Study on Compliance of Financial Reporting Requirements

(Compiled from the records of Financial Reporting Review Board)

Volume-II

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

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Foreword

The ICAI through Financial Reporting Review Board aims to develop and maintain an environment of sound financial reporting of General Purpose Financial statements in the country, which is important to promote investor confidence in audited financial statements.

The Institute has always been active in improving the transparency in financial reporting and good governance. The Financial Reporting Review Board (FRRB) has been constituted by the ICAI with an objective to improve the financial reporting practices in the country by undertaking review of the general purpose financial statements of various enterprises. It issues advisories to the members on the non-compliances observed by it during the review process to enable them to exercise more diligence while discharging their duties. If the Board observes any instance of gross accounting irregularities, it refers the material non-compliances to the relevant regulators. Over the time, review carried out by the FRRB has become an established mechanism for monitoring compliance by reporting enterprises.

This publication by the Financial Reporting Review Board is an attempt to share with members, both in practice and industry, instances of common non compliances. This will help them to observe the highest level of best practices and thus enhance overall image of the profession.

I compliment all the members of the Board, particularly, CA Nilesh S. Vikamsey, Chairman for their efforts in bringing out this publication.

February 6, 2014
New Delhi

CA. Subodh Kumar Agrawal
President, ICAI

Preface

Financial reporting involves presentation of financial statements to the users, who use the same to take more informed financial decisions. The users of financial statements vary widely and include shareholders, creditors, suppliers, financial analysts, government authorities and other stakeholders. Thus, the quality of financial statements is of prime concern not only for the stakeholders of the company but for the entire economy as it collectively affects the economic decisions of various users, whether related directly or indirectly, which may have significant impact. Transparent financial reporting is an effective tool for sustaining in fast changing economic environment and globalisation. If the financial statements are prepared in accordance with prevailing Generally Accepted Accounting Principles while complying with the various rules and regulations prescribed by various statutes, it will ensure transparency in financial reporting.

In the pursuit of its objective to improve the financial reporting practices in the country, the Financial Reporting Review Board (FRRB) undertakes review of the general purpose financial statements to determine compliance with the reporting requirements of various applicable statutes, accounting standards and standards on auditing. The observations of the Board made during the review of financial statements have been compiled as second volume of the publication. This publication contains common observations of the Board on compliance aspects of various Financial Reporting Requirements. These observations have been classified Accounting Standards wise and also include observations on certain sections of the Companies Act, 1956, Companies (Auditor's Report) Order, 2003 (CARO) and Standards on Auditing (SA) 700 – 'The Auditor's Report on Financial Statements' which should be complied with while preparing the financial statements or expressing opinion thereupon.

I am confident that this publication would sharpen the financial reporting skills of the preparers of financial statements as well as of the members of our Institute thus paving the way for enhancing the quality of the financial statements and the quality of services rendered by the members as well as leading to professional development. It will educate the preparers of financial statements and members about the compliance of financial reporting requirements with respect to the preparation and presentation of financial statements, disclosures requirements prescribed by various regulatory bodies, statutes and rules and regulations relevant to the enterprise and also the reporting obligations of the auditor.

The Accounting Standards referred in the publication may be read as notified under the Companies (Accounting Standards) Rules, 2006.

I wish to place on record my sincere gratitude to the members of the FRRB both past and present, for their valuable inputs during the meetings which have become basis of the publication. Many thanks are also due to my Council colleagues at the Board, viz. CA. Nihar Niranjan Jambusaria, Vice-Chairman, CA. J. Venkateswarlu, CA. Abhijit Bandyopadhyay, CA. Manoj Fadnis, CA. Shriniwas Yeshwant Joshi, CA. Sanjeev K. Maheshwari, CA. Babu Abraham Kallivayalil, and CA. Sanjiv Kumar Chaudhary as well as the members of the Financial Reporting Review Groups and the Technical Reviewers empanelled with FRRB. I would also like to place on record my sincere thanks to CA. Nalin M Shah for sparing time out of his pressing preoccupations to review the draft of this Study. I also wish to express my thanks to Dr (CA.) Rashmi Goel, Secretary, Financial Reporting Review Board, CA. Ankita Mangla, Sr. Executive officer and CA. Chetna Gupta, Sr. Executive officer for their efforts in giving the draft its final shape.

I am sure that this volume of the publication would prove to be a useful reference material to the members, preparers of financial statements and other interested readers.

CA. Nilesh S. Vikamsey
Chairman
Financial Reporting Review Board

February 6, 2014
New Delhi

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Observations on Accounting Standard (AS) 1: Disclosure of Accounting Policies

S. No.	Matter contained in Annual report	Observations
1.	From the Annual Report of a company, it has been noted that the company has filed an application with the High Court to merge with its subsidiary company with effect from the first day of the financial year. Further, it was also noted that a loan was given by it to its subsidiary and the subsidiary company had given assets to it on lease. In view of the aforesaid application, the company has neither disclosed the interest income on the loan given to the subsidiary company nor the lease rentals payable by it to the subsidiary during the year.	It may be noted that paragraph 27 of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', requires that if the fundamental accounting assumptions, viz. going concern, consistency and accrual are followed in the financial statements, specific disclosure is not required. However, if a fundamental accounting assumption is not followed, that fact should be disclosed. It was viewed that since the decision of the High Court was pending till the date of preparation of the financial statements, it was not appropriate to assume that the two companies had merged for the said financial year. Accordingly, not recognising the interest income as well as lease rent payable to the subsidiary company in the financial statements, although they have become due, tantamount to not following the accrual concept with regard to them. This is contrary to the provisions of the Section

		209(3) (b) of the Companies Act, 1956 as well as paragraph 27 of AS 1.
2.	From one of the notes to accounts given in the Annual Report of a company, it has been noted that although there was an unrealised loss as on the Balance Sheet date, it, had not been recognised in the financial statements.	It may be noted that paragraph 17 of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', provides as follows: "17. For this purpose, the major considerations governing the selection and application of accounting policies are:— *a. Prudence* In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information." In view of the above, all known liabilities and losses should be provided for even though their amount cannot be determined with certainty. In other words, 'prudence' prohibits the recognition of future expected profits but mandates the recognition of future expected losses. Accordingly, it was viewed that the provision of paragraph 17 of

		AS 1 was not correctly applied in the extant case.
3.	From the notes to accounts given in the Annual Report of a company, it has been noted that accounting policies were given under various notes to accounts instead of stating all such policies under a single head of significant accounting policies.	It may be noted that paragraph 25 of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', requires that the disclosure of the significant accounting policies as such should form part of the financial statements and the **significant accounting policies should normally be disclosed in one place** (emphasis added). Accordingly, the disclosure of accounting policies at different places in the notes to accounts is not in compliance with paragraph 25 of AS 1.
4.	From the notes to accounts given in the Annual Report of a company, it has been noted that information relating to contingent liabilities has been disclosed under various notes instead of disclosing the same at one place.	It may be noted that paragraph 20 of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', states that: "20. It would be helpful to the reader of financial statements if they are all disclosed as such in one place instead of being scattered over several statements, schedules and notes." It was felt that for better presentation, the information of the same nature should have been shown under one head at one place rather than disclosing the same under various notes. Hence, it was viewed that the presentation of the information

		has not been made as required by the spirit of paragraph 20 of AS 1.
5.	From the schedules of other income given in the Annual Reports of some companies, it has been noted that these companies had recognised significant amounts of income arising from various sources such as income from DEPB license, property development projects and interest etc. However, the accounting policies adopted by them for their recognition were not disclosed.	It may be noted that paragraph 24 of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', requires that all significant accounting policies adopted in the preparation and presentation of the financial statements should be disclosed. It was noted that since such income constitutes significant sources of income for the companies, it was imperative that the accounting policies adopted by them for recognition of the same should have been disclosed.
6.	In the Annual Reports of some companies, the accounting policies regarding impairment losses and provision for taxation, have been stated as follows: • Impairment losses, if any, are recognised in accordance with the accounting standard issued in this regard by the Institute of Chartered Accountants of India. • Provision for Current Tax and Fringe Benefit Tax has been made as per the provisions of Income Tax Act, 1961 and adjustment for Deferred Tax	It may be noted that paragraph 11 of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', states that: "11. The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements." It was noted that while in some cases the companies have merely mentioned in their accounting policies that they are in accordance with the requirements

	is made in accordance with Accounting Standard-22. • In the opinion of the Company's management there is no impairment to the assets to which Accounting Standard – 28 "Impairment of Assets" applied requiring any revenue recognition". The observations on the above are quite similar in all the cases as provided adjacent to them.	of the accounting standards as issued by the Institute, in other cases, the companies merely provide a representation of management. It was observed that such policies only provide means to understand the accounting policies adopted by the companies rather than providing the accounting policies. Accordingly, it was viewed that the accounting policies should be explicitly stated so that they may help the reader in understanding the financial statements. Hence, stated accounting policies are not in line with the requirements of AS 1. It was also noted that reference should have been made to the Accounting Standards notified under the Companies (Accounting Standards) Rules 2006, rather than those issued by the Institute of Chartered Accountants of India.
7.	In the Annual Report of a company, the accounting policy of Revenue Recognition has been stated as follows: "Disposal of company's produce is accounted for as Sales whenever appropriate documents are received even when the proceeds are received after the accounting period."	It was noted that whereas paragraph 24 of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', requires the disclosure of all significant accounting policies adopted by the company for preparation and presentation of the financial statements, paragraph 11 of Accounting Standard (AS) 9, 'Revenue Recognition', provides that the sale of goods may take place when all significant risks

		and rewards of ownership have been transferred to the buyer and no significant uncertainty exists regarding the amount of the consideration that will be derived from such transaction. It was noted that the sales have been recognised when 'appropriate documents' are received. It was observed that the usage of the term "appropriate documents" is ambiguous and as such, the reader cannot understand whether revenue has been recognised on transfer of significant risks and rewards of ownership or not as required by AS 9. Accordingly, it was viewed that the nature of documents based on which the revenue has been recognised should have been explicitly stated to comply with the requirements of paragraph 24 of AS 1.
8.	In the schedule of significant accounting policies given in the Annual Report of a company, the accounting policy on accounting convention has been stated as follows: "The Company maintains accounts on historical cost convention in accordance with applicable standards. The current assets, loans and advances and liabilities are approximately of the value stated, if realised in the	It was noted that although the accounts have been stated to have been prepared in accordance with 'applicable standards,' the standard issuing authority has not been specified. Thus, the stated accounting convention appears to be ambiguous and not properly drafted. Reference should have been made to the Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006.

	ordinary course of business, otherwise those stated separately.”	
9.	In the Annual Report of a company, the accounting policy of Revenue Recognition, inter alia, has been stated as follows: “…In appropriate circumstances, revenue (income) are recognised when no significant uncertainty as to measurability or collectability exists and in case of, Export benefits / incentives are accounted on accrual basis.”	It may be noted that paragraph 11 of Accounting Standard (AS) 1, ‘Disclosure of Accounting Policies,’ provides as follows: “11. The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.” It was observed that the usage of the term ‘applicable circumstances’ is ambiguous. Such term makes the accounting policy vague, since ‘appropriate circumstances’ cannot describe a policy. It was observed that the situation under which such policy has been adopted is not explicitly disclosed. It was viewed that the policy should state the specific accounting principles and the methods of applying those principles adopted for recognising the revenue.
10.	From the Balance Sheet given in the Annual Report of a company, it has been noted that certain capitalised amount is being carried forward under the head ‘Miscellaneous expenditure.’ However, the details relating to its	It may be noted that paragraph 14 of Accounting Standard (AS) 1, ‘Disclosure of Accounting Policies’, provides the areas in which different accounting policies may be adopted by different enterprises and these

	nature and the method of amortising the same have not been disclosed.	include method of depreciation, depletion and amortisation. It was viewed that the company should have disclosed the accounting policy with regard to miscellaneous expenditure. Non-disclosure of the same is contrary to the requirement of AS 1.
11.	In the Annual Reports of some companies, accounting policy regarding revenue recognition has been stated as follows: • Income is recognised on accrual basis. • Sales comprises sale of goods net of excise duty and include export benefits. • Sales are net of Sales tax, claims / returns, discounts & breakages • Revenue is recognised and expenditure is accounted for on their accrual. • Sales turnover for the year includes sales value of goods, excise duty and other recoveries such as insurance, transport and packing charges excluding VAT/ CST. The observations on the above are quite similar in all the cases as provided adjacent to them.	It was noted that although the policies state the value at which revenue is recognised, they omit to state explicitly the point of time when significant risks and rewards in goods stand transferred to the buyer and revenue is recognised in the books of accounts. It was also felt that the policy regarding timing of recognition of revenue arising from sale is an important accounting policy for any company and therefore, it should be disclosed as per the requirements of paragraph 24 of AS 1.
12.	From the Annual Reports of some companies, it has been noted that they had omitted to disclose the	It was observed that a company generally has share capital, borrowed funds, inventories,

	accounting policies with regard to one or more of the following: • Valuation of Inventories • Net profit or loss for the period, prior period items and changes in accounting policies • Revenue Recognition • Accounting for Fixed Assets • Foreign Currency Transactions • Accounting for Investments • Employee Benefits • Borrowing Costs • Segment Reporting • Lease • Related Party Disclosures • Earning per Share • Accounting for taxes on income • Intangible Assets • Impairment of Assets • Provisions, Contingent liabilities and Contingent Assets The observations on the above are quite similar in all the cases as provided adjacent to them.	revenues and employs some employees. Further, the assets held by the company may also be subject to impairment. There may also be a need to carry certain provisions for meeting contingent liabilities. It also incurs expenditure in the nature of income tax. Further, a company may engage in both importing and exporting of goods. It may be noted that paragraph 24 of AS 1 requires that all significant accounting policies adopted in the preparation and presentation of the financial statements should be disclosed. Accordingly, it was viewed that, subject to circumstances of a company, it should disclose all the significant accounting policies as adopted by it for preparation of the financial statements viz. Valuation of Inventories, Revenue Recognition, Accounting for Fixed Assets, Employee Benefits, Borrowing Costs, Earning per Shares, Accounting for taxes on income, Impairment of Assets and Provisions, Contingent Liabilities and Contingent Assets etc.

2

Observations on Accounting Standard (AS) 2: Valuation of Inventories

S. No.	Matter contained in Annual Report	Observations
1.	In the Annual Reports of some companies, different accounting policies relating to valuation of inventories had been adopted by them. An illustrative list of which is provided as below: • Useful designs are valued at actual cost and Stock in progress is valued at direct cost. • Bunkers remaining on Board are valued at weighted average cost. • Raw materials and stores and spares are valued at cost. • Raw Material & Components, Stores and Spares, Die Steel Blocks are valued at cost and Work in progress is valued at estimated cost. • Stock-in-trade is valued at or below cost • Inventories of raw materials, stock-in-process, semi finished products, stores, packing materials, spares and loose tools, finished products are valued at lower of cost or realisable value.	It was felt that the stated accounting policies are not as per Accounting Standard (AS) 2, 'Valuation of Inventories'. It may be noted that paragraph 5 of AS 2 requires that inventories should be valued at the lower of cost and the net realisable value. Further, AS 2 defines net realisable value as "the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale." In given cases, either the inventories have been stated to be valued only at cost or at lower of cost and market value/ realisable value. It appears that while in former cases inventories have been valued without considering the net realisable value, in later cases the company may not be reducing estimated costs of completion and the estimated costs necessary to make the sale from the estimated selling price for the valuation of inventory.

	• Raw Materials, Stores & Spares, Loose Tools, Goods-in-Transit and Work-in-Progress are valued at material cost. • Inventories are valued at lower of the cost or market value. • Finished Goods in the warehouses and on the shop floor are valued at cost or market value whichever is lower. • Manufactured Finished Goods are valued at lower of cost or estimated realisable value. The observations on the above are quite similar in all the cases as provided adjacent to them.	Accordingly, the stated accounting policies are not in line with the requirements of AS 2.
2.	In the Annual Reports of some companies, the accounting policy for valuation of inventories simply states that raw material, stores and work in progress are valued at the lower of cost and the net realisable value.	It may be noted that paragraph 26(a) of Accounting Standard (AS) 2, 'Valuation of Inventories' , *interalia*, provides as follows: *"26. The financial statements should disclose:* *(a) the accounting policies adopted in measuring inventories, including the cost formula used; and* *(b) ..."* It was felt that although the

		companies have disclosed the policy for valuation of inventories, they have not disclosed the cost formula used for valuation of inventories, which is required to be disclosed as per paragraph 26(a) of AS 2.
3.	From the schedule of 'Inventories' given in the Annual Reports of some companies, it has been noted that inventories were described "as taken, valued and certified by the management."	It may be noted from the clarification given in the Guidance Note on Audit of Inventories, issued by the Institute of Chartered Accountants of India, that the use of expression 'as valued and certified by the management' may lead the users of financial statements to believe that the auditor merely relies on the management's certificate without carrying out any other appropriate audit procedures to satisfy himself about the existence and valuation of inventories. Therefore, usage of phrase viz "as valued and certified by the management" indicates that there is a disclaimer for inventories which should be avoided. It may be mentioned that in view of the clarification given in the Guidance Note, it has also been suggested that the auditors may advise their clients to omit the expression "as valued and certified by the management", when describing inventories in the financial statements.

4.	The accounting policy relating to inventories as given in the Annual Report of a real estate company states that: "Constructed buildings and related equipments are valued at cost less depreciation."	It was noted that the stated policy indicates that apparently the company is not considering the net realisable value in the valuation of constructed buildings and related equipments. It was observed that the stock is valued at cost less depreciation. However, as per AS 2, inventory should be valued at cost or net realisable value, whichever is lower. Further, on reviewing the definition of net realisable value, it was viewed that the value of depreciation cannot be construed as providing the value of estimated costs of completion and the estimated costs necessary to make the sale. Hence, the stated policy would not reflect the true value of the constructed buildings and the related equipments held as inventories.
5.	The accounting policy regarding inventory as given in the Annual Report of a company, states as follows: "Inventories are valued in accordance with method of valuation prescribed by the Institute of Chartered Accountants of India at weighted average rates."	It was felt that although there is an implied disclosure that inventories have been valued as per Accounting Standard (AS) 2, 'Valuation of Inventories', there is no disclosure whether the net realisable value of such inventories has also been considered for determining the value of inventories. Further, it was observed that the cost formula as adopted by the company for each category of inventories has also not been disclosed.

