in the Journal.

Let us greet all with a smile. Let us show respect to all and, together, we will touch new heights of success for sure. Dutch artist Vincent van Gogh says: *Great things are not done by impulse, but by a series of small things brought together*. Let me take this opportunity to congratulate all of you, on behalf of the Council, on the festival of colours, *Holi*, in advance. May this festival spread colours of merriment, delight and togetherness amongst all!

Best wishes!!!



CA. G. Ramaswamy
President, ICAI

February 23, 2011





ACTION PLAN

CA. G. Ramaswamy

President, ICAI, New Delhi

Goals

- Uphold public confidence: ICAI will act in the public interest and help our members excel in Independence, Integrity and Quality
- Create Global Accountants by inculcating international best practices
- Strengthen Corporate Governance
- Render assistance to Government in promoting nation building
- Promote Chartered Accountants as a complete business solution provider
- Positioning the profession for a greater role in nation building and public participation
- Positioning ICAI as the single premier source of providing of multi-disciplinary services
- Act as assurance provider for utilisation of government grants and assessment of end use of government funds and welfare schemes
- Play pro-active and significant role in international standards setting process
- Creation of a national think-tank and public advisory committee in the interest of the nation
- Constitute Regional and National groups of experts to provide support to formulate Forms and Rules for Direct Tax Code and hand over the same as our contribution to the nation
- Improve ICAI interface with corporate sector and trade and industry associations
- Tie-up with universities for linking research studies of ICAI-ARF with Ph.D programmes
- Create Regional Standard Setters Advisory Group (RSSA) and National Standard Setters Advisory Group (NSSA) for the involvement and inputs from the membership at large in the standard setting process
- Re-alignment and promotion of Post Qualification courses with current requirement of the profession
- Accelerate growth of membership and students
- Strengthening the relations with Central Government and the State Governments to utilise the services of profession in various areas
- Supporting implementation inputs of Goods & Services Tax in India and new legislations

- Special Committee for Members in Entrepreneurship and Public Service
- Constitute Public Interest Advisory Committee for improving transparency
- Development of faculty and pool of 'Trainers' to impart Continuing Professional Education and Coaching classes
- HRD – Focus on recruitment and training
- CABF – Strengthening to improve need-based support
- Speedy implementation of Project Parivartan
- Speedy development of infrastructure at branches and regions
- Retirement Plan for members
- Insurance Schemes for members and students

Branding

- Advertisement and publicity about ICAI and Profession
- National and international brand building exercise by organising special programmes and recognising trade, business and industry.
- Introduce Highest Tax Payer awards for individuals and corporates
- Confer awards on members for outstanding contribution to the nation and the profession
- Remember the Foundation Day as Day of Festival of thinkers and involve top economists, academics, thinkers, educationalists, judicial authorities and leaders in public life as a mark of respect

Members in Practice

- Seek exemption from appearing at exams for acquiring additional qualification from any university or management institute or any other international body to enhance the profile of our members
- Streamline tendering procedures for the profession
- Creating facilities for use by Small and Medium Practitioners at affordable rates
- Enhancing capacity to adopt new technical standards and emerging best practices
- Create awareness about good governance and best accounting practices in the Co-operative and NGO sectors

Samsung ad



- Encouraging multidisciplinary partnership and Limited Liability Partnership.
- LLP consultancy entities and corporate form of practice without affecting CoP status.
- Special cell to promote mergers and networking with Indian and international accounting firms.
- IFRS hands-on training and e-learning
- XBRL initiatives and promotion
- Implementation guide to new pronouncements on technical standards
- Promoting development of IT-based tools for practice
- Create national and regional Faculty Grid to create world class faculty
- Continuing Professional Education programmes through Satellite and Web TV
- Coordinating with senior firms to provide opportunity for SMPs as a part of capacity building measures and create legal framework
- Strengthen capacity to facilitate rendering of services to larger clients
- Recognition and creating talent pool among the young practitioners
- Facilitating Accounting, Auditing and management consultancy outsourcing opportunities and export of accounting and other professional services
- Developing professional skills in newer area

Members in Industry

- Frequent and focused interactive meetings with CFOs and CEOs and internal auditors to understand and address contemporary issues and needs
- Create Industry-specific group for designing and developing course-ware and technical guide to enhance the capacity of the profession for effective core competence in respective fields.
- Greater involvement of members in industry in the research activities of ICAI
- Create awareness among members about industry-specific exposure in different fields
- Update portals sector-wise
- Facility to switch over from employment to practice to utilise the core competence and special knowledge in the industry
- Experienced Chartered Accountants Conclave with trade bodies to focus on employment opportunities
- Create new employment opportunities by aggressive marketing within India and internationally

- Industry-specific e-learning and certificate courses

Students

- National Study Centres at major places
- Student registration centres – at CA's offices
- Educational services for students in rural and mofussil centers
- Integrate Indian and international universities with ICAI
- Creation of Web Portal
- Development of education portal for students and Web TV
- Focused career counseling programmes in schools and colleges throughout the country
- Adoption of district schools and colleges to provide more support for commerce education
- Join CA movement for the growth in enrolment for CA curriculum concept of 'think beyond commerce education'
- Career counseling cell to educate the value of CA qualification as a career option
- Create Special Library facility through local bodies and educational institutions
- Create Chairs in Universities in India and abroad.
- E-learning tool for improving performance and student participation.
- Universal classes through Satellite and ICAI TV channel

International Initiatives

- Strategic collaboration with relevant international bodies for global opportunities and exposure
- Popularising Indian CA qualification in countries of interest to Indian accountancy profession
- Positioning the Indian Accountancy & Auditing profession globally
- Technical Cooperation to developing and least developed countries
- Capacity building of the profession through increased Member-to-Member and Firm-to-Firm contact in overseas jurisdiction
- Towards increased mobility of ICAI members by augmentation & consolidation of the recognition arrangements already in place in terms of Implementation Groups
- Services to students and members abroad
- Promoting professional opportunities abroad
- Resource sharing and trade facilitation
- Representation before Government accruing of international developments
- Publication and Research activities



Journal Increasingly Becoming More Useful

The February 2011 issue, which focused on 'Bank Branch Audit' proved to be highly useful for members as well as students. The issue comprehensively covered various important aspects of bank branch audit. All the authors deserve to be praised for enriching the knowledge of the members and students. The features 'ICAI Achievements' and 'Major Council Decisions' were also highly informative and updated us on the activities which have been, and are being initiated by the Institute for the profession.

-CA. S. Jain



The emerging professional issues throw up new challenges for us. The January 2011 issue aptly addressed this through the insightful articles on PSU audit, HR Accounting, Audit Committee and IFRS implementation. While we CAs are gearing up for another successful year of Bank audits, PSU Audits and Tax Audits, many of us are also working overtime to facilitate the process of IFRS convergence and also implementing new technologies in the form of risk management & control frameworks, ERP, corporate governance, CSR, Sustainability services and other best practices. Spearheading these radical changes in the business review, reporting and regulatory landscape calls for exhaustive knowledge management. Cutting edge software tools, data mining and e-office suites are increasingly employed by many of us to equip ourselves with the latest updates in the professional sphere. In this august venture, ICAI stands out as a beacon of light, whether it is the noble initiative of Capacity Building for CA Firms and launch of Certificate Courses or the novel model of virtual classes and CPE in e-learning mode. We are indebted to our alma mater for the incessant efforts made to ensure that we Chartered Accountants continue to be the Change Accelerators for a new business milieu, catapulting our profession to the highest levels of capability, performance, impact, value-add and credibility.

-CA. Arijit Cakraborty



I read with great interest the article published in January 2011 issue of 'The Chartered Accountant' on Audit of Public Sector Undertakings by CA. K Sekar. It is a thoughtfully prepared article full of informative data which will be very useful for all CAs who do public sector audit.

-CA. K. George Philip

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.

FORM IV (SEE RULE 8)

1. Place of Publication : New Delhi
2. Periodicity of its publication : Monthly
3. Printer's Name : Vijay Kapur
Nationality : Indian
Address : Journal Section
Institute of Chartered Accountants of India, Indraprastha Marg, Post Box 7100, New Delhi-110002.
4. Publisher's Name : Vijay Kapur
Nationality : Indian
Address : Journal Section
Institute of Chartered Accountants of India, Indraprastha Marg, Post Box 7100, New Delhi-110002.
5. Editors Name : CA. G. Ramaswamy
Nationality : Indian
Address : Journal Section
Institute of Chartered Accountants of India, Indraprastha Marg, Post Box 7100, New Delhi-110002.
6. Name and addresses of individuals who own the newspaper and partners or shareholders holding more than one per cent of the total capital : Council of the Institute of Chartered Accountants of India, constituted under the Chartered Accountants Act, 1949 (Act XXXVIII of 1949). There is no share capital.

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

Date: sd/-
February 23, 2011 Vijay Kapur
Signature of publisher



The article on "Implementation of GST" by CA. Ajay Gupta and "LLP ACT" by CA. P.N. Shah published in August 2010 issue proved to be very helpful to understand these topics in detail. As vast changes are going to occur in the economy, it is desired that more valuable articles relating to DTC, GST, IFRS and other such areas are published to update the readers. I hope Institute will continue to publish such write-ups.

-CA. Bhupesh Chaubey, Bhilai

Write to Editor

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

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

MEMBERS OF THE TWENTY-FIRST COUNCIL & THE SECRETARY [as on 12th February, 2011]



1st Row (L to R): CA. Vinod Jain, CA. Abhijit Bandyopdhayay, Shri T. Karthikeyan (Secretary), CA. Jaydeep N. Shah (Vice-President), CA. G. Ramaswamy (President), CA. Amarjit Chopra, CA. Bhavna G. Doshi, CA. J. Venkateswarlu

2nd Row (L to R): CA. Atul C. Bheda, CA. Sanjeev K. Maheshwari, CA. Anuj Goyal, CA. Subodh K. Agrawal, CA. M. Devaraja Reddy, CA. K. Raghu, CA. V. Murali, CA. Sanjay K. Agarwal

3rd Row (L to R): CA. Charanjot Singh Nanda, CA. Mahesh P. Sarda, CA. Pankaj I. Jain, CA. Nilesh S. Vikamsey, CA. Shiwaji B. Zaware, CA. P. Rajendra Kumar, CA. Jayant P. Gokhale, CA. Rajkumar S. Adukia

4th Row (L to R): CA. S. Santhanakrishnan, CA. Ravindra Holani, CA. Naveen N. D. Gupta, CA. Pankaj Tyagee, CA. Sumantra Guha, CA. Dhinal A. Shah, CA. Madhukar N. Hiregange, CA. Vijay K. Garg, CA. Manoj Fadnis

Not in Picture: Shri Anil K. Agarwal, Shri Ashutosh Dikshit, Shri Deepak Narain, Shri Prithvi Haldea, Shri Sidharth Birla, Dr. T. V. Somanathan, Smt. Usha Narayanan, Smt. Usha Sankar



CA. G. Ramaswamy Takes Charge

Immediate ICAI past-President CA. Amarjit Chopra and ICAI Secretary Shri T. Karthikeyan helps ICAI President CA. G. Ramaswamy in taking over the President's Collar. (February 12, 2011)



Meeting with MCA Minister

ICA I President and Vice-President CA. G. Ramaswamy and CA. Jaydeep N. Shah were greeted by Union Minister of Corporate Affairs Shri Murlidhara Deora.



Meeting with Deputy Chair, Rajya Sabha

ICA I President CA. G. Ramaswamy greets Rajya Sabha Deputy Chair CA. K. Rahman Khan. (February 21, 2011)



MoU for Insurance against Professional Indemnity of Members

ICA I President (then Vice-President) CA. G. Ramaswamy and the immediate past-President (then President) CA. Amarjit Chopra, and General Manager of New India Assurance Co. Ltd. Shri Virander Kumar on the occasion of MoU between ICA I and New India Assurance Co. Ltd. (February 10, 2011)



CAPA's Strategic Committee Meeting

ICA I President CA. G. Ramaswamy with CAPA President Mr. In Ki Joo, President of Philippines Institute of Certified Public Accountants Mr. Jose C. Cabalum, Jr. are seen joining hands on the occasion. (February 18 & 19, 2011)



IFAC's PAODC Meeting in Singapore

ICA I President CA. G. Ramaswamy and the immediate past-President CA. Amarjit Chopra can be seen with other significant members of international accounting fraternity at the meeting of Professional Accountancy Organisation Development Committee of IFAC in Singapore. (February 14 & 15, 2011)



MoU with CICA

President of Canadian Institute of Chartered Accountants Mr. Kevin Dancey and then ICAI President CA. Amarjit Chopra signed the MoU from respective institutions. Central Council member CA. Manoj Fadnis and CIRC Chairperson CA. Kemisha Soni can be seen supporting the occasion. (February 7, 2011)



Spreading Awareness about XBRL

ICAI Vice-President CA. Jaydeep N. Shah shares the dais with CA. T. V. Mohandas Pai, Director, Infosys Technologies Ltd., and CEO of XBRL International, Mr. Tony Fragnito on the occasion of National Conference on XBRL in Mumbai. (February 18, 2011)



Auspicious Ceremony at Rohini Land

ICAI President (then Vice-President) CA. G. Ramaswamy and the immediate past-President (then President) CA. Amarjit Chopra along with the Central Council colleague CA. Sanjay Agarwal and the then NIRC Chairman CA. Atul Gupta performing the auspicious rites of the Bhoomi Pujan at Rohini land of the Institute. (February 2, 2011)



Infrastructure Leap for Faridabad Branch

ICAI President CA. G. Ramaswamy inaugurates the Computer Lab at the Faridabad Branch of ICAI, while Vice-President CA. Jaydeep N. Shah, Central Council member CA. Sanjay Agarwal, past Central Council member CA. Vijay Gupta, NIRC Chairman CA. Rajesh Sharma and office bearers of Faridabad Branch share the moments. (February 22, 2011)



Inauguration of First Floor of Hubli Branch

ICAI President (then Vice-President) CA. G. Ramaswamy and the immediate past-President (then President) CA. Amarjit Chopra are seen along with the officials of the Hubli Branch on the occasion. (February 6, 2011)



Invoking Gods to Bless Saharanpur Branch Building Foundation

ICAI President (then Vice-President) CA. G. Ramaswamy and the immediate past-President (then President) CA. Amarjit Chopra offering yajna with the officials of the Saharanpur Branch of ICAI towards foundation stone laying ceremony. (February 1, 2011)



Decennial Royal Celebrations at Udupi

ICAI President (then Vice-President) CA. G. Ramaswamy lights the lamp for the decennial celebrations of the Udupi Branch of SIRC, while the past-President CA. T. N. Manoharan, Padma Shri, and Central Council colleague CA. K. Raghu among others share the spirit of the moments. (February 5, 2011)



FEEDBACK FORM

Dear Member/Student of ICAI,

As part of an intensive and comprehensive drive to serve its members and students in most efficient, responsive and hassle-free manner, the ICAI has launched several initiatives, including hi-tech online mechanisms, systems and facilities. However, while it is continuous endeavour to provide the best, prompt and most efficient service to you, we believe there is always scope for improvement. We would therefore request you to take a few minutes to fill up this form to enable us to serve you better. Feedback given by you would be kept strictly confidential.

Visit or Phone Call to the Institute

1. Date and time of your visit/phone call. Date: _____ Time: _____
2. Office Visited/called: Head Office ☐ Regional Office ☐
Western ☐ Southern ☐ Central ☐ Eastern ☐ Northern ☐
3. Section/Department visited/called _____
4. Did the reception direct you to the correct official? Yes ☐ No ☐ Went directly ☐
5. Did you have to wait for the concerned official? Yes ☐ No ☐
If Yes- For how many minutes 0-5 ☐ 5-15 ☐ more than 15 ☐
6. Based on your interaction with the concerned official, please tick:

• Understanding of your query:	Excellent ☐	Good ☐	Average ☐	Poor ☐
• Behaviour:	Courteous ☐	Normal ☐	Rude ☐	Indifferent ☐
• Timeliness:	Prompt ☐	Lethargic ☐	Delaying ☐	
• Grievance Handling:	Intelligent ☐	Good ☐	Satisfactory ☐	Poor ☐ Not applicable ☐
• Effort:	Extra effort ☐	Out of the way help ☐	Tried level best ☐	
• Would you again like to meet/call the concerned official:	Yes ☐	No ☐		
7. Has your visit/phone call to the Institute been fruitful: Yes ☐ No ☐
8. Would you like to mention the name of the official(s) you met/called _____
9. Is this your 1st visit/phone call to this office of the Institute? Yes ☐ No ☐
If no, do you feel the service has improved? Yes ☐ No ☐

Hi-tech Initiatives

10. How useful do you find the e-Sahaayataa initiative? Prompt ☐ Average ☐ Slow ☐
11. How useful do you find the helpline numbers of the ICAI? Very Useful ☐ Useful ☐ Average ☐ Unsatisfactory ☐
12. Are you satisfied with various online facilities available on ICAI website? Yes ☐ No ☐

Suggestions

13. Your suggestions to Help Us Serve You Better and take ICAI to further glorious heights.

14. What is/are your expectation(s) from the ICAI in the next 12 months?

15. What would be your contribution to achieve best goals set by the ICAI?

Signature

Name: _____

Membership No./Student Regn. No. _____

The form should be sent to: Officer Incharge, Members & Students Section, The Institute of Chartered Accountants of India, ICAI Bhawan, P.O.Box No. 7100, Indraprastha Marg, New Delhi-110002.

ICAI Celebrates a Year of Success in its 61st Annual Function

The Institute of Chartered Accountants of India celebrated yet another year of success at its 61st Annual Function held on 11th February, 2011 in the convention hall of The Ashok hotel, 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 Secretary Ministry of Corporate Affairs Shri D.K. Mittal. Former Union Minister CA. Suresh Prabhu also graced the occasion with his presence. 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.



▲ Secretary Ministry of Corporate Affairs Shri D.K. Mittal inaugurates the function as the then ICAI President CA. Amarjit Chopra, the then Vice President CA. G Ramaswamy, ICAI Secretary Shri T. Karthikeyan and the then NIRC Chairman CA. Atul Gupta look on.

At the outset ICAI Secretary **Shri T. Karthikeyan** in his welcome address gave a brief account of ICAI's mission, objectives and illustrious journey over last year. He welcomed the guests and huge gathering, and re-emphasised on the Institute's commitment



▲ Shri T. Karthikeyan

as pro-active partner in nation building.

The then ICAI President **CA. Amarjit Chopra**, in his extempore presidential address, gave a detailed account of the major milestones achieved and successful initiatives launched

by the ICAI during his tenure. He said he was overwhelmed with the support, love and affection showered upon him across the country. "I don't have the words as to how to repay this debt. I think the best way to repay the debt is to continue to serve the cause of the profession after laying down the office... I have tried to exercise one thing and that is, speaking from my heart and make this Institute Council driven," he said. CA. Amarjit Chopra said that this Institute is so great and its foundations are so strong that no turbulence can harm it. "Our greatest strength has been our past Presidents, our past and present Council Members, and of course 1,66,000 members and more than 7,00,000 students," he added.



▲ CA. Amarjit Chopra

Giving an account of some of the significant achievements for students, he said a major milestone of the year has been the launch of virtual classes for the students with a plan to put in place 250 centres for the same. He said that as promised, there had been no change in the



▲ The then ICAI President CA. Amarjit Chopra greets Secretary MCA Shri D.K. Mittal.

curriculum or fees for students. He said that the Council has tried to bring some changes in the examination pattern so that the students who have been becoming insensitive to the training should be brought back to the training table. The modalities for the same are being worked out and the Diary Report of the students will be hosted on the Institute counter-signed by the principals, he said. He informed that all study materials have been revised, the transfer of articles liberalised and articles' stipend enhanced.

Informing about some of the major initiatives undertaken for members, he said members have been provided free tool kit for audit whereas the Transfer Pricing data has been made available to them at a nominal price. He said ICAI has entered into an agreement with Corporation Bank for loans for members, both for working capital and the acquisition of various assets. He also informed that ICAI has also tied up with

New India Insurance Company whereby the Professional Indemnity Insurance will be undertaken at 25 per cent of market premium.

CA. Amarjit Chopra said ICAI has entered into MRAs with Institute of Ireland and the Canadian Institute which will give a boost to Indian professionals. "We are very clear that in the periods to come, we will have to shift our emphasis from the developed countries to the third world countries," he said and informed that agreements have been signed with the University of Djibouti and the College for Higher Technologies in Abu Dhabi. He said that in another first, "we have been able to allow the training of the articles by the people practicing outside India in partnership with any one outside India. We have also been able to allow industrial training outside India under our own members who are in the jobs there".

The then ICAI President informed that in a major

breakthrough following persistent efforts by the Council, tendering in respect of Government schemes, audits will come to an end probably beginning from 1st April, 2011. "The fees will be fixed by the C&AG and the auditors will be appointed from the panel being maintained by the C&AG". Further, it has been decided to give Unique Identification Numbers for the documents to check the frauds and forgery committed by non-members, he said, adding that there have been important breakthroughs so far as professional opportunities are concerned, particularly in Health and Education. Regarding a special initiative for capacity building, he informed that a meeting of bigger firms was organised wherein they were requested to do the 'hand-holding exercise' for smaller firms. "Our request to them has been that don't acquire various firms, do the hand-holding exercise, identify 50 firms in every region or 25 firms in every region," he said and informed that ICAI has received a "very positive" response from some of them in this regard. "The world is today talking of de-congestion of the profession

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▲ Secretary MCA Shri D.K. Mittal releases an ICAI publication along with the then ICAI President CA. Amarjit Chopra, the then Vice President CA. G Ramaswamy, former Union Minister CA. Suresh Prabhu, ICAI Secretary Shri T. Karthikeyan and the then NIRC Chairman CA. Atul Gupta.

and not of the concentration of the profession.”

CA. Amarjit Chopra informed that another major success of the last Council year has been the massive contribution of ₹2.40 crore, compared to ₹95.75 lakhs in the preceding year, received from the members towards Chartered Accountants Benevolent Fund following a sustained drive in this regard. “I salute all the members, branches and all chapters who have generously contributed to this cause and particularly some people like TV Mohan Das Pai who contributed ₹10 lakhs and Past President CA. N.P. Sarda who contributed ₹11 lakhs.”

On the administration front, he said, a unique initiative has been the launch of ‘e-Sahaayataa,’ which has proved to be very useful for members. “Since 10th May, 2010 we have received more than 26,300 complaints out of which now only 152 complaints are pending,” he said, adding that “I can say with a lot of satisfaction that barring

a few cases, every one has said that the staff responded within 48 to 72 hours. My compliments to the staff for that particular matter.” He said the progress with regard to ‘Project Parivartan’ has also been remarkable and within next 16 months almost everything in the Institute will be web-enabled and on-line. Further, accounts of various branches will be integrated with

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the Head Office Accounts in the next six months which will result in tremendous improvement in the financial statement of the Institute.

He said the Institute has achieved milestones with regard to physical infrastructure too. “This morning we have done *Bhoomi Pujan* in the North West Rohini and I can assure that before Mr. G. Ramaswamy (the then Vice President) lays down his office on 12th February 2012, you will have a grand well-equipped building in that particular area.” He also referred operationalisation of Hyderabad Centre of Excellence, upgrading of Kanpur Regional HQ, purchase of land in Panipat, and laying of foundation stone of branch buildings in Sahranpur, Ahmedabad, Patna, Coimbatore, and Jodhpur. He also said that in periods to come ICAI should be investing more in research and the technical staff. “This Institute should be dominated by the technical people,” he added.

He said that in Satyam episode all the pillars of corporate governance failed but unfortunately only the auditors got the flak. “Post-Satyam, we only tried to rebuild the trust and this year we have been able to complete almost 170 disciplinary cases. I think we are the first institute probably in the world who had the courage of conviction to host the names of the people whom we had held guilty on the website of the Institute. We are the only institute who is able to recommend to the Government that we are willing to proceed against the firms if there is an act of repetitive

gross negligence or collusion in any fraud," he said.

CA. Amarjit Chopra also highlighted the exemplary achievement of the Institute with regard to Indian Accounting Standards converged with IFRS. "We completed it. We have done our job, whether it is IFRS, or whether it is Schedule 6 or Schedule 14 or any other issue," he said adding "Institute's contribution in this direction should be definitely recognised" by the Government. He also requested the Government that setting up of the Auditing & Assurance Standards must continue to be with the Institute in the Companies Bill as only a "doctor knows how best operation can be conducted". He also said that there was no need of any Over-sight Board as Institute has already been actively safeguarding the interests of the society through various measures.

"We will not flinch for a moment from that path which the Government desires us to follow," he said. He commended CA. G. Ramaswamy as a 'great source of strength' and added that "GR means not G. Ramaswamy but *Greatly Reliable*". "He must out-perform me because if he out-performs me, the institution will grow," CA. Amarjit Chopra said, adding that he will always be available for the Institute and the profession.



CA. Suresh Prabhu

The distinguished guest former Union Minister **CA. Suresh Prabhu**, in his address hailed the progress made by the Institute over the years and services rendered by the Indian accountancy profession for the development of the country and the society. "It is a great day for all CAs. It is a day on which we all come together not only to just express the camaraderie but also to reinforce our own belief that we Chartered Accountants can contribute a great deal for the development of our own country. I don't see any other profession in India which has done so much more for the society and for a country, going beyond professional interests on its own," he said.

Hailing the series of research publications that the ICAI brings out on a continuous basis, he said that the Chief Guest Shri D.K Mittal "might be wondering that how come the CAs keep practicing tax, auditing, management services and at the same time could also do so much of research... that really shows that it is an Institute, it is a profession which constantly thinks, constantly researches and expresses opinion based on a study and research". He congratulated the CA students who won awards and said that it was heartening to see students receiving the awards at this young age and hoped that they will add to strength and spirit of the profession.

CA. Suresh Prabhu appreciated the improvement of results of CA Examination when compared to the times when he was doing the CA. "I was just asking Shri T. Karthikeyan what was result of this year; he said very low; I said how much; he said very low, really low. I said how much; he said about 20%. I said 20% is low? When I was trying to appear for the examination, we were happy when the results were 2% or 3%," he said adding that "probably this also means that the results have improved because the quality of the students is far better today than when we were studying." However, he said, that irrespective of the number of students going to pass in the examination, the quality of the Institute and the syllabus must not be compromised. "That is something which really speaks

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very well about the quality of the students as well quality of the profession,” he said.

Addressing Secretary, Ministry of Corporate Affairs Shri D.K. Mittal, he said that it was good that both the minister and secretary of Ministry of Corporate Affairs are new because this may facilitate a fresh look at the Institute and far better utilisation of Institute’s services for the betterment of the country. Referring to an ICAI publication on sustainability reporting, he said sustainability reporting “has nothing to do with the ICAI’s direct interests but we feel that if the society has to progress and prosper, it must be on a sustainable ground”. Citing another ICAI publication on ‘government accounting’, he said that there is an urgent need of reforms in government accounts to bring about better transparency and accountability and ensure better utilisation of

the resources. “I am sure Shri Mittal will use services of CAs more than his predecessors could do,” he said and expressed hope that the ICAI and the Government will now join hands more firmly for the good of the country.

Secretary, Ministry of Corporate Affairs **Shri. D.K.**



▲ Shri D.K. Mittal

Mittal in his address acknowledged the services rendered by the Institute and accountancy profession

for the uplift of the country and growth of Indian accountancy profession across the world. He also emphasised on ethics, training and expectations from Indian accountancy profession in the present and the future. “While the CA Act entrusts the ICAI with financial audit, and the Regulation of the profession of Chartered Accountants in India, the domain of CAs has gone well beyond auditing. I am happy to know that the profession is now striving to excel in the entire governance mechanism by concentrating on its core

“Secretary, Ministry of Corporate Affairs Shri D.K. Mittal in his address acknowledged the services rendered by the Institute and accountancy profession for the uplift of the country and growth of Indian accountancy profession across the world. He also emphasised on ethics, training and expectations from Indian accountancy profession in the present and the future.”

“Emphasising on the importance of practicing ethics, Shri D.K. Mittal said: “we are passing through the phase of acute turbulence caused by matters of financial impropriety. Do we need to believe that the transactions which are being debated have not been drawn by the CAs. That shows the need for ethics and whose enforcements have to be facilitated by your noble profession. Enforcement could be by acting as a whistle blower and advising those who are into it and against it... this is not an easy task”.”

competence,” he said.

He acknowledged that the ICAI plays a multi-faceted role as an academic body and as a standard setter with a focus on the multi-dimensional abilities to render services. Having strengthened and consolidated itself as a qualification of honour and value in Indian society, the ICAI has also extended beyond national frontiers in collaborating with other countries’ provisions, he said. “The dawn of an able regime followed by the process of economic reforms has meant more and more investment flowing into the country. It has necessitated the entrance of global players virtually in all sectors of economy. As such, the need of having professionals who know the global reaction and the dynamics of emerging scenario needs no emphasis,” he said, adding that “in this context your efforts for convergence with IFRS need a special mention.” He complimented the ICAI for “ably assisting in the long consultative process with timely

technical inputs” that has enabled Government to find an Indian solution to suit the Indian needs.

He said he was pleased to note that ICAI facilities in the international arena are acculturating the profession and the professionals to the latest in the field. “Our 10000 CAs are already working in different countries. While the ICAI has signed MoUs with many developed countries we need special focus on neighbouring countries and other countries of Asia, Africa, CIS and Latin America as growth of the world in this century is to be driven by these economies only”.

Emphasising on the importance of practicing ethics, Shri Mittal said: “we are passing through the phase of acute turbulence caused by matters of financial impropriety. Do we need to believe that the transactions which are being debated have not been drawn by the CAs. That shows the need for ethics and whose enforcements have to be facilitated by your noble profession. Enforcement could be by acting as a whistle blower and advising those who are into it and against it... this is not an easy task”.

He said that another related area that needs special attention of Indian accountancy profession is ‘corporate governance’. The responsibility to enforce discipline is much more direct on the members of the Institute and the Institute should continuously improve its guidelines so that they are contemporary and ahead of the curve, he advised, adding that the Institute has to improve its internal mechanism to take exemplary disciplinary

action against such members who indulge in malpractices out of consent or inaction. “We copy the West in many things. But I wish we should also be copying them in the promptness of action. One of the top five companies has been annihilated by the US after the fiasco of Enron and other companies. Can we have a single example in India?” he questioned.

Touching upon another issue he said: “we need to look at the requirement of our country India by 2030 because we would be touching more than \$6,000 per capita as against \$1,000 today. It is necessary to have our direction and steps in synchronisation and only then we can reach that goal. ‘India 2030’ needs integrated professional services.” He said that yet another requirement of ‘India 2030’ is to have super-specialised courses. “These courses have to be put ahead of the utility having been proven and demands having arisen,” he said, adding that “the disciplines have to be India-specific but we could very well be benefited by the experience of other countries’ mechanisms”. He said the Institute, therefore, has to be very vigilant about these issues and will have to put in place a mechanism which continually identifies new issues and then works out specialised courses to meet the challenges.

Shri Mittal said there was a need for looking at the way we train ICAI members for the present and the future. “Does the quality of the member after passing out the CA examination meet best international level benchmark? I think it needs

a lot of soul searching,” he said and added that the “past practices cannot be a drag on future. They can at best be an experience.” “If we are not the best ones, we will lose leadership as an Institute and as a country,” he stated and advised that ICAI may prepare a two-year rolling plan in this regard. He said Indian accountancy profession has established a sound reputation and has had many accomplishments to its credit. “I am sure that in times to come, one would hear of more and more accomplishments by CAs and for that I have only one thing to say: develop yourself so as to be competitive, adapt to the market plays and adhere to the high standards of ethics. Once these are there, the sky is the limit for you,” he concluded.

Shri Mittal also gave away awards to meritorious CA students and the ICAI Regional Councils and branches who were adjudged outstanding in the year gone by.

The vote of thanks was proposed by the then Vice President **CA. G. Ramaswamy**. He said



that Secretary MCA Shri Mittal has rightly pointed out many issues and given suggestions on improving the disciplinary mechanism, ethical standards and early disposal of the complaints filed with the Institute. “We have a Disciplinary Committee in the new mechanism under the CA (Amendment) Act, 2006, which is a fast track mode wherein complaints are disposed of as early as possible without any intervention from any of the Council’s activities,” he informed. He assured the Government that ICAI is taking proactive measures for regulating the profession and informed that ICAI’s Financial Reporting Review Board has received more than 301 cases, which are being examined and analysed for taking appropriate actions. The then Vice President sought constant guidance and support from the Ministry of Corporate Affairs and said that all the suggestions of Shri Mittal have been well taken by the ICAI. He also thanked Shri Suresh Prabhu for his inspiring address. He also acknowledged the services rendered by the Past Presidents for taking the profession and the Institute to newer and newer heights of success in the last 61 years. He also thanked all the award winner students, regional councils and branches. ■

Know Your Ethics*

Ethical Issues in Question-Answer Form

Q. What will be the procedure where a member is guilty of charges both under the First Schedule and Second Schedule to the Act?

A. The Procedure to be followed when a member is accused of misconduct under both Schedules is the procedure which is followed for misconduct under the Second Schedule.

Q. Can a member in practice have a branch office/additional office/ temporary office?

A. Yes, a member can have a branch office. In terms of Section 27 of the CA Act, if a Chartered Accountant in practice or a firm of Chartered Accountants has more than one office in India, each one of such offices should be in the separate charge of a member of the Institute. Failure on the part of a member or a firm to have a member in charge of its branch and a separate member in case of each of the branches, where there are more than one, would constitute professional misconduct.

However, exemption has been given to members practicing in hill areas subject to certain conditions. The conditions are:

1. Such members/firm be allowed to open temporary offices in a city in the plains for a limited period not exceeding three months in a year.
2. The regular office need not be closed during this period and all correspondence can continue to be made at the regular office.
3. The name board of the firm in the temporary office should not be displayed at times other than the period such office is permitted to function as above.
4. The temporary office should not be mentioned in the letter-heads, visiting cards or any other documents as a place of business of the member/firm.
5. Before commencement of every winter it shall be obligatory on the member/firm to inform the Institute that he/it is opening the temporary office from a particular date and after the office is closed at the expiry of the period of permission, an intimation to that effect should also be sent to the office of the Institute by registered post.

The above conditions apply to any additional office situated at a place beyond 50 km from the municipal limits in which any office is situated.

It is necessary to mention that the Chartered Accountant in charge of the branch of another firm should be associated with him or with the firm either as a partner or as a paid assistant. If he is a paid assistant, he must be in whole time employment with him. However, a member can be in charge of two offices if they are located in one and the same accommodation.

Q. Can a Chartered Accountant in practice share his fees with the Government in respect of Government Audit?

A. In respect of the Government Audit, the Institute has come across certain Circulars/Orders issued by the Registrar various State Co-operative Societies wherein it has been mentioned that certain amount of audit fee is payable to the concerned State Govt. and the auditor has to deposit a percentage of his audit fee in the State Treasury by a prescribed challan within a prescribed time of the receipt of Audit fee. In view of the above, the Council considered the issue and while noting that the Government is asking auditors to deposit such percentage of their audit fee for recovering the administrative and other expenses incurred in the process, the Council decided that as such there is no bar in the *Code of Ethics* to accept such assignment wherein a percentage of professional fees is deducted

by the Government to meet the administrative and other expenditure.

Q. Can a Chartered Accountant in practice enter into partnership with a practicing Chartered Accountant of a recognised foreign professional body for sharing fee of their partnership within India?

A. Yes, Clause (4) of Part-I of First Schedule to the CA Act permits partnership between members of the Institute and the members of the recognised foreign professional bodies which are recognised by the Council or by the Central Government.

Q. Whether the word "Chartered Accountant" and name of city after the name of the members of the Institute be mentioned in the articles contributed by such members and published in the Institute's Journal?

A. Yes, under Clause (6) of Part I of the First Schedule to the CA Act there is no restriction in the *Code of Ethics* for mentioning the word "Chartered Accountant" and also the name of city in an article contributed by a member in the Institute's Journal as well as in newspapers and other periodicals.

Q. Whether website of any Chartered Accountant can provide a link to the website of ICAI, its Regional Councils and Branches and also to the websites of Govt./Govt. Departments/Regulatory authorities?

A. Yes, please refer pages 140- 144 of Code of Ethics, 2009 (under commentary to clause-6 of Part-I of First Schedule).

Q. Can a Chartered Accountant in practice use/fix a monogram of the Institute on any column/wall located inside the office or on professional documents?

A. No, in view of the directions under Clause (7) of Part I of the First Schedule to the CA Act a Chartered Accountant in practice is not permitted to use/fix a monogram of the Institute on any column/wall located inside the office or on any professional documents.

Q. Whether a member in practice is allowed to become whole-time director of a company?

A. Yes, a member in practice may become a Managing Director or a whole-time Director of a body corporate within the meaning of the Companies Act, 1956 subject to guidelines of corporate practice. However, w.e.f. 1.4.2005, he is not entitled to do attest functions.

Q. Can a Chartered Accountant working in a CA firm hold CoP?

A. Yes, a Chartered Accountant working in a C.A. firm can hold CoP. He is not entitled to do any attest function.

Q. Whether the Chartered Accountant who is appointed as a liquidator of a company can do the audit of that company?

A. No, Clause (4) of Part I of the Second Schedule to the CA Act and regulations framed there under may be referred.

Q. Whether a member can audit an enterprise/concern where a partner or relative of the member is a director in the company who has a substantial interest?

A. No, in such cases for the reason as not to compromise with the independence of mind, the member may desist from undertaking the audit of financial statements and/or expression of opinion thereon. ■

*Contributed by the Ethical Standards Board of ICAI

LEGAL DECISIONS¹

DIRECT TAXES

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

Where non-resident TV channels uplink TV programme to satellite through their own facilities situated outside India and satellite, which is not stationed over Indian airspace amplifies and relays waves using transponder capacity and Indian cable operators receive signals, merely because footprint area of satellite transponder includes India and ultimate viewers are watching programmes in India, it would not mean that satellites owner/operator is carrying out its business operations in India; amounts received by non-resident satellites owner from non-resident TV channels is not chargeable to tax in India, nor does it represent income by way of royalty as defined in Explanation 2 to Section 9(1) (vi)

Asia Satellite Telecommunications Co. Ltd. v. Director of Income Tax, January 31, 2011 (DEL)

The appellant-assessee is a non-resident broadcaster and owner/operator of satellites placed in a geostationary orbit allotted to China. The footprint area for relaying signal from the appellant's satellite extend over four continents. It enters into an agreement with non-resident TV channels who desire to utilise the transponder capacity available on the appellant's satellite to relay their signals. These customers have their own relaying facilities, which are not situated in India. From these facilities, the signals are beamed in space where they are received by a transponder located in the appellant's satellite. The transponders receive the signals and amplify them to facilitate the transmission of signals without distortion. There is no change in the content. Thereafter, the signals are relayed over the entire footprint area where they can be received by the facilities of the appellant's customers or their customers. The Tribunal held that the amounts received by the appellant from its non-resident customers for availing transponder capacity was chargeable to tax in India.

The Delhi High Court held that under the agreement with TV channels, role attributed to the appellant can be paraphrased in the following steps: (i) programmes are uplinked by the TV channels (admittedly not from India); (ii) after receipt of the programmes at the satellite (at the locations not situated in India airspace), these are amplified through complicated process; (iii) the programmes so amplified are relayed in the footprint area including India where the cable operators catch the waves and pass them over to the Indian population.

Accepted position is that the first two steps are not carried out in India. Merely because the footprint area includes India and the ultimate consumers/viewers are watching the programmes in India, even when they are uplinked and relayed outside India, would not mean that the appellant is carrying out its business operations in India. It was necessary to establish that any part of the appellant's operations were carried out in India. No machinery or computer, etc. is installed by the appellant in India through which the programmes are reaching India. The process of amplifying and relaying the programmes is performed in the

satellite which is not situated in the Indian airspace. Even the Tracking, Telemetry and Control (TTC) operations are also performed outside Indian in Hong Kong. No man, material or machinery or any combination thereof is used by the appellant in the Indian territory. There is no contract or agreement between the appellant either with cable operators or viewers for reception of signals in India. Therefore, Section 9(1)(i) is not attracted in the present case.

Applicability of Section 9(1)(vi)

The process of transmission of TV programmes, it starts with TV channels (customers of the appellant) uplinking the signals containing the TV programmes; thereafter the satellite receives the signals and after amplifying and changing their frequency relays it down in India and other countries where the cable operators catch the signals and thereafter distribute them to the public. If any person has got dish antenna, he can also catch the signals relayed from these satellites. The role of the assessee in this cycle is that of receiving the signals, amplifying them and after changing frequency relaying them on the earth. It is for this service, the TV channels make payment to the assessee.

Ambit and scope of term 'royalty' appearing in Explanation 2 to sub-clause (vi) of Section 9(1)

Considering the role of the appellant in the light of meaning of the term 'process', it is evident that the particular end, viz., viewership by the public at large was achieved only through the series of steps taken by receiving the uplinked signals, amplifying them and relaying them after changing the frequency in the footprint area including India. This is held that the TV channels in entire cycle of relaying the programmes in India were using the process provided by the assessee and, therefore, it is liable to be taxed as royalty income.

Where the operator has entered into an agreement for lease of transponder capacity and has not given any control over parts of satellite/transponder, the provisions of sub-clause (vi) would not apply. In the present case also, the appellant had merely given access to a broadband with available in a transponder which can be utilised for the purpose of transmitting the signals of the customer.

It needs to be emphasised that a satellite is not a mere carrier, nor is the transponder something which is distinct and separable from the satellite as such. It was explained that the transponder is in fact an inseparable part of the satellite and cannot function without the continuous support of various systems and components of the satellite, without which it simply cannot function. Consequently, it is entirely wrong to assume that a transponder is a self-contained operating unit, the control and constructive possession of which is or can be handed over by the satellite operator to its customers. On the contrary, the transponder is incapable of functioning on its own.

In the present case, control of the satellite or the transponder always remains with the appellant. From various clauses of the said agreement, it becomes clear that the control always remained with the appellant and the appellant had merely given access to a broadband available with the transponder, to particular customers.

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

The fact remains that there is no use of 'process' by the TV channels. Moreover, no such purported use has taken place in India. It is stated at the cost of repetition that the telecast companies/customers are situated outside India and so is the appellant. Even the agreements are executed abroad under which the services are provided by the appellant to its customers. The transponder is in the orbit. Merely because it has its footprint on various continents would not mean that the process has taken place in India.

The Tribunal has made an attempt to trace the fund flow and observed that since the end consumers, i.e., persons watching TV in India are paying the amounts to the cable operators who in turn are paying the same to the TV channels, the flow of fund is traced to India. That is a far-fetched ground to rope in the appellant in the taxation net. The Tribunal has glossed over an important fact that the money which is received from the cable operators by the telecast operators is treated as income by these telecast operators which have accrued in India and they have offered and paid tax. Thus, the income which is generated in India has been duly subjected to tax in India. It is the payment which is made by the telecast operators who are situated abroad to the appellant which is also a non-resident, i.e., sought to be brought within the tax net. For the aforesaid reasons, it is difficult to accept such far-fetched reasoning with no causal connection.

For the aforesaid reasons, the view taken by the Tribunal in the impugned judgment on the interpretation of Section 9(1) (vi) cannot be accepted. Thus, issue is decided in favour of the assessee and against the Revenue.

Section 14A of the Income-tax Act, 1961 - Total income - Expenditure incurred in relation to income not includible in

Prior to the introduction of sub-sections (2) and (3), Section 14A would entitle department to make disallowance of expenditure incurred by Banks for earning tax free income in cases Banks did not maintain separate accounts for investments and other expenditure incurred for earning tax free income

CIT v. The Catholic Syrian Bank Ltd, October 21, 2010 (KER)

Section 14A was introduced to the Income Tax Act by Finance Act, 2001 with retrospective effect from 1.4.1962. This provision provide for disallowance of expenditure incurred by the assessee in relation to income which does not form part of the total income. In other words, if the assessee incurs any expenditure for earning tax free income such as interest paid for funds borrowed, for investment in any business which earns income that is free from tax, assessee is not entitled to deduction of such interest or other expenditure. Even though the provision was brought to the statute with retrospective effect from 1.4.1962, the retrospectivity is neutralised by a proviso later introduced by Finance Act, 2002 with effect from 1.5.2001 whereunder reassessment, rectification of assessment etc. were prohibited for any assessment year beginning on or before 1st April, 2001. In other words, assessments for any

assessment year upto the assessment year 2000-2001 that were finalised when the proviso was introduced without making any disallowance under Section 14A, were allowed to achieve finality. Disallowance under Section 14A was intended to be made only for pending assessments and for assessments for the assessment years commencing from 2001-2002 onwards. In all these cases disallowance made under Section 14A are either in pending assessments or for assessments for the assessment years commencing from 2001-2002 onwards. No dispute is raised by the assessee against application of Section 14A by virtue of operation of the proviso to the said Section introduced by Finance Act, 2002.