		Hence, it was viewed that there has been neither an explicit disclosure with regard to accounting policy as adopted by the Company for valuation of inventories nor has the cost formula as used by it for each classification of inventories been disclosed as required by paragraph 26(a) of AS 2.
6.	In the Annual Report of a company, the accounting policy on valuation of inventories has been stated as follows: "Inventories are valued at cost or net realisable value, whichever is lower. Costs comprise all cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition. 'First-in-first-out' or 'Average cost' method is followed for determination of cost."	It may be noted that paragraph 16 of Accounting Standard (AS) 2, 'Valuation of Inventories', provides as follows: *"16. The cost of inventories, other than those dealt with in paragraph 14, should be assigned by using the first-in, first-out (FIFO), or weighted average cost formula. The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition."* It was viewed that the company has used the 'Average Cost' method and not the 'weighted average cost' method for the determination of cost, which is not in line with the requirement of paragraph 16 of AS 2.
7.	In the Annual Reports of some companies, different accounting policies relating to valuation of inventories had been adopted to	It may be noted that paragraph 6 of Accounting Standard (AS) 2, 'Valuation of Inventories', requires that the cost of

	determine the cost of inventories. An illustrative list of which is provided as below: • Cost includes direct labour and direct overheads. • Stock-in-process are valued at raw material cost. • For valuation of finished goods the cost is determined by taking materials, labour and related factory overheads excluding depreciation. • Excise duty on finished goods shown separately. The observations on the above are quite similar in all the cases as provided adjacent to them.	inventories should comprise all costs of purchase, costs of conversion and other cost incurred in bringing the inventories to their present location and condition. It was viewed that costs of conversion include costs directly related to the units of production as well as fixed and variable production overheads that are incurred in converting materials into finished goods. Accordingly, it was noted from the stated accounting policies that all the costs incurred in bringing the inventory to its present location and condition have not been considered to determine its value. Costs like indirect overheads, depreciation, excise duty although incurred for converting material into finished goods have not been considered for determining the cost of inventories which is not in line with paragraph 6 of AS 2.
8.	From the Annual Report of a company, accounting policy on inventories has been stated as given below: "As per the consistent practice of the company, while valuing stocks, the relative impact /incidence of manufacturing, administrative and financial expenses has been considered."	It was noted from the accounting policy of valuation of inventories that the relative incidence of administrative overheads and financial expenses has been included in cost of inventories. It may be noted that while paragraph 6 of Accounting Standard (AS) 2, 'Valuation of Inventories', provides that the

	(Emphasis added)	cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition; paragraphs 12 and 13(c) of AS 2 do not consider either interest and other borrowing costs or administrative costs as relating to bringing inventories to their present location and condition and therefore, they cannot be included in the valuation of inventories. It was, accordingly, noted that financial expenses, unless incurred specifically to bring the inventories to their present location and condition cannot be considered as part of inventories. Further, the financial expenses should be treated as per the principles prescribed under AS 16, Borrowing Costs. Accordingly, the said accounting policies were not considered to be in compliance with the requirements of AS 2.
9.	From the schedule of Current Assets given in the Annual Report of a company, it has been noted that Stock in Trade also includes the stock of DEPB Receivables as well as Plant & Machinery retired from active use.	It may be noted that paragraph 3.1 of Accounting Standard (AS) 2, 'Valuation of Inventories', define 'inventories' as follows: "*3.1 <u>Inventories</u> are assets*: *(a) held for sale in the ordinary course of*

		business; *(b) in the process of production for such sale; or* *(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services."* It may be further noted from paragraph 4 of AS 2 that inventories encompass finished goods produced, or work in progress being produced by the enterprise and include materials, maintenance supplies, consumables and loose tools awaiting use in the production process. It was viewed that the stock of DEPB Receivables should be treated as a part of loans and advances and it should not be included in stock in trade. Further, the Plant & Machinery retired from active use is a part of fixed assets; hence, it should also be not included in stock in trade. It was viewed that such assets should have been shown separately in the fixed assets schedule as "held for disposal".
10.	From the Schedule of Inventories given in the Annual Report of a company, it has been noted that	It may be noted that as per paragraph 34 of the Guidance Note on Accounting Treatment for

	the cost of raw material includes amount of MODVAT as per past practice consistently followed.	Excise Duty, issued by the Institute of Chartered Accountants of India, the inventory of inputs should be valued at net of input duty. In other words, the specified duty paid on inputs will not form part of the cost of inventories and that the debit balance in MODVAT/CENVAT Credit Receivable (Inputs) Account should be shown as asset under the head 'advances.' Hence, it was felt that including MODVAT credit in the cost of inventories is not in line with the aforesaid Guidance Note.
11.	From the Annual Reports of some companies, certain non-compliances were observed with respect to Excise Duty, an illustrative list of which is given below: • In respect of stocks, keeping in view that State excise duty payable on finished product is not determinable, as it varies depending on the places to which they are dispatched. The excise duty on such stocks lying in factory is accounted for on clearance of such goods. The method of accounting has no impact on the results of the year. • Excise Duty has been	It may be noted that as per paragraph 7 of Accounting Standard (AS) 2, 'Valuation of Inventories', the cost of purchase consists of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase. It may further be noted that as per paragraph 18 of the Institute's 'Guidance Note on Accounting Treatment for Excise Duty',

	accounted on the basis of those goods cleared on payment of Excise Duty. • The Company has not provided for the Excise Duty on the closing stock of Finished Goods and accordingly the said amount has not been included in the valuation of Finished Goods. • No provision is made towards the estimated liability on unsold finished goods lying at the factory premises at the end of the year. The observations on the above are quite similar in all the cases as provided adjacent to them.	issued by the Institute of Chartered Accountant of India, the liability for excise duty arises when the manufacture of the goods is completed; hence, it is necessary to create a provision for liability of unpaid excise duty on stock lying in the factory or bonded warehouse. It was, therefore, viewed that provision for the liability of Excise Duty should be made at the time when goods are manufactured rather than when the same is paid or at the time when goods are cleared from the factory/warehouse as the case may be. Further, for determining the cost of finished goods for the purpose of valuation of inventories, the amount of unpaid Excise Duty should be included in the cost of finished goods which are lying in the factory or bonded warehouse. It was felt that the policies as adopted by the companies for recognising the liability towards Excise Duty are not as per the requirements of AS 2 as well as the aforesaid Guidance Note.

3

Observations on Accounting Standard (AS) 3: Cash Flow Statements

S. No.	Matter contained in Annual Report	Observations
1.	From the Annual Reports of certain companies, it is noted that the financial statements neither include the Cash Flow Statement nor provide any information for non-inclusion of the same.	It may be noted that Accounting Standard (AS) 3, 'Cash Flow Statements', is not a mandatory Standard for Small and Medium Sized Companies. However, if an enterprise falls in any of the following category: • Equity or debt securities are listed or in the process of listing on any stock exchange, whether in India or outside India, or • it is a bank, financial institution or an insurance company, or • its turnover (excluding other income) exceed rupees fifty crores in the immediately preceding accounting year, or • it has borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year or • it is a holding or subsidiary

		of a company which falls in any of the aforesaid categories then such exemption from AS 3 is not available to the company. However, it was noted from Profit and Loss Account that such companies were either having the turnover exceeding Rs. 50 Crores or having borrowings in excess of Rs. 10 crores in the immediately preceding accounting year or they are subsidiaries of a listed company. Hence, AS 3 was applicable on them. Non preparation of the Cash Flow Statement in the aforesaid cases is a non-compliance of AS 3.
2.	From the Cash Flow Statement given in the Annual Reports of some companies, it has been noted that movement in borrowings, purchases or sales of investments/ fixed assets were reported on *net basis*.	It may be noted that paragraph 21 of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows: *"21. An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis."* It may be noted that while movement in borrowings are cash flows arising under financing activities and purchases or sales

		of fixed assets/ investments are cash flows arising under investing activities. It was viewed that such transactions should be reported on gross basis providing separately figures of cash flows received and paid during the period. Accordingly, it was viewed that presentation of significant receipts and payments on net basis is not in line with the requirements of paragraph 21 of AS 3.
3.	From the schedule of Cash & Bank Balances given in the Annual Report of some companies, it has been noted that the companies were holding certain balances in foreign banks or foreign branches of certain banks.	It may be noted that paragraph 25 of Accounting Standard (AS) 3, 'Cash Flow Statements', *interalia*, provides as follows: *"25. ...The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period."* It was observed that holding certain balances in foreign banks or foreign branches of certain banks tantamount to holding cash and cash equivalents in foreign currency which also gives rise to exchange difference on conversion to Indian Rupees for the purpose of reporting the same in the financial statements.

		It was, accordingly, viewed that exchange differences arising due to such conversion should be reported as a part of the reconciliation of the changes in cash and cash equivalents in the Cash Flow Statement, as required under paragraph 25 of AS 3.
4.	From the Annual Reports of some companies, it has been noted that cash and bank balances as reported under the Cash Flow Statement were the same as that reported in the schedule to the Balance Sheet and such balances include items like Dividend Account, Unclaimed Debenture and Interest, Margin money account and/ or fixed deposit which is under lien with banks.	It may be noted that paragraph 45 of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows: "45. *An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it*." It was observed that cash & cash equivalents include certain amounts which are earmarked against specific liabilities that would not be available with the company for use by it. Accordingly, a separate note as required under paragraph 45 is necessary. Hence, it was viewed that the requirement of paragraph 45 of AS 3 has not been complied with.
5.	From the Cash Flow Statements as given in the Annual Reports of the *Non-Financial Entities*, the following was noted:	It may be noted that paragraph 30 of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows:

	• Dividend paid has been shown under the head of 'Cash Flows from Operating Activities'. • Interest received is shown as Cash Flow from Financing Activities. • Interest paid as well as interest received is shown as 'Cash Flow from Operating Activities.' • Interest paid has been netted off against interest received and shown as 'Cash Flow from Operating Activities.' The observations on the above are quite similar in all the cases as provided adjacent to them.	*"30. Cash flows from interest and dividends received and paid should each be disclosed separately. Cash flows arising from interest paid and interest and dividends received in the case of a financial enterprise should be classified as cash flows arising from operating activities. In the case of other enterprises, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities."* It was viewed that in case of non-financial entities, cash outflow due to interest paid and dividend paid are 'cash flows arising from financing activities' and interest income or dividend income are 'cash flows arising from investing activities', hence, they should be shown under respective activities rather than being shown under cash flow from operating activities. It was also noted that in certain cases cash outflow due to interest paid has been netted off against interest income which was viewed to be incorrect because they are two separate kinds of cash flows;

		therefore, they cannot be netted off against each other. Accordingly, it was felt that all such presentations were not in accordance with paragraph 30 of AS 3.
6.	From the Annual Reports of some companies, it has been noted from the schedules of 'Provisions' and 'Loans, advance and Deposit' that the provision for taxation as well as the amount of tax deducted at source have increased during the current financial year but no cash flow has been reported due to taxes on income.	It may be noted that paragraph 34 of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows: *"34. Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities."* Irrespective of the fact whether such increase in liabilities under the head of 'provisions' and assets under the head of 'loans, advances and deposits' pertain to current assessment year or previous assessment year, it was viewed that certain tax has been paid in advance during the financial year under review. Hence, it should have been disclosed separately as per paragraph 34 of AS 3.
7.	From the Cash Flow Statement given in the Annual Report of a company, it has been noted that the taxes paid include dividend tax as reported under the head of	It may be noted that paragraph 34 of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows:

	Cash flows from the operating activities.	*"34. Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities."* It was viewed that the dividend distribution tax is tax payable on the dividend paid to shareholders and therefore, it should be shown separately under the head 'cash flows from financing activities' as required by paragraph 34 of AS 3.
8.	From the schedule of investments as well as note providing details of movement in investments and value of investments as given in the Annual Report of a company, it has been noted that during the year certain investments in subsidiary have been made as well as sold but no cash flows have been reported for the same in the Cash Flow Statement.	It was noted that paragraph 37 of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows: *"37. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities."* It was noted that although certain cash flows have occurred due to acquisition and disposal of investments in subsidiaries, no separate disclosure has been made for the same under the head 'Cash flow from investing activities' as per the requirement of paragraph 37 of AS 3.

9.	From the Cash Flow Statement given in the Annual Report of a company, it has been noted that the adjustments made for working capital changes for arriving at cash flow from operating activities includes 'Share Application Money Deposited', which was given under the Schedule of 'Loan and Advances.'	It may be noted that as per paragraph 15 (c) of Accounting Standard (AS) 3, 'Cash Flow Statements', Investing Activities *interalia* include "cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures." Accordingly, it was viewed that adjustment of Share Application Money to determine 'Cash Flow from Operating Activities' instead of reporting the same under 'Cash Flow from Investing Activities' is not in line with the requirement of paragraph 15(c) AS 3.
10.	From the Annual Reports of a certain companies, the following has been noted : • In the Cash Flow Statement, net proceeds from issue of shares have been reported, but the statement of fund raised in IPO and utilisation thereof, as given in Notes to Accounts, reported the same at a different amount. • There is a significant difference in the figures of provision for doubtful debts and doubtful advances as adjusted in Cash Flow Statement from the increase reflected in the Balance Sheet.	It was noted that the difference in two reported figures had not been explained anywhere in the Notes to Accounts or the Cash Flow Statement. It was viewed that the Cash Flow Statement as well as the Notes to Accounts form integral parts of the same financial statements and therefore, the amounts stated therein should either be the same or the difference should have been properly explained / reconciled.

	The observations on the above are quite similar in all the cases as provided adjacent to them.	
11.	From the Annual Reports of some companies, it has been noted that there was significant difference in the figures of Cash and Cash equivalents as reported in the Cash Flow Statement and that reported in schedule to the Balance Sheet.	It may be noted that paragraph 42 of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows: *"42. An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet."* It was noted that despite significant differences in the figures of cash and bank balances as reported in the Balance Sheet and the Cash Flow Statement, no reconciliation was provided to reconcile these two amounts. It is against the aforesaid requirement of AS 3.
12.	From the Annual Reports of some companies, it has been noted that while following the "indirect method" for preparation of the Cash Flow Statement, the companies have simply adjusted net changes in Current Assets vis-à-vis Current Liabilities under the head 'Cash Flow from Operating Activities'.	It may be noted that paragraph 20 (a) of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows: "20. Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of: (a) changes during the period in inventories and operating receivables and payables;

		…" It was viewed that the changes in each of the components of current assets and current liabilities viz inventories, receivables, payables etc, should be disclosed separately for determining the 'Cash Flow from Operating Activities' as required by paragraph 20 of AS 3.
13.	From the Annual Reports of some companies, the following has been noted: • Certain amount of miscellaneous expenditure has been written-off during the year. • Foreign currency translation loss on FCCBs proceeds although reported in the Profit and Loss Account has not been adjusted in the Cash Flow Statement. • The unrealised foreign exchange gain although reported in the Profit and Loss Account has not been adjusted to derive Net Cash Flow from Operating Activities. The observations on the above are quite similar in all the cases as provided adjacent to them.	It may be noted that paragraph 20 (b) of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows: "20. Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of: … (b) non-cash items such as depreciation, provisions, deferred taxes, and unrealised foreign exchange gains and losses; and …" It was noted that non-cash items like miscellaneous expenditure written off, unrealised foreign exchange gain although reported in the Profit and Loss Account, have not been adjusted against Net Profit Before Tax to determine

		the Cash Flow from Operating Activities. It was viewed that none or partial adjustment of non-cash items to determine the 'Net Cash from Operating Activities' is not in line with AS 3.
14.	From the Annual Report of a company, it was noted that the Deferred Tax Asset has been adjusted against Net Profit before Tax to determine the cash flows from operating activities.	It was viewed that any tax expense should be adjusted against 'Net Profit after Tax' instead of 'Net Profit before Tax'. Thus, the given Cash Flow Statement was considered to be non-compliant with the requirement of Accounting Standard (AS) 3, 'Cash Flow Statements'.
15.	From the Cash Flow Statement given in the Annual Report of a company, it was noted that the overdrawn book balance has been disclosed under the head of Cash Flow from Financing Activities.	It was noted that overdrawn book balance is in the nature of Current Liabilities which does not involve any cash flows. Accordingly, it was viewed that it should have been shown as an adjustment for working capital changes as a part of 'Cash Flow from Operating Activities' or it should have been shown as an overdraft adjustment in bank balances of current accounts and taken as a part of cash and cash equivalents rather than being disclosed as financing activity. Accordingly, the presentation of overdrawn book balance in Cash Flow Statement was not considered to be appropriate.
16.	In the Annual Report of a company, it has been noted that the subsidy income from the State	It may be noted that paragraph 12 of Accounting Standard (AS) 3, 'Cash Flow Statements', *interalia,*

<table>
<tr><td></td><td>Government has been disclosed as Cash flow from investing activities.</td><td>provides as follows:

“12. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss...”

Hence, it was viewed that since the subsidy income from the State Government is associated with the principal revenue producing activity, hence, it should be shown under the head ‘Cash flow from operating activities’ rather than ‘Cash Flow from Investing Activities’.</td></tr>
<tr><td>17.</td><td>In the Annual Reports of some companies, one or more of the following information was noted from the schedule of loans and advances and the notes to accounts:

• Certain loans and advances were given to subsidiary companies and other companies.
• Advance for share application money was paid.
It was noted the aforesaid changes in the figures of ‘loans and advances’ have been treated as working capital changes and used to determine ‘Cash flow from</td><td>It may be noted that paragraphs 15 (c) and (e) of Accounting Standard (AS) 3, ‘Cash Flow Statements’, provide as follows:

“15. The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

(a)…
(b)…</td></tr>
</table>

	operating activities'. The observations on the above are quite similar in all the cases as provided adjacent to them.	(c) cash payment to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing trading purposes) (d)… (e) cash advances and loans made to third parties (other than advances and loans made by a financial enterprise)." It was viewed that the cash flows arising due to loans and advances made to third parties or given as share application money are in the nature of investment activity and should be disclosed separately under the head 'Cash Flow from Investing Activities' in terms of paragraph 15 of AS 3.
18.	From the Annual Report of some companies, the following has been noted: • In the Cash Flow Statement, an increase in share capital has been shown as cash flow from investing activities. • Arrangement fee and upfront fee although paid and expensed in current year through Profit and Loss	It may be noted that paragraph 17 of Accounting Standard (AS) 3, 'Cash Flow Statements', provides as follows: "17. The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise.

	Account but not reflected in Cash Flow Statement. The observations on the above are quite similar in all the cases as provided adjacent to them.	Examples of cash flows arising from financing activities are: (a) cash proceeds from issuing shares or other similar instruments; (b) cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings; and (c) cash repayments of amounts borrowed." It was noted that the cash proceeds from issuing shares is a part of financing activity. Further, any payment made towards arrangement fee and upfront fee in respect of the borrowings also facilitate the finances of the business. Hence, both of these transactions should be disclosed under the head 'Cash Flow from Financing Activities' in the Cash Flow Statement.
19.	In the Annual Report of a company, the company has adopted indirect method for preparation of the Cash Flow Statement and interest expense as well as interest income appearing in the Profit and Loss Account has not been shown as an adjustment.	It may be noted that paragraphs 18(b) and 20 of Accounting Standard (AS) 3 , 'Cash Flow Statements', provide as follows: *"18. An enterprise should report cash flows from operating activities using either:* *...* *(b) the indirect method, whereby net profit or loss is adjusted for the effects of*

		transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows." "20. Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of: (c) all other items for which the cash effects are investing or financing cash flows." It was viewed from the aforesaid provisions that under the 'indirect method' for preparation of its Cash Flow Statement, all the items of income or expenses associated with cash flow from investing activities as well as financing activities should be adjusted against the net profit and loss to determine 'Cash Flow from Operating Activities'. Accordingly, interest income and interest expenses being associated with investment activities and financing activities respectively should be adjusted against net profit to derive Cash Flow from Operating Activities as required by paragraphs 18(b) and 20 of AS 3.

		Accordingly, they should be shown as cash flows under the respective activities. Such presentation gives true and fair view of the cash flows of the enterprise.
20.	In the Annual Report of a company, it was noted from the Cash Flow Statement that the provision for employee's benefit debited to general reserve has been shown as cash flow from financing activities.	It was noted that the provision for employee's benefits debited to general reserve is a non-cash adjustment, accordingly, it should be excluded from the Cash Flow Statement.
21.	In the Annual Report of a company, it was noted from the Cash flow Statement that the written down value of fixed assets has been shown under the head of 'Cash flow from Investing Activities' and the amount of profit on sale of fixed assets has been shown under the head of 'Cash flow from Operating Activities.'	It may be noted that the cash proceeds from sale of fixed assets are the aggregate of the written down value of fixed asset and the profit earned on its sale. Accordingly, it was viewed that, instead of disclosing the written down value of fixed assets and profit accruing thereon separately, the aggregate cash proceeds arising from the sale of fixed assets should be shown under the head of 'Cash flow from Investing Activities' in terms of paragraph 15(b) of AS 3, read with paragraph 13 of AS 3 whilst the profit on sale of fixed assets should be deducted from the Net Profit Before Tax to determine 'Cash Flow from Operating Activities' in the Cash Flow Statement.
22.	In the Annual Report of a company, it was noted from the Cash Flow Statement that neither 'positive sign' nor 'negative sign'	It was observed that in the absence of such 'signs' all such adjustments would be regarded as bearing positive sign, thus,

	was affixed on the values stated in the Cash Flow Statement, thereby implying that all values are positive values increasing the cash and cash equivalents of the company.	adding to the cash flow. However, on such assumption, the figures did not match with the closing balance of cash and cash equivalents. Hence, it was felt that the presentation was not correct. It is imperative that there should be a proper distinction made between cash inflows and cash outflows by assigning proper 'signs' to each nature of cash flows.
23.	From the Annual Report of a company, it was noted that in the Cash Flow Statement, the company has disclosed an extraordinary item under the heading 'Cash Flow from Operating Activities' whereas, in the Profit and Loss Account, the same amount was disclosed as a 'prior period adjustment'.	It was felt that prior period adjustments cannot be considered as extraordinary. While prior period items of income or expense are a result of error or omission in the preparation of financial statements of prior periods, extraordinary items occur on rare occasions due to an event or transaction of extra-ordinary nature viz earthquake etc. Hence, it is not appropriate to recognise a 'prior period adjustment' as an 'extraordinary item' in the Cash Flow Statement. There should be no inconsistency between the Cash Flow Statement and the Profit and Loss Account, both of which form integral parts of the same set of financial statements.

4

Observations on Accounting Standard (AS) 4: Contingencies and Events Occurring After the Balance Sheet Date

S. No.	Matter contained in Annual Report	Observations
1.	From one of the notes to accounts given in the Annual Report of a company, it has been noted that advances were made to certain companies which had incurred losses and their net worth had eroded, still such amounts were included under the head of 'sundry advances' or 'sundry debtors' on the pretext that the management was confident of recovering these dues and no provision was considered necessary.	It may be noted that as per footnote given to title of Accounting Standard (AS) 4, 'Contingencies and Events Occurring After the Balance Sheet Date', which states as follows: "All paragraphs of this standard that deals with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by this standard." It clearly indicates that impairment of 'sundry advances' or 'sundry debtors' would be governed by the provisions of AS 4. It was further noted that, paragraph 10 of AS 4, provides as follows: *"10. The amount of a*

		contingent loss should be provided for by a charge in the statement of profit and loss if: *(a) it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and* *(b) a reasonable estimate of the amount of the resulting loss can be made."* It was viewed that the erosion of the net worth of the companies from whom the debts were due itself indicates that the amount due may not be fully recoverable. Further, the future events should be considered to confirm impairment of asset rather than expecting its recoverability. It was viewed that the asset should be stated as per the facts prevailing on the date of Balance Sheet. In case, if the net worth of the companies was eroded and they were incurring losses, provisions should be made until or unless such companies had already entered into contracts to confirm profitability for such companies in future. Accordingly, it was viewed that non-creation of the provision in this regard is contrary to the requirements of AS 4.

5

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

S. No.	Matter contained in Annual Report	Observations
1.	In the Annual Reports of some companies, the following information with regard to prior period adjustments has been disclosed: • Prior period expenses and income are adjusted in respective heads of expenses and income in the Profit and Loss Account. • Prior period expenses were shown under the head of selling & administrative expenses without mentioning the nature of expenses. • Prior period adjustment (net) was shown in the Profit and Loss Account without mentioning the nature of expenses. • Prior period expense was shown under the head of other expenses without mentioning the nature of expenses. • Depreciation charged during the year included an amount of depreciation pertaining to the previous year.	It may be noted that paragraph 15 of Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', requires as follows: "15. *The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived".* It was felt that contrary to the requirement of paragraph 15 of AS 5, the nature of prior period items had not been disclosed either in the Profit and Loss Account or in the schedules or in the notes. It was observed that clubbing the prior period adjustments in their respective heads does not enable the reader to understand the effect of such adjustments on the current profit or loss which is

	The observations on the above are quite similar in all the cases as provided adjacent to them.	against the aforesaid requirements.
2.	In the Cash Flow Statement given in the Annual Report, other income has been adjusted below the line 'Cash flow before extraordinary items' for determination of net cash from operating activities, as given below: Cash Flow from Operating Activities xxx Cash Flow before extra ordinary items xxx Other Income xxx Net Cash from operating activities xxx	It may be noted that paragraph 8 of Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', provides as follows: *"8. Extraordinary items should be disclosed in the statement of profit and loss account as part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived."* It was observed that inclusion of 'other income' below the extra ordinary items indicates that 'other income' includes an extraordinary item. It was viewed that in case 'other income' includes any extraordinary item, the same should have been disclosed separately as per the requirement of paragraph 8 of AS 5.
3.	One of the notes to accounts given in the Annual Report of a company states as follows: "A massive fire broke out at the company's CFL Unit at place X	It may be noted that paragraph 12 of Accounting Standard (AS) 5, 'Net Profit and Loss for the Period, Prior Period Items and Changes in Accounting Policies', provides as follows:

	and the Raw materials, Finished Goods Lying at the Factory along with Plant and Machinery and Building were totally gutted. The assets were adequately insured with ABC Insurance Company and accordingly the company has lodged claim with the insurance company. The final amount of loss is yet to be assessed by the surveyor." Further, it has been noted from the schedules that the company has reported the value of raw material and finished goods lost by fire. However, the loss of plant and machinery, building, due to such fire, has not been reported anywhere, in the financial statements.	"*12. When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."* It was viewed that a loss due to fire is an exceptional item as per paragraph 12 of AS 5 which requires a separate disclosure either in the financial statements or by way of notes. Although there is a disclosure of information that a loss has occurred due to fire, the total loss occurred due to it has not been disclosed as required by paragraph 12 of AS 5 viz value of plants, machinery, building loss by fire has not been reported.
4.	In the Annual Report of a company, the accounting policy regarding depreciation has been stated as follows: "Depreciation rates on some of fixed assets have been revised so as to keep them as per the requirements of Schedule XIV of the Companies Act".	It may be noted that paragraph 27 of Accounting Standard (AS) 5, 'Net Profit and Loss for the Period, Prior Period Items and Changes in Accounting Policies', provides as follows: *"27. The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods should be disclosed. If it is impracticable to quantify*

		the amount, this fact should be disclosed." In view of the stated fact, it was felt that depreciation rates appear to have been revised during the period. Such revision lead to a change in accounting estimate and may result in a provision for depreciation which may be of higher or lower amount than that of provision for depreciation at pre-revised rates, which may have a material impact on the financial statements of the company. Accordingly, the company was required to comply with the requirements of paragraph 27 of AS 5. However, the company has not disclosed the aggregate effect of the revision in depreciation rates on the profit for the period.
5.	From the Profit and Loss Account given in the Annual Report of a company, it has been noted that the provision for taxation for earlier years has been adjusted under the head of 'Appropriations'.	It was noted that paragraphs 15 and 19 of Accounting Standard (AS) 5, 'Net Profit and Loss for the Period, Prior Period Items and Changes in Accounting Policies', provide as follows: "***15. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived."*** "19. Prior period items are normally included in the

		determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.” It was viewed that adjustments arising due to prior period items should be included in the determination of net profit or loss for the current period instead of showing these as ‘appropriation’ of profits. It was viewed that income tax expense relating to prior years cannot be disclosed as appropriation of profits. Hence, the profit of the company for the year is overstated and the Profit and Loss Account cannot be considered to be providing true and fair view of the profit of the business. Accordingly, it was viewed that the requirements of AS 5 have not been complied with.
6.	One of the notes to accounts given in the Annual Report of a company states as follows: “In accordance with recent notification, G.S.R. 225 (E) dated 31st March, 2009, issued by the Central Government in regards AS 11, company has opted to	It has been noted that paragraph 32 of Accounting Standard (AS) 5, ‘Net Profit and Loss for the Period, Prior Period Items and Changes in Accounting Policies’, provides as follows: *“32. Any change in an accounting policy which has a*

	capitalize the foreign exchange loss/gain on reporting of long term foreign currency monetary items used for depreciable assets retrospectively w.e.f. 1st July, 2007. Consequently, Rs. xxxx Lacs (including Rs. xxx lacs related to previous year) has been added to the cost of depreciable assets.”	*material effect should be disclosed. The impact of, and the adjustments resulting from, such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. Where the effect of such change is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.”* In view of above, it was felt that there are two distinct aspects of the paragraph. The first requires the disclosure of change in an accounting policy which has a material effect whereas the second aspect requires the disclosure of the impact of such change in the financial statements. It was noted that the company has opted to capitalise the foreign exchange gain/ loss to the cost of depreciable assets retrospectively

		w.e.f. 1st July, 2007. Further, from the stated note, although it is implied that there was a change in an accounting policy, the impact on financial statements was only partly disclosed. It was viewed that such change would impact the financial statement two fold – write back of exchange difference of earlier years and the aggregate impact due to the write back of exchange difference of earlier years and the additional depreciation thereon on the profit for the year. It was noted that while the aggregate impact is disclosed but its impact of current year profit viz additional depreciation has not been brought out in the disclosure. Accordingly, it was viewed that the requirement of AS 5 has not been complied with.
7.	From the Annual Report of a company, it has been noted that the company has disclosed an extra-ordinary item in the Profit and Loss Account which has further been explained in one of the notes to accounts stating as follows: "FCCB were considered as non-monetary liability during the previous period, but keeping in view of the provisions of AS-11 and the principle of prudence as enunciated in AS-1, the foreign	It may be noted that paragraphs 4.1 and 4.2 of Accounting Standard (AS) 5, 'Net Profit and Loss for the Period, Prior Period Items and Changes in Accounting Policies', provide as follows: *"4.1 Ordinary activities are any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.*

	exchange loss xxxx million arising out of revaluation in respect of outstanding FCCB of USD xx million as on 31.03.2008 has been recognised and charged to Profit and Loss Account of the year as an extra ordinary item."	*4.2 Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly".* It was observed that the foreign exchange gain or loss arising on outstanding balance of FCCB is an ordinary activity since FCCB, are taken by the company as a part of its business only. Therefore, classification of the gains or losses on such foreign exchange fluctuations as an extraordinary item is a non-compliance with the aforesaid paragraphs of AS 5.
8.	In the Annual Report of a company, the items related to earlier years like excess depreciation charged in earlier years and leave encashment liability for earlier years have been adjusted against general reserve	Paragraph 15 of Accounting Standard (AS) 5, 'Net Profit and Loss for the Period, Prior Period Items and Changes in Accounting Policies', provides as follows: *"15. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.* " In view of above, it was observed that the prior period items should have been accounted in the Profit and Loss Account instead of

		adjusting them against the general reserve. Further, it was also noted that no disclosure has been made with regard to such adjustments either in the related schedules or in the notes to the accounts explaining these adjustments against general reserve.

6
Observations on Accounting Standard (AS) 6: Depreciation Accounting

S. No.	Matter contained in Annual Report	Observations
1.	In the Annual Reports of some companies, the accounting policy regarding 'Depreciation' has been stated as follows: • Depreciation is provided on the straight-line method as per the rates and in the manner prescribed in Schedule XIV to the Companies Act, 1956. During the current year, the company has re-estimated the useful lives of some of its fixed assets and provided higher rate of depreciation. Accordingly the depreciation charge for the year is higher by Rs. xxxx. • Depreciation is provided on assets (other than asset X and assets acquired on amalgamation) under the straight-line method. For asset X at rate, arrived at based on technical evaluation of the remaining useful life of the asset X. In respect of assets acquired on amalgamation, depreciation is provided at the rate prescribed under the Income	It may be noted that Schedule XIV to the Companies Act, 1956 as well as paragraph 29(ii) of Accounting Standard (AS) 6, 'Depreciation Accounting', require that depreciation rates or the useful life of the assets should be disclosed, if they are different from the principal rates specified in the statute governing the enterprise. It was observed from the stated accounting policies that certain fixed assets have been depreciated at rates which are different from those prescribed in Schedule XIV to the Companies Act, 1956. However, depreciation rates, so charged, although different from those specified under Schedule XIV to the Companies Act, 1956, have not been disclosed which is a violation of Schedule XIV to the Companies Act, 1956 as well as AS 6.

	Tax Act, 1961 on written down value method. • In the cases where the estimated useful life of the asset is less as compared to useful life estimated in Schedule XIV of the Companies Act, 1956, such assets are depreciated at rates higher than those prescribed under Schedule XIV of the Companies Act, 1956." The observations on the above are quite similar in all the cases as provided adjacent to them.	
2.	In the Annual Report of a company, the accounting policy regarding depreciation, states as below: "…In case of X unit and Y unit depreciation is calculated at straight line method and in all other units the written down value method has been followed."	It may be noted that paragraph 29 of Accounting Standard (AS) 6, 'Depreciation Accounting', provides as follows: *"29. The following information should also be disclosed in the financial statements alongwith the disclosure of other accounting policies:* *(i) depreciation methods used; and* *(ii) depreciation rates or the useful lives of the assets, if they are different from the principal rates specified in the statute governing the enterprise."* It was observed that although the company had disclosed the

		depreciation methods as adopted by it, however, the rates or the useful life of such units have not been disclosed. It was viewed that being silent on this aspect cannot be construed to be charging depreciation at rates specified in the statute governing the enterprise. Hence, it was viewed that the stated accounting policy cannot be considered to be in line with the requirements of AS 6.
3.	The schedule of fixed assets given in the Annual Report of a company includes an asset under the head of 'Others' which as per the accounting policy of depreciation has been provided for on the basis of written down value method, at the rates prescribed in Schedule XIV to the Companies Act, 1956.	It has been noted that Schedule XIV to the Companies Act, 1956 does not prescribe any separate rate of depreciation for 'Other' assets. Further, no separate disclosure has been made with respect to depreciation rates being charged on such 'other assets'. It is also pertinent to note that Schedule VI requires the class of assets to be disclosed. Therefore, it was viewed that the disclosure requirements of paragraph 29 of Accounting Standard (AS) 6, 'Depreciation Accounting', and Schedule VI to the Companies Act, 1956 have not been complied with.
4.	From the Annual Reports of some companies, it has been noted that the schedule of fixed assets amongst others also included 'Leasehold Land' on which no depreciation has been provided.	It may be noted that paragraph 3.2 of Accounting Standard (AS) 6, 'Depreciation Accounting', provides as follows: *"3.2 Depreciable assets are assets which*

		(i) are expected to be used during more than one accounting period; and *(ii) have a limited useful life; and* *(iii) are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business."* As per paragraph 1 of AS 6, the Statement also does not apply to land unless it has a limited useful life for the enterprise. From the above, it was noted that a depreciable asset should exclude land unless it has a limited useful life for the enterprise. (Emphasis added). It was viewed that leasehold land by its nature has a limited useful life and as such, it should be amortised as required by AS 6. However, in the extant cases, it was noted that although the companies hold Leasehold Land, no amortisation has been charged on the same. Hence, it was viewed that the requirement of AS 6 has not been complied with.
5.	From the schedule of fixed assets	Paragraph 28(ii) of Accounting

	given in the Annual Report of a company, it has been noted that whilst the accumulated depreciation for each class of assets has been disclosed, the depreciation provided for the year against each of them has not been separately disclosed either in the Schedule of fixed assets or in the notes to account.	Standard (AS) 6, 'Depreciation Accounting', requires the disclosure of "***total depreciation for the period for each class of assets***." It was observed that although the **accumulated depreciation** for each class has been disclosed, there is no disclosure of the **depreciation for the year** as mandated by paragraph 28(ii) of AS 6. It is a non-compliance with the requirements of paragraph 28(ii) of AS 6.
6.	In the Annual Report of a company, the accounting policy regarding depreciation accounting, *inter alia*, has been stated as follows: "...In respect of tools and dies meant for the manufacture of certain slow moving two wheeler models, accelerated depreciation amounting to Rs xx has been provided during the year…"	It was noted that in respect of tools and dies used for manufacturing slow moving models, an ad hoc amount of depreciation charged off has been disclosed as a part of the accounting policy for depreciation. It was viewed that this information should have been disclosed under notes to accounts rather than being disclosed as a part of the accounting policy as the note suggests that this may be a "one off" charge.
7.	In the Annual Report of a company, the accounting policy with regard to depreciation states as follows: "Depreciation on fixed assets is provided pro-rata on the straight-line method with double shift	It was noted that the stated depreciation policy appears to be specific for the financial year. It was felt that by using the phrase "for the period ending 31.03.20XX" in context of depreciation rates adopted for the financial years appears to

	rates as prescribed under the Companies Act for the period ending 31.03.20XX."	indicate that there might be change in the accounting policy from that adopted in the earlier years. It may further be noted that Paragraph 21 of Accounting Standard (AS) 6, 'Depreciation Accounting', *interalia*, provides as follows: *"21. The depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise... Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed."* In view of above, it was felt that if there is a change in the accounting policy of depreciation, then its effect should be quantified and disclosed.

		However, no such disclosures have been made in context of the same under the stated policy. Accordingly, it was viewed that non-disclosure of the effect due to changes in accounting policy is not in line with the disclosure requirement of AS 6.

7

Observations on Accounting Standard (AS) 7: Construction Contracts

S. No.	Matter contained in Annual Report	Observations
1.	From the Annual Reports of some companies, engaged in the construction activities, it has been noted that the revenue from constructed properties has been recognised on the 'percentage of completion method', however, no disclosures have been made.	It has been noted that these companies have adopted AS 7 for recognition of revenue arising from construction activities. However, the companies have not made disclosures as required by paragraph 39 of Accounting Standard (AS) 7, 'Construction Contracts', in the Notes to Accounts. Paragraph 39 of AS 7 provides as follows: "39. *An enterprise should disclose the following for contracts in progress at the reporting date:* (a) *the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;* (b) *the amount of advances received ; and* (c) *the amount of retentions.* Incidentally, it was noted that certain companies states that revenue is recognised on

		‘proportionate completion method’, however, the terminology used in AS 7 is ‘Percentage of Completion Method.’ Hence, referring to ‘proportionate completion method’ instead of ‘percentage of completion method’ is incorrect. The terminology used in the Standard should be used in narration of accounting policies.
2.	As per the accounting policy regarding revenue recognition, given in the Annual Report of a construction company, job work revenue is accounted ‘on the basis of running bills raised and approved by the clients.’ Revenue expenditure is accounted on accrual basis as and when it is incurred.	It was viewed that accounting for revenue ‘on the basis of running bills raised and approved by the clients’ may not necessarily reflect the percentage of work completed. There may be works which have been completed but bill on it has not been raised. Further, it was observed that under stated policy, the company has neither disclosed the method used to recognise contract revenue nor the methodology used to determine the revenue accrued to the company. Accordingly, it was viewed that the requirements of paragraph 38 of Accounting Standard (AS) 7, ‘Construction Contracts’, which provides as follows, has not been complied with: *“38. An enterprise should disclose:* *(a) the amount of*

		contract revenue recognised as revenue in the period; *(b) the methods used to determine the contract revenue recognised in the period; and* *(c) the methods used to determine the stage of completion of contracts in progress."*
3.	From the segment reporting given by a company in its Annual Report, it has been noted that significant income was generated from project construction division, however, neither any related disclosures nor any accounting policy in respect of the same was reflected in the financial statement.	It may be noted that paragraphs 38 and 39 of Accounting Standard (AS) 7, 'Construction Contracts', provide as follows: *"38. An enterprise should disclose:* *(a) the amount of contract revenue recognized as revenue in the period;* *(b) the methods used to determine the contract revenue recognized in the period; and* *(c) The methods used to determine the stage of completion of contracts in progress.* *39. An enterprise should disclose the following for contracts in progress at the reporting date:*

		(a) *the aggregate amount of costs incurred and recognised profits(less recognised losses) upto the reporting date;* (b) *the amount of advances received; and* (c) *the amount of retentions."* It was viewed that being a construction company, the disclosures required by paragraphs 38 and 39 would be applicable to it. Further, since significant amount of income was earned from project construction contracts, the accounting policy in relation to the same becomes an important policy. However, the non disclosure of information sought under AS 7 and the accounting policy as adopted by the company for the same is against the requirements of AS 1 as well as AS 7.