The assessee-Banks earned substantial tax free income by way of interest from tax free bonds and dividend income which is also tax free. So much so, substantial expenditure is incurred for earning the tax free income such as interest paid on borrowed funds (including deposits) utilised for investment and administrative expenditure for the same. Since accounts of actual expenditure incurred for earning the tax free income was not available, for making disallowance under Section 14A, the Assessing Officer found out the average cost of deposit of the relevant year. The Assessing Officer worked out 8.72 per cent of total investment as the interest expenditure incurred by the assessee for earning tax free income. The disallowance was accordingly worked out.

The purpose of Section 14A itself is to get over judgments of the Supreme Court and High Courts declaring assessee's eligibility for deduction of business expenditure incurred for earning the income irrespective of whether such income is taxable or not. The object of Section 14A is to ensure that so much of the expenditure incurred for earning income that do not constitute total income of the assessee, should not be allowed. In other words, when income is outside the tax net, expenditure incurred for earning such income also should not be allowed to be set off in the computation of taxable income. Therefore, the short question to be considered is whether non-maintenance of separate accounts by the assessee with regard to expenditure incurred for earning non-taxable income is justification for them to claim immunity from the operation of Section 14A. In fact, the subsequent legislation i.e. introduction of sub-section (2) and the prescription of Rule 8D thereunder, make it clear that there may be cases where it would be difficult for assessee to maintain separate accounts for earning taxable as well as non-taxable income. However, such difficulty may be experienced in the case of overhead expenditure and administrative expenditure incurred by the assessee-Banks. So far as investments in securities and bonds and also in shares, the income wherefrom is tax free are concerned, there is no reason why assessee could not have maintained separate accounts for the sources of funds utilised for such investments which, if the assessee-Banks wanted, they could have maintained. In other words, if the assessee-Banks had a case that surplus funds available or funds sourced other than through borrowing only were utilised for investing in securities, bonds and shares which



yield tax free income, they could have maintained such accounts and produced the same before the Assessing Officer when proportionate disallowance was proposed by the Assessing Officer. By subsequent amendment through sub-section (2) and by prescribing Rule 8D therein what is achieved is prescribing specific guideline for disallowance in cases where separate accounts are not available on the expenditure incurred for earning tax free income. These are, therefore, only clarificatory provisions and the main clause of Section 14A apply for all periods after the introduction of the same in the statute which authorises the officer to make disallowance of the expenditure incurred for earning tax free income, irrespective of whether assessee maintained separate accounts or not. Considering the significant amount of tax free income earned by the assessee-Banks for all the years involved, the investments for earning tax free income is substantial and if assessment is made without making disallowance under Section 14A, the same will render a distorted figure of taxable income which is not permissible under the Act. If the assessee does not maintain separate accounts, it is for the Assessing Officer to estimate the same by adopting a rational basis. In principle, the disallowance made by the Assessing Officer under Section 14A was to be upheld.

Section 32 read with Section 263 of the Income-tax Act, 1961 - Depreciation

Assets which are included in definition of 'intangible assets' under Section 32(1)(ii) includes, along with other things, any other business or commercial rights of similar nature; goodwill, when appositely understood, does convey a positive reputation built by a person/company/business concern over a period of time and hence, it is an asset, eligible to depreciation

CIT v. Hindustan Coca Cola Beverages Pvt. Ltd, January 14, 2011 (DEL)

The scope of Section 32 has been widened by the Finance (No.2) Act, 1998 whereby depreciation is now

allowed on intangible assets acquired on or after 1st April, 1998. As per Section 32(1)(ii), depreciation is allowable in respect of know-how, patent, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature being intangible assets. Scanning the anatomy of the section, it can safely be stated that the provision allows depreciation on both tangible and intangible assets and clause (ii) enumerates the intangible assets on which depreciation is allowable. The assets which are included in the definition of 'intangible assets' under Section 32(1)(ii) includes, along with other things, any other business or commercial rights of similar nature.

To effectively understand what would constitute an intangible asset, certain aspects, like the nature of goodwill involved, how the goodwill has been generated, how it has been valued, agreement under which it has been acquired, what intangible asset it represents, namely, trademark, right, patent, etc. and further whether it would come within the clause, namely, 'any other business or commercial rights which are of similar nature' are to be borne in mind.

The depreciation was claimed on goodwill by the assessee on account of payment made for the marketing and trading reputation, trade style and name, marketing and distribution, territorial know-how, including information or consumption patterns and habits of consumers in the territory and the difference between the consideration paid for business and value of tangible assets. The Tribunal had treated the same to be valuable commercial asset similar to other intangibles mentioned in the definition of the block of assets and, hence, eligible to depreciation. It has also been noted by the Tribunal that the said facts were stated by the assessee in the audit report and the assessing officer had examined the audit report and also made queries and accepted the explanation preferred by the assessee. The acceptance of the claim of the assessee by the assessing officer would come in the compartment of taking a plausible view inasmuch as basically intangible assets are identifiable non-monetary assets that cannot be seen or touched or

physical measures which are created through time and / or effort and that are identifiable as a separate asset. They can be in the form of copyrights, patents, trademarks, goodwill, trade secrets, customer lists, marketing rights, franchises, etc. which either arise on acquisition or are internally generated.

It is worth noting that the meaning of business or commercial rights of similar nature has to be understood in the backdrop of Section 32(1)(ii). Commercial rights are such rights which are obtained for effectively carrying on the business and commerce, and commerce, as is understood, is a wider term which encompasses in its fold many a facet. Studied in this background, any right which is obtained for carrying on the business with effectiveness is likely to fall or come within the sweep of meaning of intangible asset. The dictionary clause clearly stipulates that business or commercial rights should be of similar nature as know-how, patents, copyrights, trademarks, licences, franchises, etc. and all these assets which are not manufactured or produced overnight but are brought into existence by experience and reputation. They gain significance in the commercial world as they represent a particular benefit or advantage or reputation built over a certain span of time and the customers associate with such assets. Goodwill, when appositely understood, does convey a positive reputation built by a person / company / business concern over a period of time.

Section 32 of the Income-tax Act, 1961 - Depreciation

For allowing depreciation, user of each and every asset is not essential when particular asset forms part of 'block of assets' [Assessment Year 1998-99]

CIT v. Oswal Agro Mills Ltd, December 24, 2010 (DEL)

The written down value (WDV) of any block of assets shall be the aggregate of the WDV of all the assets falling within that block of assets at the beginning of the previous year. From this, the adjustment has to be made for the increase or reduction in the block of assets during the year under consideration. The deduction from the block of assets has to be made in respect of any asset, sold discarded or demolished or destroyed during the previous year.

As per amended Section 32, deduction is to be allowed – “In the case of any block of assets, such percentage on the written down value thereof as may be prescribed”. Thus, the depreciation is allowed on block of assets, and the Revenue cannot segregate a particular asset therefrom on the ground that it was not put to use. With the aforesaid amendment, the depreciation is now to be allowed on the written down value of the 'block of assets' at such percentage as may be prescribed. With this amendment, individual assets have lost their identity and concept of 'block of assets' has been introduced, which is relevant for calculating the depreciation.

Another significant and contemporaneous development, which needs to be noticed is that the Legislature has also deleted the provision for allowing terminal depreciation in respect of each asset, which was previously allowable under Section 32(1)(iii) and also taxing of balancing charge under Section 41(2) in the year of sale. Instead of these two provisions, now whatever is the sale-proceed of sale of any depreciable asset, it has to be reduced from the block of assets. This amendment was made because now the assessee is not required to maintain particulars of each asset separately and in the absence of such particular, it cannot be ascertained whether on sale of any asset, there was any profit liable to be taxed under Section 41(2) or terminal loss allowable under Section 32(1)(iii). This amendment also strengthens the claim that now only detail for "block of assets" has to be maintained and not separately for each asset.

Having regard to this legislative intent contained in the aforesaid amendment, it is difficult to accept the submission that for allowing the depreciation, user of each and every asset is essential even when a particular asset forms part of 'block of assets'. Acceptance of this contention would mean that the assessee is to be directed to maintain the details of each asset separately and that would frustrate the very purpose for which the amendment was brought about. It is also essential to point out that the Revenue is not put to any loss by adopting such method and allowing depreciation on a particular asset, forming part of the 'block of assets' even when that particular asset is not used in the relevant assessment year. Whenever such an asset is sold, it would result in short term capital gain, which would be exigible to tax and for this reason, we say that there is no loss to Revenue either.

Section 73 of the Income-tax Act, 1961-Losses-In Speculation Business

Only those Companies which are excepted from purview of Section 73 read with explanation, will have speculation business as defined in the Act; loss suffered in share dealing by companies falling within ambit of said explanation has to be treated as speculation loss which has to be treated as speculation loss which cannot be set-off against other income [Assessment Year 1994-95]

Paharpur Cooling Towers Ltd. v. CIT, October 5, 2010 (CAL)

The assessee-company was engaged in manufacturing of Cooling Towers and in the business of selling and purchasing shares. It had income chargeable under the heads 'Profit and Gains of Business of Profession' and 'Income from other sources'. The amount of loss arising out of the purchase and sale of shares as stock in trade at the end of previous year, was treated as deemed speculation loss and was not allowed to be a set off against the other income of the assessee.

The Calcutta High Court held that Section 73 generally provides that any loss arising out of speculation business can be set off only against another speculation business of assessee. Reading sub-section (1) the word 'assessee' covers all types of assessee as mentioned in Section 2 (7)

of the said Act which includes individuals and company. Section 73(2) of the said section provides that the loss arising out of speculation business which cannot be set off in a particular assessment year fully the balance may be carried forward for the next assessment year and so on not exceeding eight five assessment years immediately after succeeding year as provided in Section 73(4).

By the explanation all companies are not included within the word 'assessee' as mentioned in Section 73. The companies other than a company whose gross total income contains mainly of income which is chargeable under the heads interest, security, income from house property, capital gains and income from other sources or a company the principal business of which is the business of banking or granting of loan and advances consists in purchase and sale of shares of other companies, such company shall be for the purpose of this section, be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of shares. Thus the explanation has really employed restricted meaning of the word 'assessee' as mentioned in Section 73.

It has only been explained about the nature of the company which shall be deemed to be carrying on speculation business. The said explanation is not inconsistent with the object of introduction as the explanation itself has made it clear that those companies whose business consists of the purchase and sale of shares of other companies, therefore, the very object of curbing manipulation resorted to by the business house controlling group of companies is sought to be served. This statutory fiction is extended to achieve very purpose and object for which it has been created.

Departmental Circular dated 24-7-1976 cannot be treated as guide for interpretation of the section when the same with explanation is very clear and free from any ambiguity. The CBDT Circular is of no help when the section is very clear. Even when the entire business of the assessee is purchase and sale of shares the said explanation to Section 73 applies.

By virtue of explanation 2 to Section 28 business of speculative transaction must be distinct and separate from any other business. Thus any speculative transaction cannot be treated as speculative unless such a transaction takes place as a part of business activity of the assessee concerned. It is not necessary the assessee must carry on speculative business exclusively it can be one of the businesses but this must be distinct and separate from any other business.

In order to apply the Section 73 with explanation the business must be speculative business which in its turn must be a speculative transaction. All speculative business is speculative transaction but not the vice versa. The definition of speculative transaction as above demands that there must be actual delivery or transfer of commodity or scrips, this must be by way of paper transaction only then it can be said to be the speculative transaction.

Under the definition of the said speculative business includes the speculation transaction which must be in case of purchase and sale of shares the same must be effected with the physical delivery of the same. Explanation to Section 73 will be applicable in respect of the companies

and companies alone and not any other assessee namely individuals or other assessees. However, part of the business of the company other than a few category of companies as mentioned therein, shall be treated speculation business, if such part consists of the purchase and sale of shares, not other category of speculative dealings total income consists mainly of income which is chargeable under the heads interest from securities, income from house property, capital gains and income from other sources, or a company the principal business of which is the business of banking of granting loans and advances. Hence in the case of companies which are excepted from the purview of Section 73 read with the explanation will have the speculation business as defined in the Act.

The benefit of setting off and also carry forward of losses in speculation business as mentioned in sub-section (1) and sub-section (2) of Section 73 is permissible in respect of other companies which are not excepted companies as against the other head of speculation.

Where the assessee admittedly was a company and did not fall within the excepted category of the companies as mentioned in the said Explanation, by virtue of the legal fiction mentioned in explanation the assessee company was not entitled to benefit of setting off or carry forward except as against the other speculation business. Just because physical delivery of share scrips is effected for sale of the shares, a company will not get the benefit under Section 73 as by virtue of the said explanation containing deeming clause the said definition of speculation business includes

not only settlement on papers but also actual delivery of the said scrips.

Any purchase or sale of shares by certain companies is to be speculation transaction for the purpose of Section 73 only. For the purpose of setting off or carrying forward of loss the company selling of shares by certain companies are recorded by the statute as speculation business, even though the transaction of purchase and sale was followed by delivery of scrips and such cannot be treated as speculative transaction as defined in Section 43(5). The definition in Section 43(5) of speculation transaction, read with the second explanation of Section 28 it would appear in some extent inconsistent with the speculation business mentioned in Section 73, as Section 43 sub-section (5), while defining speculation transaction exclude the actual delivery or transfer of commodity or scrips and several speculation transactions constitute speculation business.

Where admittedly the sale of shares has been effected by physical delivery of shares, company cannot get the benefit of set off or carry forward of speculation loss. For the purpose of applicability of any provision of the law the Court need not look into the object and reason for enactment by way of amendment. The Court will be looking at the provision of the statute, and on clear and plain reading if it appears that the same can be applied without any difficulty or without any aid whatsoever, then the object and reasons need not be looked into.

The explanation added to Section 73 does not bring about any inconformity with the object and purpose of

Section 73 which has been enacted for special purposes and for that section only and the provision of this section with explanation overrides the other provision.

Section 90, read with Section 37 of the Income-tax Act, 1961 – Double Taxation Agreement – Existence of

In absence of any specific thin capitalisation rules in India, it is not open to revenue authorities to recharacterise debt capital as equity capital, and, accordingly, disregard interest payments as tax deductibles [Assessment Year 2002-03]

Besix Kier Dabhol, SA v. Deputy Director of Income-tax (International Taxation), November 10, 2010 (ITAT-MUM)

The assessee UK-Belgian company had an issued and fully paid up capital . N V Besix SA, Belgium and Kier International (Investments) Limited, United Kingdom were two shareholders owning the equity shares in the ratio of 60:40. The total share capital was thus approximately US \$ 83,334 or ₹ 38,20,000. The assessee raised the capital by resorting to borrowings from the shareholders, ₹ 57,09,18,579 from NA Besix SA and ₹ 37,01,55,921 from Kier International (Investments) Limited, which was in the same ratio in which equity was held by the shareholders, i.e., 60:40. This debt, as stated by the assessee, was raised by the permanent establishment directly from the shareholders, and not routed through the assessee company's head office. The debt equity ratio 248:1. The assessee claimed deduction of interest on these borrowings from the shareholders. The Revenue authorities was of the view that the payments made by a branch office to the head office, under the Indian Income Tax Act 1961, do not constitute admissible deductions as these payments are 'from self to self'.

The Mumbai Tribunal held that the Belgian tax laws, which *inter alia* restrict the interest deductions only to the extent of debt capital ratio of 1:7 in sharp contrast to the debt ratio in the present case which is 1:248; the mode of borrowings, i.e., via GE or via PE, may have some tax implication even though at somewhat superficial level. That would perhaps explain as to why the borrowings are claimed to have been resorted to by the Indian PE and not the Belgian GE directly. If these borrowings were resorted to by the Belgian GE directly, *prima facie* the thin capitalisation rules would have restricted the interest disallowance in excess of borrowings exceeding seven times the equity capital, whereas in the present case borrowings were two hundred forty eight times the equity capital. As the capital was structured, and the borrowings having been resorted to by the Indian PE directly, it could possibly be said, or at least argued, that there was no debt capital in the assessee company, i.e., the Belgian entity, and this debt capital was confined to borrowing directly by the PE. Be that as it might, it could not be open to apply these thin capitalisation rules in the hands of the assessee company while computing its taxable income in India, because so far as taxability in India is concerned, the limitations to be placed on deduction of expenses has to be limitation under the laws of the state in which PE is situated i.e. India. It may be useful to recall that in terms of the provisions of Article 7 (3)(b) of Indo-Belgian tax treaty, "In the determination of the profits of a permanent

establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere, subject to the limitations of the taxation laws of that State". Admittedly, there are no limitations on deduction of interest expenses on borrowings, which can be attributed to thin capitalisation rules, in India.

In the absence of any specific thin capitalisation rules in India, it is not open to the revenue authorities to recharacterise the debt capital as equity capital, and, accordingly, disregard the interest payments as tax deductibles.

Merely because a suitable limitation provision in the treaty or the domestic legislation is considered desirable, and attempt are being made to legislate the anti-abuse provisions subsequently, it would not render the effort to take advantage of existing provision of the treaty illegal. Thus, the claim of deduction of interest by the assessee, in respect of capital borrowed from the shareholders or joint venture partners was to be upheld.

It is also important to bear in mind that when there are no thin capitalisation rules vis-à-vis domestic thin capitalisation situations, and in the light of the Section 90(2) as it exists at present, any attempts to neutralise thin capitalisation vis-à-vis PEs of Belgian enterprise would be clearly contrary to the scheme of non discrimination envisaged by Article 24(5) which provides that, "enterprises of a Contracting State, the capital of which is wholly or partly-owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in



the first mentioned Contracting State to any taxation or any requirement connected therewith which is other, or more burdensome, than the taxation and connected requirement to which other similar enterprises of that first mentioned State are or may be subjected in the same circumstances and under the same conditions". In this view of the matter, it cannot be open to the revenue authorities to put any limitation on deduction of interest, in respect of funds borrowed by the PE, while computing income in accordance with the provisions of Article 7 of Indo Belgium tax treaty, when no such limitations are placed on the domestic enterprise.

Therefore, the assessee was indeed justified in claiming deduction on account of interest paid on borrowings from its shareholders/joint venture companies.

The interest payment in the present case did not constitute an intra organisation transaction at all. Even if these interest payments were to be treated as intra organisation transactions by treating the same as payments made to the GE, and not to the joint venture partners, these payments could not be viewed as notional payments because in such a situation the GE will have corresponding liability to pay the same to the joint venture partners. The interest paid by the assessee might have been contrary to the spirit, if not letter, of the Reserve Bank of India guidelines, but then this fact, by itself and particularly in view of Explanation to Section 37 being confined to the amounts admissible as deduction under Section 37, would not render the interest paid by the assessee as not deductible, and it was not even necessary to examine the scope of Explanation to Section 37. It was also quite possible that tax considerations may have played a role in assessee's planning the capital structure, but an element of planning in structuring capital did not transform a tax deductible expense of interest into an expense that was non tax deductible. In view of these discussions, it was clear that the impugned disallowance was indeed contrary to the scheme of the law; the grievance of the taxpayer deserved to be upheld.

Section 148 of the Income-tax Act, 1961 - Income escaping assessment – Issue of Notice

At the stage of issuing notice, it is not necessary to have established fact of escapement of income but what is necessary is that there is relevant material on which a reasonable person could have formed requisite belief; conclusive proof was not germane at this stage but formation of belief must be on base or foundation or platform of prudence which a reasonable person is required to apply [Assessment Year 2003-04]

Sarthak Securities Co. Pvt. Ltd. v. ITO, October 18, 2010 (DEL)

The formation of belief is a condition precedent as regards the escapement of the tax pertaining to the assessment year by the assessing officer. The assessing officer is required to form an opinion before he proceeds to issue a notice. The validity of reasons, which are supposed to sustain the formation of an opinion, is challengeable. The reasons to believe are required to be recorded by the assessing officer.

On a perusal of various decisions, it is graphically clear that once the ingredients of Section 147 are fulfilled, the assessing officer is competent in law to initiate the proceedings under Section 147. To put it differently, the conditions precedent as engrafted in the said provision are to be satisfied.

The petitioner decided to issue shares in accordance with its Memorandum and Articles of Association and for the said purpose approached a number of prospective investors. Four private limited companies, decided to invest in the shares of the petitioner company. The assessee-petitioner allotted the shares to these four companies. The return filed by the assessee-petitioner was accepted the Assessment Officer. A notice under Section 148 was issued by the ITO to the petitioner alleging that he had reason to believe that the income chargeable to tax for the assessment year 2003-04 had escaped assessment within the meaning of Section 147 and, accordingly, he required the petitioner to file the return for the said assessment year.

The Delhi High Court held that in *CIT v. Lovely Exports (P) Ltd.* 216 CTR 195 (SC), the Apex Court held that if the share application money is received by an assessee from alleged bogus shareholders, whose names are given to the assessing officer, then the department is free to proceed to reopen their individual assessments in accordance with law. The assessing officer was aware of the existence of four companies with whom the assessee had entered into transaction. Both the orders clearly exposit that the assessing officer was made aware of the situation by the investigation wing and there was no mention that these companies were fictitious companies. Neither the reasons in the initial notice nor the communication providing reasons remotely indicated independent application of mind. True it was, at that stage of issuing notice, it was not necessary to have the established fact of escapement of income but what was necessary was that there was relevant material on which a reasonable person could have formed the requisite belief. To elaborate, the conclusive proof was not germane at this stage but the formation of belief must be on the base or foundation or platform of prudence which a reasonable person is required to apply. As was manifest from the perusal of the supply of reasons and the order of rejection of objections, the names of the companies were available with the authority. Their existence was not disputed. What was mentioned was that these companies were used as conduits. In that view of the matter, the principle laid down by the Apex Court in *Lovely Exports (Supra)* gets squarely attracted. The same had not been referred to while passing the order of rejection. The assessee in his objections had clearly stated that the companies had bank accounts and payments were made to the assessee company through banking channel. The identity of the companies was not disputed. Under these circumstances, it would not be appropriate to require the assessee to go through the entire gamut of proceedings. It was totally unwarranted.

Resultantly, the initiation of proceedings under Section 147 and issuance of notice under Section 148 were to be quashed.

Section 253 read with Section 32 of the Income-tax Act, 1961 - Appellate Tribunal - Appeal to

Where notice sent by Registered Post with AD (RPAD) was not served and it was returned for want of correct address, Tribunal, thus, could not have treated such service by RPAD as good service and dismissed the appeals

Jagjivandas Nandlal v. ITAT, October 18, 2010 (BOM)

During the pendency of the appeal filed by the petitioner, the petitioner assessee vide its letter dated 17th March, 2004 claimed to have informed the new address to the Assistant Registrar of the Tribunal with further three letters. However, the order reads that the Notice fixing the hearing of the above appeals on 26/2/2003, sent by RPAD at the address indicted by the assessee in column No.10 of Form No. 36 had not been returned by the postal authorities. However, at the time of hearing none appeared on behalf of the assessee, nor any request for adjournment was also filed. Therefore, the appeals were dismissed as unadmitted.

The Bombay High Court held that the notice intimating date of hearing sent by RPAD was, admittedly, returned back to the Tribunal by the postal authorities with postal endorsement "Not found at given address. Returned to Sender". It was, thus, clear that the notice sent by RPAD was not served. It was returned for want of correct address. The Tribunal, thus, could not have treated the service by RPAD as good service. Under these circumstances, the impugned order was unsustainable and was liable to be quashed and set aside since it was clearly in breach of principles of natural justice. It was also expected on the part of the Tribunal either to issue fresh notice or at least to send an additional copy of the notice to the advocate appearing for the assessee. No such notices appeared to have been sent. Consequently, the orders of Tribunal were in breach of principles of natural justice.

INDIRECT TAXES

Central Excise

Section 35G of the Central Excise Act, 1944 – Statement of case to High Court

Even in absence of an express provision in the Act conferring the power of review, the High Court has a power to review its decision

VIP Industries Ltd. v. CCE, December 16, 2010 (BOM)

The dissection of Section 35G reveals that the sub-sections of Section 35G viz sub-sections (2), (2A), (3) upto sub-section (8) provide for various procedures to be applied

by the High Court while deciding the appeals filed under Section 35G. The procedure provided through various sub-sections may be in variance with those provided in the Civil Procedure Code. Being a special enactment, subsections (2) to (8) of Section 35G will override a general law such as the Code of Civil Procedure on these aspects. However, in circumstances not governed by these subsections, the general provisions of the Code of Civil Procedure relating to appeals will continue to apply. Section 35G(9) reiterates the same by way of abundant caution, merely to ensure that in the event of conflict between Section 35G and the Civil Procedure Code, the procedure under Section 35G(2) to (8) will be applicable. It merely gives an overriding effect to these subsections of Section 35G vis-a-vis the Code of Civil Procedure.

When an ordinary court is referred to by a special enactment, the ordinary law of that court would apply and govern those proceedings notwithstanding absence of specific provision in that behalf. However, to the extent that the special law contains provisions contrary to the general law, the special law would prevail. Therefore, Section 35G(9) is merely stating the obvious and has been enacted by way of abundant caution. It would thus be incorrect to imply from this that other general laws and powers of the High Court conferred by the Code of Civil Procedure have been excluded.

In the light of various pronouncements of the Supreme Court and the Privy Council, ordinary Courts which have been seized of a dispute in respect of a legal right or liability under a special enactment, should be regarded as having power to adjudicate such dispute according to the ordinary rules of practice and procedure which would include the power to review judgments and orders.

On the above premise, even in the absence of an express provision in the Act conferring the power of review, the High Court has a power to review its decision.

Section 35G of the Central Excise Act, 1944 – Statement of case to High Court

Where a statute has been amended retrospectively, a judgment applying unamended law would constitute an error on face of record liable to review

VIP Industries Ltd. v. CCE, December 16, 2010 (BOM)

In *Raja Shatrunji Vs. Mohammad Azmat Azim Khan*, reported in (1971) 2 SCC 200, the Supreme Court held



that one of the grounds for review is an error apparent on the face of record and where a statute has been amended retrospectively, a judgment applying the unamended law would constitute an error apparent on the face of record.

It was further held that the Court is to apply the legal provision as it always stood. It would, therefore, be error on the face of record. The error would be that the law that was applied was not the law which is applicable.

OTHER ACTS

Trade Marks Act

Section 46 of the Trade and Merchandise Marks Act, 1958 – Removal from Registered and Imposition of Limitations on ground of non-use



In terms of Section 46(1), not only that applicant has to show that he is an aggrieved person as his interest is being affected but Intellectual Property Appellate Board (IPAB) must also be satisfied, before it directs removal of registered trade mark, that applicant is an aggrieved person before it invokes power in directing removal of registered trade mark; this is so because pre-requisite for exercise of power under Section 46(1) is that applicant is a person aggrieved
Infosys Technologies Ltd. v. Jupiter Infosys Ltd, November 9, 2010 (SC)

On April 21, 1992, the name of the company-Infosys Consultants Pvt. Limited was changed to Infosys Technologies Pvt. Ltd. and thereafter on June 2, 1992, the name was changed to the present name, i.e. Infosys Technologies Limited. The first respondent Jupiter Infosys Limited was incorporated and registered in September 1978 under the name of Jupiter Agencies Pvt. Limited. The name of the first respondent was changed to Jupiter Infosys (P) Limited in August, 1995 and since July, 2003, the name was changed to Jupiter International Limited. On October 11, 1996, the appellant instituted a suit in the High Court for perpetual injunction, for restraining the first respondent from infringing the appellant's mark 'Infosys'. As a result different restrained order was passed. The first respondent filed composite applications under Sections 46 and 56 of the 1958 Act for rectification/removal of the trade mark 'Infosys' registered in Classes 7, 9 and 16.

The Supreme Court held that to be an aggrieved person under Section 46, he must be one whose interest is affected in some possible way; it must not be a fanciful suggestion of grievance. A likelihood of some injury or damage to the applicant by such trade mark remaining on the register may meet the test of *locus standi*. The persons who are aggrieved are all persons who are in some way or the other substantially interested in having the mark removed - where it is a question of removal - from the register; including all persons who would be substantially damaged if the mark remained, and all trade rivals over whom an advantage was gained by a trader who was getting the benefit of a registered trade mark to which he was not entitled. The above statement of law was to be accepted.

Insofar as Section 56 is concerned, it provides for varying situations in which the person aggrieved may apply for rectification of the registered trade mark from the register.



Although both sections, namely, Sections 46 and 56 require 'person aggrieved' to apply for removal of the registered trade mark from the register or rectification of a trade mark in the register, the expression 'person aggrieved' for the purposes of these two sections has different connotations.

The phrase "person aggrieved" for the purposes of removal on the ground of non-use under Section 46 has a different connotation from the phrase used in Section 56 for cancelling or expunging or varying an entry wrongly made or remaining in the Register.

In terms of Section 46(1), not only that the applicant has to show that he is an aggrieved person as his interest is being affected but the IPAB must also be satisfied, before it directs the removal of registered trade mark, that the applicant is an aggrieved person before it invokes the power in directing the removal of the registered trade mark. This is so because the pre-requisite for exercise of power under Section 46(1) is that the applicant is a person aggrieved.

The grievance of the applicant when he invokes Section 46(1) must not only be taken to have existed on the date of making application but must continue to exist when such application is decided. If during the pendency of such application, the applicant's cause of complaint does not survive or his grievance does not subsist due to his own action or the applicant has waived his right or he has lost his interest for any other reason, there may not be any justification for rectification as the registered trade mark cannot be said to operate prejudicially to his interest. ■

CIRCULARS/NOTIFICATIONS

INDIRECT TAXES

A. SERVICE TAX

1. Notification No. 3/1994-ST dated 30.06.1994 exempts *inter alia* Janta Personal Accident Policy (JPAP) from service tax payable thereon. Since a description of JPAP Policy is not available in the said notification, it has been clarified vide Circular No.133/2/2011-ST dated 18.01.2011 that customised group JPAP insurance schemes floated by various insurance companies as per the specifications of State Governments concerned, to extend risk cover to target populations, and to fulfill the prescribed 'rural or social sector' obligation, are covered by the above service tax exemption. Hence, no service tax is payable thereon.
2. Service Tax Audit Manual, 2010 has been published by the Director General of Audit, New Delhi. As per the Manual, the frequency of audit for the service taxpayers would be as per following norms:-



S. No.	Service Tax Payment (Cash + CENVAT)	Frequency of Audit
i.	Exceeding ₹3 crores	every year
ii.	Between ₹1 crore and ₹3 crore	once in every two years
iii.	Between ₹25 lakh and ₹1 crore	once in every five years
iv.	Up to ₹25 lakh	2 per cent of taxpayers to be audited every year

The CBEC has clarified that the non-monetary taxpayers would be selected on the basis of assessment of the risk potential to revenue. The taxpayers whose returns are selected for detailed scrutiny, may not be taken up for Audit that year and the taxpayers who have been selected for Audit, may not be taken up for detailed scrutiny of their ST-3 Returns during that year.

[Source : www.cbec.gov.in]

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

FEMA

1. Participation by Full Fledged Money Changers (FFMCs) and Authorised Dealers Category-II (ADs Category-II) in the Currency Futures and the Exchange Traded Currency Options markets

RBI/2010-11/384 A.P. (DIR Series) Circular No. 40 & A.P. (FL Series) Circular No. 10 dated January 25, 2011

RBI has modified the guidelines contained in A.P. (DIR Series) Circular No. 5 dated August 6, 2008 and A.P. (DIR Series) Circular No. 5 dated July 30, 2010 on trading of currency options contracts on recognised stock/new exchanges.

RBI has now decided that the FFMCs and the ADs Category-II [which are not Regional Rural Banks (RRBs), Local Area Banks (LABs), Urban Co-operative Banks (UCBs) and Non-Banking Financial Companies (NBFCs)], having a minimum net worth of ₹5 crore, may participate in the designated currency futures and currency options on exchanges recognised by the Securities and Exchange Board of India (SEBI) as clients only for the purpose of hedging their underlying foreign exchange exposures.

FFMCs and the ADs Category-II, which are RRBs, LABs, UCBs and NBFCs, may be guided by the instructions issued by the respective regulatory departments of the RBI in this regard.

2. Deferred Payment Protocols dated April 30, 1981 and December 23, 1985 between Government of India and erstwhile USSR

RBI/2010-11/402 A.P. (DIR Series) Circular No. 41 dated February 11, 2011

Rupee value of the special currency basket was indicated as ₹62.788607 with effect from July 7, 2010 vide A. P. (DIR Series) Circular No.2 dated, July 21, 2010.

Further revision has taken place on January 26, 2011 and accordingly, the Rupee value of the special currency basket has been fixed at Rs. 64.7004 with effect from January 31, 2011.

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

CORPORATE LAWS

1. Format for submission of data to credit information companies

www.rbi.gov.in

The RBI has issued Circular No. 41/03.05.33/2010-11 dated 24.12.2010 whereby in terms of Section 17(1/2) of the Credit Information Companies (Regulation) Act, 2005, a credit information company may require its members to furnish credit information as it may deem necessary in accordance with the provisions of the Act and every such credit institution has to provide the required information to that credit information company. Further, in terms of Regulation 10(a) (ii) of the Credit Information Companies Regulations, 2006, every credit institution shall, (a) keep the credit information maintained by it, updated regularly on a monthly basis or at such shorter intervals as may be mutually agreed upon between the credit institution and the credit information company, and, (b) take all such steps which may be necessary to ensure that the credit information furnished by it, is update, accurate and complete. This Circular clarifies that RRBs which have become members of credit information company/companies may provide them the current data in the existing format and that such RRBs may also provide historical data in order to enable the new credit information companies to validate their software and develop a robust database. The Circular also notes that in many cases, names of Directors of various firms/companies are similar. It is, therefore, necessary to ensure that Directors are correctly identified and in no case, names appearing to be similar to the names of Directors appearing in the list of defaulting borrowers are wrongfully denied credit facilities on such grounds. To avoid such situations, it has been decided that the Director Identification Number (DIN) may be included as one of the fields in the data format submitted by RRBs to credit information companies. Such provision of DIN will further ensure that the data relating to credit information is accurate and complete. One may refer to the above website for further details.

2. Issuance of non-convertible debentures (NCDs)

www.rbi.gov.in

The RBI has issued Circular No. IDMD. PCD.25/14.03.03/2010-11 dated 27.12.2010 in relation to the Issuance of Non-Convertible Debentures (Reserve Bank) Directions, 2010 issued on June 23, 2010 in relation to NCDs covering the regulation of NCDs of maturity up to one year for which by this Circular it is now clarified that where the issuer is, (a) maintaining banking facilities with multiple banks/FIs, the issuer may obtain a certificate from any one of its banks on the quality of the asset and also give an undertaking that its accounts maintained with the other banks/FIs are classified as Standard Assets by the banks/FIs. Accordingly, the auditor verifying the eligibility conditions set forth in the Directions (in terms of Section 8.2 of the Directions) must also ensure that such an undertaking is available on record, and, (b) raising funds through issuance of NCDs in multiple tranches based on a single valid rating for the consolidated amount, each tranche need not be separately certified by the auditor (in compliance with Section 8.2 of the NCD Directions). However, where the issuer obtains a separate/fresh rating for an issuance, such issuance must be backed by an auditor's certificate confirming the issuer's compliance with the eligibility criteria for issuance. One may refer to the above website for further details.

3. Accounting procedure for investments – settlement date accounting

www.rbi.gov.in

The RBI has issued Circular No. 34/09.80.00/2010-11 dated 18.01.2011 in relation to ready forward contracts in Government Securities and on settlement of transactions in Government Securities. It was observed that there is no uniformity in the practice adopted by banks while accounting for investments in Government Securities i.e. they are accounted for either on "Trade Date" or the "Settlement Date". Hence, with a view to bringing in uniformity, it has been decided that banks should follow "Settlement Date" accounting for recording both outright and ready forward purchase and sale transactions in Government Securities. These instructions will be applicable with immediate effect. One may refer to the above website for further details.

4. Arbitration Mechanism of Stock Exchanges and Limitation Act

www.sebi.gov.in

The SEBI has issued Circular No. CIR/MRD/DSA/2/2011 dated 09.02.2011 stating that vide an earlier Circular it was prescribed that the limitation period for filing an arbitration reference shall be governed by the provisions of the Limitation Act, 1963. In this regard upon consideration of various representations received by SEBI, it has been decided that the limitation period, as modified to three years in terms of Limitation Act, 1963, shall be applicable to cover *inter alia* the cases of, (a) where three years have not yet elapsed and the parties have not filed for arbitration with the stock exchange, or (b) where the arbitration application was

filed but was rejected solely on the ground of delay in filing within the earlier limitation period of six months; and three years have not yet elapsed. In this regard, it is provided that the cost for arbitration in such cases would be, (a) cases which were not filed earlier will be subject to the fee amount in terms of SEBI circulars dated August 11, 2010 and August 31, 2010, and, (b) for cases filed earlier and rejected on the ground of bar of limitation as per the earlier limitation period of six months, the amount of fee already paid would be deducted from the amount computed in terms of SEBI circulars dated August 11, 2010 and August 31, 2010. The balance shall be borne by the parties to the arbitration in the manner specified vide SEBI circulars dated August 11, 2010 and August 31, 2010. One may refer to the above website for further details.

5. No government approval for managerial remuneration for unlisted companies with no profits

www.mca.gov.in

The Ministry of Corporate Affairs (MCA) has issued notification No. 70(E) dated 08.02.2011 in relation to managerial remuneration in unlisted companies having no profits/inadequate profits and it is now provided that in the case of unlisted companies, so long as the conditions specified in Schedule XIII, including special resolution of shareholders and absence of default on payment to creditors, are fulfilled, approval of the MCA will not be needed hereafter. Accordingly, Schedule XIII of the Companies Act, 1956 is being amended to provide that unlisted companies (which are not subsidiaries of listed companies) shall not require government approval for managerial remuneration in cases where they have no profits/inadequate profits, provided they meet the other conditions stipulated in the Schedule XIII. One may refer to the above website for further details.

6. Directions under Section 212 for attaching subsidiaries' financial statements

www.mca.gov.in

The MCA has issued General Circular No. 2/2011 dated 08.02.2011 and stated that Section 212 of the Companies Act, 1956 requires holding companies to attach with their balance sheet a copy of the balance sheet, profit and loss account, etc. of each of its subsidiaries and that in recent years, with the globalisation of the Indian economy, there has been a large increase in the number of holding companies and subsidiaries. Accounting policies and practices have also evolved, and accounting standards have been issued regarding preparation of consolidated financial statements. The MCA is receiving many applications seeking permission not to attach the accounts of subsidiaries which are granted on case-by-case basis on the basis of certain conditions which are intended to protect the interests of investors. Now, in the context of the emerging trends in the economy and regulatory and accounting practices, it has been decided that the **permission may be granted on a general basis** wherever the board of directors of the holding company gives its consent and the conditions, prescribed by the MCA are complied with, like,

- a) The board of directors of the company has by resolution given consent for not attaching the balance sheet of the subsidiary concerned;
- b) The company shall present in the annual report, the consolidated financial statements of holding company and all subsidiaries duly audited by its statutory auditors;
- c) The consolidated financial statement shall be prepared in strict compliance with applicable accounting standards and, where applicable, listing agreement as prescribed by the SEBI;
- d) The company shall disclose in the consolidated balance sheet the following information in aggregate for each subsidiary including subsidiaries of subsidiaries:- (a) capital (b) reserves (c) total assets (d) total liabilities (e) details of investment (except in case of investment in the subsidiaries) (f) turnover (g) profit before taxation (h) provision for taxation (i) profit after taxation (j) proposed dividend;
- e) The holding company shall undertake in its annual report that annual accounts of the subsidiary companies and the related detailed information shall be made available to the shareholders of the holding and subsidiary companies seeking such information at any point of time. The annual accounts of the subsidiary companies shall also be kept for inspection by any shareholders in the head office of the holding company and of the subsidiary companies concerned and a note to the above effect will be included in the annual report of the holding company. The holding company shall furnish a hard copy of details of accounts of subsidiaries to any shareholder on demand;
- f) The holding as well as subsidiary companies in question shall regularly file such data to the various regulatory and government authorities as may be required by them;
- g) The company shall give Indian rupee equivalent of the figures given in foreign currency appearing in the accounts of the subsidiary companies along with exchange rate as on closing day of the financial year.

One may refer to the above website for further details.

7. Exemption under Section 211 to FIs from disclosing investment particulars

www.mca.gov.in

The Ministry of Corporate Affairs (MCA) has issued Notification No. 300(E) dated 08.02.2011 exempting Public Financial Institutions as specified under Section 4A of the Companies Act, 1956 from disclosing Investments as required under paragraph (1) of Note (1) of Part-I of Schedule VI in their balance sheet subject to fulfillment of certain conditions as under:

- a) the Public Financial Institutions shall make the complete disclosures about investments in the balance sheet in respect of immovable property, capital of partnership firms, all unquoted investments and investments in subsidiary companies.
- b) the Public Financial Institutions shall disclose the

- total value of quoted investments in the respective categories, namely, Government and trusts securities, shares, debentures, bonds and other securities.
- c) in each of the above categories referred to in sub-paragraphs (a) and (b), investments where value exceeds two percent of total value in each category or one crore rupees, whichever is lower, shall be disclosed fully provided that where disclosures do not result in disclosure of at least fifty percent of total value of investment in a particular category, additional disclosure of investments in descending order of value shall be made so that specific disclosures account for at least fifty percent of the total value of investments in that category.
 - d) the Public Financial Institutions shall also give an undertaking to the effect that as and when any of the shareholders ask for specific particulars the same shall be provided.
 - e) all unquoted investments shall be separately shown.
 - f) the company shall undertake to file with any other authorities, whenever necessary, all the relevant particulars as may be required by the Government or other regulatory bodies.
 - g) the Investments in subsidiary companies or in any company such that it becomes a subsidiary, shall be fully disclosed.

One may note that this notification shall be applicable in respect of balance sheet and profit and loss accounts prepared in respect of the financial year ending on or after the 31 March, 2011. One may refer to the above website for further details.

8. Exemption under Section 211 from disclosing quantitative details

www.mca.gov.in

The Ministry of Corporate Affairs ("MCA") has issued Notification No. 301(E) dated 08.02.2011 exempting certain classes of companies from disclosing in their profit and loss account certain information relating to quantitative details mentioned under column (3), against each class of companies mentioned under column (2) of the table given below subject to fulfillment of the conditions stipulated in this Notification.

S. No.	Class of companies	Exemptions from paragraphs of Part-II of Schedule VI
1	Companies producing Defence Equipments including Space Research	Paragraphs 3(i)(a), 3(ii)(a), 3(ii)(d), 4-C, 4-D (a) to (e) except (d)
2	Export Oriented company (whose export is more than 20 per cent of the turnover)	Paragraphs 3(i)(a), 3(ii)(a), 3(ii)(b), 3(ii)(d)
3	Shipping companies (Including Airlines)	Paragraphs 3(i)(a), 3(ii)(a), 3(ii)(b), 3(ii)(d)
4	Hotel companies (including Restaurants)	paragraphs 3(i)(a) and 3(ii)(d)
5	Manufacturing companies/ multi-product companies	Paragraphs 3(i)(a) and 3(ii)(a)
6	Trading companies	Paragraphs 3(i)(a) and 3(ii)(b)



The conditions to be fulfilled by the above class of companies are as under:

- a) The Board of Directors of the company has given consent with regard to non-disclosure of information referred to in Paragraph 1.
- b) The company shall disclose in the Notes forming part of the balance sheet and profit and loss account, the fact of grant of the exemption under this notification.
- c) The company shall conform to the prescribed Accounting Standards.
- d) The company shall ensure that its financial documents represent a true and fair state of affairs of its finances.
- e) The company shall maintain and file such information as may be prescribed or called for or required by the government or the Reserve Bank of India or any regulator.
- f) For representation of foreign currency holdings, if any, exchange rate as on date of closing of accounts shall be applicable.
- g) The exemption in respect of the companies referred to in serial numbers 5 and 6 of the Table shall be applicable only for those goods which form less than ten percent of the total value of turnover, purchase, consumption of raw material, etc, as the case may be.