8

Observations on Accounting Standard (AS) 9: Revenue Recognition

S. No.	Matters Contained in Annual Report	Observations of the Board
1.	From the Annual Reports of some companies, the disclosures with regard to sales as shown on the face of the Profit and Loss Account have been given as follows: • Sales (net of excise duty) are shown on the face of the Profit and Loss Account as well as in a schedule. The amount of excise duty deducted from sales has been indicated in the schedule to the Profit and Loss Account by way of narration only. It indicates that gross sales have not been disclosed either in the schedule or on the face of the Profit and Loss Account. • Sales including excise duty have been shown on the face of the Profit and Loss Account. The excise duty have been shown as an expense in the Schedule 'Manufacturing, Administrative and Selling Expense'.	It may be noted that the explanation to paragraph 10 of Accounting Standard (AS) 9, 'Revenue Recognition', *interalia,* provides as follows: *Explanation: The amount of revenue from sales transactions (turnover) should be disclosed in the following manner on the face of the statement of profit and loss:* *Turnover (Gross) xxx* *<u>Less:</u> Excise Duty <u>xxx</u>* *Turnover (Net) xxx* *The amount of excise duty to be deducted from the turnover should be the total excise duty for the year except the excise duty related to the difference between the closing stock and opening stock..." (Emphasis added)* It was viewed that as per the requirement of AS 9 the excise duty should be deducted from the sales on the face of Profit and

	The observations on the above are quite similar in all the cases as provided adjacent to them.	Loss Account. In other words, both gross sales and sales net of excise duty should be shown on the face of Profit and Loss Account. It was viewed that reporting only sales (net of excise duty) or gross sales with expensing excise duty separately in the Schedule is not in line with the requirements of AS 9. It was further noted from a schedule forming part of the accounts, that gross sales included sales tax and VAT, though these had been deducted to arrive at the net sales. Since sales tax and VAT are collected by a company as an agent for the government, these should not even be included in the amount of gross sales, as per paragraph 39 of Guidance Note on Accounting for State Level Value Added Tax (VAT) issued by the Institute of Chartered Accountants of India.
2.	It has been noted that the difference in excise duty on opening and closing stocks of finished goods has been disclosed in the schedule of material consumed.	It has been noted that the explanation to paragraph 10 of Accounting Standard (AS) 9, 'Revenue Recognition', *interalia* , provides as follows: "*...The excise duty related to the difference between the closing stock and opening stock should be recognised*

		separately in the statement of profit and loss, with an explanatory note in the notes to accounts to explain the nature of the two amounts of excise duty." It was noted that the excise duty relates to 'finished goods', therefore, its disclosure under the head of 'Materials Consumed' is incorrect. It was felt that the aforesaid disclosure as required by AS 9 has not been correctly made.
3.	From the Annual Report of a company, it has been noted that schedule of sales includes the consignment sales.	It may be noted that paragraph 4.1 of Accounting Standard (AS) 9, 'Revenue Recognition', *interalia,* provides as follows: *"4.1. <u>Revenue</u> is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends..."* Consignment sale is by definition not a 'sale' since such sale is made to an agent for subsequent sale to an ultimate customer. Inclusion of 'consignment sales' as part of Sales is not in accordance with AS 9 since significant risks and rewards

		remain with the seller until the consignment goods are sold by the consignee agent to the ultimate customer. In fact, such sales should be recognised at the time of sale to the ultimate customer as per the requirements of paragraph 4.1 of AS 9.
4.	In the Annual Reports of some companies, it has been noted from the schedules of income that the foreign exchange fluctuations have been adjusted against gross turnover/exports sales. Similar non-compliance was also noted in the Annual Reports of some companies as stated below: • Sales revenue is recognised when property in the goods with all significant risk and rewards as well as the effective control goods usually associated with ownership, are transferred to the buyer, at a price and **includes excise duty and exchange fluctuation** in case of the export. (Emphasis added) • Service charges for transportation of shipments are recognized as income when shipments are manifested and represent the amount invoiced, net of service tax, **exchange fluctuation** and all discounts	It may be noted that paragraph 4.1 of Accounting Standard (AS) 9, 'Revenue Recognition', *interalia,* provides as follows: "4.1. ***<u>Revenue</u> is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends..."*** The foreign exchange fluctuation is not an inflow of cash receivable etc. arising from the sale of goods but from settlement of non-monetary item. Hence, accounting such fluctuation as part of Sales revenue is not in accordance with the aforesaid paragraph of AS 9.

	and allowances. (Emphasis added) The observations on the above are quite similar in all the cases as provided adjacent to them.	
5.	From the Annual Reports of some companies, it has been noted from the accounting policy on revenue recognition that: • Sales **include duty drawback, license premium on exports, and insurance claims on stocks** and are recorded net of trade discounts and other rebates. (Emphasis added) • Revenue from sale of products is recognised on dispatch or appropriation of goods in accordance with the terms of sales and is inclusive of excise and **export incentives**, but **net of incentive on sales including commission, rebates and discounts.** (Emphasis added) • Sugar sales include incentive on export of sugar. The observations on the above are quite similar in all the cases as provided adjacent to them.	The following discrepancies have been noticed in the accounting policy of revenue recognition: (a) It may be noted that paragraph 4.1 of AS 9 provides as follows: *"4.1 <u>Revenue</u> is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not gross inflow of cash, receivables or other consideration."*

		It has been stated that sales reported on the face of Profit and Loss Account are inclusive of duty drawback, license premium on exports and insurance claims on stocks/ export incentives. In other words, these items have not been disclosed separately, instead the reported sales have been increased by them. Considering the above mentioned definition of 'revenue', it was viewed that the receipts from duty drawbacks, license premium on exports or insurance claims on stocks is not a consideration arising from sale of goods. Hence, they should not be merged with the sales and should be disclosed as separate line items. This aspect has also been explained in the Expert Advisory Opinion (Query No. 1.15, Volume VI, page 43). (b) Further, it has been noted that the sales have been reported net of commission, rebates and discounts. Considering the definition of revenue, it was viewed that the sales should be reported on gross basis. Hence, any commission paid on sales should be treated as an

		expense rather than deducting it from the sales. It was also observed that nature of rebate and discounts is not clear as to whether they are in the nature of trade discount or cash discount. It was viewed that if the discount is trade discount and rebate is volume rebate, then inclusion of the same in the sales is in accordance with AS 9, otherwise, there is a non-compliance of AS 9. Cash discounts and cash rebates should be disclosed separately as an expense rather than netting off such cash and rebate discount against sales. Considering the above-mentioned discrepancies, it was felt that the revenue is over estimated/under estimated in the given financial statements considering the requirements of AS 9.
6.	From the schedule of sales given in the Annual Report of a company, it has been noted that gross sales reported include VAT or service tax.	As regards VAT, it may be noted that paragraph 39 of Guidance Note on Accounting for State Level Value Added Tax (VAT), issued by the Institute of Chartered Accountants of India, states as follows: "The Value Added Tax (VAT) is collected from the customers on behalf of the VAT authorities and, therefore, its collection from the

		customers is not an economic benefit for the enterprise and it does not result in any increase in the equity of the enterprise. Accordingly, it should not be recognised as an income of the enterprise." Keeping in view of above requirements, it was viewed that the VAT collected should not be included under sales and should be directly credited to VAT payable account without routing the same through the Profit and Loss Account. Similarly, with regard to service tax, it was viewed that it is collected from the customer on behalf of third party and it cannot be treated as revenue from sales. Accordingly, it was viewed that inclusion of VAT or service tax to report gross sales is not in line with the requirements of paragraph 39 of aforesaid Guidance Note as well as paragraph 4.1 of AS 9.
7.	In the Annual Report of some companies, it has been noted from the accounting policy of revenue recognition that dividend income is recognised on receipt.	It may be noted that paragraph 13 of Accounting Standard (AS) 9, 'Revenue Recognition', *interalia* provides as follows: *"13. Revenue arising from the use by others of enterprise resources yielding interest,*

		royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases: *...* *(iii) Dividends from Investments in Shares: when the owner's right to receive payment is established."* It was noted that the company recognises dividend income on receipt of the same while paragraph 13 of AS 9 requires recognition of dividend income when the right to receive the same is established. It was further viewed that recognising the dividend income on cash basis is also against Section 209 (3) (b) of the Companies Act, 1956. Accordingly, the stated accounting policy with regard to the recognition of dividend income is not in line with the requirements of AS 9 as well as the Companies Act, 1956.
8.	In the Annual Report of a company, it has been noted from the accounting policy regarding revenue recognition read with Note under the paragraph of 'Outlook' given under 'Management Discussions and Analysis' of the Directors' Report which read as under respectively:	It has been noted from note under Significant Accounting Policies that the stated accounting policy as adopted by the company relating to revenue recognition is very ambiguous. Further, it was observed from paragraph relating to 'Outlook' as given in the Director's Report that the

	"(ii) Recognition of Income and Expenditure Revenues / Income and Costs / Expenditure are generally recognised on actual as they are earned or incurred." Note under the paragraph of 'Outlook' given under 'Management Discussions and Analysis' of the Directors' Report which reads as under: "The Company continues to look out for addition of newer products, which can be sold through the same marketing and distribution set up that the Company has in the Healthcare Industry. As such we are confident that your Company will continue to grow the sales and profitability during the current year subject to unforeseen circumstances."	company has marketing and distribution set up for selling its product which indicates that timing of recognising such revenue is important and as such this should have been explicitly stated by the company.
9.	From the Annual Report of a company, it has been noted that Project Management / Development Income is recognised as and when the bill is raised.	It may be noted that paragraph 7.1 of Accounting Standard (AS) 9, 'Revenue Recognition', provides as follows: "7.1 Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method. *(i) Proportionate completion method.* Performance

		consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance. *(ii)* *Completed service contract method.* Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly

		revenue is recognised when the sole or final act takes place and the service becomes chargeable." It was observed that as per the requirements of AS 9, revenue generated by way of project management should be recognised on the basis of principles laid down in paragraphs 7.1 (i) and (ii) of AS 9 and not when the bill is raised. It was viewed that the accounting policy followed of recognising revenue 'as and when the bill is raised' is not in line with the requirements of AS 9.
10.	From the Annual Report of a company, it has been noted that goods self-consumed had also been included in the figures of sales.	In terms of paragraph 4.1 of Accounting Standard (AS) 9, 'Revenue Recognition', "*Revenue* is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods…"It was viewed that in case of self-consumption of goods produced, the risk and rewards remain within company and also there is no consideration from the point of view of the company as a whole, hence, recognising them as sales is not in compliance with AS 9.
11.	In the notes forming part of the accounts of a company, it has been noted that the company has given significant amount of loans to subsidiary company, however,	Paragraphs 13 and 14 of Accounting Standard (AS) 9, 'Revenue Recognition', provide as follows:

	it has been clearly stated that no interest has been recognized in the Profit and Loss Account.	*"13. Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends, should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following lines:* *(i) Interest: On a time proportion basis taking into account the amount outstanding and the rate applicable.* *14. In addition to the disclosures required by Accounting Standard 1 on 'Disclosure of Accounting Policies' (AS 1), an enterprise should also disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties."* The company should have recognised interest in accordance with paragraph 13 of AS 9 unless the recoverability of the amount is uncertain. In case, if there is an uncertainty of recoverability of the amount of interest receivable, the company should have disclosed the circumstances in which revenue recognition has been postponed in accordance with the

		aforesaid requirements of AS 9. In the extant case, it has been observed that neither the company has recognised the interest receivable from its subsidiary nor has it given any reason for the postponement of its recognition which is not in line with AS 9.
12.	From the Annual Report of a company, the following has been noted from one of the Notes to the Accounts : "Inter divisional transfers of goods, as marketable products produced by separate divisions of the company for captive consumption are made as if sales were to third parties at current market prices and are included in turnover."	As stated in the Note, 'Inter divisional transfers of goods' have been included in 'turnover'. It may be noted that the ICAI has issued an Announcement titled as 'Treatment of Inter-divisional Transfers', which provides that: "Since in case of inter-divisional transfers, risks and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers." Thus, the recognition of inter-divisional transfers as sales indicates an inappropriate recognition of revenue, which is not in line with AS 9.

9

Observations on Accounting Standard (AS) 10: Accounting for Fixed Assets

S. No.	Matter contained in Annual Report	Observations
1.	From the notes to the accounts given in the Annual Report of a company, it has been noted that the company was operating an integrated business at three geographical locations. Further, it has been noted that the company had revalued only certain assets of a unit/ location.	It may be noted that paragraph 27 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', provides as follows: *"27. when a fixed asset is revalued in financial statements, an entire class of assets should be revalued, or the selection of assets for revaluation should be made on a systematic basis. This basis should be disclosed."* It was noted that the company had revalued one of its units, whereas the company owned two more properties situated in different locations also. It was viewed that the company had revalued only a single asset while AS 10 requires the company to revalue the entire class of the asset, and in case if such revaluation had been done on selective basis then the basis of such selection should have been disclosed in terms of paragraph 27 of AS 10. However, in this case, the company had failed to disclose the basis of such

		selection for revaluation of assets.
2.	From the Annual Report of a company, it has been noted that the expenses included under the head 'Miscellaneous Expenditure (to the extent not written off)' comprises of deferred replacement expenses. Further, it has been noted that the accounting policy relating to deferred revenue expenditure states as follows: "Major revenue expenditure incurred by way of/in connection with planned replacement of worn out parts of plant and equipments is amortised over the estimated period, the benefit from such expenditure is expected to endure".	It was observed that the deferred replacement expenses included under the head 'Miscellaneous Expenditure' was in the nature of subsequent expenditure incurred in connection with replacement of worn out parts of plant and equipments. It may be noted that paragraph 23 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', provides as follows: *"23. Subsequent expenditures related to an item of fixed asset should be added to its book value only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance."* It was felt that such expenditure should be added to the book value of the plant and equipment only if it leads to increase in the future benefits from them. Otherwise AS 10 does not apply on such expenditure and it should be expensed off as and when incurred. Even the accounting policy clearly states that the expenditure is of "revenue" in nature.

		Accordingly, the capitalisation of such expenditure as miscellaneous expenditure is not in accordance with the requirements of paragraph 23 of AS 10 as well as AS 26.
3.	From the schedule of pre operative expenses given in the Annual Report of a company, it has been noted that it also comprises of expenses related to payment of income tax, wealth tax and interest paid and received and excess provision of interest credited back.	It may be noted that paragraph 9.4 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', provides as follows: "9.4. If the interval between the date a project is ready to commence commercial production and the date at which commercial production actually begins is prolonged, all expenses incurred during this period are charged to the profit and loss statement. However, the expenditure incurred during this period is also sometimes treated as deferred revenue expenditure to be amortised over a period not exceeding 3 to 5 years after the commencement of commercial production." It was noted that pre-operative expenses in the extant case comprised of all expenses which are incurred by the company prior to commercial production whereas aforesaid requirement prescribes to captialise all expenses till the date at which the project is ready to commence commercial production. From the stated facts, it appears that

		income tax and wealth tax have also been considered as pre-operative expenses which logically arise only after the commencement of commercial production. Similarly, in case of interest paid and received, excess provision of interest credited back, it was felt that proper justification had not been disclosed for inclusion of such expenses as part of pre-operative expenses.
4.	From the schedule of fixed assets given in the Annual Report of a company, it has been noted that computer software and goodwill were shown as part of (tangible) fixed assets.	It may be noted that as per paragraph 18 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', 'Items determined in accordance with the definition in paragraph 6.1 should be included under fixed assets in the financial statements.' Further, paragraph 6.1 of AS 10, provides as follows: *"6.1. <u>Fixed asset</u> is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business".* It may further be noted that paragraph 6 of Accounting Standard (AS) 26, 'Intangible Assets', defines an intangible asset as 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. Further, paragraph 10 of AS 26, *interalia*, provides that: "10…In determining whether such an asset should be treated under AS 10, 'Accounting for Fixed Assets', or as an intangible asset under this Standard, judgment is required to assess as to which element is predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset". It was viewed that both computer software and goodwill do not have physical substance and therefore, they are intangible in nature. Accordingly, they should be shown as intangible assets rather than as tangible fixed assets.
5.	The schedule of fixed assets, given in the Annual Report of a	It was observed from the stated notes that while in the former

	company contain certain notes in context of fixed assets included therein which states as follows: • Gross block of assets includes certain (free hold) lands which have been awarded as settlement in arbitration proceedings towards settlement of claims of certain creditors of the company, are pending to be transferred. Pending transfer of title deeds, no adjustment has been carried out in the books to give effect to the arbitration award. • CWIP includes an amount being development expenditure incurred on a property out of advances made in earlier years. That property has been sold and advances received are reflected as current liability, pending completion of certain legal and contractual obligations.	case, the company had accepted the arbitration award, in the later case, the property appears to have already been sold by the company. In such cases, merely the pretext that since title deeds had not been transferred or pending completion of certain legal and contractual obligations, does not justify postponement of passing necessary entries of sale etc. in the books of account. It was also noted from the definition of 'fixed asset' as given in paragraph 6.1 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', that a "fixed asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business." It was further noted that according to paragraph 17 of Accounting Standard of (AS) 1, 'Disclosure of Accounting Policies', one of the major considerations governing the selection and application of accounting policies is 'Substance over form' as per which the accounting treatment and presentation in financial statements should be governed by their substance and not merely by the legal form. It was observed that, in the former case, certain

		freehold land had already been awarded to the creditors of the company against the settlement of certain claims. Apparently, such freehold land belongs to the creditors, although the title deed was still in the name of the company. Further, in the later case, it was clearly stated that the property which was earlier held as CWIP had been sold during the year. Therefore, it was viewed that in substance such fixed assets could not be considered as fixed assets of the company, as they were neither available with the company for the purpose of producing or providing goods or services and nor were these held for sale in the normal course of business. Thus, to show such properties as 'fixed assets' of the company was not proper. In other words, the fixed assets of the company had been overstated and profit and loss account had been incorrectly stated to the extent of the profit or loss not recognised in respect of the above.
6.	From the schedule of fixed assets given in the Annual Report of a company, it has been noted that leasehold land has been shown as a part of fixed assets for which a footnote was given stating that Leasehold land	It was noted that paragraph 49(a) of "Framework for the Preparation and Presentation of Financial Statements" defines "Asset" as follows: *"An asset is a resource*

	represents amount paid to State Industrial Development Corporation for land **to be purchased** on 95 years lease, for which compliance with certain conditions as mentioned in the license agreement and registration is pending as on date.	***controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise."*** It was observed from the stated footnote that leasehold land had not yet been purchased but was yet "to be purchased". It was viewed that neither the land was in the possession of the company nor it had obtained the legal ownership, and as such it is classified as a fixed asset of the company. Thus, its inclusion in the schedule of fixed assets results in overstatement of fixed assets. It was viewed that such amount paid should have been disclosed as an advance against fixed asset.
7.	From the schedule of reserve & surplus given in the Annual Report of a company, it has been noted that the revaluation reserve was shown under the head of revenue reserve.	It may be noted that paragraph 8 of the Guidance Note on Treatment of Reserve issued by the Institute of Chartered Accountants of India, created on Revaluation of Fixed Assets provides as follows: "When accumulated losses and depreciation (including arrears of depreciation) are adjusted against Revaluation Reserve it will amount to setting off actual losses against unrealised gains. **If dividend is declared out of the**

		current profits after adjusting accumulated losses or arrears of depreciation against the Revaluation Reserve, it will mean that dividend is declared out of profits which should, in fact, have been utilised in setting off past losses and arrears of depreciation. In effect, the company will be declaring dividend out of profits which are not available for distribution. By adopting this method, the company will be declaring dividend out of unrealised gains appearing in the accounts in the form of Revaluation Reserve. Accordingly, accumulated losses of arrears of depreciation should not be set off against Revaluation Reserve. (emphasis supplied) In view of above, an increase in book value arising due to revaluation is not free for distribution. Accordingly, it should not have been shown under the head of 'revenue reserve'.
8.	From the footnote given under the schedule of fixed assets of some companies, it has been noted that certain assets included the amounts which was added as a surplus on revaluation of those assets.	It was observed that although certain assets had been stated at revalued amounts, the companies had not disclosed the information required by paragraph 37 (iii) of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', which ,*interalia,* provides as follows:

		"37. The following information should be disclosed in the financial statements: *...* *(iii) revalued amounts substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts."*
9.	In the Annual Report of a company, the accounting policy of fixed assets states as follows: "Fixed assets are stated at cost net of cenvat / value added tax and include amount added on revaluation less accumulated depreciation and impairment loss, if any. All cost is inclusive of freight, duties (net of tax credits as applicable) levies and any directly attributable cost till commencement of commercial production"	It may be noted that paragraphs 9.4 and 20 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', provide as follows: "9.4. If the interval between the date a project is ready to commence commercial production and the date at which commercial production actually begins is prolonged, all expenses incurred during this period are charged to the profit and loss statement. However, the expenditure incurred during this period is also sometimes treated as deferred revenue expenditure to be amortised over a period not exceeding 3 to 5 years after the commencement of commercial production."

		"20. The cost of a fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use." It was noted from the stated accounting policy that the cost incurred till the commencement of the commercial production was capitalised. It was viewed that there may be certain cases when the dates on which the assets are brought to working condition for their intended use and the date of commencement of commercial production may be different and as per paragraph 9.4 of AS 10, expenses incurred between the period on which the commercial production is ready to commence and the date on which commercial production actually starts should be charged to the Profit and Loss Account. However, in the stated policy the expenses incurred till the commencement of commercial production have been capitalised which is contrary to the requirement of AS 10.
10.	In the Annual Report of a company, the accounting policy regarding 'Depreciation and Amortisation', included the following statement:	It was viewed that in order to present the financial statements in a better manner, this statement should have been covered either under the accounting policy of borrowing cost or that of fixed assets, instead of covering the

	"…Fixed Assets are capitalised at cost inclusive of expenses and interest wherever applicable."	same under the accounting policy on depreciation and amortisation.
11.	In the Annual Report of a company, the accounting policy regarding preoperative expenses has been stated as follows: "Expenditure (including financing cost and exchange rate fluctuations relating to the borrowed funds for construction and acquisition of qualifying fixed assets) incurred on projects under implementation are treated as pre-operative expense pending allocation to the assets and are shown under 'Capital Work in Progress' and transferred to the concerned assets on pro-rata basis".	It may be noted that paragraphs 20 and 21 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', provide as follows: *"20. The cost of a fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use.* *21. The cost of a self-constructed fixed asset should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset".* It was noted from the stated accounting policy that pre-operative expenses which were incurred on projects had been transferred to the concerned assets on pro-rata basis. It was felt that as per AS 10, the cost of fixed assets should comprise only those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the

		specific asset. Accordingly, it was viewed that the allocation of preoperative expenses to the concerned assets on pro-rata basis would be correct only if the expenses being allocated (on pro-rata basis) have been incurred on construction activity and can be allocated to that specific asset as per the principles of AS 10.

10

Observations on Accounting Standard (AS 11): The Effects of Changes in Foreign Exchange Rates

S. No.	Matters Contained in Annual Report	Observations of the Board
1.	From the Annual Report of a company, it has been noted that the accounting policy provides as follows: "…Premium in respect of forward foreign exchange contract is charged to the Profit & Loss Account. Premium in respect of foreign exchange option contracts is charged to the Profit & Loss Account as and when the contracts are entered into but the gain on such option contracts, if any, is recognised on maturity / cancellation of such option contract." It has also been noted that fluctuation in foreign currency has been disclosed under a separate schedule.	It may be noted that paragraph 36 of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', *interalia,* provides as follows: *"36. …The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract. Exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period."* It was noted from the stated accounting policy that premium in respect of forward foreign exchange contract is charged to the Profit & Loss Account as and when the contracts are entered

		into instead of amortising the premium over the life of the contract in terms of the aforesaid paragraph. Although certain amount has been charged off as fluctuation in foreign currency, no policy has been disclosed with regard to recognition of profit or loss on forward exchange contract that may arise on cancellation/ renewal/ end of the reporting period as required under paragraph 36 of AS 11. Apparently, either the company is not recognising such gains or losses or the accounting policy for the same is not disclosed. Accordingly, there is non-compliance with the requirements of both AS 11 and AS 1.
2.	In the Annual Report of a company, it has been noted from one of notes which states as follows: "The company uses forward contracts to hedge its risks associated with foreign currencies relating to foreign currency liabilities. The company does not use forward contracts for speculative purpose."	It may be noted that paragraph 36 of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', provides as follows: "*36. An enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward exchange contract, which is not intended for trading or speculation purposes, to establish the*

		amount of the reporting currency required or available at the settlement date of a transaction. The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract. Exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period." It was noted that during the year, the company had undertaken certain forward exchange contracts to hedge the risk associated with foreign currencies, due to which gain or loss would have arisen on the forward exchange contracts. However, no such disclosure has been made in the Profit and Loss Account which is contrary to the requirement of paragraph 40 (a) of AS 11 which requires the disclosure of *"the amount of exchange differences included in the net profit or loss for the period."*

		It was viewed that in case there had been no effect due to foreign exchange fluctuation, the same should have been stated as "nil" rather than omitting the same from the financial statements.
3.	In the Annual Report of a company, the accounting policy relating to Derivative Instruments and Hedge Accounting is stated as follows: "The Company uses foreign currency forward contracts to hedge its risks associated with foreign currency fluctuations relating to certain firm commitments and forecasted transactions. Such forward contracts are utilised against the inflow of funds under firm commitments and the profit/loss arising thereon is accounted in the year of settlement of forward contract. The Company does not use the forward contract for speculative purposes."	It has been noted that paragraph 36 of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', provides as follows: "36. An enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward exchange contract, which is not intended for trading or speculation purposes, to establish the amount of the reporting currency required or available at the settlement date of a transaction. The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract. Exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period."

		It was noted that the company has recognised profit/(loss) only on the settlement of the Forward Exchange Contracts while paragraph 36 of AS 11 requires that apart from recognising the profit/(loss) on the settlement of contracts, it should also recognise the same in each reporting year based on the foreign currency rate as on the date of the Balance Sheet. Further, the premium or discount that arose during the inception of such contract had also not been dealt with by the company to reflect a true and fair view of foreign exchange fluctuation. Therefore, the accounting policy of the company with regard to derivative instruments and hedge accounting is not in compliance with the requirements of AS 11.
4.	In the Annual Report of a company, the accounting policy relating to foreign currencies transactions is stated as follows: "Transactions in foreign currency are accounted for at the exchange rates prevailing on the date of transactions. Monetary assets and liability related to foreign currency transaction remaining unsettled at the end of the year are translated at year-end exchange rate.	It was noted that although the accounting policy relating to premium or discount arising at the inception and at the time of cancellation/renewal of forward exchange contract has been disclosed, there is no disclosure of the accounting policy relating to forward exchange contract held by company as at the end of the reporting period as required under paragraph 36 of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates'.

	Gain/Losses arising out of fluctuations in the exchange rate are recognised in the accounts in the period in which they arise. Differences between the forward exchange rates and the exchanges rate at the date of transactions are accounted for as Income/Expenses over the life of the contracts."	Further, it was also noted from the accounting policy of foreign exchange transactions that although the accounting policy relating to monetary items has been disclosed, there is no disclosure of the accounting policy relating to non-monetary items. Accordingly, the requirements of paragraph 24 of AS 1 as well as paragraph 11 of AS 11 have not been complied with.
5.	The accounting policy relating to foreign exchange transactions given in the Annual Report of a company states as follows: "Transactions in foreign currency are accounted at the exchange spot rate prevailing on the date of the transaction. **Year-end receivables and payables are translated at year-end rate of exchange except in case of transactions covered by forward exchange contracts which are translated at the contracted rate.** The difference between the spot rate at the date of transaction & contracted rate is spread over the life of the contract. The difference on account of fluctuation in the rate of exchange is recognised in the Profit and Loss Account. In case of sales and purchases, the same are included under the respective heads." (Emphasis added)	It may be noted that paragraphs 36 and 37 of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', provide as follows: *"36. An enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward exchange contract, which is not intended for trading or speculation purposes, to establish the amount of the reporting currency required or available at the settlement date of a transaction. The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract. Exchange differences on such a contract should be recognised in the statement of*

		profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period. 37. The risks associated with changes in exchange rates may be mitigated by entering into forward exchange contracts. Any premium or discount arising at the inception of a forward exchange contract is accounted for separately from the exchange differences on the forward exchange contract. The premium or discount that arises on entering into the contract is measured by the difference between the exchange rate at the date of the inception of the forward exchange contract and the forward rate specified in the contract. Exchange difference on a forward exchange contract is the difference between (a) the foreign currency amount of the contract translated at the exchange rate at the reporting date, or the settlement date where the transaction is settled during the reporting period, and (b) the same foreign currency amount translated at the latter of the date of inception of the forward exchange contract and the last reporting date."

		It was noted that the year-end receivables and payables were translated at the year-end rate of exchange except in case of transactions covered by forward exchange contracts which were translated at the contracted rate. It was noted that no such exception has been provided under AS 11. Therefore, the foreign currency transactions viz sales or purchases giving rise to receivables or payables should be recorded at the rate prevailing on date of the transactions and any gains or losses arising on forward contracts covering such transactions should be recorded separately as per the principles prescribed under paragraph 36 of AS 11. Accordingly, it was viewed that the accounting policy adopted by the company to recognise forward exchange contracts is not in compliance with the requirements of paragraphs 36 and 37 of AS 11.
6.	From the Annual Reports of some companies, it has been noted that: • Purchases/Sales were net of difference arising on account of fluctuation in the rate of exchange. • The adverse / favourable exchange difference arising on foreign currency transactions have been	It may be noted that paragraph 13 as well as 40 (a) of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', provides as follows: "*13. Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially*

	accounted for in the Profit and Loss Account in Consumption of Raw Materials, Consumption of Stores, Colours and Chemicals, Consumption of Machinery Stores & Spares, Interest & financial charges, Sales, Capital Goods. • Sale of goods is net of trade and includes exchange differences arising on sales transactions. The observations on the above are quite similar in all the cases as provided adjacent to them.	*recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise, with the exception of exchange differences dealt with in accordance with paragraph 15."* *"40. An enterprise should disclose:* *(a) the amount of exchange differences included in the net profit or loss for the period;"* In view of above, it was felt that exchange difference arising as income or expense should be shown separately in the Profit and Loss Account for the period. However, in the extant case, it was noted that the exchange differences which have been included in sales as well as consumption of raw material and stores etc., had not arisen due to such sales or purchase transactions. It was viewed that the sales and purchase transactions are recorded at the exchange rates prevalent on the dates of the transactions and foreign exchange fluctuations arising on the balances of debtors and creditors, have arisen subsequent to the dates of such

		sales and purchase transactions. Accordingly, such fluctuations should be treated as arising due to changes in value of monetary assets and/or monetary liabilities. Hence, such fluctuations giving rise to gain or loss should be separately recorded rather than being adjusted in the respective heads viz. value of such sales / purchases transactions. It was viewed that any exchange difference arsing on sales/ purchases/ any other transaction is independent of that transaction. It was viewed that although inclusion of exchange differences as part of sales and consumption of raw material, stores etc. does not impact the profit of the company, however, it does not reflect the correct figures of turnover, cost of raw material consumed, cost of stores consumed during the year etc. Accordingly, it was viewed that the impact of exchange rate fluctuation should not be included under the respective heads as per the requirements of paragraph 13 as well as 40 (a) of AS 11.
7.	The accounting policy relating to foreign exchange transactions as	It may be noted that paragraph 11 (b) and (c) of Accounting

	given in the Annual Report of a company states as follows: "Transactions in foreign currencies are accounted for at the prevailing exchange rates on the date of the transactions. The gains or losses arising out of subsequent fluctuations on the date of Balance Sheet or settlement before that date are charged to the Profit and Loss Account."	Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', provides as follows: *" 11. At each balance sheet date:* *(a) ...* *(b) non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction; and* *(c) non-monetary items which are carried at fair value or other similar valuation denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined."* It was noted from the stated accounting policy that the company is following the stated policy for all transactions irrespective of the fact whether they have occurred in context of monetary or non-monetary items. In case, if the stated accounting policy is also being followed for non-monetary transactions then it is not in line with the requirements of paragraph 11 (b) and (c) of AS 11.

8.	From the Annual Reports of some companies for the financial year 2007-08, the following accounting policies in context of 'Foreign Exchange Transactions have been noted: • Any income and expense on account of exchange rate difference either in settlement or on translation is recognised in the Profit and Loss Account except in cases where they related to acquisition of fixed assets, in which case, they are adjusted to the carrying cost of such assets. • Exchange differences (including arising out of forward exchange contracts) in respect of liabilities incurred to acquire fixed assets from outside India are adjusted to carrying amount of such fixed assets. • Any income or expense on account of foreign exchange difference either on settlement or on transaction, is being recognised in the Profit and Loss Account except in cases where they relate to the acquisition of fixed assets. In such cases, these are adjusted to the carrying cost of such assets.	It may be noted that paragraph 13 of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', provides as follows: *"13. Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise, with the exception of exchange differences dealt with in accordance with paragraph 15."* In view of the above, capitalisation of foreign exchange differences is not allowed as per AS 11. AS 11, as issued by Ministry of Corporate Affairs and published in the Notification in the Official Gazette dated 7th December, 2006, carries the following footnote: "It may be noted that the accounting treatment of exchange differences contained in this Standard is required to be followed irrespective of the Companies Act, 1956."

	The observations on the above are quite similar in all the cases as provided adjacent to them.	Thus, the treatment of exchange differences contained in AS 11 notified as above is applicable in respect of accounting periods commencing on or after 7th December, 2006. However, it was noted that the exchange difference arising on foreign currency loan for acquisition of fixed assets has been adjusted to the carrying cost of such assets. It has also been noted that subsequently, notification no. G.S.R. 225 (E) dated 31st March, 2009 was issued by the Ministry of Corporate Affairs, which provides that the exchange difference arising on foreign currency loan for acquisition of fixed assets can be recognised as follows: "…Exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset and in other cases, can be accumulated in a "Foreign

		Currency Monetary Item Transaction Difference Account" in the company's financial statements and amortised over the balance period of such long-term asset/liability but not beyond 31st March, 2011…" It was viewed that although this notification has a retrospective effect, it was issued on 31st March, 2009. The financial statements under review relate to the financial year 2007-08 when no such pronouncement existed and as per the then prevailing requirements of AS 11, any such gain/ loss was required to be adjusted in the Profit and Loss of the period. Hence, considering the period of the financial statements, the treatment adopted by the company is a non-compliance of AS 11 as applicable at the relevant time.
9.	From the Annual Reports of some companies, it has been noted that they had recorded significant amount of transactions relating to imports and exports. Further, following has been noted from accounting policy of foreign exchange transactions: • In respect of Imported Assets the cost is recorded in Rupees by applying the foreign currency exchange	It was noted that only the accounting policies relating to the initial recognition of foreign currency transactions and the fluctuations arising on settlement of foreign currency transactions (payments) have been stated but the accounting policy followed by the company for recognising exchange gain or loss on monetary assets and monetary liabilities as on every Balance Sheet date has not been disclosed.

	rate existing at the time of transaction. Exchange fluctuations are recognised at the time of actual payment. All exchange differences arising on account of revenue transactions are charged to Profit and Loss Account. • Transactions in foreign currency are recorded at the exchange rates prevailing on the date of the transaction. Liability in respect of imported materials remaining unpaid is stated at the exchange rates prevailing at the year end. • Foreign currency transactions are recorded at rates of exchange prevailing on the date of transaction. All exchange differences during the year are on account of raw material purchases. These are dealt with in the statement of profit and loss. The observations on the above are quite similar in all the cases as provided adjacent to them.	Accordingly, it was felt that the accounting policy as adopted by the companies to recognise the foreign exchange transactions cannot be considered complete.
10.	From the accounting policy of foreign exchange transactions, it was noted that while accounting policy for transactions in foreign currencies to the **extent not covered by forward contracts** was given but omit to provide the accounting policy for the transactions covered by forward contracts.	The accounting policy was indicating that there were transactions which are covered by forward contracts. It was viewed that transactions in foreign currencies are independent of forward exchange contracts. Therefore, following two separate accounting policies for same nature of transactions is not

		correct. Hence, the accounting policy followed by the company is not in line with AS 11.
11.	In the Annual Report of a company, it has been noted as follows from one of the notes to accounts: "…The foreign currency loans and deposits held outside India in foreign currency were re-stated as on the Balance Sheet date as per the requirements of Accounting Standard 11 and the net gain arising out of such re-statement amounting to Rs……… (Last year Rs…….) is credited to Profit and Loss Account in Interest and Finance charges. Sales include realised exchange fluctuation on exports …"	It may be noted that paragraphs 13 and 14 of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', provide as follows: *"13. Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise, with the exception of exchange differences dealt with in accordance with paragraph 15.* 14. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a

		subsequent accounting period, the exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period." It was noted that the amount of interest and finance charges as well as sales include the exchange rate fluctuation although the exchange rate fluctuation arising on any transaction is independent of transactions underlying it. It was viewed that any foreign exchange transaction giving rise to any monetary assets /liabilities should be initially recorded at the rate prevailing on that date and any foreign exchange gain or loss arising on realisation/settlement of such monetary asset/liabilities should be recorded as income or loss arising on foreign exchange transaction which is independent of former transaction. Accordingly, it was viewed that the gains or losses arising due to exchange rates variation should be recognised separately instead of accounting the same in the respective heads as has been done by the company in case of foreign currency Loans and Deposits as well as Sales. In addition to above, it has been

		noted that the company has not disclosed the accounting policy relating to monetary items as well as non - monetary items as required under paragraph 14 of AS 11.
12.	In the Annual Report of some companies although the accounting policy relating to Foreign Exchange Transactions was disclosed but no gain or loss arising from foreign exchange fluctuation was reported either in the profit and loss account or in the notes to accounts.	It may be noted that paragraph 40 (a) of Accounting Standard (AS) 11, 'The Effects of Changes in Foreign Exchange Rates', provides as follows: *"40. An enterprise should disclose:* *(a) the amount of exchange differences included in the net profit or loss for the period;"* It was observed that the disclosure of accounting policy on foreign exchange transactions indicates that the company was engaged into foreign currency transactions. Accordingly, it should have incurred exchange gain or loss and thus, non disclosure of the same is against the requirements of paragraph 40(a) of AS 11. In case, if there is nil effect due to foreign exchange gains in some transactions being set off against the losses of other transactions, then it is viewed that such fact should have been disclosed separately rather than omitting the same from the financial statements.
13.	The accounting policy of Foreign Exchange Transactions given in	It may be noted that paragraph 9 of Accounting Standard (AS) 11,

	the Annual Report of a company was stated as follows: "During the year, foreign currency transactions relating to purchases of goods and services are translated at the rate prevailing at the time of **settlement of the transactions**…" (Emphasis added)	'The Effects of Changes in Foreign Exchange Rates', provides as follows*:* *"9. A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction."* It was noted that foreign currency transactions relating to purchases of goods and services were translated at the rate prevailing at the time of settlement of the transaction instead of translating them at the rate prevailing on the date when such purchases took place. In other words, such transaction was not at all recorded initially when such transaction took place. It was recorded on its settlement. Hence, the accounting policy as adopted by the company for accounting of the foreign currency transactions is not in accordance with paragraph 9 of AS 11.
14.	The accounting policy of foreign exchange transactions given in the Annual Report of a company states as follows : "**Foreign currency assets and liabilities** are converted at the	It appears from the accounting policy that all foreign currency assets and liabilities are translated at the year-end rates. This is contrary to paragraph 11(a) of AS 11 which requires

	rate prevailing on the last day of the accounting year and transactions completed during the year are accounted for at the then ruling rate." (Emphasis added)	only assets and liabilities in the nature of monetary items (and not **all** assets and liabilities) to be converted at the closing exchange rate. Accordingly, it was viewed that the company has not complied with the requirement of paragraph 11(a) of AS 11.
15.	From one of the notes to accounts given in the Annual Report of a bank, it has been noted that: "During the year, the company has obtained external commercial borrowing amounting to EURO XXX. The balance outstanding as at March 31, 200X is Rs XXX. The Company has fully hedged the foreign currency risk on this borrowing including interest thereon through forward rate contracts. The premium amortised during the year amounting to Rs. XXX has been included in 'Other Finance Charges' under Schedule. The amount of premium to be recognised as expense in the Profit and Loss Account over subsequent accounting periods is Rs. XXX. The net exchange difference on forward contract and on loan liability of the above stated external commercial borrowing has been adjusted in 'Interest on Term Loan and Deposits' under Schedule.	From the facts, it was noted that although the amount of premium being amortised on forward rate contracts has been disclosed, there is no disclosure of the amount of exchange difference in the Profit and Loss Account. It was viewed that certain exchange difference would have arisen on such forward contract and on loan liability at the Balance Sheet date which has been reported in the Profit and Loss Account. This is not as per the requirement of paragraph 40(a) of AS 11 which requires separate disclosure of the amount of exchange differences included in the net profit or loss for the period.
16.	The accounting policy of foreign currency transactions of a	It may be noted that paragraph 12 of Accounting Standard (AS) 11,

	company has been stated as follows : "Foreign currency designated assets, liabilities including fixed assets are restated at the year-end rates and the resultant gain and loss is taken to Profit and Loss Account."	'The Effects of Changes in Foreign Exchange Rates', provides examples of monetary and non-monetary items as follows: "12. Cash, receivables, and payables are examples of monetary items. Fixed assets, inventories, and investments in equity shares are examples of non-monetary items..." Further, paragraph 11(b) of AS 11 requires that: *"11. At each balance sheet date:* *(a) ...* *(b) non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction; and ..."* It was viewed that fixed assets are non-monetary items and accordingly, they should have been reported using the exchange rate at the date of transaction. Further, it has been noted from the stated accounting

		policy that all foreign currency assets and liabilities are restated at the year-end rates without distinguishing between monetary and non-monetary items. This is against the aforesaid principles of AS 11. It may be mentioned that AS 11 has not defined the term 'foreign currency designated assets', accordingly, the usage of such terms is not appreciated for the understanding of the financial statements by readers.
17.	From the Annual Report of a company, it has been noted that an accounting policy relating to gain or loss on derivatives has been disclosed, however, no disclosures have been made in the notes to accounts in this regard.	It was noted from the accounting policy relating to gain or loss on derivatives that the company is dealing in derivative instruments. It was also noted that the Institute of Chartered Accountants of India has issued an Announcement titled as 'Disclosure regarding Derivative Instruments' which provides as follows: "3. The Accounting Standards Board of the Institute of Chartered Accountants of India is in the process of developing Accounting Standards on (i) 'Financial Instruments: Presentation', (ii) 'Financial Instruments: Disclosures' and (iii) 'Financial Instruments: Recognition and Measurement' which would deal with the presentation, disclosure

		and recognition and measurements aspects of all financial instruments including derivative instruments. Pending the issuance of the said Accounting Standards, the Institute is of the view that with a view to provide information regarding the extent of risks to which an enterprise is exposed, it should, as a minimum, make following disclosures in its financial statements: (a) category-wise quantitative data about derivative instruments that are outstanding at the Balance Sheet date, (b) the purpose, viz., hedging or speculation, for which such derivative instruments have been acquired, and (c) the foreign currency exposures that are not hedged by a derivative instrument or otherwise." However, there is no separate disclosure about the extent of risk with regard to unhedged foreign currency to which the company is exposed. It has been noted that the company has not disclosed the details of derivative instruments

		as per the requirement of the aforesaid announcement relating to Disclosures of Derivative Instruments. At times, the companies disclose the accounting policy as adopted by them for recognising the derivative transactions, however, omit to provide any disclosures in relation to them.
18.	From the Annual Report of a company, it has been noted that the company has entered into in the derivative instruments and hedging contracts.	It was noted that the company has entered into the derivative and hedging contracts but the policy as adopted by it for its recognition was not disclosed which is not in line with the requirements of AS 1.
19.	From the Annual Report of the year ending 2009, it has been noted that the company had capitalised exchange difference in the value of depreciable fixed asset, however, no further details were provided.	As per paragraph 46 of AS 11, if company adjusts the exchange difference in the cost of depreciable capital asset, then it should be depreciated over the balance life of the asset in so far as they relate to the acquisition of such asset. Further, if such option as given in paragraph 46 is exercised, then such following disclosures are required by it : a) Of the fact of exercise of the option and b) Of the amount remaining to be amortised (till it remains unamortised) Accordingly, it was viewed that the amount remaining to be

		amortised in the note has not been disclosed as per the requirement of Notification no. G.S.R. 226 (E) issued by Ministry of Corporate Affairs.