This notification shall be applicable in respect of balance sheet and profit and loss accounts prepared in respect of the financial year ending on or after the March 31, 2011. One may refer to the above website for further details.

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

Accounting for rescheduling of lease rentals

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 non-listed company registered under the Companies Act, 1956 (hereinafter referred to as 'the company'), is a subsidiary of a listed public limited company. The company is a Non-Banking Financial Company (NBFC) registered with the Reserve Bank of India. The company has a network of branches over a large part of India to carry on its business and hence, takes on lease, various properties for its branches. The company is not in the business of leasing and renting.
2. The querist has stated that the company has entered into a lease agreement which has the following main features:
 - (i) The lease agreement is for a period of nine years.
 - (ii) The rent for the first three years is at market rate on the date of lease agreement and has an escalation clause applicable after every three years.
 - (iii) The lessee has the option to exit from the agreement by giving three months' notice.
3. The querist has stated that in the current scenario, the real estate rates in India as well as abroad have undergone various changes due to global financial meltdown and the fall in the equity markets. The property rates have gone down substantially in the range of 30% to 40% and are expected to go down further. Consequently, the rent agreed initially has turned out to be substantially high with respect to the current circumstances. The company has been successful in renegotiating the lease rentals of its premises downwards. The issue has arisen as to the accounting for lease rentals with respect to the lease period.
4. The original lease deed was entered into on 5.10.2006. The original and renegotiated terms of the contract are as follows:
Original lease deed:

Term	Rent
20.11.2006 to 19.11.2009	₹ 70,000 per month
20.11.2009 to 19.11.2012	₹ 80,500 per month*
20.11.2012 to 19.11.2015	₹ 92,575 per month*

 (*escalation of 15%)

The lessor was paid rent upto 31st December, 2008. The lease deed was renegotiated and the revised supplementary lease deed was entered into on 16.02.2009. The revised terms of the lease deed are as follows:

01.01.2009 to 31.12.2009	₹ 56,000 per month
01.01.2010 to 31.12.2013	₹ 61,600 per month*
01.01.2014 to 19.11.2015	₹ 67,760 per month*

(*escalation of 10%)

5. The company has accounted for lease rentals since the inception of the lease on a straight line basis with respect to the original lease term. The querist has reproduced the following paragraphs of Accounting Standard (AS) 19, 'Leases', which, according to the querist, have an impact on the issue at hand:

"3.6 The lease term is the non-cancellable period for which the lessee has agreed to take on lease the asset together with any further periods for which the lessee has the option to continue the lease of the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise."

"23. Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit."

24. For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense in the statement of profit and loss on a straight line basis unless another systematic basis is more representative of the time pattern of the user's benefit, even if the payments are not on that basis."

6. According to the querist, the accounting for lease rent escalations would be governed by paragraph 23 of AS 19. As per the querist, in accordance with paragraph 23, an entity should account for lease rentals in the following

manner, which should be recognised as an expense in the statement of profit and loss:

- (i) on a straight line basis over the lease term, or
- (ii) another systematic basis if it is more representative of the time pattern of the user's benefit.

The querist has stated that in the given case, the lease term would be the entire nine year period as the entity has already decided the same at inception.

7. The querist has stated that the benefit that is derived by leasing a property can be generally measured from the market rates for similar properties. For example, if the market rate of a property in a year is ₹100, the benefit derived from the property is ₹100. In case the market rate falls to ₹80 in the next year, the benefit derived would be ₹80. Accordingly, under the current circumstances, the company believes that the fact that it will derive the same benefit throughout the lease term does not hold good due to the changed circumstances of a significant fall in the market rates.
8. The querist has also stated that in the current scenario, since the company has been able to successfully renegotiate rent, it can be reasonably assumed that the rent actually paid by the company reflects the benefit that accrues to the entity and accordingly, the rents actually paid should be debited as expense to the profit and loss account. Further, the company feels that the current scenario is such that the terms in the lease deed have a very high probability of being renegotiated in future. Thus, in the view of the querist, the aforesaid agreed rentals in the agreement are likely to be renegotiated as a further fall is expected.

B. Query

9. Under the aforesaid facts and circumstances, the querist has sought the opinion of the Expert Advisory Committee on the following issues:
 - (i) Whether the principle of recognising lease rentals over the lease term on a straight line basis is correct. If not, then what should be the basis of accounting for such lease rentals.
 - (ii) Whether the monthly rental should be accounted for at the value of actual lease rent paid in such a case.

C. Points considered by the Committee

10. The Committee notes that the basic issue raised in the query relates to accounting for lease rentals in the case of an operating lease, where the company has

been successful in renegotiating/amending the lease rentals over the remaining period of lease and where it is expected that the terms in the lease deed have a high probability of being renegotiated in future. The Committee has, therefore, considered only this issue and has not touched upon any other issue that may arise from the Facts of the Case, such as, propriety of determining the lease in the present case as an operating lease as per the requirements of AS 19, legal implications, if any, arising out of such renegotiations in the lease deed, etc.

11. The Committee notes paragraph 23 of AS 19 as reproduced by the querist in paragraph 5 above. The Committee is of the view that as per the principles of AS 19, any departure from the straight-line basis of recognition of lease expense under an operating lease must reflect the time pattern of the user's benefit, which, in the view of the Committee, should be considered from the angle of use of the leased asset in physical terms rather than the benefit derived from the angle of market rates of leased properties as being argued by the querist. Since the leased property in the instant case would be used by the lessee throughout the lease term on a consistent basis, even though the lease rentals have been reduced due to economic slow down, the Committee is of the view that the lease expense over the lease term should be recognised on a straight line basis. The Committee also notes that volatility in the lease rentals due to economic changes or the expectations that the lease rentals would further go down does not affect the physical use of the property and, therefore, such considerations cannot form the basis for any departure from the straight line basis of recognition of lease rentals over the lease term in case of an operating lease. Also, the Committee is of the view that since the terms of a lease deed are legally binding on both the parties to the agreement, merely an expectation of deviation from the terms of the lease deed in future should not be considered while accounting for lease rentals.
12. With respect to accounting for lease rentals in the case of the existing operating lease, the Committee notes that due to economic changes, lease rentals have been re-negotiated and for the revised terms of the contract, a supplementary lease deed has been entered into. The Committee is of the view that for the purpose of accounting, the revised lease rentals should be taken into account for determining the charge to the profit and

loss account over the lease period of 9 years. Keeping in view the requirement of straight line basis for recognition of lease rentals over the lease term as per paragraph 23 of AS 19 as discussed in paragraph 11 above, the Committee is of the view that lease rentals payable over the whole period of nine years should be considered for determining the annual charge to the statement of profit and loss on this account. Accordingly, the lease rentals paid under the original lease deed and the revised lease rentals payable over the remaining period of the lease as per the supplementary lease deed, should be considered for determining the amount of annual charge on account of lease rentals on straight line basis. Any resultant adjustments on account of lease rent already recognised in past should be recognised in the current year's profit and loss account.

D. Opinion

13. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 9 above under the facts and circumstances of the case:
- (i) The principle of recognising lease rentals over the lease term on a straight line basis is correct.

- (ii) The monthly rental cannot be accounted for at the value of actual lease rent paid. See paragraphs 11 and 12 above.

1	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2	The Opinion is based on the facts supplied and in the specific circumstances of the querist.
3	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in twenty eight volumes. A CD of Compendium of Opinions containing twenty eight volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.org .

Plagiarism: A Matter of Growing Concern

[Our journal, The Chartered Accountant, is a means to enhance our members' knowledge and update them on contemporary developments in the area of accountancy and other allied professions and topics of professional interest. We cater this service to all our members, e.g. more than 1,60,000 in number. Our Journal is read by more than 2 lakh readers across India and abroad.]

We receive articles from our authors either on their own or in response to our invitation when we bring out special issues. In the recent past, we have come across the practice of *plagiarism* in some of the submissions by our authors. Contents of some articles have been found to be lifted from resources including books, websites, etc., and presented to us as authors' original work, which is nothing but plagiarism, an infringement of others' intellectual property rights and, therefore, a punishable offence. It is an intellectual crime.

Authors who submit plagiarised work for publication will be strictly proceeded against as per policy and rules of Institute of Chartered Accountants of India and the law of the land. We will also represent such cases to authorities of the organisations where these authors work.

We appeal, therefore, to all our prospective authors not to send a plagiarised work to us for publication and not try to take credit for a work which is not theirs. Any reference of other sources/authors/content should be duly given within quotes with the name of the source in the body of the submitted articles' text itself. By following this practice, we will essentially show respect towards the creative community which all of us value immensely.

- Editor

Depreciation on Intangible Assets and Reporting & Discloser Practices by Indian Corporate



The intangible assets such as brand, patents, franchises, software, research programme, ideas, and expertise are playing a major role in the modern era. As firms now become more knowledge and information based, intangible assets will consist of a significant percentage of the overall value of the business. Until 1998, depreciation was allowed only on tangible assets (L/B, P/M, furniture, etc.) not for intangible assets. But, Finance (No.2) Act, 1998, for the first time, provided for allowance of depreciation on 'intangible assets' under the Income-tax Act, 1961 (Act). Section 32(1) (ii) of the Act provides that any know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature, acquired by the assessee on or after 1-4-1998, shall be eligible for depreciation allowance with effect from the assessment year 1999-2000. However, although more than one decade has passed, discloser and reporting for depreciation on intangible assets are not uniform in intra industry as well as inter industry in India. Due to lack of harmonisation in the reporting for depreciation on intangible assets, profitability and shareholders value creation is also different for the different companies, even if they are doing similar business. This article highlights the concept of depreciation on intangible assets and reporting and discloser practices adopted by the Indian corporate during the last decade.



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In recent years, the growth of the service sector and information technology related business, along with the dramatic increase in the number and size of international mergers and acquisitions, has made accounting for Intangible Assets (IA) very significant¹. The value attached to intangible assets has increased manifold in the current era of knowledge economy. The intangible assets such as brand, patent, franchise, software, research programme, ideas, and expertise are playing key role in the modern knowledge era. Intangible assets are a major tool for firms to build competitive advantages. As firms now become

¹ Lev, B. (2001) *Intangibles: Management, Measurement, and Reporting*, Washington, D C: The Bookings Institution.

more knowledge and information based, intangible assets will consist of a significant percentage of the overall value of the business. Intangible assets as defined by The Institute of Chartered Accountant of India, “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.” The IAS-38 also defines “an intangible asset as an identifiable non-monetary asset without physical substance”².

Disclosure of accounting information related with intangibles assets, especially depreciation and amortisation of intangible assets, etc., is also an important aspect of the fair reporting practices. It is because it will directly affect the overall reporting, profitability and shareholder wealth creation for a specific period. Based on such information, interested parties and potential investors will be informed of the strengths and weaknesses of a particular firm, in terms of earning capacity, and/or whether the management of the business unit acts in a manner which can be of beneficial to the potential investors. Keeping this view in a mind, the article explains the reporting and disclosure practices by Indian companies with special regard to depreciation/amortisation on intangible assets. Whether they are following a uniform policy for depreciation on intangible assets or there is any specific policy according to the nature of industry in contemporary environment. An attempt is also made to analyse inter-industry and intra-industry reporting & disclosure for depreciation on intangible assets.

Intangible Assets and Depreciation

Depreciation allowance is granted to compensate the assessee for depreciation suffered by him in respect of specific assets. Depreciation is a measure of the effective life of an asset owing to use or obsolescence. Depreciation is one kind of notional loss, which arises due to physical wear and tear of the assets during production and manufacturing process. Depreciation allowance is provided for the replacement of assets after expiry of life and on the other side it is one of the tax shields, which will minimise the tax liability of the individuals or corporate assessee.

Until 1998, depreciation was allowed only on tangible assets (L/B, P/M, furniture, etc.) not for intangible assets. But, Finance (No.2) Act, 1998, for the first time, provided for allowance of depreciation on ‘intangible assets’ under the Income-tax Act, 1961 (The Act). Section 32(1) (ii) of the Act provides that any know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature, acquired by the assessee on or after 1-4-1998, shall be eligible for depreciation allowance with effect from the assessment year 1999-2000. Sections 35A and 35AB which earlier

“Until 1998, depreciation was allowed only on tangible assets (L/B, P/M, furniture, etc.) not for intangible assets. But, Finance (No.2) Act, 1998, for the first time, provided for allowance of depreciation on ‘intangible assets’ under the Income-tax Act, 1961 (The Act). Section 32(1) (ii) of the Act provides that any know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature, acquired by the assessee on or after 1-4-1998, shall be eligible for depreciation allowance with effect from the assessment year 1999-2000.”

provided for amortisation of expenditure on patent rights, copyrights and know-how over a period of six years was also amended and such expenditure was to be treated as intangible assets, eligible for depreciation. Consequently, depreciation can now be claimed on intangible assets, acquired for a price, on the satisfaction of the following conditions namely:

- (1) The intangible assets are acquired by the assessee on or after 1.4.1998.
- (2) Such assets are owned by him either wholly or partly; and
- (3) Such assets are used by him for the purposes of his business or profession during the previous year.

At present applicable rate for depreciation on intangible assets is @ 25%. Now the question arises that their amortised value depends upon their performance and market demand or cost of acquisition less depreciation.

Intangible Assets and Harmonisation

In the knowledge era it is well accepted that intangible assets are the key drivers of the organisations. According to nature and legality, intangible assets are categorised in different ways. Persistent competitive pressure induced by globalisation of trade, deregulation and technological changes have forced the companies to rely on continuous innovations for survival and growth. Innovation in turn is primarily achieved by investment in intangible assets. It is, therefore, hardly surprising that in recent times ‘intangibles’ has become an important issue of discussion both in the academic and the corporate world. *Intangible business ltd*, a leader in accounting and valuation for intangibles assets, suggested a comprehensive list of the intangible assets (refer exhibit I) which are commonly used by all the business entities according to their nature and environment.

Harmonisation of reporting and disclosure for intangible assets & amortisation/depreciation is important for fair reporting and global acceptability point of view. Harmonisation

² IAS-38 Para 8.

means maintaining uniformity in financial accounting principles and practices at the international level. It implies international harmony in transactional financial reporting. It aims to narrow the areas of differences and to eliminate undesirable alternative practices in financial reporting. It is process of blending and combining various practices into an orderly structure, which produces synergistic results.

are many judgements that have held that sums paid as compensation towards non-compete results in enduring benefit and, therefore, cannot be allowed as revenue expenditure. In this scenario, the assessee regularly argue that the non-compete fee should be allowed to be written off over a number of years in the form of tax depreciation.

Exhibit I: List of Intangible Assets & Intellectual Properties

• Airport gates and slots • Bank customers -deposits, loan, trust and credit card • Blueprints • Book libraries • Brand names • Broadcast licenses • Buy-sell agreements • Certificates of need • Chemical formulas • Computer software • Computerised databases • Contracts • Cooperative agreements • Copyrights • Credit information files • Customer contracts • Customer & client lists • Customer relationships • Designs & drawings • Development rights • Distribution networks • Distribution rights • Drilling rights	• Easements • Employment contracts • Engineering drawings • Environmental rights • FCC licenses • Favorable financing • Favorable leases • Film libraries • Food flavorings& recipes • Franchise agreements • Historical documents • HMO enrollment lists • Insurance expirations • Insurance in force • Joint ventures • Know-how • Laboratory notebooks • Landing rights • Leasehold interests • Literary works • Loan portfolios Location value • Management contracts • Manual databases • Manuscripts	• Medical charts and records • Mineral rights • Musical compositions • Natural resources • Newspaper morgue files • Non compete covenants • Options, warrants, grants, rights • Patent applications • Patents -both product & process • Patterns • Permits • Prescription drug files • Prizes and awards • Procedural manuals • Production backlogs • Product designs • Property use rights • Proposals outstanding • Proprietary computer Software • Proprietary processes • Proprietary products • Proprietary technology	• Publications • Retail shelf space • Royalty agreements • Schematics & diagrams • Securities portfolios • Security interests • Shareholder agreements • Solicitation rights • Stock & bond instruments • Subscription lists • Supplier contracts • Technical & specialty Libraries • Technical documentation • Technology sharing agreements • Title plants • Trade secrets • Trained & assembled workforce • Trademark and trade names • Training manuals • Use rights -air, water, land
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Source: *Intangible business Ltd.*

Goodwill as Intangible Assets and Depreciation

Goodwill is an intangible asset, probably the most intangible of all intangible assets, hard to measure and even more difficult to account for. Goodwill today constitutes a much larger part of acquisition prices than it did previously, resulting in a much greater impact on financial statements. Goodwill is also a main part of intangible assets, but due to lack of clarity in the Act and in accounting standards in many cases depreciation was not allowed by the taxation authorities on goodwill as intangible assets. According to the Section 55(2) (a) of the Act, which was amended by the Finance Act, 1987, the cost of acquisition in case of goodwill would be the purchase price and in case of *self-generated goodwill it will be Nil*. Thus, purchased goodwill is now specifically recognised as a capital asset. Specially, M&A transactions usually result in the transferee company paying a consideration higher than the value of the assets taken over, which is accounted and recorded as 'Goodwill'. Under many judgments depreciation was not allowed by the tax authorities on intangible assets.

Depreciation on Non-compete fees: A Non-compete fee is another unique intangible asset which is popular in acquisition deals, is generally paid to eliminate competition in certain region or geographical area. There

Intangible Assets & Depreciation Disclosure & Reporting: A Survey of Indian Companies

As we know that since 1998 depreciation was allowed on intangible assets by the tax authorities and AS-26 will also be applicable for accounting and reporting for intangible assets. However, although more than one decade has passed, disclosure and reporting for depreciation on intangible assets are not uniform in intra-industry as well as inter-industry in India. Due to lack of harmonisation in the reporting for depreciation on intangible assets, profitability and shareholders value creation will also be different for different companies, even if they are doing similar business.

To analyse the reporting and disclosure for depreciation on intangible assets, a comprehensive survey was done by the author among the top BSE companies to know the method of recognition of intangible assets, amortisation/depreciation during the last one decade. The Consolidated comprehensive information is given in tabulated form regarding the nature of companies (IT, FMCG, Automobile, Pharma, Capital Goods, and Infrastructure, etc), types of intangible assets reported in the annual report/financial statements and disclosure and reporting methods for depreciation on intangible assets. Intra-industry and inter-industry analysis is as follows.

Information technology industry is the leader in respect of disclosure and reporting on a voluntary basis in the annual reports. In companies such as Infosys, Satyam, TCS, HCL and Wipro etc, most of the intangible assets are in form of technical know-how, Patents, trademarks and rights, brand value, and goodwill (refer exhibit II). Regarding amortisation and depreciation of intangible assets, some variations are observed for example in Wipro, Data processing equipment and software are depreciated with 2-6 years, but in TCS Software licenses are depreciated on straight line basis @ 20%. However, in Satyam, software used in Development for Projects have a life of 3 years. In Infosys, intangible assets are amortised over their respective individual estimated useful lives on a straight-line basis, commencing from the date the asset is available to the company for its use. It is clear from the above observation that even within the industry, reporting & disclosure for depreciation on the same type of intangible assets are not uniform.

Exhibit II: Information Technology Industry–Intangible assets and depreciation disclosures

Name of companies	Types of Intangible assets	Discloser and reporting methods for depreciation and Intangible assets
WIPRO	Technical know-how, Patents, Trademarks and rights and Brand value	- Intangible assets are stated at the consideration paid for acquisition less accumulated amortisation. - The goodwill arising on acquisition of a group of assets is not being amortised. It is tested for impairment on a periodic basis and written off if found impaired. - Depreciation: Data processing equipment and software depreciated with 2 - 6 years
INFOSYS	Human Resource Value, Brand Value and Goodwill	- Intangible assets are recorded at the consideration paid for acquisition. - Intangible assets are amortised over their respective individual estimated useful lives on a straight-line basis, commencing from the date the asset is available to the company for its use.
TCS	Intellectual property/ distribution rights, Goodwill, Brand value and Software	- Intellectual Property/Distribution Rights amortised on the basis of straight line within 24–36 months. - Software license are depreciated on straight line basis @ 20%.
SATYAM	Human resource, Brand value, Software	- Costs of application software for internal use are generally charged to revenue as incurred due to its estimated useful lives being relatively short, usually less than one year. - Software – used in Development for Projects their life will be 3 years.
HCL Tech	Goodwill, Computer Software	- Estimated useful life of goodwill five years and the carrying value of goodwill at the end of each accounting years is reviewed for impairment. - Software life will be 3 years.
HCL Info	Acquired software	- Intangible Assets are stated at cost net of amortisation. - Intangible Assets are amortised over a period of 1-3 years.
PATNI Computers	Computer software	Intangible Assets are amortised over a period of 3 years of life of assets which ever is shorter.

Source: Information collected & compiled from annual reports from 2004-05 to 2008-09.

Pharma Sector Industries: In Pharma Sector Industry, Lupin, Ranbaxy, Dr Reddy, Nicholas, and Sun Pharma are the major contributors. Their main intangible assets are in the form of patent, customer contracts, technical know-how, trademarks, designs and licenses, non-compete fee and Computer software, etc (refer exhibit III). They are also disclosing information about intangible assets on voluntary basis; Dr Reddy's is one of the leading firms in this regard. In pharma sector, non-compete fees is a unique intangible assets. In Ranbaxy non-compete fee is capitalised and amortised on a straight-line basis over the term of the non-compete agreement. But in Dr Reddy's non-compete fees is amortised within 1.5 to 10 years. However, in SUN Pharma, intangible assets consisting of non-compete fees and other intangible assets are amortised by Straight Line Method from the date they are available for use, over the useful lives of the assets (10 to 20 years), as estimated by the management. With the above analysis it is clear that within the industry (pharma sector) reporting and disclosure for depreciation on the same kind of intangible assets are also not uniform.

Exhibit III: Pharma Sector industry –Intangible assets and depreciation disclosures

LUPIN	Computer software, Goodwill and Human resource value	- The intangible assets are recorded at cost and are carried at cost less accumulated amortisation and accumulated impairment losses, if any. - Intangible assets (including computer software) amortised within the period of 6 years.
RANBAXY	Patent, Trademarks, designs and licenses, Software, Non compete fee	- Patents, Trademarks, Designs and licenses, are capitalised and amortised on a straight-line basis over a period of five years. - Computer software which is not an integral part of the related hardware is classified as an intangible asset and is being amortised over a period of 6 years, being its estimated useful life. - Non-compete fee is capitalised and amortised on a straight-line basis over the term of the non-compete agreement
Dr Reddy's	Customer contracts, Technical know-how, Non-compete fees Patents, Trademarks and designs (including marketing know-how)	- Intangible assets are recorded at the consideration paid for acquisition. Intangible assets are amortised over their estimated useful lives on a straight-line basis. - The management estimates the useful lives for the various intangible assets as follows: Customer contracts 2 to 5 years, Technical know-how 10 years, Non-compete fees 1.5 to 10 years, Patents, trademarks and designs (including marketing know-how) 3- 10 years.
PIZER	Trademarks, Computer software	- Trademarks are recorded at their acquisition cost and are amortised over the lower of their estimated useful life and period of ownership on straight line basis i.e. over a period of 3 years. - Cost of application software not exceeding US\$ 1 million is being charged to the profit and loss account.

NICHOLAS	Brand/ Know-how/ Intellectual Property Rights, Computer Software	- Brands/know-how (including US FDA / TGA approvals and Business Application Software intended for long term use) are recorded at their acquisition cost and in case of assets acquired on merger, at their carrying values. - Brands/know-how (including US FDA/ TGA approvals)/Intellectual Property Rights are amortised from the month of product launch/commercial production, over their estimated economic life not exceeding ten years. - Computer Software is being depreciated on straight line method at the rates specified in Schedule XIV of the Companies Act, 1956.
SUN Pharma	Trademarks, Designs Technical know how, non-compete fees and Other Intangible Assets	- Intangible assets consisting of trademarks, designs, technical knowhow, non-compete fees and other intangible assets are amortised on Straight Line Method from the date they are available for use, over the useful lives of the assets (10 to 20 years), as estimated by the Management. - Leasehold land is amortised over the period of lease.

Source: Information collected & compiled from annual reports from 2004-05 to 2008-09.

“But unfortunately current accounting and reporting practices not cover up all the intangible assets in annual reporting statements and due to this, some of the companies cannot claim depreciation on such intangible assets leading to loss of revenue by way of higher tax liability. There are many more effective intangible assets which cannot be recognised by the firm in the current definition and practice due to unstable nature and continuous changes in their structure.”

FMCG Industries: In FMCG industry, intangible assets are in the form of goodwill, trademarks & patent, computer software, copyrights and design, business and commercial rights, technical know-how and strong customer base, etc (refer exhibit IV). In this sector very limited information is provided by firms regarding intangible assets. Dabur, ITC and HUL are amortising computer software over a period of 5 years by the Straight Line method. Britannia and Godrej are amortising computer software over a period of six years. However, in case of Marico, Computer software is amortised within 3 years and Other intangible assets are amortised over their estimated economic useful lives as estimated by the management, but not exceeding the period for technical know how of 6 years, non-compete covenants non-compete period (not exceeding 10 years). One important observation that FMCG sector is claiming higher contribution of their intangible assets in market capitalisation as compared to other industries, but limited information is provided in the annual reports on voluntary basis.

Exhibit IV : FMCG sector industry–Intangible assets and depreciation disclosures

DABUR	Trade marks & Patent, Computer Software	- Patents are being amortised over the period of ten years on straight line basis. - Software is being amortised over the period of five years on straight line basis.
HUL	Trade Marks, Goodwill & Software	- Intangible assets are stated at cost of acquisition less accumulated amortisation. - Goodwill and other intangible assets (except computer Software) are amortised over the assets' useful life not exceeding 10 years. - Goodwill arising on consolidation in accordance with AS-21 is amortised over 4 years at quarterly rests commencing from the quarter of recognition of goodwill. - Computer software is amortised over a period of 5 years on the straight line method.
COLGATE	Goodwill, Copyrights and Design, Technical Know-how	Goodwill and other Intangible Assets are amortised over the useful life of the assets, not exceeding 10 years.
BRITANNIA	Trademarks, Designs, & Computer Software	- Intangible assets are stated at cost of acquisition less accumulated amortisation. - Computer software is amortised over a period of six years. - Acquired Trade marks, Designs, Copyrights etc are amortised over a period of 10 years and reviewed for their useful life in line with Accounting Standard on Intangible Assets (AS 26) issued by the Institute of Chartered Accountants of India.
ITC	Trade marks, Software, goodwill, Brand value , Know-how, Business and Commercial Rights	- Software is capitalised on the basis of future enduring economic benefits. Capitalisation costs include license fees and costs of implementation/system integration services. - To calculate depreciation on Intangible Assets in a manner that amortises the cost of the assets after commissioning, over their estimated useful lives or, where specified, lives based on the rates specified in Schedule XIV to the Companies Act, 1956, whichever is lower, by equal annual instalments. - To amortise capitalised software costs over a period of five years.
NESTLE	Management information Systems (including software)	- An intangible asset is measured at cost and amortised so as to reflect the pattern in which the asset's economic benefits are consumed. - Management information systems (Intangible fixed asset) amortised within 5 years
GODREJ	Trade marks and Computer software	- Intangible assets are stated at cost of acquisition less accumulated amortisation. - The cost of acquisition of trade marks is amortised equally over a period of ten years. - Computer software is amortised over a period of six years on the straight line method.

Marico	Trademarks and copyrights, business and commercial rights, computer software, other intangibles	• Trademarks, copyrights and business & commercial rights are amortised over their estimated economic life, but not exceeding 10 years. In case of Sundari, trademark is amortised over a period of 15 years, subject to annual impairment review. • Other intangible assets are amortised over their estimated economic useful lives as estimated by the management, but not exceeding the period given here under: Technical know-how 6 years, Non-compete covenants Non-compete period (not exceeding 10 years), Computer software 3 years.
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Source: Information collected & compiled from annual reports from 2004-05 to 2008-09

Automobile Industry: Automobile sector is one of the fast growing sectors in the last two decades in India. In Automobile sector, intangible assets are in the form of technical know-how, industrial designs, models, fees, brand value, product designs, software, strong service network and goodwill (refer exhibit V). This sector is also providing limited information related to depreciation on intangible assets as reporting practices. In this sector model fees and industrial & product design are the unique intangible assets. In Hero Honda intangible assets comparing of expenditure on model fees, etc., incurred up to 31st March, 2003 and on after 1-4-2003 are amortised by Straight Line method over periods of three year and five years respectively. However, Tata Motors, Mahindra & Mahindra, Bajaj Auto were amortised technical know-how within six years. Technical know-how developed by the Bajaj Auto- the cost of technical know-how developed, is amortised equally over its estimated life i.e. generally three years. One of the important observations is that in all the sample companies, especially in automobile sector, Bajaj Auto Ltd. is the only company which is providing a separate section for technical know-how as intangible assets in their annual report. They are providing complete information about cost, depreciation and amortisation, etc.

Exhibit V: Automobiles sector industry –Intangible assets and depreciation disclosures.

TATA MOTORS	Technical Know-how, IT Assets taken on lease & Software	• The product development cost incurred on new vehicle platform, engines, transmission and new products are recognised as intangible assets and are amortised over a period of 36 months to 120 months or on the basis of actual production to planned production volume over such period after commencement of the commercial production of the underlying product. • Intangible assets are depreciated as: Technical Know-how at 16.67% (SLM), Software in excess of ₹25,000 is amortised over a period of sixty months or on the basis of estimated useful life which ever is lower.
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HERO HONDA	Industrial designs, Models fees, Brand value, goodwill.	• Intangible assets comparing of expenditure on model fees etc, incurred up to 31 March 2003 and on after 1-4-2003 are amortised on straight line method over period of three year and five years respectively.
MAHINDRA & MAHINDRA	Technical Know-how, Development Expenditure, & Software Expenditure	• All Intangible Assets are initially measured at cost and amortised so as to reflect the pattern in which the asset's economic benefits are consumed. • Technical Know-how: The expenditure incurred is amortised over the estimated period of benefit, not exceeding six years commencing with the year of purchase of the technology.
BAJAJ AUTO	Technical Know-How (As a separate section in the annual report)	• Technical know-how acquired: Expenditure on technical know-how acquired (including Income-tax and R&D cess) is being amortised equally over a period of six years. • Technical know-how developed by the company: Expenditure incurred on know-how developed by the company, post research stage, is recognised as an intangible asset, if and only if the future economic benefits attributable are probable to flow to the company and the costs can be measured reliably. The cost of Technical Know-how developed is amortised equally over its estimated life i.e. generally three years.
EICHER Ltd	Product designs, Prototypes etc. Computer Software, Goodwill.	• Intangible assets comprising of product designs, prototypes, etc, either acquired or internally developed, are amortised over a period of ten years, the estimated minimum useful life of the related products. • Cost of software is amortised over a period of 5 years or less depending on the estimated useful life of the asset. • Goodwill purchased is amortised on a pro-rata basis from the month of acquisition over a period of three years.
ASHOKA LEYLAND'S	Computer software (both purchases and acquired) Technical know-how.	• Intangible assets and assets given on lease, where the cost exceeds ₹10,000 and the estimated useful life is two years or more, is capitalised. • Intangible assets and assets given on lease, over their estimated useful lives or lives derived from the rates specified in Schedule XIV to the Companies Act, 1956, whichever is lower;
TVS MOTORS	Software	• During the year the company acquired the following assets falling under the definition of intangible assets as per the Accounting Standard and the following disclosure is made in respect of these assets: • Software: Estimated useful life of the asset 2 years amortisation rate used 50% each year as depreciation. • Expenditure pending allocation on new products estimated useful life of the asset is 3 years amortisation rates used not amortised as asset not put to use.

Source: Information collected & compiled from annual reports from 2004-05 to 2008-09.

Capital Goods Industry: Capital Goods industry is regarded as backbone of the economy. In this sector, BHEL, RIL, L&T, Hindalco, Crompton Greaves and ABB they are the leaders. Their main intangible assets are in form of technical know-how, computer software, goodwill, etc. (refer exhibit VI). In BHEL and L&T, intangible assets are amortised over their estimated useful lives not exceeding three years in case of software and not exceeding ten years in case of others on a Straight Line Pro-rata Monthly basis. In RIL and Crompton and Greaves computer software is amortised over a period of 5 years. However, in case of Hindalco, mining rights and leasehold land are amortised over the period of lease on Straight Line basis. Other intangible assets are amortised over their estimated useful lives on Straight Line basis. It is clear from the above analysis that within the capital goods industry, there are a lot of variations in the nature of intangible assets and their reporting/amortisation among the different companies.

Exhibit VI : Capital Goods industry–Intangible assets and depreciation disclosers

BHEL	Brand Value, Software and Goodwill	- Intangible assets are capitalised at cost if (a) it is probable that the future economic benefits that are attributable to the asset will flow to the company, (b) the company will have control over the assets, and (c). the cost of these assets can be measured reliably and is more than ₹ 10,000/-. - Intangible assets are amortised over their estimated useful lives not exceeding three years in case of software and not exceeding ten years in case of others on a straight line pro-rata monthly basis.
RIL	Technical know-how, Software and others.	- Intangible Assets are stated at cost of acquisition less accumulated amortisation. - Technical know how is amortised over the useful life of the underlying assets. - Computer Software is amortised over a period of 5 years. - Amortisation is done on written down value basis except in respect of crude oil refining where it is amortised on straight-line basis.
Crompton and Greaves	Computer software, Technical know-how, Leasehold land.	- Lump sum fees paid for acquisition of technical know-how relating to plant and machinery is capitalised as intangible asset. - Intangible assets are recognised as per the criteria specified in the Accounting Standard (AS) 26 Intangible Assets and are amortised as under: (a) Leasehold land: Over the period of lease; (b) Specialised software : Over a period of five years; and (c) Lump sum fees for technical know-how: Over a period of five years from the year of commercial production.
HEG	Intangible assets.	- Capital Expenditure on purchase and development of identifiable non-monetary assets without physical substance is recognised as Intangible Assets in accordance with principles given under AS-26 – Intangible Assets. - These are grouped and separately shown under the schedule of Fixed Assets. These are amortised over their respective expected useful lives.
L&T	Lease hold lands, specialised software, lump sum fees for technical know how.	Intangible assets are recognised as per the criteria specified in Accounting Standard (AS) 26 "Intangible Assets" as specified in the Companies (Accounting Standards) Rule, 2006 and are amortised as follows: (a) Leasehold land: Over the period of lease, (b) Jetty: Over the period of the concession agreement signed with the appropriate authority such that the cumulative amortisation is not less than the cumulative rebate availed by the Company. (c) Specialised software: Over a period of three years,

Hindalco	Technological Licenses , Computer Software	- Intangible Assets are stated at cost less accumulated amortisation. Cost includes any directly attributable expenditure on making the asset ready for its intended use. - Mining Rights and leasehold land are amortised over the period of lease on straight line basis. - Intangible assets are amortised over their estimated useful lives on straight line basis.
ABB Ltd:	Technical know how fees, Capitalised software	- Capitalised software includes cost of ERP project and other cost relating to the software which provides significant future economic benefit. - Deprecation on intangible assets, technical know how fees over a period of six years. Capitalised software cost over a period of five years.

Source: Information collected & complied from annual reports from 2004-05 to 2008-09

Infrastructure Industry: Infrastructure sector is always important for a developing country like India, due to continuous developmental and expansion activities. In this sector, important intangible assets are in form of brand value, software, technical know-how, mining rights and goodwill (refer exhibit VII). They are providing limited information related to depreciation/amortisation of intangible assets. In ACC, cost of computer software is amortised over a period of three years while in Tata Steel computer software is amortised within 5 to 10 years. However, in SAIL and Ambuja Cement, computer software are amortised within five years. In ONGC, software is amortised @ 40% on Written Down Value method. When we analyse the intangibles for infrastructure sector, mining rights are the unique intangible assets for this sector. In TATA Steel, mining rights are depreciated over the useful life of the mine or lease period whichever is shorter. However, in SAIL mining rights are treated as intangible assets and all the related costs thereof are amortised over the period (including deemed renewal) of the lease. But in Hindalco, mining rights and leasehold land are amortised over the period of lease on Straight Line basis. With the above analysis it is clear that within the industry (Infrastructure sector) reporting and discloser for depreciation on the same kind of intangible assets are also not done in uniform manner.

Exhibit VII : Infrastructure –Intangible assets and depreciation disclosers.

ACC	Computer Software, Mining rights, Manufacturing and technology rights	- Computer Software cost is amortised over a period of three years. - Costs incurred to gain access to mineral reserves are capitalised and depreciated over the life of the quarry, which is based on the estimated tonnes of raw materials to be extracted from the reserves. - Manufacturing and technology rights purchased are amortised over the period of rights.
TATA STEEL	Computer software, Mining Rights	- Intangibles (Computer Software) amortised within 5 to 10 years. - Development of property for development of mines and collieries are depreciated over the useful life of the mine or lease period whichever is less, subject to maximum of 10 years. - Mining Rights are depreciated over the useful life of the mine or lease period whichever is shorter.

SAIL	Mining rights, Computer software	- Mining rights are treated as intangible assets and all the related costs thereof are amortised over the period (including deemed renewal) of the lease. - Software which is not an integral part of related hardware, is treated as intangible asset and amortised over a period of five years or its licence period, whichever is less.
Ambuja Cement	Water Drawing Rights, Computer Software	- Expenditure to acquire Water Drawing Rights from Government/Local Authorities/other parties, is amortised over the period of rights to use the facilities ranging from 10 to 30 years. - Expenditure on computer software is amortised over the period of expected benefit not exceeding five years.
TATA power	Technical know-how, Licenses	- Intangible assets are recognised only if it is probable that the future economic benefits that are attributable to the asset will flow to the company and the cost of the asset can be measured reliably. - Technical know-how is written off on a straight line basis over a period of six years. - Leasehold Land is amortised over the period of the lease. - Goodwill is amortised over a period of five years.
ONGC	Computer software	- Intangible Assets Costs incurred on intangible assets, resulting in future economic benefits are capitalised as intangible assets and amortised on written down value method beginning from the date of capitalisation. - Software is amortised @ 40% on written down value method.
HPCL	Right of way, Technical and process licenses, software	- Cost of Right of Way for laying pipelines is capitalised as Intangible Asset and being perpetual in nature, is not amortised. - Costs incurred on technical know-how/ license fee relating to process design/ plants/facilities are capitalised as Intangible Assets. - Cost of Software directly identified with hardware is capitalised along with the cost of hardware. Application software is capitalised as Intangible Asset. - Intangible Assets other than application software are amortised on a straight line basis over the useful life of the parent asset. - Application software are normally amortised over a period of four years, or over its useful life, whichever is earlier.
Hindalco	Technological Licenses, Computer Software	- Intangible Assets are stated at cost less accumulated amortisation. Cost includes any directly attributable expenditure on making the asset ready for its intended use. - Mining Rights and leasehold land are amortised over the period of lease on straight line basis. - Intangible assets are amortised over their estimated useful lives on straight line basis.

Source: Information collected & compiled from annual reports from 2004-05 to 2008-09.



After the analysis of inter-industry and intra-industry for depreciation on intangible assets and reporting practices, we come to know that a lot of differences exist due to the different/specific nature of intangible assets according to the industry and different utility. The analysis of nature of intangible assets in different industries reveals that they are having some unique intangible assets like in IT sector -- technical know-how and patents, in pharma -- patent, trademarks, designs, licenses and non-compete fee, in FMCG -- business and commercial rights and strong customer base, in automobile -- industrial designs, models fees, product designs and strong servicing networking, in capital goods -- technical know-how, and in infrastructure -- technical know-how and mining rights. Accordingly they are charging depreciation/amortisation as per the life and utility of the particular intangible assets.

Conclusion

Deprecation is not a new concept in the field of accounting but depreciation on intangible assets is the new one especially in the last one decade due to increased contribution of the knowledge and service sectors in Indian economy. As contribution of service oriented industry increases in our economy (52.8% of GDP) intangible assets are acquiring greater importance in earning as well as wealth creation for the shareholders. But unfortunately current accounting and reporting practices not cover up all the intangible assets in annual reporting statements and due to this, some of the companies cannot claim depreciation on such intangible assets leading to loss of revenue by way of higher tax liability. There are many more effective intangible assets which cannot be recognised by the firm in the current definition and practice due to unstable nature and continuous changes in their structure. It is a need of the hour that regulatory authorities may take suitable steps to enhance the definition of intangible assets, describe the intangible assets according to the nature of business and correspondingly structure of depreciation rates, discloser and reporting practice for the different companies, which will provide a suitable base for the comparison of intra as well as inter industry for the various stakeholders to take decision regarding earning capacity & valuation of the business/investment decision. ■

International Financial Reporting Standards: Impact on Infrastructure and Power sectors



This article provides an analysis and evaluation on the 'Impact of IFRS on Power & Infrastructure sectors' and also a brief on the various areas having an impact on the financial statements of Indian companies on the adoption of the International Financial Reporting Standards (IFRS). The article also deals with the areas which specifically impact the Power and Infrastructure sectors i.e. service concession arrangements, power purchase agreements and decommissioning of assets. It includes general as well as specific differences that may impact the net-worth and profitability of companies. The reviews have been limited to the details available in the annual reports of the companies.

Background

The Ministry of Corporate Affairs has issued a road map for adopting IFRS. As per the road map, all the listed companies, commercial scheduled banks and urban co-operative banks with network of ₹300 crore and above and unlisted companies, including non-banking financial companies, having network of ₹500 crore and above would have to adopt the converged Indian Accounting Standards. Converged

Indian Accounting Standards would be the existing Accounting Standards as amended for IFRS by the Institute of Chartered Accountants of India (ICAI) and approved by the National Committee of Accounting Standards set up by the Ministry of Corporate Affairs. For unlisted companies with network less than ₹500 crore, the existing accounting standards issued by the ICAI would be applicable.

Important dates for implementation of IFRS in India



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Date (Opening balance sheet)	Applicability
April 1, '11	All Nifty 50 and Sensex 30 companies (excluding banking, insurance and NBFCs) All companies whose securities are listed abroad (excluding banking, insurance and NBFCs) All companies having network of 1,000 crore and above (excluding banking, insurance and NBFCs)
April 1, '12	All insurance companies
April 1, '13	All companies (listed and unlisted) having network of 500 crore and above (excluding banking, insurance and NBFCs) All scheduled commercial and urban co-operative banks having network of 300 crore and above All NBFCs forming part of Nifty 50 and Sensex 30 All NBFCs having network of 1,000 crore and above
April 1, '14	All listed companies having network of 500 crore and below All unlisted NBFCs having network of 500 crore and above Urban co-operative banks having network of 200 crore and above

All the entities covered would prepare their opening balance sheets under the converged Indian Accounting Standard (AS) on the respective dates as per the roadmap. When the accounting year ends on a date other than 31st March, the conversion of the opening balance sheet will be made in relation to the first balance sheet which is made after 31st March.

Significant Differences Between Indian GAAP and IFRS for Infrastructure Companies and Power Sector Companies

Although Indian GAAP and IFRS are similar in certain respects, the below-mentioned differences would have a direct impact of the financial statements of infrastructure and power sector companies. Since the converged Indian Accounting Standards, as finalised by the ICAI are yet to be notified, the requirements have been discussed as per the existing IFRS.

A. Revenue recognition for Build-Operate-Transfer contracts (service concession arrangements):

A Build-Operate-Transfer (BOT) contract or a service concession agreement generally involves a government or other public sector entity (grantor) conveying to a private sector entity (operator) the right to provide services that gives public access to major economic and social facilities for a certain period. Such facilities typically involve the use of infrastructure such as roads, railways bridges, schools, hospitals, airports, water distribution and waste management systems. The operator is remunerated for its services, either directly by the grantor or given the right to charge the users during the period of the agreement or both. Generally, the income is received by the operator, once the infrastructure is brought into use under a BOT (a form of project financing where a private entity receives a concession from a

public or private sector to finance, construct and operate a facility which is stated in the concession contract) agreement.

Indian GAAP: Companies generally recognise and depreciate infrastructure assets (existing/constructed/purchased) as their own property, plant and equipment. Any amount received from the government and users is charged to the income statement over the life of the contract.

IFRS: In the initial construction phase, the operator will have to recognise revenue on construction contracts to the extent of the value of services performed i.e. cost of constructing the infrastructure asset with a reasonable margin. The revenue would be accounted by creating a financial asset or an intangible asset based on the following:

- Financial asset – to the extent the company has an unconditional right to receive cash or another financial asset from the grantor
- Intangible asset – to the extent the company receives a right to charge the users of a public service

The financial asset and the intangible assets are recognised based on their fair values.

The costs incurred during construction would be debited to the income statement.

In subsequent operating phase, the borrowing cost attributable to the arrangement will be recognised as an expense in the period in which it is incurred (unless the company has a contractual right to receive an intangible asset. In which case the interest will be capitalised.)



The above accounting would apply to only those arrangements wherein the grantor controls or regulates the services provided with their infrastructure and their prices, and controls any significant residual interest in the infrastructure.

Example:

Intangible asset model:

A company enters into a public private arrangement to construct a bridge costing ₹450 crore. The company will have a right to receive the toll receipts for a period of seven years. The borrowing cost is assumed at 9 per cent p.a. The company is capitalised at 70 per cent debt and 30 per cent equity.

The expected toll receipts as estimated by the company and the operating expense are given in the table below.

Year	Contract cost	Operating cost	Toll receipts
1	250.00	-	-
2	200.00	-	-
3	-	10.00	140.00
4	-	10.00	150.00
5	-	10.00	160.00
6	-	10.00	170.00
7	-	10.00	180.00

Accounting under Indian GAAP

(i) The profit and loss account for the seven years under Indian GAAP is given in the table below.

Years	1	2	3	4	5	6	7
							in crore
Revenue	-	-	140.00	150.00	160.00	170.00	180.00
Depreciation ¹	-	-	(99.10)	(99.10)	(99.10)	(99.10)	(99.10)
Borrowing cost	-	-	(32.45)	(25.70)	(14.90)	(4.10)	0.00
Operating cost	-	-	(10.00)	(10.00)	(10.00)	(10.00)	(10.00)
Profit before tax	-	-	(1.55)	15.20	36.00	56.80	70.90

1. The total project of ₹450 crore and interest on borrowing during the construction of ₹15.75 crore and ₹29.77 crore is depreciated over a period of five years.

Accounting under IFRS

Under IFRS, the operator's right to collect tolls from road users in the third to seventh year would be accounted for as an intangible asset (license to charge the users of the infrastructure) in accordance with IAS 38, Intangible assets. The intangible assets would be accounted for at costs i.e. the fair value of consideration transferred to acquire the assets which is the fair value of the consideration received or receivable for the construction services delivered.

In the existing example, the operator estimates the fair value of its consideration received to be equal to the forecast construction costs plus 5 per cent margin.

Accordingly, the profit and loss account for the seven years under IFRS is given in the table below.

Years	1	2	3	4	5	6	7
	in crore						
Revenue	262.50	210.00	140.00	150.00	160.00	170.00	180.00
Contract cost	(250.00)	(200.00)	-	-	-	-	-
Operating cost	-	-	(10.00)	(10.00)	(10.00)	(10.00)	(10.00)
Amortisation	-	-	(103.60)	(103.60)	(103.60)	(103.60)	(103.60)
Borrowing cost	-	-	(32.45)	(25.70)	(14.90)	(4.10)	0.00
Profit before tax	12.50	10.00	(6.05)	10.70	31.50	52.30	66.40

Financial asset model

In the above example, the accounting would be different if the grantor gives the operator a fixed amount of ₹147 crore from the third year till the seventh year for making the bridge available to the public instead of the right to receive the toll.



Accounting under Indian GAAP

The profit and loss account for the seven years under Indian GAAP is given in the table below.

Years	1	2	3	4	5	6	7
	in crore						
Revenue	-	-	147.00	147.00	147.00	147.00	147.00
Depreciation	-	-	(99.10)	(99.10)	(99.10)	(99.10)	(99.10)
Borrowing cost	-	-	(32.45)	(25.70)	(14.90)	(4.10)	0.00
Operating cost	-	-	(10.00)	(10.00)	(10.00)	(10.00)	(10.00)
Profit before tax	-	-	5.45	12.20	23.00	33.80	37.90

Accounting under IFRS

Under IFRS, the operator would account for the amount receivable from the grantor as a financial asset at its fair value. The operator would have an option to measure the amount due from the grantor at amortised costs unless the entity designates that amount as measured at fair value through profit and loss account. If the receivable is measured at amortised costs, it is measured initially at the fair value and subsequently at amortised costs i.e. the amount initially recognised plus the cumulative interest on that amount

provider and a power purchaser. The PPA provider, also termed as independent power provider for the project, receives funding, maintains

and monitors the energy production and sells the electricity to the purchaser at a predetermined contractual price for a specific period of time as per the terms of the contract.

The duration of power purchase agreement is generally between 5 to 25 years, which also depends on the nature/type of input used for power generation. At the end of the contract period, the purchaser may have an option either to renew the contract or purchase the power generating equipment or may also request the equipment be decommissioned.

Presently, under Indian GAAP, long-term power purchase agreement is shown as purchases and sales i.e. sale of electricity and revenue from sales are shown in the income statement of the relevant period.

Under IFRS, such long-term power purchase agreement would have to be evaluated to determine as to whether its terms and conditions are similar to a finance lease agreement. Any of the following terms & conditions in a PPA, if satisfied would make it a finance lease.

calculated using the effective interest method minus repayment.

Accordingly, the profit and loss account for the seven years under IFRS is given in the table below.

Years	1	2	3	4	5	6	7
	in crore						
Revenue	262.50	210.00	12.00	12.00	12.00	12.00	12.00
Contract / Operating cost	(250.00)	(200.00)	(10.00)	(10.00)	(10.00)	(10.00)	(10.00)
Finance expenses	(15.75)	(29.77)	(32.45)	(25.70)	(14.90)	(4.10)	0.00
Finance income	-	28.46	54.31	45.56	35.87	25.12	13.20
Profit before tax	(3.25)	8.69	23.86	21.86	22.97	23.02	15.20

B. Impact of Power Purchase Agreements

A Power Purchase Agreement (PPA) is a contract between electricity/power

- the transferor transfers ownership of the asset to the transferee at the end of the lease term;

- the transferee has the option to purchase the asset at a price which is expected to be lower than the fair value at the date the option becomes exercisable such that at the inception of the lease, it is reasonably certain that the option will be exercised;
- the lease term is for the major part of the economic life of the asset even if its title is not transferred;
- at the inception of the lease, the present value of the minimum lease payment amounts to at least substantially all of the fair value of the leased asset;
- where the transferee can cancel the lease, the transferor's losses associated with cancellation are borne by the transferee;
- where the gain and loss from fluctuation of loss is borne by the transferee; and
- where the transferee can continue with the lease for the secondary period at a rent which is substantially lower than the market rate.

In case the power purchase agreement satisfies any of the above conditions, it would have to be accounted for as a finance lease. Under a finance lease, the power generator will de-recognise the power plant from its books. The present value of the receivables under the PPA would be disclosed as an asset in the power generator's books. The amount of cash received would be bifurcated into the principal and the interest.

The power purchaser will book the power generating asset and also a financial liability at the present value of the payables under the PPA.

For example, assume company A enters into an agreement with company B (power provider) to supply a minimum quantity of power needed in its production process for a specified period of time and provides for the following:

1. The power provider has a contractual right to supply power from other sources though the unit is explicitly identified in the agreement and supplying power from other sources is not economically feasible or practicable.
2. The power provider can sell the power to other customers and has the right to remove and replace the unit's equipment and modify or expand the unit. However, the unit is designed to meet only the purchaser's needs and the power provider has no plans to modify or expand the facility.
3. The power provider is responsible for repairs, maintenance and capital expenditure.
4. The power provider is required to deliver a minimum quantity of power each month.
5. On a monthly basis, the purchaser will pay a fixed capacity charge and a variable charge based on actual production. The fixed capacity charge is payable irrespective of whether there is production or not. The variable charge includes the facilities actual energy costs, which comprises approximately 90 per cent of the unit's total variable costs. The power provider is subject to increased costs resulting from the facility's inefficient operations.
6. If the facility does not produce the stated minimum quantity, the supplier must return all or a portion of the fixed capacity charge.

The arrangement contains a lease within the scope of IAS 17. An asset (unit) is explicitly identified in the arrangement and fulfillment of the arrangement is dependant on the unit. While the supplier has the right to supply power from other sources, its ability to do so is not substantive. The purchaser has obtained the right to use the facility on the facts presented

i.e. in particular that the facility is designed to meet only the purchaser's needs and the supplier has no plans to expand or modify the facility. It is remote that one or more parties other than the purchaser will take more than an insignificant amount of the facility's output and the price the purchaser will pay is neither contractually fixed per unit of output nor equal to the current market price per unit of the output as of the time of delivery of the output.

The above case will need to be evaluated as to whether the same would further qualify as a finance lease by applying the conditions for finance leases.

C. Decommissioning of assets

Decommissioning would mean any dismantling or restoration of any site or any conventional facility which includes all cleanup of radioactivity and progressive demolition of the plant. Once any facility is decommissioned there are no threats of any radioactive accidents. The decommissioning or site restoration costs are significant items of expenditure for which provisions are made based on the long lives of the plants and on regulatory requirements.

Under Indian GAAP, there is no specific guidance on accounting for decommissioning of assets

Under IFRS, all the companies would require to recognise any constructive liability also i.e the restoration costs for the present value of the cost of dismantling, removal or restoration as a result of legal or construction obligation is recognised and the corresponding costs are included as a part of the related property plant & equipment.

Analysing the Impact of IFRS on Infrastructure and Power sectors

For analysing the impact of IFRS on the market value and the future profitability,

it is very important to understand IFRS adjustments, as discussed above, and the impact that it would have on the investors and the existing stakeholders.

Converged Indian Accounting Standards would be mandatory for all Nifty 50 and Sensex 30 companies with effect from 1st April, 2011 and all listed companies having a paid-up capital of more than ₹ 1,000 crore. This would imply that these companies would have to make the opening balance sheet as per the converged Indian Accounting Standards. All the changes impacting the assets and the liabilities of these companies would be directly adjusted in the reserves of the company. However, the following exemptions are available to certain companies.

The exemption from the converged Indian Accounting Standards and their likely impact on the companies in the Infrastructure and Power sectors are given in the table below. The discussions in the table below are

based on the existing IFRS.

Impact and Summary of Individual Companies

After considering the differences between Indian GAAP and IFRS and assuming that the Indian companies would opt for all the exemptions, the following companies have been reviewed.

- Larsen & Toubro Ltd.
- Hindustan Construction Company Ltd.
- GMR Infrastructure Ltd.
- IVRCL Infrastructures & Projects Ltd.
- The Tata Power Company Ltd.

The annual reports as of 31st March, 2010 were reviewed for assessing the impact of various areas.

a. **Larsen & Toubro Ltd.**

Under IFRS, the network of L&T as of 31st March, 2010 would be positively impacted by the following:

- Accounting of the intangible

assets relating to right to toll receipts for BOT projects during the construction period.

Offset by:

- Unvested employee stock options which have been accounted for at intrinsic value. The same would have little or no impact on the opening balance sheet.
- The expenditure on research and development that has been capitalised would now be adjusted from the network under IFRS.
- Interest free loans given to its staff. The same has to be accounted for at fair value under IFRS. Under the terms of IFRS, the first-time adopters have to account for loans given below the market rates at fair value. On adoption of IFRS for the first time, L&T would have to fair value certain loans which were given below the market rates.

Exemption	Impact
De-recognition of financial assets and liabilities Under IFRS, a non-financial asset can be de-recognised only if certain criteria are satisfied. First-time adopters are exempted for applying IFRS for de-recognition of financial assets for transactions before the transition date.	This exemption would impact future transfers of assets.
Hedge accounting Under IFRS, an entity is allowed to designate an item as a hedging item only if certain specific conditions are met. First-time adopters are not allowed to designate any derivative as a hedging item until it qualifies for a hedging relationship under IFRS, even though the same would have been accounted for as a hedge under Indian GAAP. However, they are allowed to account for the same as discontinued hedges on the transition date.	This would impact entities that have designated certain derivative items as hedges under Indian GAAP, which will not qualify as hedges under IFRS.
Business combinations A first-time adopter may elect not to apply IFRS retrospectively to the business combinations consummated before the transition date. However, if a first-time adopter elects to apply IFRS to any business acquisition, it shall restate all the later business combinations and also apply the consolidation requirements from the same date. Subject to - The first-time adopter shall exclude from its opening IFRS balance sheet any item recognised in accordance with Indian GAAP that does not qualify for recognition as an asset or liability under IFRS e.g. preliminary expenses, intangible assets, etc. - IFRS requires subsequent measurement of some assets and liabilities at fair values. A first-time adopter shall measure these assets and liabilities at fair value in its opening IFRS balance sheet even if they were acquired or assumed in a past business combination with the resulting change in the reserves. - The first-time adopter would have to recognise any asset or liability acquired in a business combination which qualifies as an asset or a liability as per IFRS even though it did not qualify as an asset/liability as per Indian GAAP e.g. finance leases, contingent liabilities, Intangible assets, etc. - The goodwill created if any would be tested for impairment on the transition date.	In cases where business combinations have resulted in accounting for large amounts of goodwill/intangible asset, the impact on the reserves and the profits for the future years could be impacted.
Share based payment transactions A first-time adopter is allowed to use the intrinsic value method for accounting the stock options that were vested before the transition date.	In the case of entities which have issued stock options to employees, there would be little or no impact on the reserves.
Cumulative translation differences A first-time adopter is exempted from carrying forward the balances outstanding in the cumulative translation differences for foreign operations on the transition date. Accordingly, the cumulative translation differences for foreign operations are deemed to be zero at the date of transition.	This would impact the opening reserves of the companies opting for this exemption.

Exemption	Impact
Investments in subsidiaries, jointly controlled entities & associates A first-time adopter is allowed to use carrying amount of its investments in each of its subsidiaries, jointly controlled entity or associate as its deemed cost.	No impact
Decommissioning liabilities included in cost of PPE A first-time adopter is exempted from adding/deducting any decommissioning, restoration or similar liabilities to the cost of the asset to which it relates. First-time adopter using the above exemption shall measure the liability as per requirement of AS 29 (provisions for contingent liability and contingent assets).	No impact

*The impact given are based on the present guidelines which are subject to exemptions claimed by the companies on implementation.

b. Hindustan Construction Company Ltd.

Under IFRS, the network of HCC as of 31st March, 2010 would be positively impacted by the following:

- Accounting of the intangible assets relating to right to toll receipts for BOT projects during the construction period
- Accounting for unrealised gains on investments. Under IFRS, the unrealised gains would have to be accounted for either in the profit and loss account or other comprehensive income based on the classification of investments.
- Under IFRS, the first-time adopters have to account for loans taken below the market rates at fair value. On adoption of IFRS for the first time, HCC would have to fair value certain loans which were given below the market rates.

c. GMR Infrastructure Ltd.

Under IFRS, the network of GMR as of 31st March, 2010 would be positively impacted by the following:

- Accounting of the intangible assets relating to right to toll receipts for BOT projects during the construction period
- Foreign exchange gain included in fixed assets would have to be accounted for in the income statement.
- Under IFRS, the first-time adopters have to account for loans taken below the market rates at fair value. On adoption

of IFRS for the first time, GMR would have to fair value certain loans which were given below the market rates.

Offset by:

- Accounting for business combinations.
- Accounting for government grants included in reserves.

d. IVRCL Infrastructures & Power Ltd.

Under IFRS, the network of IVRCL as of 31st March, 2010 would be positively impacted by the following:

- Accounting of the intangible asset relating to right to toll receipts for BOT projects during the construction period.
- Under IFRS, the first-time adopters have to account for loans given below the market rates at fair value. On adoption of IFRS for the first time, IVRCL would have to fair value certain loans which were given below the market rates.

Offset by:

- Accounting for capital reserves and revaluation reserve included in the network would not be accounted for as reserve under IFRS.

e. The Tata Power Company Ltd.

Under IFRS, the network of Tata Power as of 31st March, 2010 would be positively impacted by the following:

- Unrealised gains on quoted investments would have to be accounted for in the revenue statement or comprehensive

income based on the classification of investments.

- Unrealised gains on derivatives have not been recognised in the income statement; under IFRS, such gains would be taken to the income statement and would increase the network to that extent.
- Under IFRS, first-time adopters have to account for loans given below the market rates at fair value. On adoption of IFRS for the first time, Tata Power would have to fair value certain loans which were given below the market rates.
- Issue expenses have been reduced from securities premium account, however under IFRS such costs are to be capitalised as part of borrowings and amortised over the period.

Offset by:

- Foreign currency translation reserve which are to be charged to the income statement under IFRS.
- Sales tax deferred under Indian GAAP which cannot be classified as an asset/liability is to be charged to the income statement.
- Certain employee cost has been capitalised under Indian GAAP. Under IFRS, employee costs cannot be capitalised except in extremely rare circumstances. In the absence of information, the impact could not be identified.
- The company has issued FCCBs which are outstanding;

the equity portion of the same are to be fair valued and the debt has to be accounted separately.

The results of the analysis of the financial statements show that mostly all the infrastructure companies could feature an increase in their network and profitability due to the upfront booking of the revenue for service concession projects which are under construction. The power sector companies may see a change in their asset base if power purchase agreements are treated as financial leases.

The items which can be classified as asset only will be taken to the balance sheet, so certain companies may see a major hit in their profit and loss accounts due to charging of capitalised expenditures against profits which may not classify as assets. The book values of financial assets and financial liabilities could also go

through a change due to adoption of fair valuation, which will give rise to unrealised profit and loss impacting the network.

IFRS Impact on Investment Decisions

IFRS would bring in transparency in financial reporting due to increased disclosures. It would also provide further insights into the risks faced by the companies. The implementation of the financial instruments disclosure standard (IFRS 7) will also provide the investors with more transparency about how the management controls the financial risks on a day-to-day basis.

The biggest challenge for the investors would be the time required to assess and understand the changes introduced by the new standards. Further, it is very important for the investors to identify and understand the accounting differences and the

differences impacting a company's underlying financial performance. For e.g. the accounting for minority interest/non-controlling interest is an accounting change, whereas the fair valuation of stock options and financial instruments could show a change in a company's underlying financial performance.

IFRS would also cause volatility in earnings and the investors/analysts would have to incorporate changes in their valuation models to appropriately address the volatility in earnings. The entity's capital gearing ratios could also undergo significant changes, leading to changes in the credit ratings and correspondingly the finance costs.

In spite of certain difficulties and complexities of IFRS, the financial statements of entities adopting IFRS would have increased information giving the investors a better perspective and would put them in a better position to make investment decisions. ■

Requirement to Furnish Permanent Account Number under Section 206AA of Income-tax Act, 1961



Tax deduction at source is covered by Chapter XVII B of Income-tax Act, 1961 (the Act) and is an important part of the Act. Non-compliance with it may result into severe penalty and interest. This Chapter has got more relevance with the introduction of Section 206AA by the Finance Act, 2009. Section 206AA, which has come into force with effect from 1st April, 2010, has been most talked about Section of the Finance Act, 2009. It casts an obligation on the payer to deduct tax at source at 20 per cent or even at higher rate, if payee does not furnish his Permanent Account Number to the payer. In this Article the author has analysed certain issues pertaining to tax deduction at source in respect of resident payee, who has not furnished his Permanent Account Number and, therefore, Section 206AA is attracted.

Intention Behind Section 206AA-

This Section has been inserted with the intention to strengthen the PAN mechanism. So far due to non-quoting of Permanent Account Number by deductees problems have been faced by the Department in the processing of return of income and in granting credit for tax deducted at source leading to delays in issue of refunds. To overcome these problems, Finance Act, 2009 introduced the provisions of Section 206AA with effect from 1st April, 2010, which mandates deduction of tax at source at higher rate if deductee does not furnish his Permanent Account Number to the deductor. This Section is applicable to a resident as

well as non-resident assessee. Thus intention behind this Section is to have a system wherein every person has a Permanent Account Number and that person quote it in every bill, voucher or any other document which are sent by deductee to deductor so that return of income and refund cases can be processed accurately and timely.

Provisions of Section 206AA Requirement to furnish Permanent Account Number

(1) Notwithstanding anything contained in any other provisions of this Act, any person entitled to receive any sum or income or amount, on which tax is deductible under Chapter XVII B (hereafter referred



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Finance Act, 2009 introduced the provisions of Section 206AA with effect from 1st April, 2010, which mandates deduction of tax at source at higher rate if deductee does not furnish his Permanent Account Number to the deductor.

to as deductee) shall furnish his Permanent Account Number to the person responsible for deducting such tax (hereafter referred to as deductor), failing which tax shall be deducted at the higher of the following rates, namely:-

- (i) *at the rate specified in the relevant provision of this Act; or*
- (ii) *at the rate or rates in force; or*
- (iii) *at the rate of 20 per cent.*
- (2) *No declaration under sub-section (1), sub-section (1A) or sub section (1C) of Section 197A shall be valid unless the person furnishes his permanent account number in such declaration.*
- (3) *In case any declaration becomes invalid under sub-section (2), the deductor shall deduct the tax at source in accordance with the provision of sub-section (1).*
- (4) *No certificate under Section 197 shall be granted unless the application made under that section contains the Permanent Account Number of the applicant.*
- (5) *The deductee shall furnish his Permanent Account Number to the deductor and both shall indicate the same in all the correspondence, bills, vouchers and other documents which are sent to each other.*
- (6) *Where the Permanent Account Number provided to the deductor is invalid or does not belong to the deductee, it shall be deemed that the deductee has not furnished his Permanent Account Number to deductor and the provision of sub-section (1) shall apply accordingly.*

Issues that Arise in View of Insertion of Section 206AA

The following issues which arise in view of insertion of Section 206AA are analysed in this article:

- (A) When does a company need to deduct tax at source at 20 per cent or at higher rate provided under Section 206AA of the Act?
- (B) Whether payer needs to deduct tax at source under Section 206AA even if payment made to a resident payee is below the limit provided under different section of Chapter XVII-B e.g. ₹30,000 for Section 194J.
- (C) Whether provision of Section 206AA will also be operative in case of a salaried employee-
 - (i) Whose taxable income is less than the maximum amount not chargeable to tax under the Act?
 - (ii) Whose taxable income is more than the maximum amount not chargeable to tax under the Act?

(A) When does a company need to deduct tax at source at 20 per cent or at higher rate provided under Section 206AA of the Act?

In all the below listed cases, payer shall deduct tax at source under Section 206AA of the Act at the rate higher of the following:

- Rate specified in the relevant provision of the Act, e.g. 10 per cent under Section 194J
 - At the rate or rates in force, e.g. rates specified in the schedule to the Finance Act.
 - 20 per cent.
- (i) Where payer is liable to pay any sum, income, or amount on which tax is deductible under Section 194, 194A 194C etc. and payee has not furnished his Permanent Account Number to payer.
 - (ii) Where the payee or recipient of any sum, money or income gives

a declaration to the payer under Section 197A in Form 15H (for senior citizen) or 15G (for any other person) but does not provide his Permanent Account Number then payer shall deduct tax at source as per Section 206AA of the Act.

- (iii) Where recipient of any sum, income, or amount applies in Form No. 13 to the Assessing Officer to get a certificate authorising the payer to deduct tax at lower or deduct no tax as may be appropriate and he does not mention his Permanent Account Number in the application. In that situation no certificate under Section 197 shall be issued and payer of any sum, income, or amount on which tax is deductible under chapter XVII-B shall deduct tax at source at 20 per cent or at higher rate as may be applicable.
- (iv) Where Permanent Account Number furnished by recipient to payer is invalid or it does not belong to deductee.

(B) Whether payer needs to deduct tax at source under Section 206AA even if payment made to a resident payee is below the limit provided under different section of Chapter XVII-B e.g. ₹30,000 for Section 194J.

Section 206AA overrides all other provisions of the Act as it start with 'Notwithstanding anything contained in any other provisions of this Act'. Therefore Section 206AA shall prevail over all other Section of the Income Tax Act and thus it also overrides provisions of Chapter XVII-B. Where payee does not furnish his Permanent Account Number and any sum, income or amount paid or payable to him is subject to tax deduction under Chapter XVII-B, provision of Section 206AA are applicable and tax shall be deducted at source in accordance with Section 206AA of the Act. The words 'any person entitled to receive any sum

or income or amount, on which tax is deductible under chapter XVII-B' in Section 206AA clarifies that the section comes into picture only when amount paid or payable to payee is subject to tax deduction under any of the Section covered by chapter XVII-B. Thus if the amount paid or payable to a resident payee is less than the amount on which payer has obligation to deduct tax at source under the relevant Section of tax deduction at source e.g. 194, 194A, 194C, 194H etc, like ₹30,000 w.e.f 1st July, 2010 in case of fee for professional and technical services under Section 194J, payer shall not be liable to deduct tax at source under Section 206AA even if payee does not furnish his Permanent Account Number, Permanent Account Number furnished by him is not valid or it does not belong to him. If on any amount, sum or income on which tax is not deductible at source under Chapter XVII-B of the Act then Section 206AA is not attracted and hence no tax shall be deducted even if payee does not furnish his Permanent Account Number.

Table shown below gives limit of amount under some of the section of Chapter XVII-B on which no tax at source need to be deducted under Section 206AA even if payee does not furnish his Permanent Account Number to the payer.

Example

X Ltd gives professional services to Y Ltd and total amount paid to X Ltd during the financial year 2010-11 is ₹60,000 and X Ltd does not furnish its Permanent Account Number to Y Ltd. In this case Section 206AA is attracted and Y Ltd will have to deduct tax at higher of -

- (i) Rate prescribed in the Act (10 per cent in our example)
- (ii) Rate in the force
- (iii) 20 per cent.

So in this example ₹12000 (20 per cent on ₹60000) will be deducted by Y Ltd as tax deducted at source in spite of the fact that rate of tax deduction at source is 10 per cent under Section 194J. However in same example, if we assume that amount paid to X Ltd during financial year does not exceed ₹20,000 upto June and ₹30,000 thereafter then Y Ltd need not to deduct tax at source and Section 206AA will not be applicable.

(C) Whether provision of Section 206AA will also be operative in case of a salaried employee

- (i) Whose taxable income is less than the maximum amount not chargeable to tax under the Act?

Section 192 of the Act requires that any person who is responsible for

paying any income chargeable under the head salaries to deduct tax at source on the amount payable. Tax is determined and deducted at the slab rates prescribed for the financial year. If the amount of salary payable for the financial year is less than the maximum amount not chargeable to tax then tax is not deducted at source by employer. However, with effect from 1st April, 2010 there is an obligation on the part of employer to deduct tax at source at 20 per cent or at higher rate even when the taxable income of an employee is less than the maximum amount not chargeable to income tax e.g. ₹1,60,000 in case of a male employee. This is due to introduction of Section 206AA by Finance Act, 2009 which is effective from 1st April, 2010. From 1st April, 2010 if an employee does not furnish his Permanent Account Number to his employer and employer pays him any amount which is chargeable to tax under the head salaries then employer will have to deduct income tax at source at 20 per cent or at higher rate from the income payable to him. In such case employer will continue to deduct tax at 20 per cent or at higher rate until employee furnishes his correct Permanent Account Number to

“ If on any amount, sum or income on which tax is not deductible at source under Chapter XVII-B of the Act then Section 206AA is not attracted and hence no tax shall be deducted even if payee does not furnish his Permanent Account Number. ”

Section	Nature of payment	Existing limit Applicable upto 30 th June, 2010 ₹	Existing limit Applicable from 1 st July, 2010 ₹
194B	Winnings from lottery or crossword puzzle	5,000	10,000
194BB	Winning from horse race	2,500	5,000
194C	Payment to contractors (single contract)	20,000	30,000
194C	Payment to contractors (total consideration for all contracts during financial year)	50,000	75,000
194D	Insurance Commission	5,000	20,000
194H	Commission or Brokerage	2,500	5,000
194I	Rent	1,20,000	1,80,000
194J	Fee for professional services or technical services	20,000	30,000



his employer. This position is different from other sections of Chapter XVII-B. This is because of Section 206AA which provides tax deduction at higher of following rates -

- (i) Rate prescribed in the Act (10 per cent in the example)
- (ii) Rate in the force
- (iii) 20 per cent.

Since rate in force for an individual, e.g. male, is NIL upto his taxable income of ₹1,60,000 and therefore higher of above three points come 20 per cent and so tax shall be deducted at 20 per cent. This is explained with the help of the following example—

Suppose Mr. X is an employee of Y Ltd and has a estimated taxable income under the Income-tax act is ₹1,50,000 for financial year 2010-11 and he has not obtained his Permanent Account Number therefore he can't furnish it to his employer Y Ltd.

Tax rates applicable to him for financial year 2010-11 are-

Range	Income Tax Rates
Up to ₹1,60,000	Nil
₹1,60,000 to ₹5,00,000	10 per cent
₹5,00,000 to ₹8,00,000	20 per cent
Above ₹8,00,000	30 per cent

Now as per tax rates applicable to him he has no tax liability for Financial Year 2010-11 but due to non furnishing of Permanent Account Number Section 206AA is attracted and accordingly Mr. X will have to pay tax at higher of two below rates-

- (i) Rate in force (Nil in our example as his taxable income is less than ₹1,60,000)
- (ii) 20 per cent.

Therefore Y Ltd will have an obligation to deduct tax at source at 20 per cent and his tax liability will be-

Taxable income 1,50,000
Tax @20 per cent 30,000

This ₹30,000 will be his tax liability for Financial Year 2010-11 and Y Ltd

will have to deduct ₹2,500 (30000/12) every month until he submits his Permanent Account Number to Y Ltd.

(ii) Whose taxable income is more than the maximum amount not chargeable to tax under the Act?

In case of an employee who has a taxable income more than the amount not chargeable to tax, Section 206AA is attracted and tax is deducted at 20 per cent or higher rate as may be applicable. This can be explain with the help of a example-

Suppose X, Y, and Z are three employees of ABC Ltd and they have following taxable income for the Financial Year 2010-11 and none of them has furnished his Permanent Account Number to ABC Ltd-

Employee	X	Y	Z
Taxable Income	3,00,000	6,00,000	900000
Tax under Section 206AA	60,000	1,20,000	1,90,000
Average tax	5,000	10,000	15833.33

In case of Mr. X and Mr. Y, ABC LTD shall deduct tax at the rate of 20 per cent as this is the higher of the rates applicable to them.

In case of Z, upto ₹8,00,000 flat 20 per cent will be deducted and on balance taxable income of ₹1,00,000 tax rate of 30 per cent will be applicable as this is the higher of 20 per cent and therefore his overall tax liability for financial year 2010-11 will be ₹1,90,000.

ABC Ltd will continue to deduct ₹5,000, 10,000 and 15,833.33 at average tax rate from the salary of Mr. X, Mr. Y and Mr. Z respectively until they furnish their Permanent Account Number to ABC LTD.

Further, Section 206AA does not provide for deduction of education cess or secondary higher education cess. It simply provides 20 per cent or at higher rate therefore when tax is deducted

Section 206AA does not provide for deduction of education cess or secondary higher education cess. It simply provides 20 per cent or at higher rate therefore when tax is deducted under section 206AA education cess and secondary higher education cess should not be deducted.



under Section 206AA education cess and secondary higher education cess should not be deducted.

Conclusion

With the introduction of Section 206AA, employer's obligation has increased. At the same time this section is just like a nightmare especially for those employees who do not have a taxable income under the Income Tax Act. Such employees are generally belong to low income group and now by the time they obtain Permanent Account Number their employer would have no option but deduct and deposited tax.

Therefore all persons who are responsible to deduct tax at source should intimate their payee/employees regarding furnishing of Permanent Account Number so that there is no excess deduction of tax. ■

Conflicting Decisions on Taxability of Software Payments: Re-entering the Maze?



The battle between 'copyright' and 'copyrighted article' has got heated again with the decision of Delhi Tribunal in the case of M/s Gracemac Corporation and Microsoft Corporation and Microsoft Regional Sales Corporation. Since the term 'copyrighted article' is not used either under the Act or the Treaty, ITAT held that there is no need for importing the expression 'copyrighted article' from OECD commentary or the U.S. guidelines, in absence of any ambiguity. The Tax Tribunal distinguished the rulings in Tata Consultancy Services (Supreme Court) and Motorola Inc (Delhi Special Bench) which supported the distinction between copyright and copyrighted article. In the following paras we have discussed the ITAT's decision in detail and its ramifications on the tax payers.

Tax treatment of cross border transactions has always been a matter of controversy. Determining the taxability of any cross border transaction involves harmonious reading of multifaceted Indian tax laws coupled with tax treaties, aided by the internationally accepted OECD guidelines, often making it a complex

task. One of the most debated issues amongst several others in international taxation arena is taxability of payments which are in the nature of royalty.

Royalty arises from commercialisation of intellectual property rights. Explanation 2 to Section 9(1) (vi) of the Income-tax Act, 1961 ('Act') and Article 12 (in most of the

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

treaties) of Double Taxation Avoidance Agreement ('DTAA' or 'tax treaties') defines the term 'royalty'. Definition of royalty as per the Act and OECD are reproduced hereunder for the ready reference:

As per Act – Section 9(1)(vi)	As per OECD – Article 12
For the purposes of this clause, 'royalty' means consideration (including any lump sum consideration, but excluding any consideration which would be the income of the recipient chargeable under the head "capital gains") for - - the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property ; - the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ; - the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ; - the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ; - the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in Section 44BB; - the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or - the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iv) and (v).	The term 'royalties' as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.



Thus, Royalty is defined under the Act to mean sum payable for the use or right to use intellectual property like patent, invention, model, design, secret formula or process or trade mark or similar property and any industrial, commercial or scientific equipment. The definition of royalty provided in OECD (which is followed in large number of tax treaties) is largely the same, but is more restrictive.

Under the Indian tax laws, royalty is deemed to accrue or arise in India if payable by a resident. Furthermore, royalty payable by a non-resident is also deemed to accrue or arise in India if it is utilised for the purpose of a business in India or for earning income from a source in India.

Royalty on Software Payments

With the ever increasing use of technology and automation, import of software and software products in India is growing at a rapid pace.

On the other hand, the software companies characterise the same as 'sales'/'business' income, contending that such income is not taxable in India in the absence of a Permanent Establishment ('PE').

The subject becomes further intricate due to the complex delivery, pricing, servicing and marketing model followed by the various software companies. Taxability of the software will differ with the slightest change in customisation i.e. off the shelf or tailor made, delivery model i.e. on CD or thorough online channels, supply chain management i.e. directly by software company or through distributors, etc.

Copyright vs. Copyrighted Article

The Special Bench ('SB') of Delhi Tribunal in case of *Motorola*¹ has laid down the litmus test for identifying software payments as royalty or business profits. SB held that if the payment is for a 'Copyright', it should be classified as royalty. But if the payment is for a 'Copyrighted article', then it only represents the purchase price of the article.

'Copyright' refers to the ownership rights of the author or creator whereas 'Copyrighted article' means a product containing the underlying copyright. For example – a writer of a book gets a copyright on his book upon its creation whereas the purchaser of the book gets 'Copyrighted article'. In other words, Copyright is a negative right which refrain others from doing what the owner/creator can do. Since, the term Copyright is not defined in the Act resort was made to The Copyright Act, 1957. Section 14 of the Copyright Act, defines copyright in case of a computer program as an 'exclusive right' to the author/creator to do the following acts:

- To reproduce work.
- To issue copies to the public.
- To make translation.
- To make adaptation.

Several global companies such as Microsoft, Oracle, etc, have prepared standard software with different functional utilities, which can be utilised by anyone who uses their operating systems. Such software are usually in the form of a product which can be used by the person purchasing the same. Normally, such software (often referred to as shrink wrapped software) cannot be modified or copied by the users for onward selling. The Software companies charge license fees from the users for providing them the right to use the product.

Indian Revenue authorities have been treating the payments by the users towards license fees as Royalty, subject to withholding tax.

¹ *Motorola Inc vs. DCIT 95 ITD 269 (S.B.)*

“A plethora of Tribunal rulings in India following the Delhi SB decision, having regard to the nature and extent of rights granted in a typical software transaction involving an end user or a distributor, have characterised the same as generating business profits. However, in a recent decision, Delhi Income-tax Appellate Tribunal has ruled against the settled principle of Tribunals across the nation concluding that sale of shrink wrapped software (what is popularly called boxed or off-the-shelf software) is to be characterised as Royalties and not business income.”

- To sell or offer for sale.

In simple words copyright is transferred if the right to commercially exploit the underlying intellectual property is transferred.

Current Position of Law

A plethora of Tribunal rulings in India following the Delhi SB decision, having regard to the nature and extent of rights granted in a typical software transaction involving an end user or a distributor, have characterised the same as generating business profits. However, in a recent decision, Delhi Income-tax Appellate Tribunal ('ITAT') has ruled against the settled principle of Tribunals across the nation concluding that sale of shrink wrapped software (what is popularly called boxed or off-the-shelf software) is to be characterised as Royalties and not business income.

In the following paragraphs, we have discussed at length the aforesaid ruling of Delhi ITAT delivered in case of *Gracemac Corporation, Microsoft Corporation and Microsoft Regional Sales Corporation (2010-TII-141-ITAT-DEL-INTL)* ('Microsoft') and other

significant rulings delivered by several Tribunals on the same issue during the year 2010.

Analysis of Delhi Tribunal's Ruling in Case of Microsoft

Facts of the case

The appellants are the US-based Microsoft Corporation (MS Corp) and its subsidiaries, the Gracemac Corporation (GC) and the Microsoft Regional Sales Corporation (MRSC).

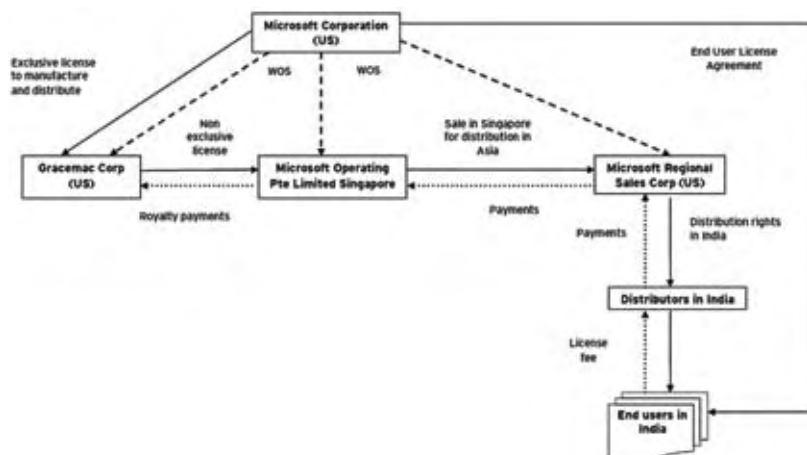
- Up to 31st December 1998, MS Corp had directly entered into agreements with various OEMs/ Indian Distributors for sale of Microsoft products being "off the shelf"/"shrink-wrapped" software, on principal to principal basis. The Indian distributors, in turn, sold these Microsoft products to resellers/consumers.
- The above business model was changed w.e.f. 1st January, 1999 and MS Corp entered into an agreement with its subsidiary, GC to grant it an exclusive license, in exchange of all shares, to manufacture and license Microsoft retail software products. All master copies provided by MS Corp would at all times remain its sole property.
- GC, in turn, entered into a license agreement with Microsoft Operations Pvt. Limited ('MO'), Singapore, under which MO was granted non-exclusive license to



manufacture Microsoft software products in Singapore and distribute the same.

- MO, in turn, entered into a non-exclusive distribution and inter-company services agreement with MRSC for selling the software products which are manufactured. MRSC, in turn, had entered into agreements with various distributors in various countries including India, for the onward distribution/selling in respective country.
- MS Corp entered into End Users License agreement (EULA) with end users to use the software products licensed to them as per terms of agreement.

This has been pictorially depicted as under:



Issue Involved and Arguments

The entire conflict revolved around the issue on taxability of income of MS Corp and GC from the sale of softwares in India. Revenue Authorities at lower level i.e. Assessing Officer and Commissioner of Income-tax (Appeals) ('CIT(A)') has taken a view that consideration received is in respect of software used in India and hence is in the nature of 'royalty' in accordance with provisions of Act as well as tax treaty (in view of the provisions of clause 7(b) of Article 12 of DTAA). Further, CIT(A) has also held that MRSC and MO were mere legal façades.

In view of above facts, we have discussed contentions raised by the assessee before the ITAT, arguments of Revenue Authorities and view of ITAT in the following paras:

Assessee's contentions:

- Consideration received in respect of sale of Microsoft software products, being copyrighted articles are not in the nature of royalty under Section 9(1)(vi) of the Act. Reliance was placed on the decision of the Hon'ble Supreme Court ('SC') in the case of Tata Consultancy Services² ('TCS').
- To analyse the taxability of a sale of computer program it is pertinent to examine the provisions of the Indian Copyright Act, 1957 ("ICA") as software and programs have been granted protection under the said Act.
- Reliance was placed on the decision of Bangalore ITAT in the case of Sonata Software³ wherein it is held that since computer program has been defined under the ICA, it is incorrect to say that computer program can also be considered as 'patent'/'invention'/'process'.
- Reliance was placed on the decision of Delhi SB in the case of Motorola

In the case of MRSC and MO Tribunal held that when the Sovereign State recognising the legal existence of an entity by issuing a tax residency certificate it is obligatory for any other sovereign state including India to recognise the same and it is not open for Revenue to declare these entities as façade without any basis.

Inc (supra) wherein it has been held that the payment of copyrighted article is not in the nature of royalty but purchase of an article.

- Reference to EULA which stated that product is licensed and not sold and there is a restriction of activation of the software before the user can copy and start using the software to conclude that the consideration has been received for grant of right of copyright in the software is misplaced.
- Further, the payment made by MO to GC is not in respect of a right used for the purposes of making or earning any income from any 'source' in India. Accordingly, the provisions of Section 9(1)(vi) of the Act are not attracted in this case and hence, the assessee is not taxable in India under the Act.
- It was also argued that Royalty received from MO is not taxable under Article 12(7)(b) of the Indo-US DTAA on the ground that the "copyright" itself should be used in India. Since, the "copyright" has not been exploited in India, provisions of Article 12(7)(b) are not applicable.

Revenue's contentions:

- Indian Income-tax Act and ICA are enacted for the different purposes – one taxes the income and the other protects rights of the authors.

Therefore, any reference to ICA has to be made for the limited purpose of finding out the meaning of the word 'copyright' as the same has not been defined either in Act or DTAA.

- Phrase "copyrighted article" has not been used either in the Act or DTAA or ICA, it finds its origin from US regulations and OECD commentary. The term "copyrighted article" may be aptly used for a book or a music CD but it is a misnomer in the case of computer program where one or more rights in copyright have necessarily to be transferred to make it workable. A dumb CD without right of any reproduction on the hard disk is of no value to the end-user unlike a book or a music-CD.
- Prerequisite of sale is "transfer of ownership". The EULA clearly stated that Microsoft product is 'licensed and not sold'.
- Nomenclature given to a transaction or to a right or a property is not decisive of the nature of the transaction or of rights or of the property. Whether it called a copyrighted article or a copyright, it makes no difference so long as the consideration paid or payable by the licensee is in respect of exercising the rights in a copyright.
- The Act maintained a clear distinction between an article and computer software. The provisions contained in Section 10A of the Act provide for deduction of 'such profits and gains as are derived from the export of articles or things or computer software'. The use of the word 'computer software' as distinguished from article or thing is clearly suggestive of the fact that computer software is not the same as an article, whether copyrighted or not.
- US courts held in the case of

² *Tata Consultancy Services v State of Andhra Pradesh* (271 ITR 401)

³ *Sonata Software Ltd v DCIT* (103 ITD 324)

Microsoft that some of the software may not be computer programs per se but may be the original inventions and hence patentable.