11

Observations on Accounting Standard (AS) 12: Accounting for Government Grants

<table>
<tr><th>S. No.</th><th>Matter contained in Annual Report</th><th>Observations</th></tr>
<tr><td>1.</td><td>In the Annual Report of a company, significant income by way of ‘Sales Tax Subsidy’ has been shown under the head of ‘Other Income’.</td><td>Paragraph 23 of Accounting Standard (AS) 12, ‘Accounting for Government Grants’, provides as follows:

“23. The following should be disclosed:

(i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;
(ii) the nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost”.

It was viewed that the sales tax subsidy is basically a government grant in kind by reducing or writing off the liability of sales tax, accordingly, the company is required to disclose the accounting policy as adopted by it for recognition of same. Non-disclosure of same is a non-compliance of AS 12.</td></tr>
</table>

12

Observations on Accounting Standard (AS) 13: Accounting for Investments

S. No.	Matter contained in Annual Report	Observations
1.	From the schedule of other income given in the Annual Reports of some companies, it has been noted that it includes profits on sale of investments, income from mutual funds, dividend income and interest income from investments.	It may be noted that paragraph 35(c) of Accounting Standard (AS) 13, 'Accounting for Investments', provides as follows: *"35. The following information should be disclosed in the financial statements:* *(c) the amounts included in profit and loss statement for:* *(i) interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid;* *(ii) profits and losses on disposal of current investments and changes in the carrying*

		amount of such investments; and *(iii) profits and losses on disposal of long term investments and changes in the carrying amount of such investments."* It was observed that as per the aforesaid requirements, a company is required to disclose separately the dividend income, interest income and profit on sale of investments from long term and current investments. It has also been noted that pursuant to clause 3(xi)(a) Part II, Schedule VI[1] to the Companies Act 1956, the amount of income from investments should be distinguished between those arising from trade investments and other Investments. It was observed from the schedule of investments that although the companies had long term and current investments and/or trade and other investments, the income generated have not been bifurcated into income from long

[1] Subsequent to the observations of the Board, Schedule VI has been revised vide Notifications No. G.S.R. 225 (E) dated 31st March, 2009, G.S.R. 913 (E) and G.S.R. 914 (E) dated 29th December, 2011 issued by the Ministry of Corporate Affairs (MCA).

		term investment and current investments and/ or trade and other investments. Accordingly, it was viewed that non bifurcation of income leads to non- compliance with the disclosure requirements of AS 13 and clause 3(xi) (a) of Part II, Schedule VI to the Companies Act, 1956.
2.	In the Annual Reports of some companies, the accounting policy relating to long term investments has been stated as given below: • Investments are stated at cost. No provision is made for diminution in the value of Investments as the Investments are considered as long term. • Long term investments are stated at cost. • Investments are Long term investment hence stated at cost. No provision has been made for appreciation in the value of investments. • Long term investments are carried at cost, less provision required, if any, for **permanent** diminutions. (Emphasis added.) The observations on the above are quite similar in all the cases as provided adjacent to them.	Paragraph 32 of Accounting Standard (AS) 13, 'Accounting for Investments', requires that: *"32. Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually."* It was noted from the policies relating to valuation of investments adopted by different companies that, while in some cases the accounting policy simply states that the long term investment have been valued at cost which indicates that the provision for diminution have not been considered for the valuation of long term investment, in other

		cases, provision for diminution, other than temporary, in the value of long term investments had either not been made at all or such provision for diminution, had been termed as 'permanent diminution.' It was viewed that valuation of investment without considering the provision for diminution other than temporary is not in line with the requirements of AS 13. With regard to referring to provision as 'permanent diminution', it was felt that there is a difference between 'permanent diminution' in the value of investments and 'other than temporary diminution' in value of investments and normally, no diminution in value of investments may be termed as permanent. Accordingly, it was viewed that the stated policies on valuation of long term investments are not in line with the requirements of AS 13.
3.	The accounting policy with regard to investments as given in the Annual Report of a company states as given below: "Investments in Subsidiary companies are valued at cost inclusive of all expenses incidental to their acquisition. The	It may be noted that paragraph 32 of Accounting Standard (AS) 13, 'Accounting for Investments', provides as follows: *"32. Investments classified as long term investments should be carried in the financial statements at cost. However,*

	dividends, if any, declared by such subsidiaries are recognised as income. The decline if any, other than of a temporary nature in value of such investment arising as a result of losses is adequately provided for in the accounts." Further, it has been noted that one of the Notes to the Accounts states as follows: "The company has invested during the year into Equity of two of its 100% subsidiaries. Further, the Company has outstanding Loans and Advances and investment in three of its 100% Subsidiaries at the year-end. The net worth of these subsidiaries has declined. The company has assured Financial Support. As the management is confident of turning around the subsidiaries in the near future provision for diminution in the value, if at all required, is not made."	*provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually."* It was observed that the balance of 'Reserves & Surplus' as reported in the Consolidated Balance Sheet is significantly less than that reported in the Standalone Balance Sheet. It was viewed that reduced balance in Consolidated Balance Sheet *prima facie* indicates that substantial losses were incurred by the subsidiaries during the period. Substantial losses coupled with the fact that there is decline in the value of investments in such subsidiaries as held by the company, clearly indicates that the diminution in the value of investments was other than temporary, which as per the stated policy has been adequately provided for. However, in the notes to account, it is stated that no such provision has been made on the pretext that management is confident of turning around. It was viewed that these are two contradictory facts for the same set of financial statement. Such contradictions should be avoided.

4.	In the Annual Report of a company, the accounting policy regarding investments provides as below: "Long-term Investments made by the company have been stated at cost, except in certain cases where these have been brought down upon commercial considerations and in keeping with the applicable accounting standard…"	The stated policy indicates that no provision has been made and the investments are written off in certain cases where these have been brought down upon commercial considerations. It was viewed that the phrase 'commercial consideration' is not clear in the accounting policy of investments. It was felt that paragraph 32 of Accounting Standard (AS) 13, 'Accounting for Investments', prescribes that to recognise provision for diminution in the value of investments, when there is decline other than temporary. However, usage of the phrase 'commercial consideration' indicates that some other basis was being followed to recognise provision, which is different from the one prescribed in AS 13. Such ambiguous accounting policy should be avoided.
5.	From the schedule of investments given in the Annual Report of a company, it has been noted that the investment in the shares of X Co-operative Bank Ltd. had been disclosed under the subhead of government securities.	It was felt that the name of the bank itself indicates that it is a co-operative bank which cannot be considered as Government or Trust Securities. Hence, the given presentation is considered to be inappropriate.
6.	In the schedule of investments given in the Annual Reports of some companies, Investments were classified in different ways, an illustrative list of which is given below:	It was viewed that the stated classification of investments neither meets the requirements of Schedule VI[2] to the Companies Act, 1956 nor AS 13.

[2] Refer Footnote 1

	• Long-term and short-term investment. • Long-term and short-term investment as well as quoted and unquoted Investments. • Trade and non- trade as well as quoted and unquoted investments. • Quoted and unquoted Investments. • Investments (without any bifurcation). The observations on the above are quite similar in all the cases as provided adjacent to them.	It may be noted that while paragraph 26 of Accounting Standard (AS) 13, 'Accounting for Investments', prescribes to classify the investments into long term investments and current investments, Part I, Schedule VI[3] to the Companies Act, 1956 prescribes to classify the same as trade and other investments. Further, it may be noted that paragraph 35 (e) of AS 13 as well as Part I, Schedule VI[4] to the Companies Act, 1956 prescribes to disclose the aggregate amount of quoted and unquoted investments, along with the aggregate market value of quoted investments. From given cases, it was noted that the investments have been classified into long term investments and short term investment or trade and non-trade investments. It was noted that in former case the investments have also been bifurcated as short term investments, however, AS 13 prescribe to classify the investments into 'current investments'. It does not define any investments as 'short term

[3] Refer Footnote 1

[4] Refer Footnote 1

		investments'. Similarly, in latter case the investments have been also bifurcated into non-trade investments, however, the Companies Act, 1956, prescribes to classify the investments into 'other investment' and not 'non trade investments'. Therefore, classification of investments as 'short term' or 'non-trade' is not in line with the requirements of AS 13 as well as Companies Act, 1956. Further, it was noted that companies has classified the investments either as per AS 13 or as per Companies Act, 1956. It was viewed that omission of either of such classification or both is a non compliance. Further, omitting the information with regard to aggregate amount of quoted and unquoted investments, alongwith the aggregate market value of quoted investments is also a non compliance of AS 13 and Part I, Schedule VI[5] to the Companies Act, 1956.
7.	From the schedule of investments given in the Annual Report of a company, it has been noted that an investment in the shares of a	It may be noted that paragraph 57 of 'Framework for the Preparation and Presentation of Financial Statements' provides as follows:

[5] Refer Footnote 1

	wholly-owned subsidiary was shown at NIL value since the amount due against it was unpaid as on reporting date, hence, the unpaid amount had been deducted against the cost of share to reflect NIL value.	"The assets of an enterprise result from past transactions or other past events. Enterprises normally obtain assets by purchasing or producing them, but other transactions or events may also generate assets; examples include land received by an enterprise from government as part of a programme to encourage economic growth in an area and the discovery of mineral deposits. Transactions or other events expected to occur in the future do not in themselves give rise to assets; hence, for example, an intention to purchase inventory does not, of itself, meet the definition of an asset." It was viewed that transactions expected to occur in future do not give rise to assets, therefore, if the shares have not been received and the amount is also still unpaid, then it is a future transaction. However, if the shares have been received but amount is not paid then these two transactions can not set off against each other. While investments will appear at cost, the liability against it will be shown separately. Hence, the recognition of the transaction was not in line with Indian GAAPs.

8.	From the Annual Reports of some companies, it has been noted that different companies have adopted the accounting policy of valuing all investments at cost and making provisions for diminutions, if such decline is other than temporary.	It was viewed that as per AS 13 this policy is required to be followed for the valuation of long-term investments only. It may be noted that as per paragraph 31 of AS 13 : *"31. Investments classified as current investments should be carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis."* It was felt that the accounting policy of the company is not in line with AS 13 to the extent if such investments include current investments. In absence of bifurcation of investments into long term and current investments, it may be assumed that the current investments, in such cases, are also being valued at 'cost', which is not in line with the requirements of paragraph 31 of AS 13.
9.	From the schedule of investments given in the Annual Reports of some companies, it was noted that the companies had invested in various units and bonds but accounting policy as adopted by the company for its valuation had not been disclosed.	It may be noted that paragraph 35 (a) of Accounting Standard (AS) 13, 'Accounting for Investments', requires the disclosure of the following: *"35.(a) the accounting policies for determination of*

		carrying amount of investments;" It was noted that although the companies hold certain investments, the accounting policy for determination of their carrying cost had not been disclosed, which is not in line with the requirements of AS 13.
10.	From the schedule of investments given in the Annual Reports of some companies, it has been noted that the aggregate amount of quoted and unquoted investments and market value of quoted investments had not been mentioned distinctly.	Paragraph 35(e) of AS 13, read with Part I, Schedule VI[6] to the Companies Act, 1956, requires that ***the aggregate amount of quoted and unquoted investment, giving the aggregate market value of quoted investment*** should be disclosed in the financial statements. However, it was observed that the companies often omit to disclose the aggregate amount of quoted and unquoted investments, as well as the market value of quoted investments under the schedule of investments, which is not in line with the requirement of AS 13 as well as Schedule VI[7] to the Companies Act, 1956.
11.	*In the Annual Report of a company, Segment Report had identified 'Investment Activities' one of the separate business*	*It may be been noted that paragraph 3.1 of Accounting Standard (AS) 13, 'Accounting for Investments', provides as follows:*

[6] Refer Footnote 1

[7] Refer Footnote 1

	segments which was also the primary segment of the company. *Further, the income from sale of shares/ mutual funds and bonds were disclosed as 'business income'. In the notes to accounts given pursuant to 'Additional information required under paragraphs 3 & 4 of Schedule VI of the Companies Act, 1956', the quantitative details in respect of purchase and sale of shares/mutual fund/bonds/ units were also given. However, such investments were shown as Investments and not as stock-in-trade.*	*"3.1 <u>Investments</u> are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'investments'."* *Further, paragraph 3.1 of Accounting Standard (AS) 2, 'Valuation of Inventories', defines the term 'Inventories' as follows:* *"Inventories are assets:* *(a) held for sale in the ordinary course of business;* *(b) in the process of production for such sale; or* *(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services."* *As per the information given under the various schedules and notes to the accounts , it was viewed that trading in shares and mutual fund units, in the extant case, was a primary business activity of the company and accordingly, disclosure of shares and mutual fund as 'Investments'*

		instead of as 'stock-in-trade' is prima facie incorrect. *Accordingly, it was felt that the requirements of AS 13 as well as AS 2 have not been complied with.*

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Observations on Accounting Standard (AS) 15: Employee Benefits

S. No.	Matters Contained in the relevant Annual Report	Observations of the Board
1.	While the accounting policy of employee benefits indicate to be in the nature of defined benefits viz. gratuity, no disclosure were made in respect to the same in the Notes to accounts of some companies as given below: • Gratuity to employees is covered under the employees group gratuity scheme and the premium is paid on the basis of actuarial valuation. • Gratuity payable to employees is provided for based on valuations made by actuaries. • Provision towards liability for gratuity is made on the basis of actuarial valuation and is charged to revenue. Liabilities in respect of gratuity of employees is ascertained on the basis of actuarial valuation and paid to the gratuity fund. The observations on the above are quite similar in all the cases as provided adjacent to them.	Employee benefits in the form of gratuity are a defined benefit plan. Paragraph 120 [clauses (a) to (o)] of Accounting Standard (AS) 15, 'Employee Benefits', prescribes extensive disclosure in respect of defined benefit plans. Non-disclosure of the required information is non-compliance with AS 15. It was noted that although the employee benefits in nature of defined benefits has been stated to be provided for as per actuarial valuation, however, no disclosures have been made as required under paragraph 120 of AS 15. It is non-compliance of AS 15.

2.	From the Annual Reports of some companies, it has been noted that although the liabilities for gratuity have been provided for but not separately shown in the Profit and Loss Account.	In terms of clause 3 (x)(f)(ii) of Part II, Schedule VI to the Companies Act, 1956, 'Contribution to Provident and Other Funds' is a separate line item. Since the Company's gratuity liability is funded, the amount debited to the Profit and Loss Account should be disclosed under the head 'Contribution to Provident and Other Funds'. Disclosing the same under the head 'Salaries and Wages' is also not in line with the requirements of Part II, Schedule VI to the Companies Act, 1956.
3.	From the Annual Report of a company, it has been noted from the actuarial assumptions of defined benefit plan that different rates of future salary increases has been assumed for liability of gratuity funded; non-funded and leave encashment.	It was observed that such basic assumptions like future salary increases cannot differ for same set of employees for different nature of liabilities viz. gratuity and leave encashment. Such difference in assumptions raises doubt on computation of liabilities under AS 15.
4.	From the Annual Report of a company, it has been noted that the accounting policy of liability towards gratuity states as follows: "Provision for gratuity has been made on the basis of actuarial valuation in the accounts in respect of employees who have completed qualifying period of service."	It may be noted that Question No. 14 of ASB Guidance on Implementing AS 15, Employee Benefits (revised 2005), issued by the Accounting Standards Board, states as follows: "In this case, the employee's right to receive the benefit is conditional on future employment for a period of five years. Although there is a possibility that the benefit may not vest, there is also a probability that the

		employee would serve for the minimum period of five years and become eligible for gratuity. An obligation exists even if a benefit is not vested. The obligation arises when the employee renders the service though the benefit is not vested. The measurement of this obligation at its present value takes into account the probability that the benefit may not vest and this is appropriately factored in the calculation of the present value of the defined benefit obligation. An enterprise should, therefore, create a provision in respect of gratuity payable during the first five years of service of an employee." Keeping in view of the above, it was felt that the provision should be created in respect of gratuity payable during the first five years of service for all employees rather than creating provision for those employees who have completed qualifying period of service.
5.	From the Annual Report of a company, it has been noted from schedule of provisions that the company has provided for defined gratuity plan as well as leave encashment. However, certain companies provide detailed disclosure in relation to only one defined benefit plan and omit to give disclosures in relation to	It was noted that complete omission of disclosures as required by paragraph 120 of Accounting Standard (AS) 15, 'Employee Benefits', in respect of any defined plan or partial disclosures is not in compliance with AS 15.

	other or give only partial disclosures in respect of them.	
6.	From the Annual Report of a company, it has been noted that although detailed disclosure with respect to employee defined benefit plans have been given, however, corresponding amounts relating to previous year have not been disclosed.	Note (n) of General Instructions for preparation of Balance Sheet given below 'Horizontal Form' of Balance Sheet under part I of Schedule VI[1] to the Companies Act, 1956, requires that "Except in the case of the first Balance Sheet laid before the company after the commencement of the Act, the corresponding amounts for the immediately preceding financial year for all item shown in the Balance Sheet shall be also given in the Balance Sheet." Accordingly, it has been noted that previous year figures are required to be reported for all items of the Balance Sheet and Profit and Loss Account. Further, the Notes and Schedules are integral part of such documents, accordingly, they should also provide the corresponding previous year figures. Accordingly, omission of such information is not in line with the requirements of Schedule VI to the Companies Act, 1956.

[1] Subsequent to the observations of the Board, Schedule VI has been revised vide Notifications No. G.S.R. 225 (E) dated 31st March, 2009, G.S.R. 913 (E) and G.S.R. 914 (E) dated 29th December, 2011 issued by the Ministry of Corporate Affairs (MCA).