Tribunal's findings:

1. Taxability of consideration as "Royalty":

- The consideration received by the assessee for the supply of computer program is taxable as 'Royalty' in accordance with provisions of Section 9(1)(vi) of the Act.
 - ♦ Copyright subsists in a computer program and it is also a literary work as well as a scientific work.
 - ♦ Computer software is also a patent, invention or a process.
 - ♦ Consideration is in respect of transfer of copyright, patent, invention, process, literary or scientific work and hence the payment is in the nature of Royalty.
- The term 'copyrighted article' has not been defined either in Act or DTAA and has been originated from US laws and OECD Commentary and hence for the taxability purposes, a copyrighted article cannot be treated as a product.
- Decision of Hon'ble SC in the case of TCS (supra) is distinguishable as the same was rendered in the context of Sales-tax Act, 1956 and issue whether transfer of computer program gives rise to "Royalty" has not been examined.
- Definition of as per the Act and DTAA is identical and under both

Mumbai Tribunal applied the litmus test of copyright vs. copyrighted article laid down in the Motorola and Samsung judgment. Based on the terms and conditions of the agreement it held that assessee has purchased a copyrighted article and not the copyright itself. There is no transfer of any part of copyright. Tribunal observed that so far as the merit of the issue is concerned, there is unanimous view of various benches of the Tribunal that payment for use of copyright article cannot be brought to tax as royalty.

the cases, royalty is deemed to arise in the state in which the payer is situated.

- End use is not simply using the CD but the program contained in the CD, which is protected by copyright and right to copy the program has to be exercised before it can be put to use. Therefore, the payments made by the end users is for the granting of license in copyright and other intellectual property rights in the product and will amount to royalty under Section 9(1)(vi) of the Act.
- Tribunal rejected the contention of assessee that royalty payments from computer software should not be taxed by relying on the second proviso to Section 9(1)(vi) of the Act. Second proviso to Section 9(1)(vi) excludes supply of software along with computer

or computer equipment. Emphasising on purpose of proviso, the Tribunal held that a proviso is meant to be an exception to something within the main enactment. However, proviso cannot exclude something which is not there in the main section. Thus, ITAT took a view that, it was always a intention of the legislation to include a software as a 'royalty' in accordance with provisions of Section 9(1)(vi) of the Act and exclusion of the same vide second proviso strengthens the said view.

While arriving at this view ITAT also relied on the provisions of Section 115(1A) of the Act.

- Further, binding decision of the Delhi SB in case of Motorola Inc (supra) is also not followed by the ITAT on the following grounds:
 - ♦ Distinguishable facts of the case; and
 - ♦ SB has relied on US Regulations and OECD commentary which is considered as unnecessary in view of SC decision in case of P.V.A.L. Kulandagan Chettiar⁴

The Tribunal rejected all the other rulings⁵ as well which placed reliance on TCS and Motorola Inc.

2. Tribunal's observations on placing reliance on OECD Model Tax Convention ("MC") and Commentary:

In a considerable deviation from the accepted practice affirmed by several rulings, Delhi Tribunal declined to

⁴ *Commissioner of Income-tax v P.V.A.L. Kulandagan Chettiar (2004-TII-01-SC-INTL)*;

In this ruling SC emphasises on supremacy of Indian tax laws and considers it unnecessary to refer to the terms addressed in OECD commentary or in any of the decisions of foreign jurisdiction or in any other agreements. The relevant extract of the judgment is reproduced as under:

"...it has been held that taxation policy is within the power of the Government and section 90 of the Income-tax Act enables the Government to formulate its policy through treaties entered into by it and even such treaty treats the fiscal domicile in one State or the other and thus prevails over the other provisions of the Income-tax Act, it would be unnecessary to refer to the terms addressed in OECD commentary or in any of the decisions of foreign jurisdiction or in any other agreements..."

⁵ *Lotus Development Asia Pacific Limited Corporation (ITA No. 564 to 566/Del/05) (Delhi), Samsung Electronics Co. Ltd vs. ITO (TDS- 1)(2005) (93 TTJ 65) (Bang), Sonata Information Technology Ltd. vs. DCIT (2006) (7 SOT 465)(Mum.), Infrasoftware Limited vs. ACIT, Circle 2(2) (ITA No 847 Delhi 2008) (Delhi)*

Clearly, the decision of the Delhi Tax Tribunal seems not to be in consonance with the settled law. Taxpayers have once again been exposed to scrutiny at the lower levels leading to the unwarranted long drawn litigation. Further, non-deduction of tax on payments exposes them to disallowance of expenditure with interest and penal consequences. Further, the complexity involved in subjecting the import of copyrighted software to withholding taxes is that if it is construed as royalty under the Act, it may attract Service tax implications which may make the life of the tax payer miserable.

place reliance on OECD on the following grounds:

- OECD Commentary merely contains the views of the authors which may vary. It also pointed towards the cleavage of opinion amongst the group of technical advisors on the issue as to whether a copyrighted article has copyright in it. The majority view was that it does not have copyright in it and is a product. However, the minority view was that the copy of a computer program has copyright in it.
- Though the developed countries are following OECD model convention, but a large number of them had reservation in following the OECD commentary. More specifically, India has expressed clear reservations on taxation of Royalty in 2008 update to the OECD MC and Commentary
- The commentary cannot be equated with the decision of the apex court or the law enacted by the Parliament.

Thus, Tribunal has taken departure from the accepted practice affirmed by several rulings and declined to place

reliance on OECD MC.

However, it is very interesting to note here, the issue of India's reservation was also brought to the attention of the Authority of Advance Rulings ('AAR') in Dassault⁶ on a similar issue. It was argued by the tax authorities that reliance cannot be placed on the OECD Commentary on Article 12 as the Indian Government has not agreed to the viewpoint expressed in the Commentary. However, the AAR referred to the OECD commentary on Article 12 and commented that the analysis and reasoning appear to project a sound approach to the issue under consideration.

3. Tribunal's observations on Treaty Override:

Interestingly, Tribunal held that the binding nature of the treaty is not without exceptions and later domestic tax legislation may override tax treaty provision wherever there is an irreconcilable conflict. Observation of ITAT reads as under:

"Sovereign power of the Parliament extends not only to the making but also breaking a treaty. Unilateral cancellation of tax treaty through an amendment to the internal law subsequent to conclusion of the treaty is a recognised sovereign power. If after the agreement has come into force, an Act of Parliament is passed which contains contrary provision, the scope and effect of the legislation cannot be curtailed by the reference to the agreement."

Tribunal has relied on the decision of Hon'ble Supreme Court in the case of *Gramophone Company of India v*



Virendra B. Pandey (AIR 1984 SC 667) wherein it is held that national courts cannot say "Yes" if the Parliament has said "No" to a principle of international law. National courts can endorse international law but not if it conflicts with international law.

4. Other relevant observations:

- In the case of MRSC and MO Tribunal held that when the Sovereign State recognising the legal existence of an entity by issuing a tax residency certificate it is obligatory for any other sovereign state including India to recognise the same and it is not open for Revenue to declare these entities as façade without any basis.
- The Tribunal held that very fact that MRSC had appointed distributors in India lead to 'business connection' in India taxable under Section 9(1) of the Act. However, since the income was considered taxable as Royalty, the same was not taxed twice in hands of MSRC.

Key highlights of Delhi Tribunal Ruling

1. Reversing the settled law on royalty, Tribunal held that sale of shrink-wrapped software is sale of 'copyright' and not the 'copyrighted article', and therefore payment is taxable as 'Royalty'
2. Accentuating India's reservations on Article-12 in the 2008 Update to the OECD MC and Commentary, Tribunal declined to place reliance on inferences from the OECD commentary labeling it as **"at best, be considered as the views of its authors"**
3. The binding nature of a tax treaty is not without any exceptions. The later domestic law legislation may override tax treaty provisions whenever there is an irreconcilable conflict.

⁶ *M/s Dassault Systems K.K Vs DCIT (322 ITR 125)*

Tribunals' take on Royalty on Software in 2010 -Post Microsoft Position

Towards the end of Calendar year 2010, immediately after the Delhi Tribunal's ruling, Mumbai Tribunal delivered following three rulings encompassing the issue of payment for shrink wrapped software:

- *DDIT, Mumbai Vs Reliance Industries Ltd*⁷ ('Reliance')
- *ADIT, Mumbai Vs M/S Tata Communications Ltd*⁸ ('Tata')
- *M/S Daimler Chrysler AG Vs DIT, Mumbai*⁹ ('Daimler')

While dealing with the above cases, Mumbai Tribunal applied the litmus test of copyright vs. copyrighted article laid down in the Motorola and Samsung judgment. Based on the terms and conditions of the agreement it held that assessee has purchased a copyrighted article and not the copyright itself. There is no transfer of any part of copyright. Tribunal observed that so far as the merit of the issue is concerned, there is unanimous view of various benches of the Tribunal that payment for use of copyright article cannot be brought to tax as royalty.

Tribunal in case of Reliance, further reiterated that it is now established law that computer software after being put on to a media and then sold, becomes goods like any other audio cassette or painting on canvas or a book and that the AO is wrong in holding that Computer software on a media, continues to be an intellectual property right and that the AO was wrong in treating this computer software as a "Patent" or as "Invention". Thus the payment cannot be termed as "Royalty".

Contrary to Delhi Tribunal's decision in Microsoft (supra), Mumbai Tribunal held that definition of the term 'Royalty' in Article 12(3) of the Indo-US DTAA is more restrictive than what is provided

“Microsoft ruling has once again spelled out the significance of the terminology used and terms and conditions laid down in the agreement. Nevertheless, it has left open some loose ends like whether the domestic tax law would prevail over the provisions of the DTAA and how far reliance can be placed on inferences drawn from widely used OECD commentary and US regulations. These questions are for sure going to be a matter of debate and long drawn litigation till some settled law comes in place.”

in Section 9(1)(vii) of the Income-tax Act, 1961 and that in such a situation the provisions of the Double Taxation Avoidance Agreement override the domestic law.

It may however be noted that the decision of the Delhi Tribunal in case of Microsoft does not seem to have been brought to the notice of the Mumbai Tribunal while pronouncing its judgment in all the three rulings discussed above.

Ramifications for the Tax Payers

Clearly, the decision of the Delhi Tax Tribunal seems not to be in consonance with the settled law. Taxpayers have once again been exposed to scrutiny at the lower levels leading to the unwarranted long drawn litigation. Further, non-deduction of tax on payments exposes them to disallowance of expenditure with interest and penal consequences. Further, the complexity involved in subjecting the import of copyrighted software to withholding taxes is that if it is construed as royalty under the Act, it may attract Service tax implications which may make the life of the tax payer miserable.



Direct Tax Code

Reference is invited to the recent development in the Income-tax arena i.e. introduction of Direct tax Code ('DTC') wherein taxability of software payments will get a new dimension. Under DTC software payments have been specifically covered within the definition of fees for technical services in contrast to treating the same as royalty by ITAT in the decision of Microsoft. These changes in the DTC would have far reaching consequences on the taxability of Royalty and FTS

Conclusion

Microsoft ruling has once again spelled out the significance of the terminology used and terms and conditions laid down in the agreement. Nevertheless, it has left open some loose ends like whether the domestic tax law would prevail over the provisions of the DTAA and how far reliance can be placed on inferences drawn from widely used OECD commentary and US regulations. These questions are for sure going to be a matter of debate and long drawn litigation till some settled law comes in place.

Further, the conflicting rulings by various Tribunals on the same issue and the uncertainty on taxability of off-the-shelf software payments continue to create a dilemma in minds of Indian corporate as well as multinational corporations operating in India. However, to put a rest to stir likely to be created by these rulings we can expect rulings from the High Courts in the near future. Till then it's a wait and watch situation for all. ■

⁷ *DDIT, Mumbai Vs Reliance Industries Ltd (2010-TII-154-ITAT-MUM-INTL)*

⁸ *ADIT, Mumbai Vs M/S Tata Communications Ltd 2010-TII-157-ITAT-MUM-INTL*

⁹ *M/S Daimler Chrysler AG Vs DIT, Mumbai (2010-TII-203-ITAT-MUM-INTL)*

Performing IT General Control Review



In today's time IT plays a major role in assisting organisations to automate and integrate the majority of its business processes; share common data and practices across the entire enterprise and produce and access information in a real-time environment. The auditor is required to understand the environment in a comprehensive manner. They need to know the Levels of IT sophistication in order to understand the impact of IT control weakness. Review of IT general computer control (ITGC) should be undertaken on priority basis in case of medium to high level IT sophistication. ITGC are pervasive controls that provide for the Proper development and implementation of applications, confidentiality, Integrity and availability of programmes, data files, and effective computer operations. Proper and consistent operation of automated controls or IT functionality often depends upon effective IT general controls. Ineffective IT operations place the entire IT infrastructure at risk of not supporting key production ERP and financial systems. This article deals with performing IT General Control Review and related concepts.



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In today's environment most of the entities are using some or other ERP. ERP system assist entities to automate and integrate the majority of its business processes; share common data and practices across the entire enterprise and produce and access information in a real-time environment. Auditors find ERP system difficult to audit due to absence of visible audit trail and complex interaction and flow of information in application system. ERP systems have not changed the objective and approach of audit, however auditors may need to adjust the audit processes and procedures when auditing in such an environment.

Various studies on impact of ERP on audit procedure have highlighted that ERP systems have had a significant impact on audit processes. Auditors

tend to use ERP to bring efficiency in audit process and provide more value to client. They spent more time on control testing when auditing an ERP and reduce substantive testing if they find control are operating effectively. They bring audit efficiency by testing and recommending automated controls. Automated controls work without manual intervention and thus are more reliable and are consistently applied, thus leading to testing of small sample size.

To audit effectively through the system the Financials generated from the ERP system, the auditor needs to have a fair understanding of the following:

- Business model and its processes
- Controls both entity and process level

“IT general controls are controls that apply to all systems components, processes, and data for a given organisation or information technology (IT) environment. The objectives of General computer controls are to ensure the proper development and implementation of applications, as well as the integrity of programmes, data files, and computer operations.”

- Application System used for supporting the process from financial recording perspective including interactions and flow of information in application system
- Operating system, database and network on which application supporting the relate process is running

To do a proper scoping for audit from financial perspective, in order to determine what risks exist as a result of the effect of IT on financial reporting, and to identify risks associated with controls embedded in IT, during the understanding phase we should also try to understand level of IT sophistication. Since the impact of control weakness may not be same if the level of IT sophistication is low as in such case entity may be using more manual procedure and manual controls. Also, generally speaking, the level of sophistication is directly related to the extent and type of IT audit procedures besides the need for SME for performing IT audit.

Level of IT Sophistication

The Effect of IT on the Auditor's Consideration of Internal Control in a Financial Statement Audit is not necessarily related to the size of the entity but rather the level of sophistication of its IT. It is possible for a large company to not to rely heavily on IT for delivering its products or

services and on IT controls in financial reporting processes. Thus, such an entity would likely be considered at a medium to low level of IT sophistication and same is true vice versa.

IT sophistication can be classified as high, medium and low. Though analysis of sophistication is more judgemental, however, we can use some logical and analytical thinking to come to the conclusion. Following is sample model which one may consider while arriving at the conclusion. The impact of weakness of IT general control is generally high in case of high level of IT sophistication as in such case IT usage, complexity, importance is high and entity uses large number of automated procedures.

To describe some of the factors that classify an entity into one of the three levels of sophistication, a model is presented that includes some quantitative IT factors (See Figure 1). Each of these criteria is limited to those associated with the financial reporting systems, technologies and processes. Those IT elements not directly associated with financial reporting and the risk to material misstatement are ignored in the assessment of relevant IT.

Generally speaking in low level of IT sophistication, there would be one server associated with financial reporting, a limited number of personnel using the system mostly finance personnel for financial data entry and processing, no remote locations (associated with financial reporting), simple applications and infrastructure, very few emerging or advanced technologies, and very few to no online transactions. In such case even if systems are not available, manual records can easily be maintained and they would be low impact of system unavailability. Internal controls over financial reporting would not be overly reliant on IT or would be embedded in the simple applications or limited to manual processes and controls. Many small to medium-sized entities would fit this description. Due to the low level of IT sophistication, impact of IT weakness may be low from financial reporting purposes. Conversely in high level of IT sophistication, this entity would have more high usage of system, operation and processes for financial reporting carried through the system. Most of employees use ERP or write custom

Figure 1

Level	High	Medium	Low
% of employee using the computer system through which financial processing is done	70-100%	40-60%	0-40%
% of financial transaction process through system	70-100%	40-60%	0-40%
% of automated control	More than 50%	20-50%	Less than 20%
Server	>3	2-3	1
Remote access to system available to employee	Yes >20%	Yes <20%	No
Whether interfacing application	Yes-automatic interface	Yes-Manual interface	No
Level of customisation	Yes >20%	Yes <20%	No
Whether system automatically initiate transaction	Yes >20%	Yes <20%	No
Level to which system are used for business decision making	70-100%	40-60%	0-40%
In case system is not available whether business can be carried out	No	Yes-But with manual processes and significant impact on employee work life balance	Yes –entity can easily adopt manual processes till system go live

software, employ a large number of emerging or advanced technologies, and have possibly a large number of online transactions. Remote access is available with lots of employees. Entity has complex network, database and automated processes and controls. The entity would also rely heavily on IT for ICFR. In case system is not available entity cannot survive for long duration or resort to manual procedure even for short period of time. Due to the high level of IT sophistication, impact of IT weakness may be high from financial reporting purposes.

In medium to high level of IT sophistication, it is advisable to first test IT General computer control because they are pervasive in nature.

What is IT General Control?

IT general controls are controls that apply to all systems components, processes, and data for a given organisation or information technology (IT) environment. The objectives of General computer controls are to ensure the proper development and implementation of applications, as well as the integrity of programmes, data files, and computer operations.

They are pervasive controls that provide for the reliability and integrity of the information processed by the ERP systems on which organisations

are dependent for their business and financial transaction processing.

Proper and consistent operation of automated processes controls or IT functionality often depends upon effective IT general controls. The effectiveness of other controls, particularly manual controls, is also more often than not dependent on the effectiveness of IT controls.

Areas of General Computer Control

They typically cover four important areas from financial reporting perspective which are:

1. IT entity level control
2. Computer operation
3. Information security
4. System and programme change

IT Entity-level Control: Standards on Auditing (SAs) 315-*Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* requires the auditor to obtain an understanding of the information system, including the related business processes, relevant to financial reporting. These controls are those employed by management over the IT function as a whole, or in general. For example, IT governance would be a part of the IT entity-level controls. Regardless of size or IT sophistication, the entity should have some relatively formal set of controls to provide governance over the IT. Other controls in this area include IT policies and procedures, IT management, planning, strategy, human resources, and IT risk management. The prime question becomes as to what kind of impact the entity-level controls have on Risk of material Misstatement. For the low level of IT sophistication, the risk is likely to be so low as to become irrelevant.

Computer Operation: These are controls relating to supervising and

“The aggregation of multiple ITGC deficiencies, however, can trigger an auditor to conclude that they are important enough to call to the attention of those responsible for oversight of financial reporting, i.e. the Chief Financial Officer and Audit Committee, and therefore, a significant deficiency. The step from significant deficiency to material weakness is largely judgemental.”

maintaining computer systems operations. They cover controls relating to defining, executing and monitoring of batch and online processing. Planning, scheduling, monitoring of data and system backup, their retention and testing. They also cover controls relating to end-user requirements for computer processing support, problem resolution and how helpdesk is administered and monitored.

Control relating to defining, executing and monitoring of batch and online processing are designed to prevent non-recording of transactions completely or accurately. Backup controls relate to the entity's ability to recover from a critical event that causes the loss of data and/or systems. Performance and helpdesk related controls are meant to provide for availability of computer system and data.

Information Security: Information security denotes protecting information and information systems from unauthorised access, use, disclosure, disruption, change or damages. It protects its confidentiality, availability and integrity. Information security relates to the financial audit because of the risk that an unauthorised party could gain access to financial reporting applications or data and intentionally or unintentionally create misstatements in the data.

“IT Entity-level Control: Standards on Auditing (SAs) 315-Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment requires the auditor to obtain an understanding of the information system, including the related business processes, relevant to financial reporting. These controls are those employed by management over the IT function as a whole, or in general.”

“IT in most organisations is constantly changing and, therefore, auditor should evaluate audit areas and controls on a case-by-case basis and be careful in using standard checklists or even last year’s audit plan. While some of these areas will end up irrelevant from the risk to material misstatement, especially when IT sophistication is low. However to provide value auditor could choose to convey to management these problems, risks or weaknesses either formally or informally.”

Information security includes both physical and logical security over all access paths to data. Thus we can discuss security in following two type of access:

- Physical access and environment controls over the data center and key systems
- Logical access to data/information, software and to networking.

A physical access and environment control protect the physical information system, assets of an organisation—personnel, hardware, facilities, supplies and documentation. They are the controls to restrict, record and monitor physical access to information technology resources and protected areas. They cover environmental control mechanisms (e.g., alternate

sources of power, smoke/fire detection & suppression, temperature or humidity monitors, and physical location considerations) to protect and monitor information resources from susceptibility to environmental threats (e.g., wind, water, fire).

Logical access includes access to applications and data through technologies not requiring a person to be physically present. They include controls relating to identification, authentication, authorisation, and accountability of user to computer software, data files and to networking.

Weakness in physical and logical security in case of high level of IT sophistication can result in risk for material misstatement as this can lead to intentional or unintentional viewing, modification, copying or unavailability of data/information and system.

System and Programme Changes:

System and programme change management controls are the controls to ensure that all changes in the System and programme are authorised properly, implemented securely and meet business requirement for which change was made. Change management applies to software (applications) and hardware (infrastructure, including operating systems and networks).

Change management is relevant to financial reports when it relates to application software used in financial reporting—either in the processing of financial data or in the automated functions of the financial reporting process. In low level of IT sophistication

risk to material misstatement may be low, however, in case of high level of IT sophistication risk to material misstatement may be high. This is because if system and programme changes or modification are not appropriately implemented and do not function as per management’s intentions depending on type of change, it may result in inaccurate calculations, unreliable processing, incomplete recording of data, cut off errors, or other misstatements of the accounting records.

Testing of IT General Control

To test design, implementation and operating effectiveness of ITGC following steps may be followed:

1. Identify control objective and control activity based on understanding of the information system for the abovementioned four areas.
2. Control testing for each identified control as per step 1. Controls testing procedures can be performed through a combination of two of the following testing techniques:
 - a. System-based tests and investigations
 - b. Review of relevant documentation and physical evidence
 - c. Corroborative interviews with key IT personnel
 - d. Physical inspections

Following is illustrative list of Key ITGC control parameters which can be adopted to perform the testing:

Key IT control parameter	Risk
Entity level control	
Comprehensive IT strategy - long term vision and roadmap are prepared and available based on same comprehensive Short term plan are developed.	Absence of well defined IT plan of action designed to achieve a business goal may result in unproductive usage of entity resources and IT system not meeting business objective.
IT investment is consistently linked to business priorities/ROI	IT may not enable business objective. It may also lead to ineffective and inefficient use of entity resources.
PMO/Governance and prioritisation processes are institutionalised	Inadequate direction and mentoring from IT perspective for achievement of envisaged IT goal. Inefficient or inappropriate usage of IT resources not in line with business needs
There exist clear and concise IT policy, standard and procedure	Lack of management direction and commitment to protect information assets.

Organisation chart exists for entire IT Team and it clearly reflects areas of responsibility and lines of reporting and communication.	Inappropriate authority and responsibility for IT function may adversely affect the quality and performance of IT function in the organisation.
Personnel within the computer processing environments receive appropriate training.	Ineffective use of technology, user errors, low productivity and non compliance with key controls and processes.
Information system Operation	
Batch and online processing procedures are defined, executed and monitored for successful and timely completion any exception are reviewed and timely resolved.	The transaction may not be recorded completely or accurately, and the related items will be inaccurately or incompletely recorded.
Access to automated job scheduling tools, and executable programs is appropriately defined to restrict to appropriate individuals as per job requirement.	Invalid items may be recorded or valid items may be inaccurately or incompletely recorded.
Entity has written agreement(s) with outside contractors and/or software vendors to provide for technical support, as needed. Management monitors compliance with these agreements.	Timely and adequate technical support may not be available and issues may not be resolved.
Help desk function exist to provide support on user queries regarding systems. Problems are recorded and the log for timely resolution of all such user queries is monitored.	User queries may not be timely and adequately resolved.
Performance and capacity utilisation of the computer systems are measured, reported, and reviewed by management	Timely execution and complete processing and availability of data may not be ensured.
All tapes, manuals, guides are properly labeled and timely stored in a secured environmentally controlled location	Unavailability of applications and data backups in the event of a disaster. It can also result in disclosure of sensitive information.
Entity plan and schedule backup and storage of data appropriately. Management periodically reviews retention and releases records.	Data may be lost and systems may not be recoverable in the event of a serious system failure. It may result in regulatory/legal compliance issue, loss of reputation beside financial loss.
Backups are archived off-site.	Backup may not be available if subject to same disaster resulting in risk of data loss
Information Security	
Super user access or administrator passwords are changed on system installation and are available with administrator only. Password of super user or administrator is adequately protected.	Significant information resources may be modified inappropriately, disclosed without authorisation, and/or unavailable when needed (e.g., they may be deleted without authorisation).
Security policies are established and management monitors compliance with policies.	Lack of management direction and commitment to protect information assets.
Vendor default passwords for applications systems, operating system, databases, and network and communication software are appropriately modified, eliminated, or disabled.	Potential Loss of confidentiality, availability and integrity of data and system
Users are required to have a unique user id	User accountability cannot be established.
The identity of users is authenticated to the systems through passwords. The password are periodically changed, kept confidential, and are complex (e.g., password length, alphanumeric content).	It is easier for unauthorised users to guess the password of an authorised user and access the system and/or data. This may result in loss of confidentiality, availability and integrity of data and system
System owners authorise the nature and extent of user access privileges, and such privileges are periodically reviewed by system owners	Unauthorised viewing, modification or copying of data and/or unauthorised use, modification or denial of service in the system.
Access to sensitive data is logged and the logs are regularly reviewed by management	Security breaches may go undetected.
Physical access restrictions are implemented and administered to ensure that only authorised individuals have the ability to access or use information resources.	Potential loss of confidentiality, availability and integrity of data and system.
Environmental control like smoke detector, fire extinguisher, temperature maintenance devices and humidity control devices are installed and monitored in data centre.	Inadequate preventive measure for key server and IT system in case of environmental threat like heat, humidity, fire, flood, etc.
Network diagram is prepared and kept updated, regular review on network security is done for network vulnerability.	Unauthorised system or data access, loss and modification. It can also result in virus, worms and Trojans.
System and program Change control	
Approved Change control policy, standard and process exist and are used to guide the acquisition, development, modification, and maintenance of system and programme.	Change may not meet management intention. Systems may not function in a manner that is consistent with management's intentions.
Changes to system and program are appropriately tested as per test plan. Formal Test plan, test scenario, test records and sign off for unit, interface and user acceptance testing are obtained before the acquired, developed, or modified programs or systems are implemented.	Testing may not be adequate and effective. System may not perform as intended by management. It can also result in errors in processing or loss of data integrity.

It may happen that some of the controls may be ineffective. In such cases we should first look for alternate/compensating controls. In case, alternate controls are not present we should identify the severity of a deficiency. Severity of deficiency depends on magnitude of potential misstatement and reasonable possibility of controls to prevent or detect a misstatement of an account balance or disclosure. In applying this standard, many auditors conclude that one ITGC deficiency by itself generally would not warrant an evaluation as a significant deficiency or material weakness since ITGC controls do not directly relate to the achievement of a financial statement assertion. However, if an ITGC issue contributes to the deficiency of a key application control, (for example, ineffective testing of programme changes to an application resulting in inaccurate system calculations of an account balance), and then the ITGC deficiency is generally considered to be severe. The aggregation of multiple ITGC deficiencies, however, can trigger an auditor to conclude that they are important enough to call to the attention of those responsible for oversight of financial reporting, i.e. the Chief Financial Officer and Audit Committee, and therefore, a significant deficiency. The step from significant deficiency to material weakness is largely judgemental.

Conclusion

Areas of ITGC identified above are identified as the minimum areas to evaluate on every financial audit. Yet, it is vitally important that in the context of a financial audit, the auditor should make sure that there is a direct and significant relationship between ITGC and Risk of material misstatement i.e., the financial data and/or financial reporting processes. IT in most organisations is constantly changing and, therefore, auditor should evaluate



Areas of ITGC identified above are identified as the minimum areas to evaluate on every financial audit. Yet, it is vitally important that in the context of a financial audit, the auditor should make sure that there is a direct and significant relationship between ITGC and Risk of material misstatement i.e., the financial data and/or financial reporting processes. IT in most organisations is constantly changing and, therefore, auditor should evaluate audit areas and controls on a case-by-case basis and be careful in using standard checklists or even last year's audit plan.

While some of these areas will end up irrelevant from the risk to material misstatement, especially when IT sophistication is low. However to provide value auditor could choose to convey to management these problems, risks or weaknesses either formally or informally.

The bottom line is that the audit plan should include gaining assurance over controls in the IT space that can be identified as having the potential to lead to a risk of material misstatement. ■

Purpose Oriented Business Valuation for MSMEs

"Character. Be more concerned with your character than with your reputation. Your character is what you really are while your reputation is merely what others think you are - John Wooden"



Business valuation field itself, in India, is still un-explored. While valuing a business is not an exact science, it is not a total mystery. A valuation requires a thorough analysis of several years of the business operation and an opinion about the future outlook of the industry, the economy and how the subject business will compete. In MSMEs the valuation requirement is not confined to know the fair value. Rather the necessity is to take a decision for specific purpose based on the value so arrived and this required value is not always the FAIR value. MSMEs are concerned with "transactional value" which can be arrived if the values under different standards of value are known. The transaction price is impliedly dependent on not only fair value but also on investment value or liquidation value also.

Introduction

In the wake of economic liberalisation, companies are relying more on the capital market, acquisitions and restructuring are becoming commonplace, strategic alliances are gaining popularity, employee stock plans are proliferating, and regulatory bodies are struggling with tariff determination. In these exercises a crucial issue is: How should the value of a company or a division thereof be appraised?

The goal of such an appraisal is essentially to estimate a fair market value of a company. So, at the outset, we must clarify what is meant by "fair market value" and what is meant by "a company". The most widely accepted definition of fair market value was laid down by the Internal Revenue Service (IRS) of the US. It defined fair market value as "the price at which the property would change hands between a willing buyer and a



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willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." When the asset being appraised is "a company", the property the buyer and seller are trading consists of the claims of all the investors of the company. This includes outstanding equity shares, preference shares, debentures and loans.

But note that, 'Fair market value' (FMV) is not designed with any particular individual in mind, nor the 'real' transaction for that matter. FMV is a hypothetical value for the 'model' transaction. The governing conditions in this ideal concept are *full knowledge* and *freedom to act*. But in reality, these ideal conditions are rarely present. Emotional and subjective elements often override rational considerations, and *full knowledge is something rarely attained by the arm's-length potential buyer* who previously has not been involved in the business.

The family-owned and/or closely held business is the more difficult tiger to tame. Publicly traded companies seek to show bottom-line profit to satisfy "public owners," while closely held enterprises seek only to satisfy private interests, *before profit falls to the bottom line*. Thus the "documents" by which the *psychology of ownerships* are measured send out different messages in each. Since ownership and management of closely held enterprises are often one and the same, financial records are massaged for tax avoidance. In addition, private ownerships can, and sometimes do, play the game of chance by stretching the "gray" areas in law beyond the limits. All of this leads to difficult interpretations of what *really* goes on in these companies. Thus, the necessary conclusion is that few buy/sell transactions involving closely held small businesses are done at so-called fair market values. (Summarised from

comments of T. S. Tony Leung, C.P.A.)

In pure sense, business valuation refers to estimation of business value. Although considerable time and effort is involved in preparing formal business valuations, unfortunately the results may or may not reflect the "real world" value of a specific company if it were formally offered for sale.

To assume there is only one "correct" estimate of value is a mistake, and "right" is a matter of opinion.

Business Valuation and MSMEs

In general, there cannot be any strict definition for a business to regard as a small or medium or large or giant. It is matter of debate to fix a basis for treatment of business as a small or large. The definition of MSME varies from country to country and from mind to mind. In our case, for business valuation, the important thing is to know whether the fundamentals of valuation changes when applied for business unit which are relatively small in size. Answer is "No". The fundamentals of valuation like Premises of value, Standards of value, valuation approaches techniques remains unchanged irrespective of size and identity. But yes, the difficulties to be faced and the considerations require by an appraiser changes due to some inherent characteristics of relatively small businesses. It includes availability and reliability of financial data and other information, quantifying the size risk and business specific risk, size of discount for lack of marketability and lack of control, if any, influence of client, etc. The businesses here considered are (1) which are relatively small and medium in size, in general and (2) functioning of which are controlled by the owners, themselves (Referred as "MSME" businesses). Of course, the need of valuation differs in case of MSMEs when compared to large of public Companies.

Characteristics of MSME

Some of the major characteristics observed are as follows:

A. Ownership

MSME businesses usually are owned by individuals, family members, friends or relatives, and are likely to be highly dependent on the owner/manager. Small businesses often have a high degree of reliance on one or more key owner/managers. In extreme cases, the business may rely on a single person for sales, technical expertise, and/or personal contacts and may not be able to survive without that person.

B. Financial Records

Small businesses tend to have lower-quality financial statements that are less likely to have been prepared by a professional accountant or qualified auditor. Their statements tend to be tax oriented rather than oriented to stockholder disclosure as in larger companies. Whereas large companies usually keep separate records for the preparation of tax returns and generally accepted accounting principles for financial statements.

C. Access to Capital

Small businesses have less access to capital than larger companies and often must rely on capital infusions from the owner family, friends and/or owner employees. Access to debt capital is also more limited because of the higher risk of smaller businesses. The cost of borrowing is higher, and the owner usually must personally guarantee debt. Many small businesses operate with little or no debt, reflecting their limited access to debt capital and a frequent reluctance of owners to take on the risk of substantial debt. Many small business owners minimise debt to reduce risk during economic

downturns and to increase the probability of keeping the business in the family.

D. Other Operational Characteristics

Small businesses can lack diversity in products, markets, and geographic location. They are very dependent on a few key customers and also on a key supplier. Small businesses may have difficulty competing for employees. In small companies, the portfolio of operations or products frequently reflects the interests and contacts of a particular owner. Sometimes these operations or products have few synergies, and the portfolio may have little appeal to potential buyers.

The characteristics of small businesses tend normally to result in overall higher risk than is found in larger businesses. These characteristics tend to be extreme in the smallest of small businesses. So in general, it can be said that "Risk tends to increase as size decreases".

An Overview of the Task of Estimating Values in Small Companies

Business value depends on the *effective* employment of capital, manpower, machine, and material to produce profits; therefore, "business" value depends on the skills that vary widely among individuals. In cases of closely held businesses, the concept for values must be carried out to include tangible assets, intangible assets, and *perception*. So, the conclusion is that *perceptions of value* in MSME are *individually swayed* and factually weighted by *productivity of assets employed*. In other words, each component of business value, including any reference to facts, might change through the personal perceptions of individual calling for valuation. This requires to examine the following: (a) general market conditions; (b) specific

business conditions; and (c) individual perceptions.

Professional service organisations, such as physicians, lawyers, accountants, consultants, and so on, are among the more difficult types of businesses to establish an intangible value. Practitioner characteristics, personalities, and *reputation* play heavily into the generation of cash streams. Take the specific practitioner out of the business, and the cash stream will quite often suffer considerably. Therefore, a fundamental question is: How much business value is directly attributable to a "person," and how much of that value will remain if he or she leaves? To the unwary, this can present the classic dilemma of "getting lost in the numbers." Subsequently, the purchase of a "sole practitioner" business can be much more risky than the purchase of a business with multiple practitioners who remain after the purchase. These "people" or owner-restrictive elements can be present in all types of small businesses and, with safety in mind, cannot be overlooked. A "business continuation" risk tends to decrease with increasing size of staff and, when the present owner is more separated from practice work, by the demands of administrative duty.

Unlike a publicly traded company that has a published market-driven share price, the value of a privately owned company must be calculated using both qualitative and quantitative analysis. The biggest difference between valuing business of the public Companies and nonpublic business is lack of information. The application of recognised valuation methodology and rigorous analysis of the closely held entity provides the foundation for valuation of business. It may be necessary to make certain adjustments to improve comparability of the subject company to industry norms, publicly traded companies, or companies involved in market transactions

considered in the valuation process. The appraisal process is subjective, time consuming and requires highly specialised professional skills.

Testing the Financials

A company's historical financial statements generally provide the most reliable information for estimating future performance and risk assessment. Audited financial statements are preferred. However, since the financial statements of many MSME businesses are neither audited nor reviewed, the analyst may have to rely on compiled financial statements, which provide no level of assurance and may not contain footnote disclosure. In other cases, the analyst may have to rely on income tax returns or internally generated financial statements, the quality of which may be suspect for purposes of proper financial statement analysis. If the historical information is unreliable, the special care should be taken to disclose the facts and degree of responsibility assumed based on financial statements.

Some common practices which condense the straight reliability of financials of MSMEs and require restructuring of financials are,

- charging the salaries and commission in name of owner or family member
- charging interest on loans from family, relatives and friends at the rate significantly different from prevailing market rate,
- missing to account the interest, commissions, remunerations etc foregone by owner or directors
- withdrawing unreasonable rent for own premises for business utilisation,
- treatment of personal expenses as a business expenses,
- unrecorded removal of goods for tax saving purposes,
- withdrawal of goods for own usage without proper accounting,

- deficiency in charging the depreciation on business assets,
- Missing treatment of deferred tax
- Inconsistency in accounting practices

The analyst is required to consider all these and other relevant factors to design a normalised financials. For valuation purpose, he also requires to consider the impact of historical transactions affecting the value of the business. These are like, impact of deferred tax, auditors' qualifications, nature and frequency of abnormal or exceptional items and non-recurring items, treatment of contingent liabilities etc.

Ratio analysis is the most useful tool because it helps an analyst to compare the strengths, weaknesses and performance of businesses and to also determine whether it is improving or deteriorating in profitability or financial strength. Ratios express mathematically the relationship between performance figures and/or assets/liabilities in a form that can be easily understood and interpreted.

Financial analysis helps to decide the key factors to consider before arriving at the conclusion on valuation of business.

The conclusions derived from analysis can further be helpful for assessing the risk involved in the business and also to develop the forecast assumptions while calculating the intrinsic value of the business. The comparable financial will be used to determine the extrinsic (market based value) of the business.

Valuation Need for MSME Sector

Every need is specific purpose oriented and the same logic is equally applicable to valuation need. Some experts are of the views that the valuation technique can be industry specific or sector based but as the intention is to find a Value of the business, the purpose is not material.

The value of business must remain neutral irrespective of the change in the purpose of valuation. In their views, one should not prepare an index of values presenting the different value against each of different purpose. While others are of the opinion that the valuation technique should be linked with the purpose that give rise to the need for valuation. The argument behind is that business has of course different value in eye of different persons based on their specific purpose if not then why one would invest their time and energy to get or to transact for the similar amount of consideration they are departing now. The "Business value" is not simply a value of business but a specific value of business in the eye of the involved participants. And so, "the investment value" of a business may differ if considered for two different buyers even at the same point of time. This is due to difference in views and synergies expected by different buyers. When subjectivity comes, questions and arguments never end.

Valuation Process

After going through the profile of client and understanding the purpose of engagement, as well as intended use of valuation, the valuation process begins with deciding the standard of value based on the accepted premise. The standard of value may be loosely said as a definition of value. It will mainly be based on the intended use of value. If the owner wants to launch a new project then he may like to know "the fair value" of existing business and the "investment value" of business combined with proposed projects. Just on the other side, a financier while financing the same project, may like to know the "fair value" as well as the "liquidation value" of the business.

If the valuation report could not be used for the purpose it is intended to be used then where is the NEED of valuation? The purpose, not always

demands the fair value but a value which can help the best to arrive at a better decision.

In order to achieve the intended benefits from valuation, analyst should consider the purpose forcing towards the need of valuation. Based on relevant standards, business appraise can derive a specific value or may come out with different value depending upon the techniques applied. The assumptions should be explicit to make the value better useful.

The basics of standards are reproduced as follow:

Fair value: that may be intrinsic value (adjusted asset based value or earning capacity based value) or the extrinsic value (market based value- relative value)

Investment value: based on the individual perceptions of the investor. It includes the value of synergy with investors' existing status. (it could be a liquidation value of concerned asset plus marginal benefits derived from the transaction)

Liquidation value: Realisable value of assets

Selection of Valuation Techniques

Once the standard of value is decided, the valuation analyst needs to finalise the appropriate techniques to consider while moving towards deriving the value of business. As we know, there are three approaches to valuation used widely to arrive at the conclusive value. These approaches are having numerous sub-approaches or techniques. Based on the requirement of specific purpose, the value analyst is required to apply his professional wisdom and experience to finalise the technique/s to consider. He should also bear in mind that the value arrived on applying each these selected techniques is very likely to differ and the range between the least value and highest value may be significant. If the fundamentals are well

considered and assumptions are well decided then this difference may not be so. Here again, after deriving values using different applied techniques, the Analyst is on the subjective mode and he can choose one or more techniques with different weightage to arrive at the conclusive value of business. Base on his best of professional judgment, he may also end up with range of value based on requirement and circumstances.

While selecting the appropriate technique to apply to arrive at the conclusive value of business enterprise subject to valuation, the four factors imbedded with the need of the valuation are:-

- (1) safety of capital (asset coverage),
- (2) expected return on capital (earnings),
- (3) time span and
- (4) purpose for which the capital is used.

Purpose for which the capital is used is assumed to be legal and pre-intended purpose only. Also, the valuation techniques are used to derive the value of business at a specific point of time and not concerned with the area of capital where it is used and not concerned whether it is used for intended purpose or not. So, this factor is not likely to affect the selection of valuation technique for specific purpose.

The reason for considering the above four factors is vary simple. Business is a game of finance and all stakeholders are investors expecting return on their investments. A business is separate entity whether it may be a corporate enterprise or partnership concern or even a proprietary business. The features differ with change of formation or change of legal status but the fact will remain that *the owner himself, is not a business*. He also invests his money, time and energy into business with expectation of getting return on his investment, monetary

or else. The other stakeholders will also, normally, invest their money with expectation of getting return. Owner needs profit against investment of his time and energy in addition to finance, financier needs interest, investor needs return in terms of interest or dividend and capital appreciation, supplier supplies materials and services with his profits, employee needs salary, and salesman needs commission, even government need taxes against permitting to business on land of the country. Value of money being function of time, all investors (including the owner of the business) would like to link their timely returns with the time span to know the actual return on their investment. Being all, investor they are concerned about the safety of their capital depending on the expected return, assumed risk and other terms of investments.

We must also check the assumptions and impact of these factors on selection of specific technique amongst numerous techniques of business valuation. While concluding a value for specific interest, a value analyst should also consider the premiums and discounts necessary to incorporate in business estimation. Now let us move towards selecting the appropriate valuation technique/s based on purpose of valuation.

Selection of Appropriate Technique for Specific Purpose

(Considering MSME units only)

In order to present the needs for MSME business valuation, the purposes giving birth to the need of valuation are compiled here and then divided those purposes in to four major categories.

- (1) Relative strategy
- (2) Investment
- (3) Value added management or Planning

- (4) Other purposes

The characteristics of each purpose will decide the matching standard of valuation and also the technique/s better suiting the other requirements.

(1) Relative strategy: Where more than one party with different objective/s is likely to be affected directly from the valuation, that is to say, the strategy or purpose/s of involved parties are different but dependable on one and the same transaction, the purpose will fall under this category. The following purposes are considered under this category:

(a) Addition of Partner/s:

When the existing owner/partners decides to add the partner, they would like to encash a portion of goodwill and will try to show a better existing value of their business. In the worst case, (like existing owner/working partner is on the verge of dyeing or retiring or incapable to growth the business sufficiently or the business is in the face of shut down otherwise) the existing owner/partners would like to know at least the liquidation value of the business. Being the continued partner also, they will like to use the investment value for negotiation purpose. So, their major concern is to know the "at least value" and "fair value" of the business.

Just on the other side, the new coming partner is going to invest his time or money or both and would like to see the benefits upon choosing this option of joining as a new partner. As the remaining partners are continued with the "fair value", he would be interested to know the fair value of the business and at the most, based on his own perceptions about risk

taking, the investment value of the business.

The analyst is now on the way to select the techniques to be applied for determining the value of business. While sharing the business or dilute the sharing, the existing owner or partner/s would like to get the appropriate consideration against the existing earning capacity and assets involved in the business. "Excess earning method" can help them to derive existing earning capacity of the business. "Adjust net asset method" will help to know the existing asset strength or the invested capital of the owners. The "Discounted cash flow" based on future earnings will help to know the futuristic value of business in which the incoming partner is proposed to claim the share. His concern is return and safety.

The incoming partner would also like to know the existing earning capacity of business and the existing assets involved in business so as to decide the goodwill of the firm with which he is likely to associate. He would prefer "Discounted cash flow" to determine his expected returns. He is interested in return, safety of his investments as well as time value imbedded with return.

The comparable company or business data or similar transactions happened in near past for such kind of business

can be used as guiding data while arriving at conclusion. For tiny and small businesses, manytimes the conclusive value is compared with traditionally adopted figure derived based on "Rule of Thumb".

(b) Business Sell/Purchase Agreement:

While the seller is interested to get the maximum value towards his business the Buyer would like to pay the minimum, expecting the best from the businesses. The seller would like to get the fair value and in case of bad need, at least the liquidation value for his business. The Buyer, here will try to pay maximum what it can derive from the business. So, he would be interested to get the investment value of the business. For negotiation point of view, he would like to know the fair value. If for example, an owner of colour shop situated on prime location at the heart of the city in main market wants to sell his shop, he would like to get the market price for its real estate-property (shop) and current assets including receivables and at least cost of the inventory out of which he can pay off his liabilities. He will intend to get this price irrespective of its usage by the proposed buyer. The buyer, if wants to continue to run the colour shop, may accept the price if he is expecting to get at least the expected rate

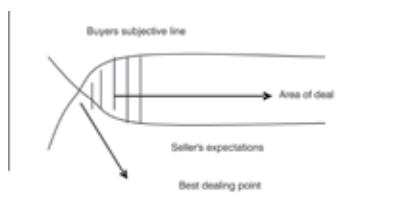
of return on this investment. Now, consider a situation where the buyer wants to start a new business and to open a gift article shop there. He is concerned with location only and not with the stock and related current assets. If the seller insists for "bundle" sale (shop and current assets plus inventory together) only then the buyer may accept the price if his investment value permits i.e. the buyer will get enough return from gift article business to cover the possible loss on purchase of colour business assets. The seller is interested in getting the fair value of its "colour business" while buyer is interested in knowing the investment value of its "gift article business". He may like to know the fair value of colour business for negotiation.

In order to get the better consideration for departing the own business, the seller would like to en cash the current earning capacity and therefore prefers a lump sum multiple of existing earnings or revenue. He would definitely compare the consideration figure so arrived with realisation value of his existing assets based on current market values. Based on the nature of business, he may claim a combination of both, that is to say he may like to negotiate for excess earning. His concern is best return of his investments.



The buyer is looking futuristic. He is major interested on future returns and synergies based on the existing status of the business. He would like to know the intrinsic value of business generally preferring discounted cash flow method. Obviously, he would also compare the consideration with the replacement value of the assets he is going to own. He interests to know the return and coverage of his investments.

The comparable company or business data or similar transactions happened in near past for such kind of business can be used as guiding data while arriving at conclusion. For tiny and small businesses, many times the conclusive value is compared with traditionally adopted figure derived based on "Rule of Thumb".



While estimated value of business provides basis for negotiation, the negotiation skills of involved parties and the structure of transaction like financing structure, transition of control etc also affect the transaction price. For example, setting the deferred payment terms is a very good option available in the interest of both the parties is: By providing for deferred payment towards consideration of business purchase, the seller can get better price of his business, at the same time the buyer can get the business at a low

initial out flow from his pocket and then he can pay from the business itself. This term of seller's finance is of course out of the preview of valuation but a very good tool of settling a deal.

(c) IPO:

The business enterprise while going for Initial Public Offerings likes to dilute the sharing based at a price which gives something in addition to existing value and being continued party to the business growth, they would like to consider the average risk and growth potentials from the view point of proposed investors and also the factors affecting while going public and therefore they also call for the investment value. On the other side, the investor would like to invest as per his own risk perceptions, at a least prices or a price very near to existing fair value so as to decide the under value offerings or over value offering of IPO. So, both of them would be interested to know the fair value and of business.

The business, once listed on any stock exchange, analysed by the market value of its shares and market capitalisation. So, while going public it is essential to know the intrinsic value as well as the market value of the business. When based on the existing worth, the intrinsic value can be calculated by applying the earnings capitalisation method. The value of assets will reveal the existing tangible strength of the business. CCI guidelines also prescribes a method of calculating "Profit Earning capacity value" (PECV) and "Net Assets value" (NAV) of the business while determin-

ing equity issue price. CCI guidelines prescribe to derive Net Asset value based on the latest audited balance sheet, *i.e.* book value, and not the current market value. Discounted cash flow will help to derive the business value based on future plans and project. The market value can be decided based on comparable companies' adjusted value. CCI guidelines prescribe to use the market value as a benchmark or guiding value and not to be used directly to determine the offering price at IPO. His interest is to get the value of his dilution and ensuring the safety of investors funds *i.e.* return on investment

The investor in IPO would also like to compare the IPO price with the intrinsic value and the possible market value. Discounted cash flow and comparable companies' adjusted value can serve his purpose.

(d) Mergers, Acquisitions, Takeovers:

Generally, these are the strategy deals and the basic characteristics remain same as applicable to normal business sale-purchase transactions except that the existing owner may remain to carry the business but with some different terms and conditions.

The transferee and the transferor both are interested for getting the best worth of their business. The existing owner would like to know the fair value of his business based on the existing earnings and wants to get at least the liquidation value of the business. On merger, acquisition or takeover, the existing owner is departing

his future business which he may continue else, and can know his opportunity cost by using the discounted cash flow based on his own perceptions. While the acquirer will calculate his synergies and present value of future earnings to decide the return on investment, he considers the replacement value of assets he is going to acquire to know the placing of his investment on acquisition. In specific case, acquirer may like to know the option value of specific investment on acquisition. Although these transactions of merger, takeovers or acquisitions are becoming importance means of diversification, there is no established technique which incorporates uncertainties involved and gives a range of values of a target firm which can form the basis for offering a price. Both the parties are concerned with return on their respective investments and the acquirer, also with asset coverage of its investments.

(2) Investments:

Where the intention of the party calling the valuation is to invest in the business or finance specific project or the business growth, the purpose will fall under this category. The investor's decision is for own self only and not intended to be used by the other person.

(a) Small business purchase:

The value of business and the value of ownership are two different terms. The value of ownership is directly associated with power of control and synergies. One who wants to acquire a power of controlling or expecting better synergies with his or her proposed set ups

may willing to pay something more than the measured value of business. When a proposed investor, based on his personal perceptions, sees better benefits on purchase of certain business, he would like to offer something in addition to the fair price of the business. It is different from the routine sell-purchase transactions in a sense that the investor is approaching to satisfy his own synergy/ies. A hypothetical buyer would have to pay a control premium, even if this buyer plans to run the business in the same way as existing management. The buyer pays a premium, because having the "right" to control how the business assets are deployed has value. So, he would be interested to get the investment value of the business. For negotiation point of view, he would like to know the fair value.

As written above, the buyer term itself is a futuristic term and the buyer is interested to know the value of any asset he is going to buy. A rational buyer will not pay more price than the worth of asset to him as this worth may be measurable or may not be. Of course, many times he needs the history of assets (or business) to assess the future worth. And so his concern is what comes now physically and what he will get in future against something payable now. He is concern with the return on investments as well as asset coverage of his investments.

The comparable company or business data or similar transactions happened in near past for such kind of business

can be used as guiding data while arriving at conclusion. Many times the conclusive value is compared with traditionally adopted figure derived based on "Rule of Thumb".

(b) Private equity funding/venture capital finance:

The investors in private equity generally provide capital as a seed money or first phase start up money. Some times, depending upon the nature and situations of the business and agreed terms they may finance second phase development. It mainly depends on achievement of decided mile stones. Here, generally the investors are pure investors and financing the business to get the better returns. The expected return ranges from 20 per cent to 70 per cent depending upon the stage of investment. They are more concern about the industry under which a business pertains and the core competence of the business. They prefer to know the fair value of the business. Normally they do not have synergies to link with specific investments but they may invest in particular sector based on own portfolio diversification policies. They want to value the business based on own perception about the risk taking and growth potentiality of the business.

The venture capitalist or investors in private equity are interested in better return based on their perceptions of risks. They may prefer "First Chicago Method" (allocating different probabilities to various possible business scenarios and to arrive at a common value) to determine

the business value. In some cases where further investment is dependable on some happenings, option pricing model can be helpful to value such "option to expand". They would like to know the coverage of their investments in terms of physical asset also. Obviously, they are more interested in return of investments knowingly the asset coverage. Normally, the exit mode in Private equity investment is IPO and therefore they tend to consider the market situations likely to exist at the time of proposed IPO. Of course, it is very difficult to judge the market. They consider DCF to calculate the offer price on the basis of the expected rate of return but also uses market multiples as a guiding factor.

The comparable company or business data or similar transactions happened in near past for such kind of business can be used as guiding data while arriving at conclusion.

(c) Business financing for new projects/expansion:

The Bankers, financial institutions and other business financiers are interested to get a reasonable return on their investments and to save their capital as well. They are concern with debt payment capacity of the business and therefore interested to know the cash flow or earning capacity of existing business as well as the viability of new projects or expansion. In order to ensure the safe guard of their funds they also would like to know the liquidation value.

The business financier is interested in knowing the debt payment capacity of the business and the securities

for safeguarding their investments.

(3) Value added management/planning:

The owner of the business would also, in many situations, like to know the value of his own business. In MSME, even though the owner is controlling each and every functions of owned business, he needs sometimes to convince himself. The valuation may be helpful for internal betterment, business expansion, value addition, strategy forming and most importantly to make appropriate decisions on time.

(a) Raising funds for expansion or new projects:

Before an owner goes to raise a capital for expansion or new projects, he remains more concerned about his payment capacity and expected returns. The expansion is fruitful if enhances the value of business. The expansion should be viable in sense that the expected return must be more than the existing rate of return and at least the additional cost of finance. The return may be tangible or intangible.

Also, the financier would like to analyse the existing business and viability of expansion in terms of debt payment capacity. Owner is required to consider this fact in his mind also. The financier may not be concern with the present value of cash flow but of course with the actual value of cash flow so as to satisfy himself about the repayment capacity of business. The liquidation value will further help him to assure the fund safety.

For accessing the financial viability while going for

expansion or new projects, the businessman would like to know the impact of borrowings on expansion or project value. He also will consider his existing business value based on future earnings. The asset value will help him in deriving the tangible value of business against which he can easily go for fund raising. His concern is additional return on investment and investment in secured assets.

(b) Restructuring the business/divestiture:

An awoken owner would like to get the benefit of leverage. The outside finance can increase the return (if the business return is more than the post tax debt cost) but simultaneously it increases the probabilities of bankruptcy. If planned properly, the debt cost being tax deductible item, it can reduce the cost of capital to a good extent. Proper capital structure can help to increase the value of the equity holdings or value of ownership. The owner would like to know the fair value of his business based upon current structure so as to increase the ownership value just by addition or repayment of outsider finance or modification of existing debt terms.

The increase in debt will reduce the profit available to the owners but at the same time it can increase the return on capital subject that the existing return is more than the proposed post-tax debt cost. The approach being futuristic the forward earning capitalisation or discounted cash flow will serve the purpose. He would like to take decision knowingly the impact of capital structure

on rate of return and absolute return.

(c) Goodwill impairment:

Every business being going concern will have goodwill (positive or may be negative) whether shown as a part of balance sheet or not. While calculating the value of business, the value of goodwill will be impliedly included. The sources of generation of goodwill are the relations of business with employee, creditors, customers, location of business etc. Based on the conservative approach principle, goodwill being intangible asset, if not recognised on the balance sheet then there is no harm but if it carries a certain amount to the balance sheet then it must be measured for impairment. If the fair value of business is equal or more than the carrying amount of business then impliedly there is no impairment in goodwill. But in reverse situation, the fair market value of goodwill is required to be found out by deriving a difference between the fair market value and carrying value of business assets on stand alone basis and such an implied market value of goodwill is to be compared with the carrying amount of goodwill to quantify the impairment. The owner can take reasonable steps to stop or lesser the impairment and to protect his ownership value if he undertakes business valuation regularly.

Goodwill is concerned with the excess earnings. In order to know the fair value for goodwill impairment purpose, we need the value of business as a whole and it is less than the total carrying value of the assets

in balance sheet, we need to know the fair market value of assets on stand alone basis.

(d) Allocation of Purchase price:

When a business is purchased and the price is paid on a lump sum basis or a fixed price is paid against the fair value of business and not being a pooling of interest method, the owner needs to show the fair value of acquired assets into his balance sheet. He requires to find the fair value of assets and liabilities purchased and also to find the amount paid extra as a goodwill. This requires the owner to find the fair value of assets and allocate the purchase price amongst it.

(e) Retirement of partner or dissolution of partnership or succession planning:

Many times the partners would like to plan the exit mode which can strengthen the partnership relations. They may pre-decide the calculation terms of goodwill on retirement and even can invest regularly, a certain portion of earnings for smooth payment, on retirement or dissolution, without badly affecting business capital. They even can pre-plan the business succession terms if regularly known about the value of business.

The concern is return on investments and the assets coverage. The comparable company or business data can be used as guiding data while determining the final value.

(f) Financial reporting:

Many Accounting Standards also require showing the assets and liabilities at their fair value. The applicability of it depends on the legal status of the busi-

ness enterprise and therefore MSME are generally, out of the preview of Accounting Standards. But of course, no one is restricted to present the better. MSME can prefer to show the fair value of its business to earn the better credibility and transparency in financial reporting. It may be helpful to them in long run in terms of mapping the actual growth.

The concern is disclosing the earning capacity and coverage of capital in various business assets.

(g) Frequent progress measure:

The owner may choose to know the value of the business on regular time interval. This can help him to measure the progress as well as to frame the appropriate business strategy in time and taking the decisions better knowingly the impact on ownership value. Like, he can timely decide diversion or sell of specific loss making business stream, can plan expansion taking advantage of intrinsic strength, can take the best advantage of capital structuring, can realise the better value through timely selling of business, etc.

The owner is interested to measure the performance of the business in terms of change in business value as well as to know the addition in asset value due to market forces. The concern is to evaluate both, the return on investments as well as safety of investments.

(4) Other Purposes:

The purposes which are not covered under above three categories will fall under this category. It includes the purposes,

the valuation for which generally is not undertaken for any intended business transaction.

(a) Ownership issues:

Sometimes, the partnership terms include increasing the share of working member based on the performance and business targets achieved by him. In some other case, a specific owner may require contributing on none fulfilling the agreed term. Like, the investor partner may not fulfill his obligation to bring the agreed finance and therefore, he has to dilute his sharing in favour of new financier or any one else. There may be a situation where a creditor or a financier is required to offer the ownership in the business.

All these case requires a proper valuation of the business and a decision taken on the basis of figures reflected on the balance sheet only may not be wise and it may effect adversely to one of the party.

Here, the selection of technique/s for determining the value of business depends on the circumstances of each case but by and large both the parties would like to know the existing earning capacity, future return prospects and value of assets involved.

Here, the selection of technique/s for determining the value of business depends on the circumstances of each case but by and large both the parties would like to know the existing earning capacity, future return prospects and value of assets involved.

(b) Litigation issues involving lost profits or economic damages:

Insurance claim, loss of

business due to impairment in reputation by whatsoever reason, impact of merger or de merger, breach of contract etc will also call for valuation. Specific care is required while valuing a business or a loss of business under such circumstances. Generally, the prescribed techniques are used to appraise the loss or business.

The selection of valuation technique will be based on specific requirement of each particular case.

(c) Family issues:

This includes the disputes and planning matters involved due to ownership in a business. It may be a sharing issue on separation of family or HUF partition. The ancestral businesses and HUF businesses are co-owned by the male members of the family and therefore the need arises to decide the sharing at the time of separation. It will be wise to allocate the business or businesses or specific sharing in a business on the basis of fair value of each business. The wealth planning and WILL planning will also be made wisely, if based on fair value of ownership.

The purpose is to identify the rate of return and the asset coverage in family business or businesses. The comparable company or business data or similar transactions happened in near past for such kind of business can be used as guiding data while arriving at conclusion.

The above four categories consider all major purposes which may need the value of business for taking a timely and wise decision.

The valuation analyst, even after finalising the standard/s of value based on characteristics of the purpose and selecting the technique/s of valuation, may rest with some different values derived by application of various selected technique/s. he may choose to conclude with a value derived by applying specific technique or he may weigh particular techniques as per his wise and conclude the valuation. It rests with the value analyst to determine the final value or a range of values of a business based on his experience and applying best of his professional skills considering the nature of business, prevailing situations and existing requirements.

Conclusion

While valuing a business is not an exact science, it is not a total mystery. A realistic business valuation requires more than merely looking at past years' financial statement. Banking a business's value solely on current operating results is risky business to say the least. A valuation requires a thorough analysis of several years of the business operation and an opinion about the future outlook of the industry, the economy and how the subject business will compete.

The quality of any value analysis or value appraising is a function of the accuracy of the data and assumptions that form the basis for any conclusion reached. Estimates of a business' value by various experts can vary significantly, if the fundamental assumptions are applied differently. If available, it is always better to use actual data or historical results than to rely on assumptions. Unfortunately, it is not always possible, particularly in case of MSMEs. It is possible, however, to make sure that any assumptions made are based on the financial, market, economic and competitive characteristics in place during the appropriate timeframe for the appraisal. ■

Support for the Financial Close

ideally in the fewest number of days possible in order to release results on a timely basis.

Despite the importance of the financial close as a key corporate governance process, the resources, or “toolbox,” that finance typically uses to execute this process is less than strategic, and focused on filling technology gaps, with the norm being:

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“To date the obsession with Fast Close velocity has been narrowly focused on the consolidation system itself — usually located in group finance at the centre or corporate headquarters. Naturally, it is highly desirable that modern consolidation software is able to compute the group results quickly. Over the years successive improvements in hardware capability together with database and software techniques help in faster collation and representation of data.”

with the knowledge of these processes in the heads of just a few employees;

- Limited reporting capabilities that have propagated spreadsheet-based reports that house critical financial results which are the company's "corporate records." Spreadsheets are further used to support multiple manipulations of the same data over and over to meet various reporting requirements, with weak controls as to accuracy, approvals, and tracking of recipients.

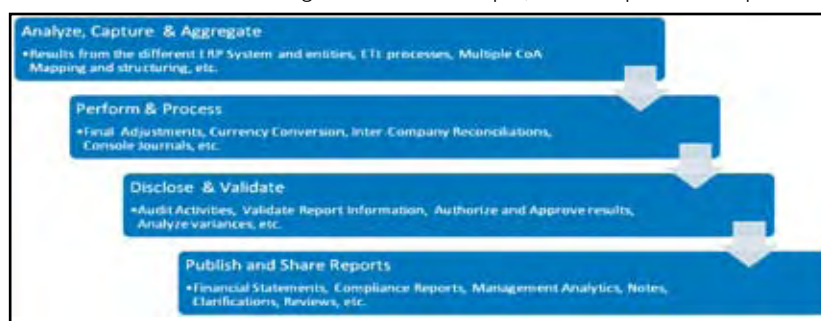
When taking a deeper look at the risks and opportunities within the close process, dealing with reporting and analysis issues is where organisations have the best opportunity to achieve both greater efficiency and reliability.

Optimising the Financial Close Process

In order to optimise the financial close process, organisations should match the key activities that drive the actual close process with the technologies that provide process support as well as information integration. With increased scrutiny of the financial close as a key internal control process, providing assurance over the internal controls that govern the close process must be

considered as well.

The water-fall process presented below outlines the key phases of the financial close process at a high level. During each phase, and as a prerequisite to moving to the next phase, analytic activities are performed to validate the results. These manual, spreadsheet-based processes are 'internal control' reports that provide the analysis of information required for assurance during the financial close. This process of validating information with manually compiled analytics is time consuming, resource intensive, error prone and presents critical control implications for financial reporting, and ultimately business decisions. Most financial consolidation systems integrate information at a high level, automate period-end activities, such as eliminations and produce summarised income statements and balance sheets with limited analysis capabilities. Detailed analysis and reporting (both variance and management) take place outside the consolidation system. Analytic reporting – a key capability on which finance professionals spend most of their time – is missing.



Modernising the Financial Reporting Environment

When a strategic goal is to modernise the financial reporting environment, the best practice is to invest in a solution that will meet financial consolidation analytic requirements, statutory financial reporting, and provide the information platform for performance management and decision support.

Leading finance users, consistently highlight the following areas where automating the financial close drives value and a corresponding return on investment (ROI).

- Process improvements – fast close, real-time reporting, shorter planning and re-forecasting cycles.
- Efficiency – less manual effort required for reporting and analysis.
- Reliance – more accurate and timely information available to more users.
- Audit efficiency – reduced resource requirements and cost of annual and quarterly audits.
- Finance ownership – a solution that is owned by finance and easy to use, with less reliance on IT.

Although there is no agreed definition of the 'Fast Close', it is commonly deemed as the number of days taken by companies to publish their final audited accounts following the year end. It is, however, a broad brush measure that says little about the efficiency of the underlying process. For example, two companies that produce

their results thirty days after the year end are ranked equally, irrespective of whether one of them uses thirty percent more finance resource than the other to meet the deadline.

Another curiosity is that a benchmark focused exclusively on the year end, says nothing about the regular monthly or quarterly reporting cycles which are the lifeblood of management

reporting, performance measurement and control. Clearly, there is a need for more holistic approach which not only drives faster reporting throughout the year, but also underpins a process of continuous improvement.

To date the obsession with Fast Close velocity has been narrowly focused on the consolidation system itself — usually located in group finance at the centre or corporate headquarters. Naturally, it is highly desirable that modern consolidation software is able to compute the group results quickly. Over the years successive improvements in hardware capability together with database and software techniques help in faster collation and representation of data.

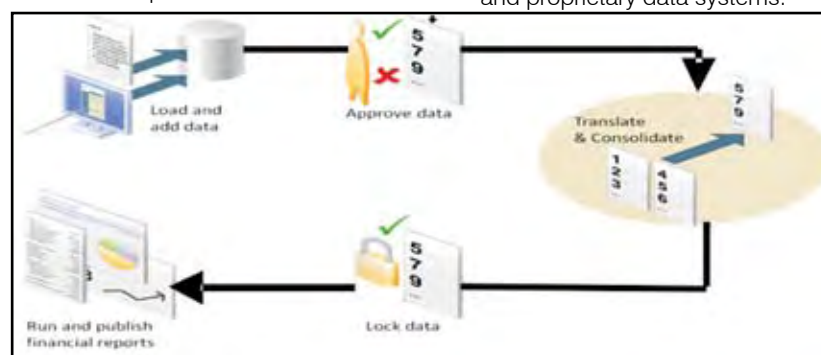
Collecting data from subsidiaries has always been fraught with difficulty. The heterogeneous nature of many global businesses, reflected in their diverse operational systems and charts of account has acted as a significant drag on the Balance Sheet Consolidation (BSC) as group finance grapple with a multitude of different systems interfaces. Even the simplest 'mapping' of data from local ERP to group systems can involve extensive manual procedures, spreadsheets, and batch transfers of files, introducing the potential for serious error along every step of the way. The scope for mistakes is also greatly magnified by the number of entities involved and frequent changes in group reporting packs, brought about by management demands and regulatory change. The difficulty is that once erroneous data enters the reporting supply chain, it tends to travel through the process unchallenged, consuming valuable time and resources to put it right.

However, vast improvements in the management of data quality are beginning to have an impact. A new generation of advanced ETL (Extract, Transform and Load) tools which bind

subsidiaries' systems tightly into the reporting supply chain and require little in the way of formal IT skills are allowing finance functions to exert control over mapping tables, data transfer and changes to charts of accounts so that the process of harvesting data from reporting entities becomes dependable and accurate. This level of automation accompanied by greater control and visibility across the entire organisation greatly accelerates the process whilst simultaneously reducing errors.

The expectation of the User Group is always to have a process as simple as the Approval Process depicted here, however to have best possible controls and efficiencies in the process, one need to ensure the application provides the ease and control both that are managed and control by the Finance team.

The fact that statutory reporting these days has partly metamorphosed into a marketing exercise and a means of delivering a corporate message has added to the pressures.



Inefficacy of Current Consolidation Systems

Meeting the consolidation challenge is difficult because organisations use manual, inadequate, or multiple consolidation systems for their financials. As a result they are unable to structure, control, and automate the process for internal and external reporting, and are unable to gain a single, accurate view of financial

“The first priority for an organisation seeking to change processes in order to maintain compliance is to focus on improving the core systems that directly support financial reporting and accuracy. This means looking at the processes for gathering, consolidating, and reporting financial information results, and finding improvements to deliver the information in a more transparent, accurate, secure, and timely manner.”

results.

• ERP Systems

Enterprise Resource Planning (ERP) and general ledger systems are excellent for storing data and managing the transactions that support the business. Companies typically have an array of ERP and other financial and non-financial application systems, ranging from state-of-the art solutions to legacy and proprietary data systems.

Unfortunately, ERP and general ledger systems are not designed to easily integrate or consolidate data from other sources. To produce appropriate financial statements, a single aggregated view across all transactional systems is required. As well, these systems do not provide all the necessary consolidation functionality. To ensure that the closing process is



To do away with the inefficacy of Current Consolidation

Systems the use of modern software solutions becomes inevitable which would lead to improved financial close and reporting process and achievement of increased quality, accountability, auditability, efficiency and ultimately, regulatory compliance. All above may result in achieving a better financial consolidation management system.

timely and accurate, the system must handle all the complexities of consolidation, such as currency conversion and inter-company eliminations. What's more, it is not flexible enough to manage the accounting of business changes such as mergers and acquisitions—in a timely manner.

• Spreadsheets

Spreadsheet systems are widely used for accounting and financial reporting. But multiple spreadsheets make each person or department an island of report information. This can lead to duplicated effort and opens the door to inconsistent data representation. Spreadsheets drive unacceptable rates of input errors—from data entry, re-keying, link-failures, and cut-copy-and-paste activities. Security of spreadsheets is inherently problematic, since communication of information is via emails or shared drives. As well, auditing of spreadsheet content is virtually nonexistent, since there is no systemic ability to track who received what information or who made which changes to the data.

As with ERP systems, spreadsheets also lack sophisticated consolidation capability. They don't have the necessary level of sophistication

needed to calculate and track important functions such as inter-company adjustments, business changes, and other journal entry changes.

Consolidation: The First Step in Sustaining Compliance

The first priority for an organisation seeking to change processes in order to maintain compliance is to focus on improving the core systems that directly support financial reporting and accuracy. This means looking at the processes for gathering, consolidating, and reporting financial information results, and finding improvements to deliver the information in a more transparent, accurate, secure, and timely manner.

The goal is to have a consolidation and financial reporting system that helps businesses effectively manage their financials; reduce the risk factors for errors, fraud and manipulation; lower the cost of compliance audits; and accelerate the closing and reporting process.

Reliable financial data is the backbone of compliance, and a robust consolidation system provides the foundation for accountability. And this is the jumping off point for delivering greater transparency and management of company performance—the broader, sustainable objectives going forward.

Compliance Calls for a Better Solution

Using manual and inadequate consolidation systems creates inefficiencies, exposes the process to errors, and increases compliance costs. Such systems negatively impact the bottom line, as businesses sacrifice performance initiatives to instead direct time and resources toward fixing errors and reworking the numbers. This can lead to further inspections, audits, and restating of financial statements, which drive expenses even higher. In

the current regulatory environment, companies need a consolidation system that streamlines processes, ensures accuracy, and helps control costs. It is essential that the system deliver in these areas:

- Financial reporting from a single version of the truth. Reporting must also support delivery of many styles and types of reports – for example, producing reports across multiple GAAPs – and providing a line of sight from management reports to financial statements.
- Future-proofing of consolidations. As requirements such as IFRS enter the fold, systems need to be able to handle the different consolidation and reporting complexities driven by common accounting standards and reporting.
- A single, centralised platform for all processing and calculations. It is no longer appropriate to provide supplementary processing with multiple systems, spreadsheets, and people.
- Adaptable to business change. The current pace of business requires a new degree of agility and nimbleness in finance. Companies need to quickly incorporate the latest information for analysis or to identify scenarios for mergers and acquisitions. As organisations add and divest new entities, financial results must reflect these changes in a timely manner.

Conclusion

In conclusion, to do away with the inefficacy of Current Consolidation Systems the use of modern software solutions becomes inevitable which would lead to improved financial close and reporting process and achievement of increased quality, accountability, auditability, efficiency and ultimately, regulatory compliance. All above may result in achieving a better financial consolidation management system. ■

Corporate Social Responsibility



Corporate Social Responsibility (CSR), which can also be termed as corporate citizenship, global citizenship or sustainable responsible business is becoming an important activity globally. Despite the growing importance of CSR, there is little confusion as to what this expression actually means. In a broader sense, it is used as framework for measuring an organisation's performance against social, economic and environmental parameters. In essence CSR is considered as a cornerstone of enduring success of any organisation. In other words, this is to set standards and develop values, such as protection, sustainability, compromise, and also establishing a synergy of ethics and developing a cohesive society. The main focus of CSR is to take care of the underprivileged community by supporting them through socio-economic, educational and health initiatives.

What is CSR?

Corporate Social Responsibility (CSR) is the backbone of any organisation. The concept of corporate social responsibility emerged from the notion of sustainable development, in the first earth summit held at Rio de Janeiro. The concept of CSR is underpinned by the idea that a corporation cannot survive in the society by acting as an isolated entity existing only for its own benefits. Corporate social responsibility,

which is also recognised as a new management tool, is the continuing commitment by business to behave morally and contribute to economic development along with improving the quality of life of the employees and their families as well as of the local community and society at large. There is no universal accepted definition of corporate social responsibility because the concept is always redefined with the changing needs and time. It is always



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up to the company individually to define its values and principles on which it stands to serve the society and protect the environment in which it works. For example, the CSR definition used by Business for Social Responsibility is: *"Operating a business in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of business"*. The European Commission recognises two definitions enfolded into one: *"A concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment. A concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis"*.

CSR is all about making healthy social investment¹, establishing transparency and trust² and fulfilling increased expectations of business³. To be precise, corporate social responsibility is represented by the contribution undertaken by the company to societies through its crux activities, its social investment and philanthropy programmes and its commitment to public policies. At present CSR has become an elementary business practice and has acquired much attention from top management i.e. chief executive, chairman, board of directors and executive management teams of larger international companies. According to them CSR is a vital element in achieving high-quality business practices and effective leadership. Now Companies have come to know that impact of their activities on the economic, social and environmental factors directly affects their relationship with stakeholders—

The European Commission recognises two definitions enfolded into one: "A concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment. A concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis". CSR is all about making healthy social investment, establishing transparency and trust and fulfilling increased expectations of business.

in particular employees, investors, customers, governments and communities. The main dimensions of corporate social responsibility are economic⁴, legal⁵, ethical⁶, voluntarily and philanthropic⁷. Ultimately CSR is behaving like a responsible corporate citizen by contributing to the community. Actually it is not philanthropy but a fundamental business practice.

According to a global survey in 2002 by a leading multinational accounting firm, 94 per cent of companies emphasise that the development of a Corporate Social Responsibility (CSR) strategy can serve actual business benefits. However, in actual practice only 11 per cent have taken significant steps in implementing the CSR strategy in their organisations. From the results of the survey it is observed that the day is not so far when the Companies not concentrating on CSR will be seen as non-trustworthy. It still remains a controversial subject, which is rejected by many companies as an unwanted interruption in the company's affairs.

Some argue that the corporate social responsibility is just a fashionable concept and not a practical approach. However, though the CSR has some limitations, it is a very important modern business strategy.

Before unfolding its importance, let us ponder over a very crucial question: Does the company, or better Say Company's top management have any responsibility or commitment towards the people and the environment where they develop their activities?

It is very fair and reasonable, rather very practical to consider shareholders as the main human, collectively concerned, and work for their interest, mainly by focusing on profit and loss account to maximise profits. But for a long term business plan and to expand its activities to make it a globally respected entity, it is very necessary to perform business activities of serving shareholders and maximising profits by keeping in view the societal benefits and the environment in which its activities are taking place. In short the final goal of the organisations should be to increase the humanity's welfare.

To realise this objective of making profit, it is of vital importance that all the people mentioned above have to cooperate and perform their activities within a geographical space, not considering its size. If some aspects are not attended to and if there is no responsibility and commitment towards these collectives, a sustainable profit will not be attainable. Further, competitive advantages will not be reachable either.

Today most of the business organisation aim at maximising profit, but this notion of maximum profit is just a mathematical concept. It can

¹ Contribution to social capital and physical infrastructure is seen as a necessary part of doing business.

² Business has low rating of faith in public perception. There is growing expectation that companies will be more open and will show high degree of trust. More responsible and be prepared to report openly on their performance in social and environmental arenas.

³ Public have high expectation from the globally reputed companies therefore they are expected to do more than providing jobs and contributing to the economy through taxes and employment.

⁴ Responsibility to earn profit for the owners.

⁵ Responsibility to comply with the law.

⁶ Doing work not only for monetary gains, working for the welfare of the society and doing what is just, fair and reasonable.

⁷ Promoting welfare of the community.

measure the quantity of profit, but in a real and practical world there is constantly a possibility of achieving higher performance. To achieve higher performance, along with profit maximisation, other aspects are required to be considered. Other aspects include training investment, just and reasonable salary, no misconduct concerning taxation, and ethical environment. Probably the axiom of "minimising cost or increasing sales with high prices will improve long term profit" is not always true and not even practical.

In the current business perspective, which is extremely competitive, with a lot of information moving rapidly, companies have to treat every one of their human collectives reliably and with commitment in order to grow and increase profits. In other words, having a corporate social strategy and responsible attitude toward stakeholders is necessary to achieve excellent results. The World Business Council for Sustainable Development (WBCSD) defines corporate social responsibility as "the commitment of the company to contribute to the sustained economic development by working with employees, their families, the local community, and the entire society in order to improve life quality⁸". If the WBCSD definition of CSR is accepted fully and also the strategy just described, a new preposition comes into sight, which is totally different from the former preposition. Mainly because of its enlargement i.e. WBCSD definition of CSR talks about commitment of the company towards families of the employees and the local community as well. The concept of CSR has come into focus only in recent years, basically because of globalisation, environment catastrophes and due to the business misbehavior and corporate frauds. The areas which are highly impacted by corporate social responsibility are

diverse and are increasing every time a company faces a new challenge. Mainly they include labour conditions, bribery, corruption, human rights, supplier relations and development of the community.

There is no universally accepted definition of corporate social responsibility. Therefore, there can be no single approach to CSR. No prescribed set of regulation can suit all the companies. To respond to different arising needs of the business in the most flexible and suitable manner, the WBCSD has invented a 12-point navigator to direct and guide companies through the social confronts and challenges.

The navigator is a conceptual approach, and, therefore, can not be applied to all the companies in a straight jacket. The navigator emphasises that the enthusiasm with which a company takes up its vision on CSR is according to the situation demanded by a particular company and its varies from company to company.

The WBCSD navigator comprises 12 different reference points which can help a company to pursue its CSR journey effectively.

The 12-point navigator of CSR are:

- Determination of 'magnetic north'
- Incorporate the strategic business case
- Attentions to each individual.
- Determining the legacy
- Giving first preference to employees.
- Enhance relations with neighbour, and be familiar with the culture and community.
- Debate and discussion
- To take up partnership smartly.
- Giving importance to reputation.
- Always try to be a good guest.
- Always measure, be responsible and committed towards the work done.
- Deal with care information,

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knowledge and technology

To sustain competitive advantage, companies need to expand community relations and develop sociable environment. For this, companies must bestow quality assurance and must provide instantaneous catastrophe response.

Internationally *Merck Pharmaceutical* (established in 1891) has set an example. If we actually want to know the meaning of corporate social responsibility, we must look at the policies adopted by Merck. Where other companies are exploiting their employees and not contributing to the society, Merck has become successful by practicing a distinguished tactic. It is one of the best companies actively involved in CSR strategy. The company devotes extensive efforts to increase access to medicines through far-reaching program that not only donate Merck medicines, but help deliver them to the people who need them. MERCK became the leading company of CSR practice in 1987, when it produced the drug Mectizan (Ivermectin). This drug treats Onchocerciasis also called as "River Blindness". This disease mainly occurs in Africa and Yemen. Around 122 million were affected by this epidemic. Through the Mectizan Donatio Programme undertaken by Merck, more than 50 billion people

⁸ Holiday et al. 2002 p.no. 103

are treated every year for Lymphatic Filariasis. Merck has undertaken a long term commitment to donate maximum to prevent and treat River Blindness. The company's CSR strategy has made it a globally reputed company. It was also praised by US President Jimmy Carter as 'company with the highest possible quality'.

Every organisation should adopt the practice of CSR as we are living in a world with scarcity of resources and we are obliged to do as much as we can to help our society. Although the CSR strategy is for the welfare of the society, it also provides more benefits to an organisation than just giving back to the society. If any organisation actively participates in corporate social responsibility efforts, it has a great impact on the employees' involvement level and consequently on the profit levels.

At national level, almost all the corporates are engaged in corporate social responsibility (CSR) practice in areas like health, education, construction work, creativity, skill development and also for the empowerment of the underprivileged section of the society. The companies which have made remarkable efforts in CSR practice are Tata Group, Infosys, Bharti Enterprises, Coca Cola India, Pepsico and ITC Welcome group, etc. Indeed, according to social enterprise CSR Asia's Asian Sustainability Ranking (ASR) India was ranked at fourth place in practicing and paying increasing attention to CSR activities. According to the study undertaken by the automotive research company, TNS Automotive, India was ranked as the second in global corporate social responsibility.

Among all, India's largest unlisted software and service company, *Tata Consultancy Services (TCS)* has been listed as the best company practicing in CSR. TCS has also won the 'Asian Corporate Social Responsibility Award'

for its welfare programme for the community to increase the literacy in the country. To eradicate illiteracy TCS has launched the 'Adult literacy programme'. S. Ramadorai, Chief Executive Officer, TCS affirms "Reading is the new civil right. No modern society can function without a literate population and no one can function well in a modern society without being literate". The company aims to adopt innovative methods by using notion of cognition, communication and language to increase the literacy within the coming five year. TCS uses IT and computers as a means to achieve this aim, monitor administration and manage logistics. TCS believes that Adult literacy empowers and is the key for growth and development of the country.

There are many companies which have excelled in CSR activities but when seen in the light of the country's vast needs, the achievement fall short of requirement. The money spent on social responsibility is generally an insignificant portion of their turnover. Although the corporate India is engaged in CSR practice, still to promote the CSR activities further, the central government is working on an agenda to quantify the CSR schemes. According to the then Minister for Corporate Affairs, Mr. Salman Khurshid (now a Union Minister for Water Resources), one of the ways by which companies can be attracted toward CSR activities

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is to highlight the success of the other companies through CSR and also through developing a system of CSR credits, similar to the system of carbon credit system given to the companies for green initiatives.

Advantages and Reasons for Adopting CSR Practice

One of the most important reasons for adopting CSR practice is competitive pressure. With more and more companies adopting social responsibility, the pressure increases on other companies in the industry to do the same. For instance, in oil industry, almost all the companies are now engaged in CSR practice because of the increasing pressure of competition. Along with this, competitive advantage also forces the companies to adopt corporate social responsibility. Many companies consider the better brand image as the best way of achieving upper hand over the rivals. To get good image of the brands, companies focus on CSR programme. Successfully adopting CSR programme has enormous importance in the areas like brand-enhancement, investor satisfaction and company morale. Some people take up CSR practice to motivate employees while some adopt it to get a higher stock price. If the employees are satisfied and happy with the job, there will be lesser problems and also less number of absentees. As a result it will improve the gains in production. Then there is great concern for shareholders returns because of which companies adopt CSR practice. A company with good CSR will always be a confident company as compare to the other. It will be glad to have high disclosures due to which analyst can easily understand it, and ultimately company will get higher rating. Good transparency and high rating by analysts not only support the stock price but also lower the cost of capital for companies.

Strong bonding with stakeholders can help the company face the challenges easily. Investment in CSR leads to intangible benefits, out of which some can be measured while some benefits cannot be quantified. One major aspect of CSR is that, once the company starts focusing and adopting social responsibility it is grueling to cut down this strategy and reverse the direction because stakeholders start expecting more and more from the company. Then it is obvious if the company doesn't fulfill the expectation of the stakeholders, business is going to suffer. Adopting and practicing corporate social responsibility actually makes business sense. There are some distinct advantages to the company by practicing CSR. Firstly, practicing CSR is an ethical thing to do. It also increases the reputation of the company which eventually enhances competitiveness in the marketplace. Although there is no trade value in the good and ethical working condition but there exist another type of value that is appreciation, which influences investors. Investors do not prefer to invest in a business where the working conditions are not good because in reality "irresponsible" behaviour is very risky. Responsible businessman will create goodwill with investors. Although, this may not result in direct profits but it will definitely increase the final value of the company in the long run. CSR can offer fundamental competitive advantages in determining the growth and continuity of any business. CSR practice can also provide the company with economic benefits. For instance,

besides the possibility of availing government grants, the non-financial benefits like customer satisfaction and reliability ultimately lead to economic gains. CSR strategy provides the companies with a strong tool to survive in the international market and also support them in integrating business acquisition throughout the country. Along with increasing reputation in the global market it also encourages the workers to work with more enthusiasm and zeal, and boosts their morale. Community participation is also one of the major benefits of CSR practice through which companies can directly help non-profit organisations.

To avoid excessive regulation, there is a great necessity to focus on CSR. Further, if the social environment will improve, investors will be attracted and it will be beneficial for the business. Ultimately CSR implementation can help organisations in many other ways also. For instance, it helps in attracting the green and ethical environment. CSR practice increases the profitability in the long run and also expands the business as the sustainable and responsible companies always have environmentally friendly premise. Further, it lowers the operating cost with increase in productivity and quality. Society too is benefited by charitable contribution from the corporation and employees volunteer programme. Corporations are expected to take care of the environment in which they are carrying out its activities. Due to CSR practice there are greater chances of material recyclability and better product durability. CSR practice also enhance

greater use of renewable resources and also integration of environmental management tools into business plan such as environmental management standards, eco labeling, life cycle assessment and costing.

To get the full advantage of CSR strategy, it has to be promoted both internally as well as externally. Internally company is required to make sure that the staff is aware about the affairs of the company as the staff is considered to be the best sales force. Secondly, use of Internet, websites, meetings, newsletter and several award schemes should be used to exhibit the activities undertaken by the company. Externally, companies should inform the outsiders e.g. customers, investors, stakeholders, suppliers about the companies affairs and management. At external level companies can generate publicity through media and can also undertake awards schemes. Further, the companies should be committed to achieve significant standards so that it can attract the people by revealing its achievement.