7.	The accounting policy relating to Retirements Benefits in the Annual Report of a company states as follows: "Liability on account of encashment of leave and gratuity to employees is provided based on the internal calculation of the management and not based on actuarial valuation…"	It may be noted that paragraph 27 of Accounting Standard, (AS) 15, 'Employee Benefits', provides as follows: "27. Under defined benefit plans, (a) the enterprise's obligation is to provide the agreed benefits to current and former employees ; and (b) actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the enterprise. If actuarial or investment experience are worse than expected, the enterprise's obligation may be increased." Further, paragraph 65 of AS 15 provides as follows: *"65. An enterprise should use the Projected Unit Credit Method to determine the present values of its defined benefit obligations and the related current service cost and, where applicable, past service cost."* It may be noted that retirement benefits in the form of gratuity and leave encashment are defined benefit plans and AS 15 mandates liability for such defined benefit obligations to be determined on actuarial basis. Hence, in the extant case, there is non-

		compliance with a fundamental requirement of AS 15.
8.	In the Annual Reports of some companies, the accounting policy regarding the Employee Benefits states as follows: • Payment to defined contribution retirement benefit scheme, if any, is charged as expenses **as they fall due.** (Emphasis added) • Contributions are made by the company to provident fund on a monthly basis and charged to Profit & Loss Account. • Company's Contribution to Provident/Pension and Superannuation Funds are charged to the Profit & Loss Account. • The Company's contribution to the provident fund is charged to the Profit and Loss Account. The observations on the above are quite similar in all the cases as provided adjacent to them.	It may be noted that paragraph 45 of Accounting Standard (AS) 15, 'Employee Benefits', provides as follows: *"45. When an employee has rendered service to an enterprise during a period, the enterprise should recognise the contribution payable to a defined contribution plan in exchange for that service:* *(a) as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the balance sheet date, an enterprise should recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and* *(b) as an expense, unless another Accounting Standard requires or permits the inclusion of the contribution in the cost of an asset (see, for example, AS 10, Accounting for Fixed Assets)."*

		The accounting policy either state that such expense has been recognised by the enterprise when it falls due or merely stating that the contribution made to such plans are charged to Profit and Loss Account is not sufficient. As per AS 15, the expense of defined contribution plan should be recognised for each period of service rendered by the employees. Accordingly, it was viewed that such policies do not clearly indicate as to whether the contribution so made is the appropriate accrual of liability or not. It is essential because the contribution paid, in excess of what is due, is to be recognised as an asset and contribution paid, which falling short is to be recognised as a liability. Thus, it was viewed that the accounting policy as adopted by the company for contribution to defined contribution retirement scheme is ambiguous and not strictly in accordance with AS 15 as well as the accrual basis of accounting mandated by the Companies Act, 1956.
9.	The accounting policy regarding retirement benefits as given in the Annual Reports of some companies states as below: • Provision has been made in	It may be noted that paragraph 119 of Accounting Standard (AS) 15 'Employee Benefits', provides as follows: *"119. An enterprise should*

	respect of gratuity. Provisions are made for leave encashment on accrual basis. • Provision for leave encashment benefits and gratuity of the continuing employees is provided on accrual basis based on actual computation. • Leave encashment: The company has provided an adhoc provision of Rs. XX lacs as accrued liability during the year which is subject to actuarial valuation. The observations on the above are quite similar in all the cases as provided adjacent to them.	*disclose information that enables users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans during the period."* It was noted that in certain cases, the accounting principles as adopted by the company for recognition and measurement of provision for gratuity has not been disclosed. In others, it has been stated that the provision for gratuity/ leave encashment has been made on accrual basis/ actual basis/ adhoc basis. It was viewed that as per AS 15 such liability should have been determined on actuarial basis rather than on actual basis/adhoc basis. Accordingly, it was viewed that the accounting policies as adopted by the companies for recognition and measurement of provision for gratuity as well as for leave encashment are not in line with the requirements of AS 15.
10.	From the Annual Reports of some companies, the accounting policy regarding the retirement benefits has been noted which state as follows: • The Company extends the benefit of encashment of leave to its employees while in service as well as on	It may be noted that paragraphs 11, 51 and 134 of AS 15 mandates to recognise the liabilities for encashment of leave/gratuity / termination benefits should be accounted for on accrual basis instead of on payment basis. It may also be noted that Section

	retirement. As the company does not have any defined retirement benefit scheme in respect of Accounting Standard (AS) 15 issued by the ICAI is not considered applicable, **encashment of leave accumulated while in service is at the option of employees and is accounted for as and when claimed, hence not provided.** (Emphasis added) • Annual contributions in respect of gratuity are made to the Life Insurance Corporation of India under Group Gratuity Scheme and are accounted for on payment basis. • Payments under Voluntary Retirement Scheme are recognised in the Profit and Loss Account of the year in which such payment is affected. • No provision for gratuity has been made for the current year. The gratuity, as and when paid, shall be charged to Revenue account in the year of payment. The observations on the above are quite similar in all the cases as provided adjacent to them.	209(3)(b) of the Companies Act 1956, provides as follows: "(3) For the purposes of sub-sections (1) & (2) ,proper books of account shall not be deemed to be kept with respect to the matters specified therein,- (b) If such books are not kept on accrual basis and according to the double entry system of accounting." Accordingly, it was viewed that the stated policies are contrary to the requirements of AS 15 as well as the accrual basis of accounting as mandated under Section 209 (3) (b) of the Companies Act,1956.
11.	From the Annual Report of a company, the accounting policy with regard to Retirement	It may be noted that paragraphs 1 and 70 of Accounting Standard (AS) 15, 'Employee Benefits'

	Benefits is noted to be stating as follows: "Contributions to the Government Provident Fund and ESI are charged to revenue. Since the company does not have any defined retirement benefit scheme in this regard, Accounting Standard 15 issued by the Institute of Chartered Accountants of India is not considered applicable."	provide as follows: "1.This Standard should be applied by an employer in accounting for all employee benefits, except employee share-based payments." "70. Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). Employee service before the vesting date gives rise to an obligation because, at each successive Balance Sheet date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced…" It was noted from the policy on retirement benefits that contribution to the Government Provident Fund and ESI are charged to revenue; further, the company does not have any defined retirement benefit scheme in regard to Provident Fund and ESI, therefore, AS 15 has not been considered by the company. It may be noted that firstly Employees' Provident Fund and contributions to ESI are not defined benefit plans but defined contributions plans for which separate requirements are provided in AS 15. Further, it was

		also noted that gratuity liability is a statutory liability and is a defined benefit plan, it is unlikely that the company has no liability in respect of gratuity. AS 15 requires liability in respect of defined benefit plans such as gratuity to be provided on an actuarial basis. It was also noted from paragraph 70 of AS 15 that the employee's right to receive the benefit is conditional on future employment although there is a possibility that the benefit may not vest but there is a possibility that the employee would serve for the future period, an obligation arises even if a benefit is not vested. Therefore, it was viewed that the liabilities towards gratuity should be created in respect of employees in service. Accordingly, it was viewed that stating that AS 15 is inapplicable on the company is incorrect and indicates non-compliance of AS 15.
12.	From the Annual Report of a company, it has been noted that there was difference in the figure reported as liabilities for gratuity in the Notes to the Accounts from that reported in the Balance sheet.	It may be noted that Part I, Schedule VI[2] to the Companies Act, 1956 given under Vertical Form of the Balance Sheet provides as follows: "The Schedules, referred to above, accounting policies and

[2] Refer Footnote 1

		explanatory notes that may be attached shall form an integral part of the balance sheet." From the above, it may be construed that Schedules as well as notes to accounts are parts of the financial statements and therefore, the information contained therein should not contradict from that reported in Balance Sheet or Profit and Loss Account. It was noted that there was a significant difference in the figures of gratuity liabilities as reported in the Balance Sheet from that reported under detailed disclosures made in pursuance to paragraph 120 of AS 15. However, no information has been provided either in the Schedule or in notes to accounts to justify this difference. Such contradictions raise doubt in relation to compliance with AS 15.
13.	From the Annual Reports of some companies, it has been noted from the Schedule of general reserve that the amount arising due to transitional effect on account of AS 15 had been adjusted against the opening balance of general reserve. It has been further noted from the notes to accounts that the details of liabilities as recognised in the	It may be noted that paragraphs 144 and 145 of Accounting Standard (AS) 15, 'Employee Benefits', provide as follows: *"144. On first adopting the Standard, an enterprise should determine its transitional liability for defined benefit plans at that date as:* *(a) The present value of the obligation (see paragraph*

	Balance Sheet had been given which either are significantly different from that adjusted against general reserve and in Profit and Loss Account or the amount adjusted indicates that the amount adjusted against general reserve have not been adjusted for tax.	*65) at the date of adoption;* *(b) Minus the fair value, at the date of adoption, of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 100-102);* *(c) Minus any past service cost that, under paragraph 94 should be recognised in later periods.* *145. The difference <u>(as adjusted by any related tax expense)</u> between the transitional liability and the liability that would have been recognised at the same date, as per pre-revised AS 15 issued by the ICAI in 1995, should be adjusted immediately, against opening balance of revenue reserves and surplus."(emphasis added)* It was noted that although there can be difference between the amount reported in the notes to accounts and the amount adjusted in the schedule of general reserve due to tax adjustment but significant differences are not justified. Further, information should be provided either in the Schedule or in the Notes to Accounts to explain this difference. It was further noted that in case of comparing of two figures , if it

		appears that no tax adjustment has been made before adjusting it against general reserve, it is against the requirements of paragraph 145 of AS 15.
14.	From the Annual Reports of some companies, it has been noted that expenditure incurred under voluntary retirement scheme which is being written off over a period of 5 years.	It may be noted that paragraph 146 of Accounting Standard (AS) 15, 'Employee Benefits', provides as follows: "146. This standard requires immediate expensing of expenditure on termination benefits (including expenditure incurred on voluntary retirement scheme (VRS). However, where an enterprise incurs expenditure on termination benefits on or before 31st March, 2009, the enterprise may choose to follow the accounting policy of deferring such expenditure for amortisation over its payback period. However, the expenditure so deferred cannot be carried forward to accounting periods commencing on or after 1st April, 2010." It was noted that during the year, an expenditure on VRS has been recognised which would be amortised over a period of 5 years, i.e. beyond 31st March, 2010 which is not as per the requirement of paragraph 146 of AS 15.

15.	From the Annual Report of a company, it has been noted that there was difference between the figures of closing balances at the end of previous year and opening balance at the beginning of next period of defined benefit obligation as well as plan assets.	It was noted from the detailed disclosures of employee benefits that the opening balances of the following items do not tally with the closing balances of the previous period: (a) present value of defined benefit obligations and (b) fair value of plan assets. It was viewed that no further information has been given explaining the differences between the figures of closing balance at the end of the previous year and the opening balance of the same item at the beginning of the next period. Such inconsistencies should be avoided.
16.	As per the accounting policy on employees benefits, the gratuity fund is administered through the scheme of insurance companies and the contribution to the above fund is charged against revenue.	AS 15 requires that liability for defined benefits should be ascertained using actuarial techniques for making reliable estimates of the amount of benefit that employees have earned in return for their service and discounting the same using the projected unit credit method. It was noted that the stated accounting policy does not reflect the actual policy to provide for gratuity liabilities. The policy as disclosed is not in accordance with the requirements of AS 15.

		Although an entity may choose to fund its gratuity through an insurance company, it is imperative that the charge to revenue should be based on an actuarial valuation and not on the basis of the premium paid to the insurance company.

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Observations on Accounting Standard (AS) 16: Borrowing Costs

S. No.	Matter contained in Annual Report	Observations
1.	In the Annual Report of a company, while the accounting policy relating to Borrowing Costs has been stated as follows, there is no disclosure of the amount of borrowing costs capitalised during the period: "Borrowing costs attributable to the acquisition or construction of qualifying assets are capitalised as a part of the cost of such assets. A qualifying asset is one that necessarily takes substantial period of time to get ready for intended use. All other borrowing costs are charged to Revenue".	It may be noted that paragraph 23 of Accounting Standard (AS) 16 'Borrowing Costs', provides that the financial statements should disclose the accounting policy adopted for borrowing costs and the amount of borrowing costs capitalised during the period. It appeared from the stated accounting policy of borrowing cost that certain portion of interest cost had been capitalised as a part of the cost of qualifying assets. However, the amount of borrowing cost capitalised during the year has not been disclosed as required by paragraph 23 of AS 16.
2.	From the schedules of secured loans and interest & financial charges given in the Annual Reports of some companies, it has been noted that certain borrowing costs had been incurred during the reporting period. Further, it has been noted from the related information given in the notes to the accounts that a	It may be noted that paragraph 23 (a) of Accounting Standard (AS) 16 'Borrowing Costs', provides as follows: *"23. The financial statements should disclose:* *(a) the accounting policy adopted for borrowing costs;"* It was observed that although

	portion of finance charges had been capitalised to the value of fixed assets and the rest had been expensed.	borrowing costs had been incurred and a significant portion of the financial charges had been capitalised to the value of fixed assets, no disclosure of the accounting policy as adopted for borrowing costs was made as required by paragraph 23 of AS 16.
3.	From the Annual Reports of some companies, it has been noted that they were treating restructuring charges as follows: “Restructuring charges which had been paid to extinguish high cost debts were written-off over the tenure of fresh loans taken for refinancing such high cost debts.”	It may be noted that paragraph 6 of Accounting Standard (AS) 16 ‘Borrowing Costs’, provides as follows : *“6. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.”* Further, as per paragraphs 3.1 and 4(c) of AS 16, “*borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds”* and it may include, interalia, “amortisation of ancillary costs incurred in connection with the arrangement of borrowings.”

		It was observed that restructuring charges paid to extinguish high cost debts do not fall within the definition of borrowing costs as referred to above. Therefore, such costs are not eligible for capitalisation with the cost of asset. Accordingly, it was viewed that in accordance with paragraph 6 of AS 16, such borrowing cost should have been recognised as an expense in the period in which they are incurred.
4.	In the Annual Report of a company, it has been stated that: "Premium on prepayment / resetting of interest liability on term loans are amortised over the remaining repayment period of the respective loans."	It has been noted that paragraph 3.1 of Accounting Standard (AS) 16, 'Borrowing Costs', defines *Borrowing costs as* *"interest and other costs incurred by an enterprise in connection with the borrowing of funds."* Further, paragraph 4(b) of AS 16 contemplates "amortisation of discounts or premiums relating to borrowings" as component of borrowing costs. However, restructuring cost viz. any fees paid on prepayment/ resetting of interest liability cannot be considered as premium or discount relating to borrowings. In fact such expenses have been incurred not for facilitating repayment of borrowings rather than arrangement of borrowings. Hence, amortisation of 'restructuring costs' is not in accordance with paragraph 4(b) of AS 16.

5.	In the Annual Report of a company, one of the Notes to Accounts states as follows: “The restructuring of ….. loan had been accounted by the Company. The ZRTL (Zero Rate Term Loan) arrived from interest overdues and NPV Loss thereon due for repayment in subsequent years has been accounted by the Company during the year under review. This liability has been met from the General Reserve of the Company.”	It may be noted that paragraph 6 Accounting Standard (AS) 16, ‘Borrowing Costs’, provides as follows: *“6. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.”* It was noted that the restructured liabilities have been adjusted from the general reserve. It was felt that the liabilities arising on restructuring are additional borrowing expenses incurred on restructuring. Accordingly, these should be recognised as expense in the period in which they are incurred, rather than adjusting them against the general reserve. Accordingly, such non-compliance resulted in the overstatement of the profit for the period as well as the Earning per Share.

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Observations on Accounting Standard (AS) 17: Segment Reporting

S. No.	Matter contained in Annual Report	Observations
1.	From the Segment Information given by a company in its Annual Report, it was noted that instead of separately reporting the assets and liabilities of the reportable segments, the company had disclosed only the capital employed for its reportable segments.	It was felt that this is not as per the disclosure requirement specified in paragraphs 40(c) and (d) of Accounting Standard (AS) 17, 'Segment Reporting', which provide as follows: *"40. An enterprise should disclose the following for each reportable segment:* *...* *(c) total carrying amount of segment assets;* *(d) total amount of segment liabilities;* *..."* It was viewed that the disclosure of capital employed for the reportable segment in place of reporting the total carrying amount of segment assets and the total amount of segment liabilities is not in compliance with the disclosure requirements of AS 17.
2.	From the Annual Reports of some companies, it has been noted that there were significant differences in the figures of net profit after	It was noted that the figures of Segment Revenue/Segment Assets / Segment Liabilities as reported in segmental information

	tax, total assets and total liabilities, as reported in the Profit and Loss Account and Balance Sheet from those disclosed in the segment report in the notes to accounts.	in the notes to accounts is significantly different from that reported on the face of Profit and Loss Account and Balance Sheet. In view of above, it was felt that the company has not complied with the requirement of paragraph 46 of Accounting Standard (AS) 17, 'Segment Reporting', which provides as follows: *"46. An enterprise should present a reconciliation between the information disclosed for reportable segments and the aggregated information in the enterprise financial statements. In presenting the reconciliation, segment revenue should be reconciled to enterprise revenue; segment result should be reconciled to enterprise net profit or loss; segment assets should be reconciled to enterprise assets; and segment liabilities should be reconciled to enterprise liabilities."* Since, the Company has not provided the reconciliation between the figures reported at different places in the same set of financial statements, it was viewed that the segment information provided is not in accordance with the requirement of AS 17.

3.	From the Annual Reports of some companies, it has been noted that in spite of having a turnover of more than Rs. 50 crores, no disclosure has been made with regard to segment reporting.	It may be noted that Accounting Standard (AS) 17, 'Segment Reporting', is not mandatory for small and medium sized companies. As per definition of small and medium sized company given in paragraph 2(f) of the Companies (Accounting Standards) Rules, 2006, if an enterprise does not fall in any of the following categories, it is a small and medium sized company and hence, it is exempted from the reporting requirements of AS 17: (i) Equity or debt securities are listed or in the process of listing on any stock exchange , whether in India or outside India, or (ii) it is a bank, financial institution or an insurance company, or (iii) its turnover (excluding other income) exceed rupees fifty crores in the immediately preceding accounting year, or (iv) it has borrowing in excess of rupees ten crore at any time during the immediately preceding accounting year or (v) it is a holding or subsidiary of a company which falls in any of the aforesaid categories. It was observed that by virtue of clause (iii) of the above

		mentioned requirement, companies having turnover in excess of Rs. 50 crores are not small and medium sized companies and accordingly, AS 17 is mandatorily applicable to them. Such companies should, therefore, comply with the segment reporting requirements of AS 17 in respect of their business and geographical segments.
4.	From the Annual Report of a company, it has been noted that under segment reporting, Segment Revenue, Segment Result, Segment Assets and Segment Liabilities had been disclosed.	It was noted that although the disclosures required under paragraphs 40 (a) to (d) of Accounting Standard (AS) 17, 'Segment Reporting', have been complied with, however, the requirement of paragraph 40 (e) to disclose "***total cost incurred during the period to acquire segment asset that are expected to be used during more than one period (tangible and intangible assets***", 40 (f) to disclose "***total amount of expense included in the segment result for depreciation and amortisation in respect of segment assets for the period***" and 40 (g) to disclose "***total amount of significant non-cash expenses, other than depreciation and amortisation in respect of segment assets, that were included in segment expenses and, therefore, deducted in measuring segment result***" have not been complied with.