Limitations of Corporate Social Responsibility

There are a few limitations related with the notion of corporate social responsibility. Firstly, the concept of CSR says that business needs to be committed towards stakeholders and perform its activities in a socially responsible way. The term "socially responsible" can never be defined. There is no limit to social responsibility and also no definite point where a business can claim to be socially responsible. Secondly, for whose interest business needs to be responsible? Should it be for the stakeholders, Customers, suppliers or Government? In the practice of CSR, sometimes money is used for the purpose which is not directly related with the business. Furthermore, if the corporation pays more attention to the



practice of CSR, there might be a shift of focus from a main business concern (profit maximisation).

In spite of some limitations in the practice of corporate social responsibility; if we analyse its advantages, we can easily come to the

“There are many companies which have excelled in CSR activities but when seen in the light of the country’s vast needs, the achievement fall short of requirement. The money spent on social responsibility is generally an insignificant portion of their turnover. Although the corporate India is engaged in CSR practice, still to promote the CSR activities further, the central government is working on an agenda to quantify the CSR schemes.”

conclusion that there is a great need to adopt CSR practice. In any case companies are now expected to have sound performance in non-financial matters also like human rights, business ethics, environment safety, employee’s satisfaction or community development.

Conclusion

The business organisations must have an ethical and social responsibility toward community and environment as they are doing the business in society by using the human resources and also by exploiting environmental resources. A business without ethics is a danger for society. Organisations are now realising the bottom line benefit of incorporating sustainability in their business. Corporate Social Responsibility (CSR) is all about managing the business to achieve both commercial and social benefits.

By investing in CSR, companies are moving towards achieving broader economic, social and environmental goals. The corporations, who are successful in implementing CSR policies, are seen to be achieving greater success than the one not practicing in CSR. Therefore, the notion of maximising profit by increasing cost can be carried out for some time, but for the long term growth and survival the corporation must be committed to take full responsibility of the society and environment. On the other hand, CSR is also a continuing challenge to which companies must remain vigilant especially in emerging global marketplace. I would like to conclude with a famous quote by William Ford Jr., Chairman, Ford Motor Co., *“A good company delivers excellent product and services, and a great company does all that and strive to make the world a better place”*. ■

■ ■ ■ Use of Contributions to Promote Education Entitled to Income-Tax Benefits: HC

The Delhi High Court has ruled that the use of contributions by educational institutions to promote the cause of education without any profit motive would enable them to claim the benefit of deduction under the provision of the Income Tax Act. "In our opinion, Section 10 (22) of the IT Act should not be given a restrictive meaning and so long as the income is used for fulfilling educational purpose, the exemption should be available," ruled a high court bench. The court rejected the plea of the Revenue Department which had said that if the donations received by the educational institutes are not voluntary, then the dominant intent is to earn the profit. Merely, non-distribution of such contributions to the members of the institutes or use of such amount for the educational activities would not be sufficient to claim exemption under Section 10 (22) of the Act of 1961, the department had said. The court, however, said: It cannot be lost sight of that if an institution has to expand, additional infrastructure has to be created, quality education has to be imparted, and all these activities require funds. There may be an original corpus of the society but thereafter the corpus for such activity can be created only through voluntary donations either from any philanthropist or through collection of funds in the process of admission. The court said: We are not concerned with the morality of the issue while deciding whether exemption has to be granted under Section 10 (22) of the IT Act as all that is required is the absence of profit motive. (Source: <http://economictimes.indiatimes.com/>)

■ ■ ■ Insurance M&A Norms to be Out in 2-3 Months: IRDA

The Insurance Regulatory and Development Authority (IRDA) will come out with guidelines for mergers and acquisitions (M&A) for the industry over the next two-three months, while the IPO norms will also be out very soon, a senior Irda official said. "We have been examining the pros and cons of the mergers and acquisitions in the industry and we are sure to come out with the final guidelines within the next two to three months," IRDA Member (Actuaries) R Kannan said on the sidelines of an international conference on actuaries. Earlier this fiscal, the Anil Ambani group company Reliance General Insurance had expressed its readiness to take over the Chennai-based Royal Sundaram Alliance Insurance by buying out the entire 74 per cent stake of the domestic promoter Royal Sundaram. But when the group approached for regulatory nod, it was held back as there were no proper regulatory systems in place on the M&A norms in the insurance space.

(Source: <http://www.business-standard.com>)

■ ■ ■ In Direct Tax Code, Religious and Caste Trusts May go Out of Exemption List

All religious and charitable trusts set up for a particular religion or caste that are currently exempt from paying income tax or wealth tax will lose these benefits once the Direct Tax Code (DTC) comes into effect from April next year. This will adversely impact the activities of all such trusts, which run temples, mosques, etc and provide free hospitalisation, education, shelters, etc, to those sections of the society lying outside the pale of the state's munificence. It may also disincentivise donors who will not be able to claim deduction of 50 per cent of the donation from taxable income if the trusts are not non-profit organisations. The problem lies in the definition of a non-profit organisation under the DTC, which has granted exemption to any such entity being a religious trust or institution from the levy of income tax so long as it is not restricted to a particular religion or caste. There are several such trusts that serve the poor and destitute belonging to the Muslim, Jain, Catholic, Parsee and Hindu communities, among others.

(Source: <http://beta.profit.ndtv.com/news>)

■ ■ ■ Gujarat First State in India to Audit Colleges

Gujarat will be the first state in the country which will conduct its own Academic and Administrative Audit (AAA) of educational institutes in the state. The Knowledge Consortium of Gujarat (KCG) formed by the state education department will begin Gujarat-AAA to enhance quality of higher education. The audit will be conducted on the lines of the accreditation done by the National Assessment and Accreditation Council (NAAC) - the autonomous institution established by the University Grants Commission (UGC). "All educational institutes go for NAAC accreditation once in five years. But the idea of Gujarat-AAA initiative is to have the audit exercise done once in two years or annually. Also, it is more of a mentoring exercise than that of monitoring the educational institutes in the state so that the colleges understand their strengths and weakness," a KCG official said.

(Source: <http://timesofindia.indiatimes.com/>)

■ ■ ■ Survey: 78 per cent Companies Planning Domestic Acquisition

An increasing number of businesses are planning to expand through acquisitions, according to the Grant Thornton International Business Report. In its latest global study, the proportion of respondents anticipating an acquisition in the next three years rose to 34 per cent this year, an increase of eight per cent over the previous year. As far as India is concerned, this has increased to 41 per cent,

up 19 per cent over 2010 and 11 per cent over 2009. At a time when economic and financing conditions are improving and as the mindset shifts from survival to strategic growth, businesses are again looking at acquisitions as a means to grow revenues. They have also begun to realise the benefits of their past acquisitions. Among the 41 per cent Indians planning an acquisition in the next three years, the motivational factors for growth are access to new geographic markets (64 per cent), acquiring new technology or established brands (58 per cent), building scale (55 per cent) and access to low-cost operations (37 per cent).

(Source: <http://www.hindustantimes.com>)

Income Tax Crackdown on Politicians Lying About Their Wealth

For the first time, the Income Tax department has launched a drive to cleanse dirty money from politics and initiated action against at least 300 high net worth politicians for alleged misreporting of wealth in their yearly returns. This includes those who have not filed returns despite huge accumulation of assets over the years. The measures were taken following a prod from the Election Commission (EC) which wanted the department to match I-T returns with the statement of assets declared by candidates in their affidavits. The election watchdog had found alleged misuse of political funds by some netas and their outfits besides allegations of disproportionate assets accumulated by others. In an action taken report, the Central Board of Direct Taxes (CBDT) told the EC that it had already proposed action against 103 politicians "where (their) affidavits did not match the I-T returns", and against 195 who had not filed returns despite having affirmed substantial assets in their poll affidavits. The status report talks about cases reviewed till March 2008. More irregularities are likely to emerge with I-T field formations investigating actual assets of these politicians against their known sources of income. These include those who contested the 2009 parliamentary elections and recent Assembly polls.

(Source: <http://beta.profit.ndtv.com/news>)

India to Seek G20-Support Against Tax Havens, Black Money

India will seek strong action by the Group of Twenty (G20) nations against tax havens as it feels any unilateral action can act as a deterrent against foreign investment. Multilateral action is more effective, a finance ministry official said, ahead of the meeting of G20 finance ministers and central bankers in Paris. India wants the G20 to pressure tax havens into revealing more information on black money from India, the official added. The government

is under pressure to bring back illicit funds stashed abroad, but finds itself facing jurisdictions with which it has little leverage. A report by Washington-based think-tank Global Financial Integrity (GFI) puts such fund flows at about \$16 billion a year from 2002-2006. Any form of curbs on a country cannot work at unilateral level, as such an action can discourage foreign investments, the official said. India has already made a strong pitch for tax information exchange agreements (TIEAs) with greater teeth at the G20 to facilitate a meaningful exchange of information on fund flows and monies parked in such jurisdictions. The official said it was because of multilateral action that a number of tax jurisdictions, including Switzerland, had agreed to share information on bank accounts of tax evaders. New Delhi is pursuing the issue at the steering group of the Global Forum on Transparency and Exchange of Information for Tax Purposes at the Organisation for Economic Cooperation and Development, of which it is a member.

(Source: <http://www.thehindubusinessline.com/>)

Govt. Seeks Private Funding for Infrastructure in 12th Plan: President

The private sector will have to join the government in the mammoth funding of \$ 1 trillion (over ₹40 lakh crore) for infrastructure development in the 12th Plan staring next fiscal, President Pratibha Patil has said. In her address to Parliament that marked beginning of the budget session, Patil said investment in infrastructure sector was doubled in the current plan to \$500 billion (over ₹20 lakh crore) from the previous Plan and it would be raised by 100 per cent again in the 2012-17 period. Seeking private sector investment in the sector was vital to maintain the economic growth, she said. "This huge quantum of investment cannot be funded by government alone. It needs to be supplemented by private participation." Asserting that the UPA government has put in place the required framework for a transparent public-private partnership, Patil said private sector contributed 34 per cent of the investment in the segment last year.

India FY11 Exports Seen at \$230 billion: PM's Advisor

Indian exports in the fiscal year to end-March are seen at \$230.3 billion, and would rise to \$271.9 billion in the next year, C Rangarajan, the chairman of the Prime Minister's Economic Advisory Council, has said. He also said he saw foreign direct investment at \$27.6 billion in FY11, rising to \$40 billion in FY12.

(Source: <http://www.hindustantimes.com/business-news/>)

■ ■ ■ G20 Ministers Fudge Deal on Imbalance Indicators

Finance ministers of the world's major economies have reached a fudged accord on how to measure global economic imbalances after China prevented the use of exchange rates and currency reserves as indicators. French Finance Minister Christine Lagarde, who chaired the Group of 20 talks, said the deal nevertheless represented a significant step towards better coordination of economic policies worldwide to help prevent another financial crisis. "The negotiations were frank, sometimes tense, and led to a final compromise which cannot attribute to any one delegation but which I can say represents a spirit of compromise and of ambition," she told a news conference. Ministers and central bank governors agreed on a list of indicators including public debts and fiscal deficits, private savings and private debt, the trade balance and other components of the balance of payments such as net investment flows. But at Chinese insistence there was no mention of the real effective exchange rate or foreign currency reserves. "Reserves have been dropped," Lagarde said, adding that the deal included a mechanism to take account of exchange rates when assessing the overall balance of payments. The United States and other western countries accuse China of keeping the Yuan artificially undervalued to boost its exports and accumulate massive foreign currency reserves that they say distort the world economy.

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

■ ■ ■ IASB and FASB Propose to Align Balance Sheet Netting Requirements

The International Accounting Standards Board (IASB) and the US-based Financial Accounting Standards Board (FASB) have published a proposal to establish a common approach to offsetting financial assets and financial liabilities on the statement of financial position (balance sheet). Offsetting, otherwise known as netting, takes place when entities present their rights and obligations to each other as a net amount in their statement of financial position. At present, the circumstances when financial assets and financial liabilities may be presented in an entity's statement of financial position as a single net amount, or as two gross amounts, differs depending on whether the entity reports using International Financial Reporting Standards (IFRSs) or US generally accepted accounting principles (GAAP). The accounting differences result in the single largest quantitative difference in reported numbers in statements of financial position prepared in accordance with IFRSs or US GAAP. This reduces the comparability of financial statements, and is especially prominent in the presentation of derivative assets and derivative liabilities by financial institutions. As a result, users and preparers of financial statements have asked the boards to find a common solution for offsetting those items. Proposing a common solution is also consistent with requests from the G20 and the Financial Stability Board (FSB). The boards proposed that offsetting should apply only when the right of set-off is enforceable at all times, including in default and bankruptcy, and the ability to exercise this right is unconditional, that is, it does not depend on a future event. The entities involved must intend to settle the amounts due with a single payment or simultaneously. Provided all of these requirements are met, offsetting would be required. The proposals would amend IFRSs and US GAAP and eliminate several industry-

specific netting practices. Investors expressed a desire for information about both the gross amounts of financial assets and liabilities and the net amounts, if credit risk has been mitigated. This proposal would change US GAAP to require netting in a narrower set of circumstances, but the effect of other forms of credit mitigation would be disclosed in the footnotes. The exposure draft Offsetting Financial Assets and Financial Liabilities [FASB: Balance Sheet (Topic 210): Offsetting] is open for public comment until 28th April, 2011 and can be accessed via the IASB and FASB websites.

Source: <http://www.ifrs.org/News/>

■ ■ ■ IASB and FASB Propose Common Solution for Impairment Accounting

The International Accounting Standards Board (IASB) and the US-based Financial Accounting Standards Board (FASB) published recently, for public comment, proposals for accounting for impairment of financial assets such as loans managed in an open portfolio. At present, International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP) account for credit losses using an incurred loss model, which requires evidence of a loss (known as a trigger event) before financial assets can be written down. The boards have proposed moving to an expected loss model that provides a more forward-looking approach to how credit losses are accounted for, which they believe better reflects the economics of lending decisions. The proposals are published as a supplement to an exposure draft published by the IASB in November 2009, and a separate FASB exposure draft published in May 2010. Those exposure drafts outlined different methods to account for credit impairment. Since then, the boards have worked to align their approaches. In doing so, they have sought to take account of responses to the original exposure drafts and recommendations made by the Expert Advisory Panel (EAP), an external group of risk management experts tasked with considering the operational consequences of applying an expected loss model as well as responses to the FASB proposal.

Source: <http://www.ifrs.org/News/>

■ ■ ■ IAASB Addresses Assurance (Other than Audit) on Financial Statements; Exposes Enhanced Review Engagement Standard

The International Auditing and Assurance Standards Board (IAASB) recently released, for public exposure, proposed International Standard on Review Engagements (ISRE) 2400, *Engagements to Review Historical Financial Statements*. This revised standard is the second IAASB proposal in recent months that addresses the growing international need for robust standards for services that can be used by entities that are either not required or do not elect to be audited. The financial statement review engagement is an important service in meeting evolving regulatory, market, and business reporting needs, in particular in the small- and medium-sized entity (SME) sector. The proposed standard seeks to establish clear and robust requirements governing the practitioner's performance of a review engagement, and thus serves to fulfill its purpose of enhancing users' degree of confidence in an entity's financial statements. A review of financial statements in accordance with the proposed ISRE consists primarily of making inquiries of management and others within

the entity involved in financial and accounting matters, applying analytical procedures, and evaluating the sufficiency and appropriateness of evidence obtained. The practitioner reports on whether anything has come to the practitioner's attention that causes him/her to believe that the financial statements, taken as a whole, are not prepared in all material respects in accordance with the applicable financial reporting framework. The procedures performed in a review are substantially less than those performed in an audit, and the practitioner does not express an audit opinion. The proposed ISRE will help practitioners around the world who perform review engagements converge towards use of a globally accepted benchmark, and facilitate development of practice in jurisdictions that currently do not have national standards in this area.

Source: <http://press.ifac.org/news/>

■■■ IPSASB Publishes Revised Guidance to Assist Public Sector Entities with Transition from Cash Basis to Accrual Basis of Accounting

The International Public Sector Accounting Standards Board (IPSASB) has released an updated and improved version of Study 14, *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities*. The third edition of Study 14, which features links to many useful resources, provides guidance on how to migrate to the accrual basis of accounting in accordance with International Public Sector Accounting Standards (IPSASs), and is relevant to governments and other public sector entities, including international governmental organisations. The latest edition of Study 14 covers all 31 IPSASs, including first-time coverage of the five IPSASs issued in late 2009 and early 2010: IPSAS 27, *Agriculture*; IPSAS 28, *Financial Instruments: Presentation*; IPSAS 29, *Financial Instruments: Recognition and Measurement*; IPSAS 30, *Financial Instruments: Disclosures*; and IPSAS 31, *Intangible Assets*. In light of the much increased global knowledge and experience in adopting IPSASs, the non-technical sections of Study 14 were also substantially improved. They now reflect the current state-of-the-art in adoption and implementation. This edition of Study 14 includes significant changes from the previous edition, and demonstrates the IPSASB's commitment to support the global implementation of IPSASs. The full text of Study 14 can be downloaded free of charge from the IPSASB section of IFAC's Publications & Resources site: web.ifac.org/publications.

Source: <http://press.ifac.org/news/>

■■■ IAESB-UNCTAD Accountancy Education Forum: Building Human Capacity and Professional Accounting Education for High-Quality Corporate Reporting

To address the requirements and public interest benefits of developing a professional accountancy education program, international accountancy and education leaders will meet on 8th March at the United Nations in Geneva for the Accountancy Education Forum, a full-day event jointly hosted by the United Nations Conference on Trade and Development (UNCTAD) and the International Accounting Education Standards Board (IAESB). The Accountancy Education Forum will feature expert speakers and participants from North and South America, Asia, Europe, and Africa. The agenda includes panel discussions and interactive sessions that aim to share best practices, provide support tools, and answer questions, with a focus on the

implementation of the International Education Standards set by the IAESB, and the UNCTAD-ISAR Accounting Model Curriculum. The critical link to ensure competence is to develop human capacity, which relies on professional accountancy organisations to develop and deliver effective professional accountancy education programs. It is a natural fit for the IAESB and UNCTAD to partner on this topic and share best practices with the international accountancy profession." The twenty-seventh session of UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) considered a capacity-building framework for high-quality corporate reporting. Human capacity-building is an essential component of this framework. The twenty-eighth session of ISAR, which will take place in Geneva from October 12-14, 2011, will further consider these issues.

Source: <http://press.ifac.org/news/>

■■■ IAASB Explores Financial Statement Disclosures and Audit Quality; Releases Discussion Paper and Thought Piece

The International Auditing and Assurance Standards Board (IAASB) recently released for public comment a discussion paper exploring key issues relating to disclosures in financial statements. Titled *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications*, the paper highlights recent trends in the range, volume, and complexity of financial statement disclosures, and explores issues and practical challenges in preparing, auditing, and using them. In addition, in order to stimulate further debate on audit quality, and in its continuing efforts to facilitate robust audits in the public interest, the IAASB also released a publication titled *Audit Quality: An IAASB Perspective*. The discussion paper addresses critical issues such as challenges in preparing disclosures, the nature and extent of evidence for different types of disclosures, and the application of the concept of materiality to disclosures. Views from all stakeholders are sought, and the discussion paper asks specific questions of preparers; investors, lenders, and other creditors; regulators; and auditors. A consultation period of over four months has been provided to enable stakeholders to consider the complex issues addressed in the discussion paper.

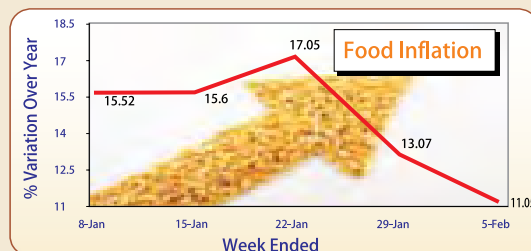
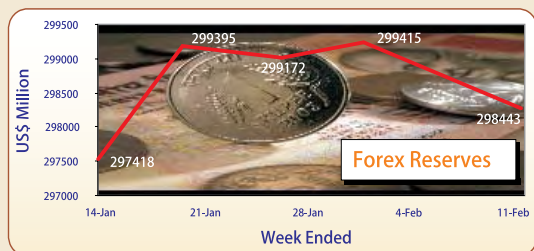
Source: <http://press.ifac.org/news/>

■■■ Gender Differences Increasing in Internal Audit Profession

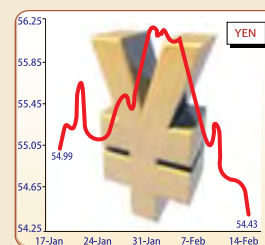
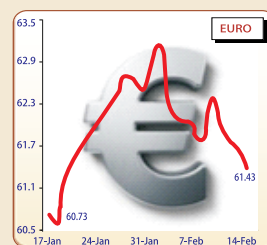
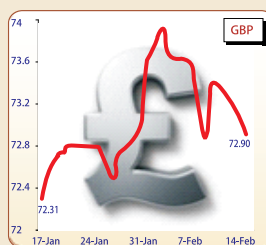
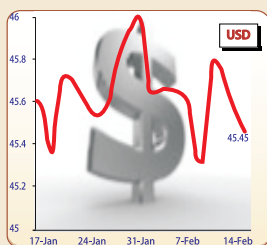
Women are far less likely to move into internal audit roles than men, according to research from Longbridge Search & Selection, an audit recruiter firm based in London. The research found that only 27 per cent of junior-level internal auditors are female, whereas women made up 49 per cent of graduates six or seven years ago. The research also looked at the gender pay gap in audit and found that on average, women get paid five percent less than a male counterpart doing the same job. However women in senior roles benefited from marginally higher pay than their male counter-parts. The average salary for senior women was £87,056 (\$172,776) compared to £86,936 for men in senior in-house auditing roles at banks. An International multi-sector recruitment company suggested fewer women may go for in-house audit roles because of the perceived 'City boy' culture of banking.

Source: <http://www.vrl-financial-news.com/accounting>

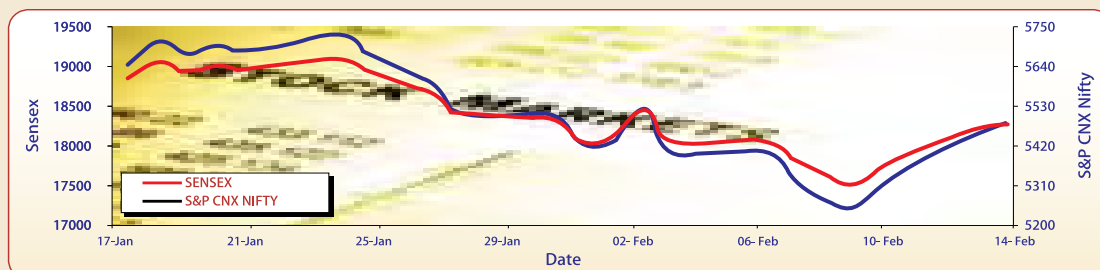
Economic Indicators



Indian Rupee vs. Major Foreign Currencies (January 17, 2011 to February 15, 2011)



Stock Markets



Selected Indicators

(per cent per annum)

Item	Unit/Base	2010		2011				
		Feb-05	Dec-31	Jan-07	Jan-14	Jan-21	Jan-28	Feb-04
Cash Reserve Ratio ⁽¹⁾	Per cent	5.00	6.00	6.00	6.00	6.00	6.00	6.00
Bank Rate	Per cent per annum	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Base Rate ⁽²⁾	Per cent per annum	11.00-12.00	7.60-9.00	8.00-9.00	8.00-9.00	8.00-9.00	8.00-9.00	8.00-9.50
Deposit Rate ⁽³⁾	Per cent per annum	6.00-7.50	7.00-8.75	7.00-8.75	7.00-8.75	7.00-8.75	7.00-8.75	8.25-9.50
Call Money Rate (Low/High)	Per cent per annum	1.00/3.40	4.00/9.25	4.00/7.95	4.00/6.50	5.40/7.35	4.00/7.00	5.00/7.05

Notes: (1) Cash Reserve Ratio relates to Scheduled Commercial Banks (excluding Regional Rural Banks).

(2) Base Rate relates to five major banks since July 1, 2010. Earlier figures relate to Benchmark Prime Lending Rate (BPLR).

(3) Deposit Rate relates to major banks for term deposits of more than one year maturity.

Readers are Invited to contribute write-ups or any relevant and interesting piece of information for this feature at eboard@icai.org.

ACCOUNTANT'S BROWSER

'PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE'

Index of some useful articles taken from Periodicals/Newspapers received during January-February 2011 for the reference of Faculty/Students & Members of the Institute.

1. ACCOUNTING

Accounting Conservatism in a Setting of Information Asymmetry Between Majority & Minority Shareholders by Wuchun Chi & Chenchin Wang. *The International Journal of Accounting*, Vol.45, 2010, pp. 465-489.

Accounting Errors & Errors of Accounting by John Christensen. *The Accounting Review*, Vol.85/6, 2010, pp.1827-1838.

Accounting & Non-Accounting Determinants of Default: An Analysis of Privately-Held Firms by Alnoor Bhimani etc. *J. Account. Public Policy*, Vol.29, 2010, pp.517-532.

Assessing the Financial Reporting Consequences of Conversion to IFRS: The Case of Equity-Based Compensation by Mary lea Mcanally etc. *Accounting Horizons*, Vol.24/4, 2010, pp. 589-622.

Comment on the IASB Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers by Jan Marton etc. *Accounting in Europe*, Vol.7, 2010, pp.13-14.

The European Union Endorsement Process for International Financial Reporting Standards: A Telos-Based Analysis by David Alexander & Eva Eberhartinger. *Accounting in Europe*, Vol.7, 2010, pp.37-62.

The Influence of Tax on IFRS Consolidated Statements: The Convergence of Germany & the UK by Maria Gee etc. *Accounting in Europe*, Vol.7, 2010, pp.97-122.

Managing the CPA Firm at Dodge Company: "Shoeing the Cobbler's Children" by Monte Swain etc. *Issues in Accounting Education*, Vol.25/4, 2010, pp. 721-739.

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Secretary: Shri N.P. Singh

Expert Advisory Committee

CA. Jayant P. Gokhale, Chairman	Mumbai
CA. J. Venkateswarlu, Vice-Chairman	Hyderabad
CA. G. Ramaswamy, President (Ex-Officio)	Coimbatore
CA. Jaydeep N. Shah, Vice-President (Ex-Officio)	Nagpur
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CA. Dhinal A. Shah	Ahmedabad
CA. Nilesh S. Vikamsey	Mumbai
CA. Sanjay K. Agarwal	New Delhi
CA. Sanjeev K. Maheshwari	Mumbai
Shri Ashutosh Dikshit	New Delhi
Shri Prithvi Haldea	New Delhi
Shri Sidharth K. Birla	New Delhi
Smt. Usha Sankar	New Delhi

Secretary: CA. (Dr.) Rashmi Goel

Committee on Financial Markets & Investors' Protection

CA. Vinod Jain, Chairman	New Delhi
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Shri Sidharth K. Birla	New Delhi
Dr. T. V. Somanathan	New Delhi
Smt. Usha Narayanan	Mumbai

Secretary: Shri A.P. Kar

Financial Reporting Review Board

CA. Abhijit Bandyopadhyay, Chairman	Kolkata
CA. Dhinal A. Shah, Vice-Chairman	Ahmedabad
CA. Anuj Goyal	Ghaziabad
CA. Mahesh P. Sarda	Jamnagar
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CA. Vijay K. Garg	Jaipur
Shri Prithvi Haldea	New Delhi
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Secretary: CA. (Dr.) Rashmi Goel

ICAI-ICWAI-ICSI Co-ordination Committee

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CA. Manoj Fadnis	Indore
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IFRS Implementation Committee

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CA. Naveen N. D. Gupta	New Delhi
CA. Nilesh S. Vikamsey	Mumbai
CA. P. Rajendra Kumar	Chennai
CA. Pankaj I. Jain	Mumbai
CA. Pankaj Tyagee	New Delhi
CA. Shiwaji B. Zaware	Pune
CA. Subodh K. Agarwal	Kolkata
CA. V. Murali	Chennai
CA. Vinod Jain	New Delhi

Secretary: CA. Parminder Kaur

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CA. Jaydeep N. Shah, Vice-President (Ex-Officio)	Nagpur
CA. J. Venkateswarlu	Hyderabad

CA. Jayant P. Gokhale	Mumbai
CA. Mahesh P. Sarda	Jamnagar
CA. Manoj Fadnis	Indore
CA. P. Rajendra Kumar	Chennai
CA. Pankaj Tyagee	New Delhi
CA. Rajkumar S. Adukia	Mumbai
CA. Ravindra Holani	Gwalior
CA. Sanjay K. Agarwal	New Delhi
Shri Ashutosh Dikshit	New Delhi
Shri Deepak Narain	New Delhi

Secretary: CA. Smita Mishra

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CA. Atul C. Bheda, Vice-Chairman	Mumbai
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CA. Jaydeep N. Shah, Vice-President (Ex-Officio)	Nagpur
CA. Abhijit Bandyopadhyay	Kolkata
CA. Dhinal A. Shah	Ahmedabad
CA. K. Raghu	Bangalore
CA. Manoj Fadnis	Indore
CA. Nilesh S. Vikamsey	Mumbai
CA. P. Rajendra Kumar	Chennai
CA. Pankaj I. Jain	Mumbai
CA. Pankaj Tyagee	New Delhi
CA. Sanjay K. Agarwal	New Delhi
CA. Sanjeev K. Maheshwari	Mumbai
Shri Deepak Narain	New Delhi
Shri Prithvi Haldea	New Delhi

Secretary: Shri Rajanikant Verma

Internal Audit Standards Board

CA. Rajkumar S. Adukia, Chairman	Mumbai
CA. P. Rajendra Kumar, Vice-Chairman	Chennai
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CA. Anuj Goyal	Ghaziabad
CA. Atul C. Bheda	Mumbai
CA. J. Venkateswarlu	Hyderabad
CA. Nilesh S. Vikamsey	Mumbai
CA. Ravindra Holani	Gwalior
CA. Shiwaji B. Zaware	Pune
CA. Vijay K. Garg	Jaipur
Shri Prithvi Haldea	New Delhi
Shri Sidharth K. Birla	New Delhi
Dr. T. V. Somanathan	New Delhi
Smt. Usha Narayanan	Mumbai
Smt. Usha Sankar	New Delhi

Secretary: CA. Jyoti Singh

International Affairs Committee

CA. G. Ramaswamy, President (Chairman)	Coimbatore
CA. Jaydeep N. Shah, Vice President (Vice-Chairman)	Nagpur
CA. Abhijit Bandyopadhyay	Kolkata
CA. Amarjit Chopra	New Delhi
CA. Atul C. Bheda	Mumbai

CA. Bhavna G. Doshi
CA. K. Raghu
CA. M. Devaraja Reddy
CA. Mahesh P. Sarda
CA. Manoj Fadnis
CA. Ravindra Holani
CA. Sumantra Guha
CA. Vijay K. Garg
Dr. T. V. Somanathan
Smt. Usha Narayanan

Secretary: CA. Anita Suneja

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CA. Mahesh P. Sarda, Chairman
CA. M. Devaraja Reddy, Vice-Chairman
CA. G. Ramaswamy, President (Ex-Officio)
CA. Jaydeep N. Shah, Vice-President (Ex-Officio)
CA. Anuj Goyal
CA. Atul C. Bheda
CA. Bhavna G. Doshi
CA. Charanjot Singh Nanda
CA. Dhinal A. Shah
CA. Manoj Fadnis
CA. Naveen N. D. Gupta
CA. Pankaj I. Jain
CA. Sanjay K. Agarwal
CA. Vijay K. Garg
Shri Anil K. Agarwal
Shri Ashutosh Dikshit

Secretary: CA. Nidhi Singh

Committee on Management Accounting

CA. Vinod Jain, Chairman
CA. Ravindra Holani, Vice-Chairman
CA. G. Ramaswamy, President (Ex-Officio)
CA. Jaydeep N. Shah, Vice-President (Ex-Officio)
CA. Abhijit Bandyopadhyay
CA. J. Venkateswarlu
CA. K. Raghu
CA. M. Devaraja Reddy
CA. Mahesh P. Sarda
CA. Sanjay K. Agarwal
CA. Shiwaji B. Zaware
CA. Vijay K. Garg
Shri Deepak Narain
Smt. Usha Narayanan
Smt. Usha Sankar

Secretary: Shri A.P. Kar

Committee for Members in Entrepreneurship & Public Services

CA. Mahesh P. Sarda, Chairman
CA. M. Devaraja Reddy, Vice-Chairman
CA. G. Ramaswamy, President (Ex-Officio)
CA. Jaydeep N. Shah, Vice-President (Ex-Officio)
CA. Anuj Goyal
CA. Charanjot Singh Nanda

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Mumbai

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Coimbatore
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Jamnagar
New Delhi
Pune
Jaipur
New Delhi
Mumbai
New Delhi

CA. Dhinal A. Shah
CA. K. Raghu
CA. Manoj Fadnis
CA. Pankaj Tyagee
CA. Shiwaji B. Zaware
CA. Subodh K. Agarwal
CA. Sumantra Guha
CA. V. Murali
CA. Vijay K. Garg

Secretary: CA. Mudit Vashistha

Committee for Members in Industry

CA. K. Raghu, Chairman
CA. Pankaj Tyagee, Vice-Chairman
CA. G. Ramaswamy, President (Ex-Officio)
CA. Jaydeep N. Shah, Vice-President (Ex-Officio)
CA. Bhavna G. Doshi
CA. Madhukar N. Hiregange
CA. P. Rajendra Kumar
CA. Pankaj I. Jain
CA. Sanjay K. Agarwal
CA. Sanjeev K. Maheshwari
CA. Shiwaji B. Zaware
CA. Subodh K. Agrawal
CA. V. Murali
Shri Anil K. Agarwal
Shri Deepak Narain
Shri Prithvi Haldea
Shri Siddarth K. Birla

Secretary: Dr. Surinder Pal

Peer Review Board

CA. Pankaj I. Jain, Chairman
CA. K. Raghu, Vice-Chairman
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CA. Madhukar N. Hiregange
CA. Ravindra Holani
CA. S. Santhanakrishnan
CA. Sanjeev K. Maheshwari
CA. Vinod Jain
Smt. Usha Sankar

VACANT (for separate nominee of C & AG)

VACANT (for separate nominee of SEBI)

Secretary: CA. Ashok Kapoor

Professional Development Committee

CA. Amarjit Chopra, Chairman
CA. Sumantra Guha, Vice-Chairman
CA. G. Ramaswamy, President (Ex-Officio)
CA. Jaydeep N. Shah, Vice-President (Ex-Officio)
CA. Anuj Goyal
CA. Atul C. Bheda
CA. Charanjot Singh Nanda
CA. K. Raghu
CA. M. Devaraja Reddy
CA. Madhukar N. Hiregange
CA. Naveen N.D. Gupta

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Indore
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Kolkata
Kolkata
Chennai
Jaipur

Bangalore
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Hyderabad
Bangalore
New Delhi

CA. Nilesh S. Vikamsey
CA. P. Rajendra Kumar
CA. Pankaj I. Jain
CA. Pankaj Tyagee
CA. Ravindra Holani
CA. Sanjay K. Agarwal
CA. Shiwaji B. Zaware
CA. Vinod Jain
Smt. Usha Narayanan
Smt. Usha Sankar

Secretary: *Shri Vijay Kapur*

Committee on Public Finance & Government Accounting

CA. Anuj Goyal, Chairman
CA. Sanjeev K. Maheshwari, Vice-Chairman
CA. G. Ramaswamy, President (Ex-Officio)
CA. Jaydeep N. Shah, Vice-President (Ex-Officio)
CA. Abhijit Bandyopadhyay
CA. Amarjit Chopra
CA. J. Venkateswarlu
CA. Madhukar N. Hiregange
CA. P. Rajendra Kumar
CA. Rajkumar S. Adukia
CA. Subodh K. Agarwal
Shri Ashutosh Dikshit
Shri Deepak Narain
Smt. Usha Narayanan
Smt. Usha Sankar

Secretary: *CA. Shalini Jindal*

Public Interest Advisory Committee

CA. G. Ramaswamy, President-in-Office (Chairman)
CA. Jaydeep N. Shah, Vice President-in-Office (Vice-Chairman)
CA. Bhavna G. Doshi
CA. Charanjot Singh Nanda
CA. J. Venkateswarlu
CA. Jayant P. Gokhale
CA. M. Devaraja Reddy
CA. Nilesh S. Vikamsey
CA. Pankaj I. Jain
CA. Pankaj Tyagee
CA. S. Santhanakrishnan
CA. Subodh K. Agarwal
CA. Sumantra Guha
CA. Vijay K. Garg
Shri Ashutosh Dikshit

Secretary: *Shri Rakesh Sehgal*

Research Committee

CA. Nilesh S. Vikamsey, Chairman
CA. Charanjot Singh Nanda, Vice-Chairman
CA. G. Ramaswamy, President (Ex-Officio)
CA. Jaydeep N. Shah, Vice-President (Ex-Officio)
CA. Atul C. Bheda
CA. Jayant P. Gokhale
CA. Madhukar N. Hiregange

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CA. P. Rajendra Kumar
CA. Pankaj I. Jain
CA. S. Santhanakrishnan
CA. Sanjeev K. Maheshwari
CA. Shiwaji B. Zaware
Shri Ashutosh Dikshit

Secretary: *CA. Deepali Garg*

Vision & Perspective Planning Committee

CA. G. Ramaswamy, President (Chairman)
CA. Jaydeep N. Shah, Vice-President (Vice-Chairman)
CA. Amarjit Chopra
CA. Bhavna G. Doshi
CA. Dhinal A. Shah
CA. K. Raghu
CA. Madhukar N. Hiregange
CA. S. Santhanakrishnan
CA. Vijay K. Garg
CA. Vinod Jain
Shri Anil K. Agarwal
Shri Ashutosh Dikshit
Shri Sidharth K. Birla
Dr. T. V. Somanathan
Smt. Usha Sankar

Secretary: *CA. Monika Jain*

C. Other Committees

Board of Discipline [Under Section 21A]

CA. G. Ramaswamy, President-in-Office (Presiding Officer)
CA. M. Devaraja Reddy
Shri R. K. Handoo
(Nominee of the Central Government)

Secretary: *CA. Vandana Nagpal*

Disciplinary Committee (Under Section 21B)

CA. G. Ramaswamy, President-in-Office (Presiding Officer)
CA. Nilesh S. Vikamsey
CA. Sumantra Guha
Ms. Ila Singh
(Nominee of the Central Government)
Shri S. K. Ghosh
(Nominee of the Central Government)

Secretary: *CA. Vandana Nagpal*

Disciplinary Committee - Satyam Bench (Under Section 21B)

CA. G. Ramaswamy, President-in-Office (Presiding Officer)
CA. J. Venkateswarlu
CA. Manoj Fadnis
Ms. Ila Singh (Nominee of the Central Government)
Shri. S. K. Ghosh
(Nominee of the Central Government)

Secretary: *CA. Vandana Nagpal*



An Initiative of the Committee for Capacity Building of CA Firms and Small & Medium Practitioners, ICAI

The Committee for Capacity Building of CA Firms and Small & Medium Practitioners, ICAI has taken a major initiative to arrange financial assistance to all members in practice / firms in the form of specially designed loan scheme through Corporation Bank. Through the scheme, eligible Chartered Accountants can avail finance for setting up of offices including cost of furniture/fixture/office equipments-computers and other accessories. The scheme would also enable the Chartered Accountants to finance a part of the working capital for building their profession and will also take care of the needs of fresher (CAs with experience below three years).

*** Members & firms may avail the benefits of this loan scheme.**

For further details, please contact nearest branch of Corporation Bank.

Highlights of the loan scheme are given below:

Eligibility: # Chartered Accountants, individually/jointly or Proprietorship Concern or a Partnership Firm/ Partnership with Limited Liability # Age of the individual/ proprietor shall not exceed 65 years. # The applicants/Firms are registered and also holding valid certificate/license for carrying out the practice. # The applicant's/firm's name shall not appear in the RBI defaulters list/CIBIL report. # In case of Firms, all partners shall join as co applicants. # The applicants/firms should not have been subjected to disciplinary action by the Institute.	Purpose: # For construction of office premises # For acquisition of ready built new office premises, partly or fully constructed # To finance cost of land and construction thereon # To finance cost of furniture & fixture, fittings of office equipments /computers/other accessories etc. # To finance working capital and /or financing receivable
Nature of facility: # Demand Loan/Term Loan for acquisition of fixed assets and/or Cash Credit/Overdraft for working capital	Margin: # For Term Loan/Demand Loan: Uniform margin of 20% # For Working Capital: 25% for Book Debts/Receivables for cash credit or clean overdraft # Value of land shall not exceed 50% of project cost in case of purchase of site and construction of premises

Quantum of loan:

Applicable For Freshers: (Experience below 3 years)					Applicable For Existing Firms (Having Practice for 3 Years & Above)				
		Metro	Urban	Other Centres	A] WHERE LATEST GROSS ANNUAL INCOME IS UPTO ₹ 5 LACS (income includes professional fees/consultancy fees etc..)				
I.	Maximum eligibility: TL/DL * Out of which:	₹20 lacs	₹ 15 lacs	₹10 lacs	I	Maximum eligibility : TL/DL * Out of which:	₹ 30 lacs	₹ 20 lacs	₹ 15 lacs
a.	For office premises	₹15 lacs	₹ 12 lacs	₹ 8 lacs	a	for office premises	₹ 20 lacs	₹ 15 lacs	₹ 12 lacs
b.	For furnishing & Other assets	₹5 lacs	₹ 3 lacs	₹ 2 lacs	b	For Furnishing & Other assets	₹ 10 lacs	₹ 5 lacs	₹ 3 lacs
II.	For Working capital requirement	₹ 2 lacs	₹ 1 lakh	₹ 1 lakh	II	For Working capital	₹ 2 lacs	₹ 1 lakh	₹ 1 lakh
B] WHERE LATEST GROSS ANNUAL INCOME IS ABOVE ₹ 5 LACS & UPTO ₹ 10 LACS AS PER LATEST IT RETURN (with experience of 3 years and above)					C] WHERE LATEST GROSS ANNUAL INCOME IS ABOVE ₹ 10 LACS, AS PER LATEST IT RETURN (WITH EXPERIENCE OF 3 YEARS AND ABOVE)				
		Metro	Urban	Other Centres			Metro	Urban	Other Centres
I	Maximum eligibility: TL/DL * Out of which:	₹ 50 lacs	₹ 25 lacs	₹ 20 lacs	I	Maximum eligibility : TL/DL * Out of which:	₹ 125 lacs	₹ 65 lacs	₹ 30 lacs
a	For office premises	₹ 40 lacs	₹ 20 lacs	₹ 15 lacs	a	For office premises	₹ 100 lacs	₹ 50 lacs	₹ 25 lacs
b	For Furnishing & Other assets	₹ 10 lacs	₹ 5 lacs	₹ 5 lacs	b	For Furnishing & Other assets	₹ 25 lacs	₹ 15 lacs	₹ 5 lacs
II	For Working capital	₹ 5 lacs	₹ 2 lacs	₹ 2 lacs	II	For Working capital	Need based		

Security: # Term Loan /Demand Loan: Assets acquired out of the loan. # For Working Capital Loan: Assignment of Book Debts/Receivable. #Collateral security: Suitable third party guarantee or Tangible securities.	Repayment: # Term Loan - Repayable in maximum period of 10 years by EMI/PMI, initial moratorium of upto 18 to 24 months. # Demand Loan - Repayable in maximum 3 years by EMI/PMI, including initial moratorium of 6 months. # Repayment to commence from date of commercial operations or after completion of initial repayment holiday or as per the terms of sanction. # Interest shall be serviced as and when debited.
Rate of interest: Upto ₹ 10 lacs – Min. 10% (Base Rate + 2.25%) Above ₹ 10 lacs – Min. 10.75% (Base Rate + 3%) (Investment in fixed assets less than ₹ 100 lacs) Above ₹ 10 lacs – Min. 11.75% (Base Rate + 4%) (Investment in fixed assets above ₹100 lacs) * Subject to gradation of the borrower # Rate of interest at floating rate linked to Base Rate # Rate of interest is subject to review	Note: Concession of 0.50% extended, if additional collateral security viz., property, LIC policies, Deposit etc., to the extent of 25% of loan amount is provided. Processing Charges: 0.25% of loan amount subject to a minimum of ₹ 5000/- Prepayment charges: -Nil-

Office of The Comptroller and Auditor General Of India 10, Bahadur Shah Zafar Marg, New Delhi – 110 124

Empanelment of Chartered Accountant firms for the year 2011-2012.

Applications are invited online from the firms of Chartered Accountants who intend to be empanelled with this office for the year 2011-2012 for appointment as auditors of Government Companies/Corporations. The format of application will be available on our website: www.cag.gov.in from 1st January 2011. Chartered Accountant firms can apply/update the data showing the status of the firm as on 1st January 2011, till 31st March 2011 and generate online acknowledgement letter for the year. Only firms who have generated online

acknowledgement letter for the year 2011-2012 will be considered for empanelment.

Any changes in the constitution of the firm occurring after the cutoff date of 1st January 2011 should continue to be updated by the CA firms in the website which will be available throughout the year. However, the changes in the firm occurring after 1st January 2011 till the time of preparing the panel that will lead to a reduction in the rank of the applicant firm shall only be taken into account for ranking the CA firms.

Sd/-
Director General (Commercial)



Empanelment of Schools/Educational Institutions for holding May-2011 Chartered Accountants Examinations and Common Proficiency Test June-2011

The ICAI conducts Chartered Accountants Examinations in most of the cities in the Country as under :

(i) Chartered Accountants Examinations

(Timings : 2.00 PM to 5.00 PM)

(a) 2nd May-2011 to 16th May-2011
(including intermittent Sundays)

(ii) Common Proficiency Test

(10.30 AM to 4.00 PM with break of 1 1/2 hrs):

(a) 19th June-2011 – One day, Sunday

The ICAI requires additional Schools/Educational Institutions with good infrastructure and facilities in addition to the existing Examination Centres to hold Chartered Accountants Examinations. Interested parties may see the terms & conditions at the

URL <http://220.227.161.86/21600announ12287.pdf>. The existing Schools/Educational Institutions which are already providing accommodation for CA Exams need not apply. **The Terms and Conditions for Empanelment have been given on page nos. 1 & 2. The Format in which the Schools/Colleges are required to submit their relevant details is given on page nos. 3 & 4. The names of the cities where Chartered Accountants Examinations May-2011 and Common Proficiency Test June-2011 are being held have been given on page no. 5.**

Sd/-
Director General (Commercial)



Classifieds

4837 Delhi FCA, DISA with more than 20 years experience in signing Bank Branch Audit willing to merger/networking/ other arrangement. Contact: dgaco@rediffmail.com, Mobile: 9811140013

4838 Kozhikode based FCA Proprietary Firm seeks professional assignments/partnership on mutually acceptable terms. Contact e-mail: indrakumar51@hotmail.com

4839 Surat based CA firm seeks on partnership /assignment basis professional work in Surat, Navsari, Vapi, Silvassa. Contact:

9687033071.Email: dhelariya@gmail.com

4840 Lucknow based 23 year old CA firm invites proposals for partnership from members. Contact: CA. S. N Gupta at 09415101759.

4841 Wanted qualified/semi qualified C.A./article with good command in English. Contact: 981855642/011-25496826, email: malhotravirender@yahoo.co.in



Insurance against Professional Indemnity...



An Insurance Protection for Members in practice & CA Firms of ICAI.....



An Initiative of the Committee for Capacity Building of CA Firms and Small & Medium Practitioners, ICAI.

The **Committee for Capacity Building of CA Firms and Small & Medium Practitioners (CCBCAF & SMP)** of ICAI has arranged insurance protection for members in practice/firms in the form of specially designed professional indemnity insurance at a reasonable premium. The scheme is already in effect for the Members in practice/ Firms of the ICAI.

Eligibility:

Chartered Accountants, individual/jointly or Proprietorship Concern or a Partnership Firm/ Partnership.

The applicants/firms should not have been subjected to disciplinary action by the Institute.

Premium Rates:

For Individual Members in Practice:

For SI of ₹10 lakh, the premium proposed is ₹1000/- (1:1), ₹803/- (1:2), ₹705/- (1:3) and ₹600/- (1:4).

Ratios indicate relationship between AOA and AOY
Additional: Per Capita for named professional employee- ₹100

Excess: 1/2% of Any One Year Limit subject to minimum ₹5,000/- and maximum of ₹1 Lac. (as per Market Agreement) For higher limits.

For Chartered Accountant Firm:

The premium of 0.10% shall be as per rates for Individual Chartered Accountants and shall be applied on the AOY limit chosen. All named professionals shall be charged ₹100/- extra over and above the basic premium.

For Example: If the CA firm chooses a Sum Insured of 2 Crore the Premium rate of 0.10% is to be applied on the AOY limit and each professional (including partners) have to be charged ₹100/- each. For example a CA firm with 20 professionals including 9 partners will pay ₹20, 000/- plus 20X ₹100 totalling to ₹22, 000/- .This would be on 1:1 ratio. If the ratio is 1:2, the Premium rate would be .08%, if the ratio is 1:3, the Premium rate would be .07% and if the ratio is 1:4, the ROL would be .06% on the indemnity limit chosen.

* Jurisdiction: India only

*Above Premium rates are subject to Service Tax @10.3%.

Members and CA firms desirous to avail the benefits under this scheme may please contact directly to New India Assurance Co. Ltd. or Committee Secretariat at the following address:

Assistant Manager (Development)
New India Assurance Co.Ltd.
Divisional Office No.141600, Jeevan Seva Bldg., 2 floor, S.V.
Road, Santacruz(W), Mumbai-400054
Email-ashok.lal@newindia.co.in
Phone No.-022-26633289

Secretary
Committee for Capacity Building of CA Firms
and Small & Medium Practitioners
ICAI Bhawan, A-29, Sector-62,
NOIDA, U.P., P.C.-201309
E-mail: ccbcaf@icai.org
Phone: 0120-3986952

Announcement for Members

New Column in Journal: *Achievers' Page*

Dear Members:

We have decided to start a new column called *ACHIEVERS' PAGE* in our Journal from April 2011 issue onwards, which will be fundamentally dedicated to the members who have achieved something very significant in their personal and social life, other than accountancy, during their career. Members are requested to nominate and forward details to the Editorial Board at ebboard@icai.org describing

significant contributions in public or private sector towards the welfare of our nation at large. After receiving such entries, they will be placed before the Board for its selection and approval. Entries on so selected and approved will be published in the Journal.

Editor-in-Chief
The Chartered Accountant Journal

For The Attention of The Members

The Council of the Institute of Chartered Accountants of India has issued the Standard on Assurance Engagement (SAE) 3402, **Assurance Reports On Controls At A Service Organisation**. The Standard deals with assurance engagements undertaken by a professional accountant in public practice to provide a report for use by user entities and their auditors on the controls at a service organisation that provides a service to user entities that is likely to be relevant to user entities' internal control as it relates to financial reporting. It complements Standard on

Auditing (SA) 402, *Audit Considerations Relating to an Entity Using a Service Organisation* in that reports prepared in accordance with this SAE are capable of providing appropriate evidence under SA 402.

SAE 3402 is effective for service auditors' assurance reports covering periods ending on or after April 1, 2011.

The complete text of the SAE 3402 can be downloaded free of cost from ICAI's website at URL <http://220.227.161.86/22053sae3402.pdf>.

Change in Examination timings from 9.00 am-12.00 noon to 02.00 pm - 05.00 pm for May, 2011 Chartered Accountants Examinations

February 23, 2011

The Candidates appearing in the next Professional Competence Examination (PCE), Integrated Professional Competence Examination (IPCE), Final Examinations and Insurance and Risk Management Examination of the Institute to be held from **2nd May, 2011 to 16th May, 2011** may kindly note that the Examination Timing has been changed from **9.00 am – 12.00 noon to 02.00 pm - 5.00 pm (IST)** owing to unavoidable circumstances.

Similarly, Examination timings at Abu Dhabi and Dubai Centres will be 12.30 pm to 3.30 pm. UAE local time equivalent to 2.00 pm to 5.00 pm (IST).

Examination timings at Kathmandu centre will be 2.15 pm to 5.15 pm Nepal local time equivalent to 2.00 pm to 5.00 pm (IST).

Further to this, please note that there will be no change in the examination schedule in the event of any day of the examination schedule being declared a Public Holiday by the Central Government or any State Government.

(Dr. T. Paramasivan)
Sr. Deputy Director(Exams)

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 uninitiated 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.

ICAI Corporate Forum 2011: A Report

Committee for Members in Industry of the Institute of Chartered Accountants of India organised Corporate Forum 2011 - a three day mega event from 28th to 30th January, 2011 in Kolkata. This is the fourth time in a row that the committee has organised such an event. These events have been a mix of opportunities for the corporates and members of ICAI. The Corporate Forum concluded with much awaited ICAI Awards – 2010 ceremony in the evening of 30th January, 2011.

The event comprised four concurrent events. Career Ascent- Mid Career Campus, Corporate Conclave, Capital Advantage, ICAI Awards 2010. The programmes were conducted simultaneously at different locations from 28th to 30th January. On the first day i.e. 28th January, 2011 Career Ascent was organised at Rotary Sadan Kolkata. A total of 267 candidates registered for the event. It provided Chartered Accountants who have one year or more of industry experience with growth and career prospects, enabling them to realise their full potential and aspirations and widen their horizon. A total of seven Companies participated in the career ascent in a span of three days and offered jobs to 40 candidates. The second event was 'Corporate Conclave,' which was a three-day National Conclave on contemporary topics and it was organised at Hotel Hyatt Regency, Kolkata from 28th to 30th January, 2011. The topics covered were 'Tax and business planning for the future,' 'Indian stock Market,' 'IFRS,' & 'XBRL'. It provided the members an opportunity to enrich their knowledge and enhance their skill sets. The third event was 'Capital Advantage -Invest & Buy Mart,' which was organised at

Science City Kolkata. Capital Advantage exhibition acted as a platform where Chartered Accountants and Corporates from all over India marked their presence. This enabled various organisations involved in Banking, Insurance, Mutual Funds, Capital Markets, Real Estate, Information Technology products and services and other technological products to interact with Chartered Accountants, Investors, Finance Fraternity, and Corporate Decision Makers.

The glittering event was graced by the presence of eminent dignitaries such as Chief Guest Shri Dinesh Trivedi, Union Minister of State for Health, Guests of Honour Shri Shovan Chattopadhyay, Mayor of Kolkata and distinguished journalist Shri. Prabhu Chawla, CA. Amarjit Chopra, (the then) President of ICAI and CA. G Ramaswamy, (the then Vice President and now President of ICAI), Central Council Members, CA. Subodh Kumar Agrawal, the then Chairman, CMAA and Members of Eastern India Regional Council. The well known Bollywood actor Mr. Jackie Shroff, Bengali actresses Ms. Rachna Banerjee and Ms. Priyadarshini were also present during the event.

The event was cheered and witnessed by a jam-packed audience. The awards honoured the exemplary work of Chartered Accountants in Industry by recognising those who have demonstrated excellence in the professional life, personal life and are the role models for others in industry. As many as 20 awards were conferred on Chartered Accountants for excellence in various categories including two Special Achievement awards. The high profile 19-member award jury, consisting of luminaries from the

industry, was chaired by Shri Adi Godrej, Chairman, Godrej Industries Ltd. Other members of the jury were Shri. Anil K. Agarwal, Former President, ASSOCHAM, Shri. A. M. Naik, CMD, L&T Ltd, Smt. Chanda Kochhar, MD & CEO, ICICI Bank Ltd., Shri. Deepak S. Parekh, Chairman, HDFC Ltd., Shri. H.M Bangur, MD, Shree Cement Ltd., Shri. J. J. Irani, Director, TATA Sons Ltd., CA. Kamlesh S. Vikamsey, Former President, ICAI, Shri. Milind Murli Deora, Member of Parliament, Lok Sabha, Shri. Nimesh N. Kampani, Chairman, JM Financial Group, Shri. Partha S. Bhattacharyya, Chairman, Coal India Ltd., Shri. Prabhu Chawla, CEO & Editor, Language Publications, India Today, Shri. Raj Kumar Dhoot, Member of Parliament, Rajya Sabha, Shri. Rana Kapoor, MD & CEO, Yes Bank, Shri. Rashesh Shah, Chairman, CEO & Founder, Edelweiss Capital Ltd., Shri. Rohinton Soli Screwvala, CMD, UTV Software Communication Ltd., Shri. R. S. Sharma, CMD, ONGC Ltd., Shri Sanjiv Goenka, Vice Chairman, RPG Enterprises, Mr. V. K. Viswanathan, MD, Bosch Ltd.

After the distribution of the awards a musical evening was presented by renowned singer Sonu Nigam. He left the audience spellbound with his magical voice. Committee for members in Industry hopes to continue organising such events in future also for the benefit of members in industry and corporates. The prestigious 3-day programme was widely covered by local as well as national media encompassing both Print Media and Electronic Media particularly DD Bangla for all Four events, R Plus - Local TV Channel, Taza TV. The Award Ceremony was also covered by UTV. The programme was also covered by Red FM.

Recipients of ICAI Awards - 2010

S. No.	Name		Designation	Organisation	Category
1		CA. R. Sridhar	Managing Director	Shriram Transport Finance Company Ltd	CA Business Achiever - Financial Services
2		CA. Yeshwant Moreshwar Deosthalee	Chief Financial Officer & Member of the Board (since 1995)	Larsen & Toubro Limited	CA Business Achiever - Corporate
3		CA. Pitamber Sharan Patwari	Executive Director (CEO)	Emami Paper Mills Limited	CA Business Achiever - SME
4		CA. Zarin B Daruwala	Group Executive-Wholesale Banking Group	ICICI bank	CA Business Achiever - Woman
5		CA. Uday Yeshwant Phadke	President - Finance, Legal Affairs & Financial Services, Member - Group Executive Board, Secretarial Function	Mahindra & Mahindra limited	CFO - Manufacturing sector
6		CA. V. Srinivasa Rangan	Executive Director	Housing Development Finance Corporation Ltd.	CFO - Financial Sector
7		CA. Chandra Mohan Sharma	Global Chief Financial Officer	Aegis Limited	CFO - Service Sector
8		CA. Anil Kashinath Patwardhan	Vice President & Head - Corporate Finance & Governance	KPIT Cummins Infosystems Ltd.	CFO - Information Technology
9		CA. Subba Rao Amarthaluru	Group CFO	GMR Infrastructure Limited	CFO - Infrastructure and Construction
10		CA. Gopal Mahadevan	Exec. VP & Group CFO, Thermax Group	Thermax Limited	CFO - Engineering & Capital Goods Sector

11		CA. S. V. Narasimhan	Director (Finance)	Indian Oil Corporation Ltd.	CFO - Public Sector
12		CA. Sangeeta Gulati	Chief Financial Officer	Educomp Solutions Limited	CFO - Woman
13		CA. Sunjoy Podaar	Joint Executive President	Ultra Tech Cement Ltd.	CA Professional Achiever - Manufacturing Sector
14		CA. Sanjay Agarwal	President and Business Head Banking	Yes Bank	CA Professional Achiever - Financial Sector
15		CA. Avishkar Prabhakar Naik	Manager	National Stock Exchange of India Limited	CA Professional Achiever - Service Sector
16		CA. Kanchan Mukhopadhyay	Solution Architect & Senior Application Consultant	International Business Machine India Private Limited-IBM	CA Professional Achiever - Information Technology
17		CA. S. N. Jayasimhan	Joint Director	The Insurance Regulatory and Development Authority	CA Professional Achiever - Public Sector
18		CA. S. N. Rajeswari	Chief Manager	United India Insurance Company Limited.	CA Professional Achiever - Woman
19		CA. A. B. L. Srivastava	Executive Director	NHPC	Special Achievement Award
20		CA. Basant Seth	Chairman and Managing Director	Syndicate Bank	Special Achievement Award

GUIDANCE NOTE ON AUDIT OF PROPERTY, PLANT & EQUIPMENT

The following is the text of the Guidance Note on Audit of Property, Plant and Equipment (PPE) issued by the Auditing and Assurance Standards Board (AASB) of the Institute of Chartered Accountants of India. This Guidance Note should be read in conjunction with the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services" issued by the Institute.

- Paragraph 26 of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services" states that "Guidance Notes are issued to assist professional accountants in implementing the Engagement Standards and the Standards on Quality Control issued by the AASB under the authority of the Council. Guidance Notes are also issued to provide guidance on other generic or industry specific audit issues, not necessarily arising out of a Standard. Professional accountants should be aware of and consider Guidance Notes applicable to the engagement. A professional accountant who does not consider and apply the guidance included in a relevant Guidance Note should be prepared to justify the appropriateness and completeness of the alternate procedures adopted by him to deal with the objectives and basic principles set out in the Guidance Note."
- This Guidance Note, does not supersede the Institute's publications which provide guidance on audit of Property, Plant and Equipment (PPE) with special reference to certain statutory requirements, e.g., the guidance contained in the Statement on the Companies (Auditor's Report) Order, 2003.
- The Guidance Note has been prepared considering the relevant Revised Accounting Standard 16, "Property, Plant & Equipment" (corresponding to IAS 16) which is being issued by the Institute pursuant to the decision to converge with the International Financial Reporting Standards (IFRS) in respect of accounting periods commencing on or after April 1, 2011 and the existing Accounting standards AS 10 "Accounting for Fixed assets" and AS 6 "Depreciation Accounting" which are applicable to the entities who are not required to comply with the *relevant Revised AS*. Both the categories of the Accounting Standards are collectively referred to as the "relevant applicable AS".
- The Guidance Note does not apply to audit of Investment Property and Intangible Assets.
- In the event of a possible or perceived contradiction between the Guidance Note and a Standard on Auditing (SA) issued by the Institute, the Standard shall prevail.

Introduction

- The term *Property, plant and equipment* in respect of those entities which are required to comply with the *relevant Revised AS* refers to such tangible items that:

- are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- are expected to be used during more than one period.

In respect of such entities which need to apply AS 10 and AS 6, the term "Property, Plant and Equipment" comprises assets held for the purpose of providing or producing goods or services and which are not meant for sale in the normal course of business. Judgement is required to be exercised in recognising what constitutes an item of property, plant and equipment having regard to an entity's specific circumstances. For example, major spare parts, servicing equipment, and stand-by equipment, which an entity expects to use during more than one period, can be recognised as PPE as per the *relevant Revised AS*.

- An asset can be classified as a PPE or otherwise, depending upon the use to which it is put or intended to be put. For example, assets which are classified as PPE in one type of business may be considered as current assets in another. Similarly, the same asset may be classified differently in an entity at different points of time. The recognition of Property, Plant and Equipment should be done as per the principles laid down in the "relevant applicable AS".
- PPE normally constitute a significant portion of the total assets, particularly in a manufacturing entity. Audit of PPE, therefore, assumes considerable importance.
- The following features of PPE have an impact on the related audit procedures:
 - By their very nature, PPE are turned over much slower than current assets which are held for sale. Normally, PPE are carried over from year to year.
 - The average unit of PPE is normally of a relatively larger rupee value.
 - Since PPE are high value items, their acquisition is normally more closely controlled. The control aspect assumes special significance where PPE are self-constructed.
 - PPE are generally accounted for once unlike other assets like stock, because of which any error would affect the financial statements permanently or at least for a significant period of time.

- (e) In an inflationary situation, where cost model is adopted, normally, the book values of PPE are considerably lower than their replacement values.

Risks Associated with Property, Plant and Equipment

Inherent Risks

10. The auditor needs to obtain an understanding of the client and its environment to consider inherent risk, including fraud risks, related to property, plant, and equipment. This includes:
- Obtaining an understanding of the internal control over property, plant, and equipment. For example, preparation of and review of capital budgets, etc.
 - Assessing the risks of material misstatement and designing tests of controls and substantive procedures that cover the following aspects:
 - Substantiate the **existence** of property, plant, and equipment. PPE may include assets that should have been derecognised following sale, other transfer of rights or abandonment. Auditor should verify title deeds, agreements or other ownership documents.
 - Establish the **completeness** of recorded property, plant, and equipment. Expenditure that should have been recognised as property, plant and equipment but has not been so recognised, including capitalised finance costs, failure to account for assets held under finance leases or hire purchase agreements.
 - Verify the **cutoff** of transactions affecting property, plant, and equipment.
 - Determine that the client has the **rights** to the recorded property, plant, and equipment.
 - Establish the proper **valuation** or allocation of property, plant, and equipment and the **accuracy** of transactions affecting PPE.
 - Determine the correctness and appropriateness of classification of property, plant and equipment. For example, incorrect split between land and buildings or between long term and short term leaseholds. Classification may have a significant impact on the application of the accounting policies. As per relevant Accounting Standard, the entities have to follow the component approach, as may be applicable.
 - Depreciation value** - Depreciation may have been incorrectly calculated on account of factors such as:
 - mechanical error; or
 - incorrect application of accounting policy; or
 - inappropriate assessment of remaining useful life; or

- inappropriate assessment of residual value; or
 - incorrect classification of the asset.
- viii. **Carrying cost** - Where a valuation model is followed - carrying amount may not reflect fair value due to factors including:
- failure to update valuations for current circumstances; or
 - failure to brief valuers correctly, use of invalid assumptions or data, etc., or
 - valuations not performed by competent personnel.
- ix. **Existence/valuation** - tangible assets acquired in a business combination may not have been initially recognised at their fair value at that date.
- x. **Value of impairment** - failure to recognise impairment or reversal of impairment.
- xi. Determine that the presentation and disclosure of property, plant, and equipment are appropriate.

Fraud Risks and Errors

11. Some of the potential misstatements in PPE on account of frauds and errors include:
- Purchase of an asset at an inflated price especially from a related party.
 - Wrong write-off of the asset as scrap, obsolescence, missing, donated, or destroyed.
 - Expenditures for repairs and maintenance recorded as PPE or vice versa.
 - Capitalisation of expenditure which are not normally attributable to the cost of the PPE.
 - Recording of an asset purchased, which in effect has not actually been received by the entity at all.
 - Removal of an asset paid for by the entity or use of an asset of the entity for the benefit of a person other than the entity.
12. Such errors and frauds could occur because of weak internal controls in the entity including:
- Inadequate involvement of management in overseeing employees with access to cash or other assets susceptible to misappropriation.
 - PPE which are small in size, marketable, or lacking observable identification of ownership.
 - Lack of complete and timely verification and reconciliations of assets.
 - Inadequate physical safeguards over PPE.
 - The misuse of the entity's assets by an employee.
 - Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).
 - The asset is intentionally sold below fair market value.
13. The auditor should perform risk assessment procedures to provide a basis for the identification and assessment of

risks of material misstatements. These would include:

- (a) Inquiries of management and others within the entity to identify the risks. For example, control procedures, entity's objectives and strategies, incentive policies, etc.
- (b) Analytical procedures, for example, Ratios, etc.
- (c) Observation and inspection of the entity's premises and plant facilities.

Internal Controls

14. An auditor should review the system of internal controls relating to PPE, particularly the following:

- (a) *Control over expenditure incurred on PPE acquired or self-constructed*-An effective method of exercising this control is capital budgeting, which, apart from ensuring proper authorisation of the expenditure incurred, also shows, in general, how effectively such expenditure is being controlled through periodical comparisons of actuals with budgeted figures. It also ensures that amounts expended do not exceed the amounts authorised, and controls allocation of expenditure between capital and revenue in the case of self constructed assets.
- (b) *Accountability and utilisation controls*-Accountability over each PPE (or each class or component of PPE (in the case of companies following the relevant Revised AS)) is established, among other things, by maintaining appropriate records. This facilitates control over custodianship of such assets, for example, physical verification by the management or establishment of procedures relating to disposal of PPE. On the other hand, utilisation controls ensure that the individual PPE have been properly used for meeting the objectives of the entity.
- (c) *Information controls*-These controls ensure that reliable information is available for calculating and allocating depreciation, recording disposals or retirements, preparing tax returns, establishing the amount of insurance coverage, filing insurance claims, controlling repairs and maintenance charges or expenses incurred for inspection to assess the condition of the asset, replacement cost of specific parts, useful life of assets or specific parts, eg, specified number of hours of use, etc.
- (d) *Safeguarding of assets*-These controls ensure that the assets owned by the entity are safeguarded and any loss on damage/destruction of such assets are made good, through for example, insurance of assets, warranties, etc. The entity may have a process by which responsibility to safeguard the assets could be identified to specific personnel.

Substantive Procedures

15. Verification of PPE consists of examination of related

records and physical verification. The auditor should, normally, verify the records with reference to the documentary evidence and by evaluation of internal controls. Physical verification of PPE is primarily the responsibility of the management.

- 16. The auditor must also consider the appropriateness of the accounting policies, including policies for determining which costs are capitalised, whether a cost or valuation model is followed and depreciation (including assessment of residual values) appropriately calculated.
- 17. As per the *relevant Revised AS*, the auditor should ensure that the entity has capitalised the assets as per the component approach, whereby a component or part of an asset which is significant in value compared to the total value of the asset or the useful life of which is different from that of the asset, has to be capitalised separately.

Verification of Records

Opening Balances

- 18. The opening balances of the existing PPE should be verified from records such as the schedule of PPE, ledger or register balances. In the case of initial engagements, as per SA 510 (Revised), "Initial Audit Engagements – Opening Balances", for the purpose of ascertaining the accuracy of the opening balance of PPE, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances.
- 19. The auditor would also need to obtain summary of changes to PPE and reconcile the same to the ledgers.

Capital Work in Progress

- 20. The auditor must verify records to ensure that the assets under construction or pending installation and not yet ready for intended use are classified as work in progress.
- 21. Capital work in progress should be verified with reference to the underlying contractor bills, work orders, certification of work performed by independent persons, comparison of the progress and the costs incurred up-to-date with the budgets, capital asset management policy and plan, pending commitments, etc.
- 22. It must be ensured that an appropriate system is in place to capture all directly identifiable costs, which can be capitalised, to be so accumulated to the capital work in progress (WIP) whilst expenses which are not eligible for being capitalised are identified and charged to revenue in the normal course. The auditor should reconcile the movement of capital work in progress from opening to closing, specifically verifying additions during the year, capital assets completed during the years and impairment of any opening capital work in

progress items. The closing work in progress value should be bifurcated asset class wise or project wise so that reconciliation of the capital WIP is made easier and more logical. The Capital work in progress should be reviewed with respect to the intention and ability of the management to carry forward and bring the asset to its state of intended use. The auditor should also specifically verify the date on which the assets are moved from the capital work in progress account to the fixed assets (the date on which the asset is ready for intended use), so that the depreciation on fixed assets may be computed correctly.

Additions to PPE

23. Acquisition of new PPE and improvements to the existing ones should be verified with reference to supporting documents such as orders, invoices, receiving reports and title deeds and applicable customs or excise documents. Due care needs to be taken when the purchase is from a related party. The auditor may employ procedures such as possible comparative prices prevalent in a ready market, evaluation, justification and approvals for the purchase.
24. Self-constructed PPE and improvements thereto should be verified with reference to the supporting documents such as contractors' bills, work-order records, installation certification, completion certificates and independent confirmation of the work performed.
25. The auditor should make appropriate enquiries and examine lease contracts to provide evidence that PPE acquired under finance leases or hire purchase agreements have been properly capitalised.
26. In respect of the additions to PPE during the year, the supporting documentation and information for the date on which the asset was put to use / was ready to use is required to be verified.
27. Assets acquired in exchange for a non monetary asset(s) should be verified with reference to the supporting documents for the commercial substance of the transaction (cash flows from the assets acquired against those given up) and the value of the asset given up.
28. The auditor should review expense accounts (e.g., Repairs and Renewals) to ascertain that new capital assets and improvements have not been included therein.

Ownership of PPE

29. The ownership of assets, like land and buildings, may be verified by examining the title deeds. In case the title deeds are held by other persons, such as solicitors or bankers, confirmation should be, at least where significant, obtained directly by the auditors through a request signed by the client.
30. The auditor would also need to perform procedures to

obtain corroborating evidence that the client actually possesses the rights associated with the assets under consideration. For example, the fact that the cash flows or economic benefits associated with it are actually accruing to the client.

Impairment of PPE

31. The auditor needs to consider whether there are circumstances as per AS that indicate a possible impairment of property, plant and equipment and if such circumstances exist, how the same have been dealt with by the entity. Decline in the market value of assets, changes in technological, legal or economic environment in which the entity operates, evidence of physical damage of assets, are some indications of impairment.

Deletions from PPE

32. Where PPE have been written-off or fully depreciated in the year of acquisition/construction, the auditor should examine whether these were recorded in the PPE register before being written-off or depreciated.
33. In respect of PPE retired, i.e., destroyed, held for sale, scrapped or sold, the auditor needs to examine the following aspects, *inter alia*:
 - (a) whether the retirements have been properly authorised and appropriate procedures for invitation of quotations have been followed wherever applicable;
 - (b) whether the assets and depreciation accounts have been properly adjusted;
 - (c) whether the sale proceeds, if any, have been fully accounted for; and
 - (d) whether the resulting gains or losses, if material, have been properly adjusted and disclosed in the Profit and Loss Account.
34. It is possible that certain assets destroyed, scrapped or sold during the year have not been recorded. The auditor may use the following procedures to ascertain such omissions:
 - (a) Review work orders/physical verification reports to trace any indicated retirements.
 - (b) Examine major additions to ascertain whether they represent additional facilities or replacement of old assets, which may have been retired.
 - (c) Make enquiries of key management and supervisory personnel.
 - (d) Obtain a certificate from a senior official and/or departmental managers that all assets scrapped, destroyed or sold have been recorded in the books.
35. The auditor would also need to review the board minutes and other correspondence for indications of significant asset acquisitions, disposals or retirements.
36. Where there has been a change of use, the auditor would need to consider whether this gives rise to a need

to change classification of the asset (eg, to inventory), assets held for sale, investment property, etc.

Physical Verification

37. It is the responsibility of the management to carry out physical verification of PPE at appropriate intervals in order to ensure that they are in existence. However, the auditor should satisfy himself that such verification was done by observing the verification being conducted by the management wherever possible and by examining the written instructions issued to the staff by the management and the relevant working papers. The auditor should also satisfy himself that the persons conducting the verification, whether the employees of the entity or outside experts have the necessary competence.
38. The auditor should examine whether the method of verification was reasonable in the circumstances relating to each asset. For example, in the case of certain process industries, verification by direct physical check may not be possible in the case of assets which are in continuous use or which are concealed within larger units. SA 501, "Audit Evidence – Specific Considerations for Selected Items" contain principles related to the auditor's responsibilities and procedures in respect of attendance at physical inventory counting undertaken by the management. It would not be realistic to expect the management to suspend manufacturing operations for conducting a physical verification of the PPE, unless there are compelling reasons which would justify such an extreme procedure. In such cases, indirect evidence of the existence of the assets may suffice. For example, the very fact that an oil refinery is producing at normal levels of efficiency may be sufficient to indicate the existence of the various process units even where each such unit cannot be verified by physical or visual inspection. It may not be necessary to verify assets like building by measurement except where there is evidence of alteration/demolition. At the same time, in view of the possibility of encroachment, adverse possession, etc., it may be necessary for a survey to be made periodically of open land. Where the PPE can be moved and where verification of all assets cannot be conducted at the same time, they should be marked with distinctive numbers.
39. The auditor should apply appropriate emphasis on the verification of assets by the management of the assets which are outside the premises of the company, with third parties. This may be by way of a process of physical verification by the management or by way of obtaining confirmation from the third party holding the asset, depending on the management's risk assessment of such assets and the materiality of such assets.
40. The auditor should examine whether the frequency of verification was reasonable in the circumstances of

each case. Where the assets are few and can be easily verified, an annual verification may be considered as reasonable. However, where the assets are numerous and difficult to verify, verification, say, once every three years by rotation - so that all assets are verified at least once in every three years – may be sufficient.

41. The auditor should test check the records of PPE with the physical verification reports. He should examine whether discrepancies noticed on physical verification have been properly dealt with. In this regard the auditor should use his judgement as to whether having regard to the circumstances, the discrepancy is material enough to warrant an adjustment in the accounts and/or modification in the internal control system.

Recognition

42. The auditor should ensure that the cost of an item of property, plant and equipment is recognised as an asset only when the costs have been reliably measured and it has been ascertained by the management that future economic benefits will flow to the entity.
43. The auditor should also verify that the entity has recognised a fixed asset in accordance with the generally accepted accounting principles applicable to the entity.
44. *Capital work in progress*: The auditor should verify that PPE under construction are recognised as capital work in progress until such time they are ready for intended use. The auditor should also verify that only those costs that could be capitalised are included under work in progress.
45. *Component approach*: As per the relevant revised AS, in the component approach of accounting for the PPE, the auditor should verify that the relevant PPE are capitalised as components where the useful life of the components significantly vary from the useful life of the entire asset (eg, Cost of relining a furnace, aircraft seats which require replacement at regular intervals and, thus, have a varying useful life from the rest of the furnace or aircraft, respectively). Each major part of the item of PPE with a cost that is significant in relation to the total cost of the item is depreciated separately. However, where the entity has originally not recognised a component separately, but subsequently replaces the part or a component, the auditor needs to verify that such replacements are capitalised only if the capacity or useful life of the asset increased, or quality of output improved or operating costs were reduced over and above that which was originally intended or estimated for the asset. The replaced part is derecognised.

Valuation

Carrying Cost of PPE

46. The auditor should satisfy himself that the PPE have

been valued in the financial statements according to the generally accepted bases of accounting and as per the applicable reporting framework which are determined by law, professional pronouncements of the Institute and the prevailing industry practices.

47. After initial recognition of the asset, in the case of subsequent measurement, the auditor should verify that the value of the asset is as per the model chosen by the entity as cost or revaluation model.
48. The auditor should also satisfy himself that the method by which the fair value has been determined is reasonable for the asset under consideration. For example, the market value method, income approach or the depreciated cost approach.
49. The auditor should also satisfy himself that the value has been determined with the help of a person competent to value the assets under consideration.
50. As per the *relevant Revised AS*, the auditor should verify that costs of major inspections, cost of spares used in connection with an asset and expected to be used for more than one period are added to cost of asset and derecognised earlier cost as per generally accepted accounting principles.
51. The auditor should consider whether the entity has reviewed the carrying value of its assets and how it determines the recoverable amount of the asset.
52. As per the *relevant Revised AS*, where several assets have been purchased for a consolidated price, the auditor should examine the method by which the consideration has been apportioned to the various assets. In case this has been done on the basis of an expert valuation, he should examine whether the same appears reasonable and based on adequate facts.
53. Where an entity owns assets jointly with others (otherwise than as a partner in a firm) the auditor should examine the relevant documents such as title deeds, agreements, etc., in order to ascertain the extent of the entity's share in such assets. The assets are used to obtain benefits for the entity and/or the entity recognises its share of the assets. The auditor needs to verify the underlying agreements and the benefits which the entity receives or expects to receive as per generally accepted accounting principles.
54. As per the *relevant Revised AS*, where the entities have obligations to dismantle, remove and restore items of property, plant and equipment, the cost of an item of plant and equipment have to include such costs. The auditor should examine the method and process of identification, estimation and treatment of such costs based on the model in which the asset is measured in accordance with the generally accepted accounting principles.
55. The auditor must ensure that the cost of self constructed assets include all the items of costs which are to be capitalised including specific direct expenses related to the asset and appropriate borrowing costs.
56. As per the *relevant Revised AS*, the auditor should ensure that the cost of self constructed assets do not include cost of abnormal wastage of material labour or other resources.
57. As per the *relevant Revised AS*, the auditor should also verify the payment towards the assets beyond the normal credit terms to confirm the cost which can be capitalised.

PPE Acquired on/or as Government Grants

58. When the entity acquires land or other fixed assets as government grants at concessional rates, then the entity has to account for such assets at the acquisition cost. In case the asset is acquired free of cost, it should be accounted at nominal value.
59. The grant can be shown as a deduction from the gross value of assets or the asset can be shown in the balance sheet at the net value.
60. Entity following *relevant Revised AS* should capitalise the assets at the full value and account for the grant according to the relevant applicable Standard.

Depreciation

61. The auditor should test check the calculations of depreciation and the total depreciation arrived at should be compared with that of the preceding years to identify reasons for variations. He should particularly examine whether the depreciation charge is adequate keeping in view the generally accepted bases of accounting for depreciation.
62. As per the *relevant Revised AS*, the auditor must check that each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately. Such part of an item may also have different useful life over which the asset is to be depreciated. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
63. The auditor should review the depreciation method applied to the asset at least at the end of each financial year to confirm that the depreciation charge reflects the usage. A change in the method of depreciation should be treated appropriately as a change in an accounting estimate.
64. The auditor must verify that those assets under construction or installation are not depreciated until such time they are ready for intended use but these should be tested for impairment, if any.

Useful Life of PPE

65. The auditor should ensure that the management has reviewed the useful life and the residual value of the asset at least annually. The useful life is, ordinarily, estimated based on the future economic benefits embodied in the asset or such other factors prescribed by the Standard or the asset management policy of the entity.

Impairment of PPE

66. An asset is impaired when the carrying amount of the asset exceeds its recoverable amount. If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount.
67. The auditor should enquire whether any compensation is receivable from third parties for items of PPE which are impaired, lost or given up and credit the same to the Profit & Loss Account when the amount becomes receivable.
68. An impairment loss recognised for an asset in prior accounting periods should be reversed if there has been a change in the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset should be increased to its recoverable amount. That increase is a reversal of an impairment loss.
69. The increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods.

Revaluation of PPE

70. Revaluation of PPE implies restatement of their book values on the basis of systematic scientific appraisal which would include ascertainment of working condition of each unit of PPE, technical estimates of future working life and the possibility of obsolescence. This is done where the fair value of the asset can be reliably measured. As per SA 620 (Revised), "Using the Work of an Auditor's Expert", if expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor needs to determine whether to use the work of an auditor's expert. For example, an expert may be used for valuation of land and buildings or plant and machinery, such an appraisal is usually made by independent and qualified persons such as engineers, architects, etc. To the extent possible, the auditor should examine these appraisals. As long as the appraisals appear reasonable and based on adequate facts, he is entitled to accept the revaluation made by the experts.
71. Where valuation is performed internally, the auditor should consider the basis on which it was done, the

adequacy of the evidence obtained to support the valuation and the overall reasonableness of the result.

72. The auditor must also satisfy himself that the frequency of revaluation is adequate and appropriate so that the fair value of the revalued asset does not materially differ from the carrying value of the asset.
73. The auditor should verify the basis of de-recognition and the accounting treatment of an asset on disposal or when no future economic benefits are expected from its use.

Disclosure

74. The auditor should verify that the entity has made relevant disclosures for PPE (or class of PPE) on depreciation methods, measurement bases, details of additions and deletions, the existence of rights and restrictions, carrying amount during the course of construction, contractual commitments, impairment of assets, revaluation of assets, etc., as per the Standards applicable to the entity.

Audit in IT environment

75. The auditor needs to check the controls based on the use of manual or automated elements which affect the manner in which transactions are initiated, recorded, processed and reported. The IT environment benefits the entity by:
- Providing consistency in application of pre defined policies. For example, application of depreciation rate based on asset classification or useful life.
 - Enhancing timeliness and accuracy of information, for example, monthly account closure procedures like passing depreciation entries.
 - Generating analytical information, for example, Ratios, comparative information, etc.
 - Reducing risks that controls can be circumvented, for example, authorisation for purchase of fixed assets.
76. The IT environment, however, may pose control threats like:
- Reliance on systems which may inaccurately process data.
 - Unauthorised access to data leading to data loss or destruction. For example, the Fixed Assets Register may be tampered with by other personnel.
 - Unauthorised changes to data in master file.
 - Inappropriate manual intervention.
 - Inability to access data as required.
77. The auditor needs to determine that the automated control is functioning as intended. Subsequently, the following also need to be verified:
- That the changes to programs are subject to controls.
 - That the authorised version of the program is used.
 - Other general controls.
 - Inspection of the record of administration of IT.

CROSS

WORD 057

ACROSS

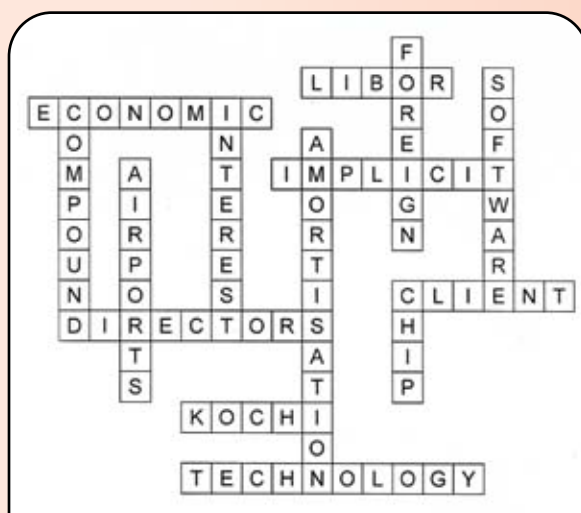
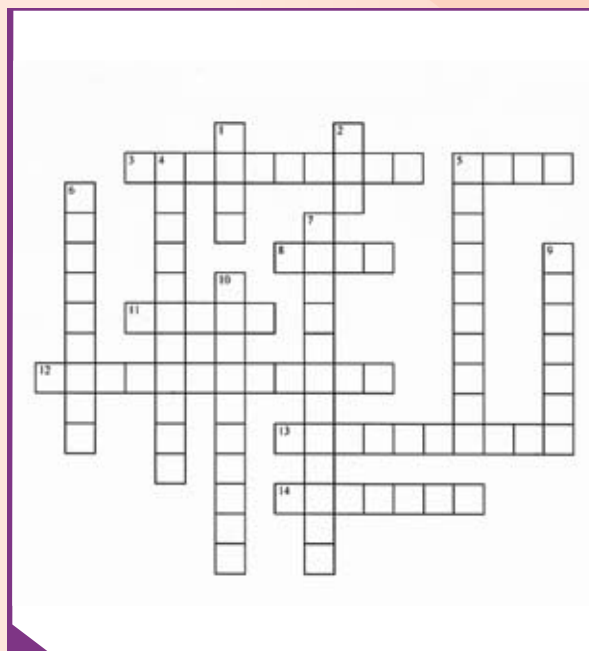
3. Activity of _____ of export cargo whether loaded into containers or otherwise is not a taxable service under 'cleaning services'. (10)
5. The Reserve Bank of India has recently revised the regulatory framework for _____ Investment Companies. (4)
8. _____ has stood the test of time in terms of its purchasing power during known human history. (4)
11. One of the newly established branches of the ICAI. (5)
12. Deductions from employees' gross salaries and wages. (12)
13. SEBI has issued master circular for Stock Exchanges related to _____. (4,6)
14. Consolidated report on the Direct Taxes Code Bill, 2010 has been submitted by the ICAI to the Parliamentary Standing Committee on _____. (7)

DOWN

1. ICAI has entered into an MoU with this Accounting body.
2. Educational institute recently recognised the CA Course for its Ph.D. Programme.
4. Full exemption from excise duties to goods cleared from industrial units in the states of _____ and Himachal Pradesh. (11)
5. A person providing services to a company who is not deemed to be an employee of the company is referred to as an Independent _____. (10)
6. An agreement has been entered into by the ICAI with the New India Insurance Co. for Insurance against professional _____. (9)
7. Worker _____ insurance covers work-related injuries. (12)
9. Goods enroute from the seller to the buyer are said to be in _____. (7)
10. New Minister of Corporate Affairs. (5,5)

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 056



1 A *fine* is a tax you pay for doing wrong and a *tax* is a fine you pay for doing all right.

2 For twenty years of service, Gopal had arrived at work at 9A.M. on the dot. He had never missed a day and was never late.

Consequently, when on one particular day 9 A.M. passed without his arrival, it caused a sensation. All work ceased, and the boss himself, looking at his watch and muttering, came out into the corridor.

Finally, precisely at ten, Gopal showed up, clothes dusty and torn, his face scratched and bruised, his glasses bent. He limped painfully to the time clock, punched in, and said, aware that all eyes were upon him, "I tripped and rolled down two flights of stairs in the subway. Nearly killed myself."

And the boss said, "And to roll down two flights of stairs took you a whole hour?"