5.	From the Annual Reports of some companies, it has been noted that no disclosure has been provided with regard to Segment Reporting.	It was observed that in case a company has neither more than one business segment nor more than one geographical segment, at least such fact should be disclosed as required by explanation to paragraph 38 of Accounting Standard (AS) 17, 'Segment Reporting', which provides as follows: "In case, by applying the definitions of 'business segment' and 'geographical segment', it is concluded that there is neither more than one business segment nor more than one geographical segment, segment information as per this Standard is not required to be disclosed. However, **the fact that there is only one 'business segment' and 'geographical segment' is disclosed by way of a note.**" (Emphasis added)
6.	From the Annual Reports of some companies, the following facts with regard to segments were noted in the notes to accounts : • The Company is primarily engaged in a single segment business of integrated air and ground transportation and distribution of time sensitive packages and is managed as one entity for its various service offerings and is governed by a similar set of	It may be noted that explanation to paragraph 38 of Accounting Standard (AS) 17, 'Segment Reporting', provides as follows: "In case, by applying the definitions of 'business segment' and 'geographical segment', it is concluded that there is neither more than one business segment nor more than one geographical segment, segment information as per this standard is not required to be disclosed. However, the fact

	risks and returns. • The company considers its principal activity of providing oil and natural gas exploitation services to be complete segment and all revenues for the period have been derived from this segment. Further, it was also observed that such companies were earning significant foreign currency by way of exports as given under additional disclosure made in pursuance to the requirements of Part II, Schedule VI to the Companies Act, 1956. The observations on the above are quite similar in all the cases as provided adjacent to them.	that there is only one 'business segment' and 'geographical segment' is disclosed by way of a note." It was noted from the stated facts that the companies have reported about the business segment only but omitted to provide any information with regard to existence or non-existence of the geographical segment. It was, further, noted that there are significant earnings in foreign currency arising from exports which *prima facie* indicates the existence of geographical segment. In case geographical segment exists, the disclosure under paragraph 49 of AS 17 becomes mandatory. It was viewed that if business segment is not considered as the primary segment then, its geographical segment would become the primary segment. Accordingly, it was viewed that the company has not complied with the requirements of AS 17.
7.	From the Annual Report of a company, the following has been noted from the accounting policy of Segment Reporting: "The company is now in DTA under EPCG Scheme for Mushrooms, Fruits & Vegetables	In view of the facts mentioned, it was evident that the company has only one business segment but the information contained under note also reflects the existence of geographical segments viz USA and India which may be treated as reportable primary segment.

	and same has been treated as primary segment." "The company is dealing into Mushrooms, Fruits and Vegetables. The Cheese Plant of the Company came into production this year. The company's sale is coming from export mainly to USA and Paneer is being sold to X Ltd. in India. All the products of the company are sold to same customers…"	Accordingly, the requirements of paragraph 49 of Accounting Standard (AS) 17, 'Segment Reporting', were applicable on extant case. It was further noted that although the requirements of paragraph 49(a) of AS 17 have been complied with, disclosures of "*the total carrying amount of segment assets"* as required under paragraph 49 (b) and "*the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible assets)"* as required under paragraph 49 (c) have not been made.
8.	From the Annual Report of a company, it has been noted from the disclosures of segment information that only business segment has been provided treating the same as primary segment although the company was earning significant income of way of exports as reported under additional disclosures.	It was noted that during the year, the company was involved in both indigenous sales as well as export sales. Further, it was noted that paragraph 27 of Accounting Standard (AS) 17 , 'Segment Reporting', *inter alia,* provides as follows: *"27. A business segment or geographical segment should be identified as a reportable segment if:* *(a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments;"*

		It was noted that the earning in foreign currency is approx 30% of the total revenue, indicating the presence of geographical segments. However, it has been noted that no geographical segment reporting has been made in the financial statements. It was viewed that if the primary format of the company for reporting segment information is business segment, the secondary format disclosures as identified in paragraph 48 of AS 17 should also have been made by the company.
9.	From the Annual Report of a company, it has been noted that one of the notes relating to segment information provides as follows: " Segment Reporting: (a) Primary Segment (by Business Segment) : Based on the guiding principles given in the Accounting Standards on Segment Reporting (AS-17) the Company is primarily engaged in the business of manufacturing and processing of synthetic yarn which mainly have similar risk and returns. The Company's business activity falls within a single geographical and business segment (synthetic yarn),	It was noted that contradictory information has been reported with regard to geographical segment. While under one paragraph of the note, it is stated that the company's business activity falls in a single business and geographical segment, on the other hand under another paragraph of the same note, details of the geographical segments have been given. Such contradiction should be avoided. Further, it was also viewed that if risk and returns of such company are predominantly affected by the fact that it operates in different countries, geographical segments should be reported as the primary segment.

	hence it has no other primary reportable segments. (Emphasis added) (b) Secondary Segment (By Geographical demarcation) 1. The secondary segment is based on geographical demarcation i.e. in India and outside India. 2. Information about secondary segment is as follows…”	
10.	From the Annual Report of a company, it has been noted that Segment Reporting has neither been given in the standalone financial statements nor in the consolidated financial statements.	It has been noted that paragraph 4 of Accounting Standard (AS) 17, ‘Segment Reporting’, provides as follows: *“4. If a single financial report contains both consolidated financial statements and the separate financial statements of the parent, segment information need be presented only on the basis of the consolidated financial statements. In the context of reporting of segment information in consolidated financial statements, the references in this Statement to any financial statement items should construed to be the relevant item as appearing in the consolidated financial statements.”* It was noted that segmental information was neither provided

		in the standalone financial statements nor in the consolidated financial statements which is contrary to the requirements of paragraph 4 of AS 17. In case the company has neither more than one business segment nor more than one geographical segment for both standalone basis and consolidation, the fact that there is only one 'business segment' and 'geographical segment' should be disclosed by way of a note as required by paragraph 38 of AS 17.
11.	In the Annual Report of a company, the following has been noted from one of the notes: "Secondary Segment Substantial Assets of the Company are Rigs/ Drillship, which are mobile assets and can operate across the world, in view of which geographical segment is not considered." It has also been noted that the company has earning in foreign currencies.	It was noted that during the year the company has generated both indigenous sales as well as export sales, and earnings in foreign currencies through drilling and production services, amounted to approx. 70 % of the total revenue of all segments. As per paragraphs 8 and paragraph 9 respectively of Accounting Standard (AS) 17, 'Segment Reporting', "a single geographical segment does not include operations in economic environment with significantly differing risks and returns" , and "the risks and returns of an enterprise are influenced both by the geographical location of its operations (i.e. where its products are produced or where service rendering

		activities are based) and also by the location of its customers (where its products are sold or services are rendered)" (Emphasis added). Paragraph 27(a) of AS 17, *interalia,* provides as follows: *"27. A business segment or geographical segment should be identified as a reportable segment if:* *(a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments;"* Considering the requirements stated in paragraphs 8, 9 and 27 of AS 17 in the light of the aforesaid information extracted from the financial statements of the company, it was viewed that in the extant case, the risk and returns of the company would be affected by the fact that it operates in other countries apart from India. Accordingly, the risks and returns due to geographical location of operations may not be ascertainable, however, the risks and returns due to location of customers – domestic customers

		and overseas customers would be different. Hence, the management's opinion that "the substantial assets of the company are mobile assets which can be operated across the world, in view of which geographical segment is not considered" is *prima facie not* tenable.
12.	From the Annual Report of a company, it has been noted from Segment information that Explosive and Chemicals were shown as a single business segment.	It was noted that in the Management Discussion and Analysis (MD&A), the performance of industrial explosives and petrochemical have been shown separately. Accordingly, it was viewed that these two segments produce different products and they are subject to different risks and returns. Therefore, the Explosive and Chemicals should have been treated as different business segments, as per the disclosure made in the MD&A.
13.	From the Annual Report of the company, it has been noted that business segment had been treated as primary segment and geographical segment had been treated as the secondary segment.	It was noted that as regards geographical segment reporting although the company has disclosed the details relating to geographical segment as required under paragraph 48 (a) of Accounting Standard (AS) 17, 'Segment Reporting', however, it has not complied with the requirements of paragraphs 48 (b) & (c) of AS 17 relating to ***"the total carrying amount of segment assets by geographical location of assets, for each geographical***

		segment whose segment assets are more 10 per cent or more of the total assets of all geographical segments” and *“the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all segments”* respectively.

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Observations on Accounting Standard (AS) 18: Related Party Disclosures

S. No.	Matter contained in Annual Report	Observations
1.	In the Annual Reports of some companies the companies had disclosed the following information with regard to related party transactions: • In the Corporate Governance Report of a company, ABC Ltd. has been reported as a Joint Venture company the shares in which were purchased by the company during the year as observed from schedule of investments. • One of the notes to accounts stated that 'legal and professional charges' include fees paid to a firm in which managing director was a partner. • From the Cash Flow Statement as well as schedule of loans and advances, it has been noted that the company had given advance for project development to its subsidiary. • While the footnote given under the schedule of loans and advances reported that	It may be noted that paragraph 23 of Accounting Standard (AS) 18 , 'Related Party Disclosures', provides as follows: *"23. If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:* *(i) the name of the transacting related party;* *(ii) a description of the relationship between the parties;* *(iii) a description of the nature of transactions;* *(iv) volume of the transactions either as an amount or as an appropriate proportion;* *(v) any other elements of the related party transactions necessary for an understanding of the financial statements;* *(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance*

	during the year the maximum amount due from director(s) was Rs.10,000, the amount due as at the end of the year was reported at NIL indicating that the advance of Rs. 10,000 have been repaid by the director(s) during the year. • From the schedule of unsecured loans as well as one of the notes to accounts, it has been noted that the company has paid interest to a key management personnel on the fixed deposits taken from him. The observations on the above are quite similar in all the cases as provided adjacent to them.	*sheet date and provisions for doubtful debts due from such parties at that date; and* *(vii) amounts written off or written back in the period in respect of debts due from or to related parties."* In view of the above, it was observed that if any transaction has taken place during the year with a related party, the reporting enterprise is required to disclose details of such transactions. It was noted that while the Schedules/ Notes to Accounts/ Cash Flow Statement/ corporate governance report, either individually or together, contains information about the transaction taking place with related parties, the same had not been reported under the related party disclosure as required by AS 18.
2.	In the Annual Reports of some companies, similar notes were stated with respect to disclosure of related party transactions. An illustrative list of which is provided as below: • The following are the *significant transactions* with related parties… • The company has not entered into *any significant*	While at times in pursuance to the requirements of Accounting Standard (AS) 18, 'Related Party Disclosures', companies provide the information of only significant/ material related party transactions, the other companies do not provide any information in context of related party transactions on the pretext that those transactions were not material transactions. It may be noted that AS 18 does not

	related party transactions during the year. • …There were *no material individual transactions* with related parties during the year, which were not in the normal course of business as well as at arm's length basis… The observations on the above are quite similar in all the cases as provided adjacent to them.	prescribe for classification of transactions with related parties as material/immaterial transactions and normal/abnormal transactions. It was viewed that all transactions with related parties must be disclosed rather than disclosing only significant transactions. Accordingly, non-disclosure of related party transactions on the pretext that no significant transactions have taken place or disclosure of only significant transactions is not in line with AS 18.
3.	In the related party disclosure given by some companies, the name of only the related parties with whom transactions have taken place during the year have been given.	It may be noted that paragraph 21 of Accounting Standard (AS) 18 , 'Related Party Disclosures', states that: ***"21.Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between related parties."*** It was observed that only those related parties have been enlisted with whom transactions had taken place during the year whereas the aforesaid requirement prescribes the disclosure of all related parties irrespective of whether any transaction has taken place with them if control exists.

		It was viewed that such non-disclosure is not in line with the requirement of paragraph 21 of AS 18.
4.	From the Annual Reports of some companies, non-compliances were observed relating to disclosure of related party transactions, as indicated below: • In the related party disclosure, the names of related parties as well as the transactions which had been taken place with them have been disclosed but the nature of the relationship with them has not been disclosed. • Certain transactions have been reported with X Ltd. but there is no disclosure of the nature of relationship that exists with X ltd. The observations on the above are quite similar in all the cases as provided adjacent to them.	It may be noted that paragraph 21 of Accounting Standard (AS) 18, 'Related Party Disclosures', requires the disclosure of the name of the related party and nature of relationship with such party, irrespective of whether or not there have been transactions between the related parties, wherever control exists. Accordingly, omission of information related to nature of relationship is not in line with the requirements of paragraph 21 of AS 18.
5.	From the Annual Reports of some companies, it has been noted that under the related party disclosures although items of similar nature and value of transactions have been disclosed in the aggregate for each type of related party, individual party-wise disclosure has not been made though material transactions have taken place with them.	It may be noted that paragraph 27 of Accounting Standard (AS) 18, 'Related Party Disclosures', provides as follows: "27. Disclosure of details of particular transactions with individual related parties would frequently be too voluminous to be easily understood. Accordingly, items of a similar nature may be disclosed in

		aggregate by type of related party. However, this is not done in such a way as to obscure the importance of significant transactions. Hence, purchases or sales of goods are not aggregated with purchases or sales of fixed assets. Nor a material related party transaction with an individual party is clubbed in an aggregated disclosure." (Emphasis added) It was further noted that the explanation to the aforesaid paragraph also states that materiality primarily depends on the facts and circumstances of each case. In deciding whether an item or an aggregate of items is material, the nature and the size of the item(s) are evaluated together. As regard size, for the purpose of applying the test of materiality as per this paragraph, ordinarily a related party transaction, the amount of which is in excess of 10% of the total related party transactions of the same type (such as purchase of goods), is considered material, unless on the basis of facts and circumstances of the case it can be concluded that even a transaction of less than 10% is material. As regards nature, ordinarily the related party transactions which are not entered into in the normal course of the business of the reporting enterprise are considered

		material subject to the facts and circumstances of the case. It was viewed from the above that if any transaction with an individual party constitutes 10% of the total related party transactions of the same nature, the same transaction shall be treated as material transaction with an individual party and accordingly, party-wise disclosure of the said transaction should be disclosed. However, it was observed from the information contained in the financial statements that certain material transactions have taken place with the related parties, both in terms of size as well as nature of transactions, thus, individual party-wise disclosure is necessary in context of such transactions to comply with the requirements of AS 18.
6.	From the related party disclosure given in the Annual Reports of some companies, it was noted that in certain cases, the nature of transactions that have taken place with the related parties have been reported but the value of the same is not stated. In other cases, the companies reported to have taken/given loans or advances to related parties. However, as at the end of the year neither they have been stated to have been repaid nor outstanding balance of such parties have been reported.	It was felt that this is contrary to paragraphs 23 (iv) and (vi) of Accounting Standard (AS) 18, 'Related Party Disclosures', which require the disclosure of the "*volume of the transactions either as an amount or as an appropriate proportion."* as well as *"the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date."*

7.	From the related party disclosure given in the Annual Report of a company, it has been noted that certain amount has been reported as outstanding as at the year-end without stating whether such amount is a debit balance or credit balance.	It was felt that from the disclosure made, it is not clear whether the amount reported to be outstanding is payable or recoverable by the company. Such incomplete disclosure is non-compliance with the requirements of AS 18.
8.	In the related party disclosure given in the Annual Report of a company, the nature of relationship with XYZ Co. Ltd. has been disclosed as 'fellow subsidiary'.	It may be noted that paragraphs 10.12 and 21 of Accounting Standard (AS) 18 , 'Related Party Disclosures', respectively provide as follows: *"10.12 <u>Fellow subsidiary</u> - a company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company."* "21 It was observed that company being a 'fellow subsidiary' of XYZ Co. Ltd *prima facie* indicates that the company itself is a subsidiary of another company. However, the name of the holding company had not been disclosed under the Related Party Disclosures. Accordingly, it was viewed that omission of such information is a non-compliance of AS 18.
9.	From the Annual Report of a company, it has been noted that the accounting heads as used under related party disclosures vis-à-vis financial statements are different.	It was felt that since the accounting heads used under related party disclosures are different from those used in the financial statements, it is difficult for the readers of the financial

		statements to understand the elements of related party transactions and assess their impact on the financial statements. For instance, under Related Party Disclosure, assets have been classified as 'Tangible Assets' and 'Intangible Assets' whereas no such classification has been adopted for assets reported in the fixed assets schedule of the Balance Sheet. Further, under related party disclosures, revenue has been reported to have been earned from related parties under the broad head "Rendering services" whereas in the Profit and Loss Account, revenue has been specifically reported for each nature of services being rendered by the company. Accordingly, it was viewed that for proper understanding of the financial statements, the accounting heads used for the related party disclosure should be in line with those used in the financial statements.
10.	From the related party disclosure given in the Annual Report of a company, it has been noted that remuneration was paid to Mr. X and Mr. Y, however, the nature of relationship that existed with them was not disclosed.	It was felt that there is a non-compliance with paragraph 23 of Accounting Standard (AS) 18, 'Related Party Disclosures', which *interalia* requires disclosure of description of the relationship between the parties.
11.	From one of the notes to accounts given in the Annual	As per paragraph 3(d) of Accounting Standard (AS) 18,

	Reports of some companies, it was noted that during the year the companies had paid managerial remuneration to the managing director as well as the whole-time director but no such transaction has been reported under related party disclosures.	‘Related Party Disclosures’, the related party relationship, *interalia* includes key management personnel. It may further be noted that paragraph 14 of AS 18 defines “Key Management Personnel” as follows: “14. Key management personnel are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.” In view of the above, it was observed that the managing director and the whole-time director are key management personnel and therefore, remuneration paid to them should also be reported under related party disclosures in the manner specified in paragraph 23 of AS 18.

17
Observations on Accounting Standard (AS) 19: Leases

S. No.	Matter contained in Annual Report	Observations
1.	In the notes to the accounts given in the Annual Reports of some companies, the notes relating to lease payment stated as follows: • Lease Rentals are accounted on accrual basis over the Lease Term as per the relevant Lease Agreements. The significant leasing arrangements of the company are in respect of operating leases for premises and vehicles. These leasing arrangements range between 11 months and 5 years and are usually renewable by mutual consent on mutually agreeable terms. The agreeable lease rental payable are charged to the Profit and Loss Account and shown under administrative, selling and general expenses in appropriate heads. • The company's significant leasing arrangements are in respect of operating leases for premises (residential, office, godowns). The leasing arrangements, which are not non-cancellable, range	It was noted from the stated notes relating to leases that certain assets had been taken on operating lease and the lease rental expenses had been charged to the Profit and Loss Account, however, no related disclosure was given as required under paragraph 25 of Accounting Standard (AS) 19 'Leases', which provides as follows: *"25. The lessee should make the following disclosures for operating leases:* *(a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:* *(i) not later than one year;* *(ii) later than one year and not later than five years;* *(iii) later than five years;* (b) *the total of future minimum sublease payments expected to be received under non-cancellable subleases at balance sheet date;*

	between six months and five years generally. The lease rentals payable are charged as rent. • Operating Lease Expenses: The Company has various operating leases for office facilities, factory, guest houses, and residential premises for employees that are renewable on periodic basis cancellable at its option. Rental Expenses for operating leases recognised on the Profit and Loss Account. The observations on the above are quite similar in all the cases as provided adjacent to them.	*(c) lease payments recognized in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;* *(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss.* *(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:* *(i) the basis on which contingent rent payments are considered* *(ii) the existence and terms of renewal or purchase options and escalation clauses; and* *(iii) restrictions imposed by lease arrangements, such as those concerning dividends and further leasing."* Further, it was noted that stating simply that "Lease Rentals are accounted on accrual basis over the Lease Term as per the relevant Lease Agreements" is not in line with the requirement of paragraph 23 of AS 19, which provides as follows: *"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." It was viewed that the phrase 'accrual basis' does not disclose the basis of recognition of such expenses. Usage of such ambiguous accounting policies should be avoided.
2.	In one of the notes to accounts in the Annual Report of a company, it has been stated that "leasehold land includes land taken on lease and Office Premises includes building taken on lease from State Industrial Development Corporation for a period of 95 years". (Emphasis added)	At the outset, in terms of paragraph 1 (c) of Accounting Standard (AS) 19 'Leases', it was noted that AS 19 does not apply to '*lease agreements to use lands.*' Hence, from the stated note, it was viewed that land being available for limited period is subject to amortisation. Accordingly, the accounting policy relating to amortisation of Leasehold Land should also be disclosed. Considering the period of lease of the office premises, it was viewed that the said assets were taken on finance lease, however, the disclosures as required by paragraph 22 of AS 19 reproduced below, had not been given in the financial statements :

		"22. The lessee should, in addition to the requirements of AS 10, Accounting for Fixed Assets, AS 6, Depreciation Accounting, and the governing statute, make the following disclosures for finance leases: *(a) assets acquired under finance lease as segregated from the assets owned;* *(b) for each class of assets, the net carrying amount at the balance sheet date;* *(c) a reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:* *(i) not later than one year;* *(ii) later than one year and not later than five years;* *(iii) later than five years;* *(d) contingent rents recognised as expense in the statement of profit and loss for the period;* *(e) the total of future minimum sublease payments expected to be received under non-cancellable*

		subleases at the balance sheet date; and *(f) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:* *(i) the basis on which contingent rent payments are determined;* *(ii) the existence and terms of renewal or purchase options and escalation clauses; and* *(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.* *Provided that a Small and Medium Sized Company, as defined in th Notification, may not comply with sub-paragraphs (c),(e) and (f)."* Non-disclosure of information related to assets taken on finance lease is a non-compliance of AS 19.
3.	From the Annual Reports of some companies, it has been noted that certain assets have been given as well as taken on operating lease, however, no related disclosures were given in the financial statements.	It was noted that although the companies had given and taken certain assets on operating leases, the relevant disclosures as required under paragraphs 25, 40 and 46 of Accounting Standard (AS) 19 'Leases', had not been

		complied with which are reproduced as follows: *"25. The lessee should make the following disclosures for operating leases:* *(a) the total of future minimum lease payments under non - cancellable operating leases for each of the following periods:* *(i) not later than one year;* *(ii) later than one year and not later than five years;* *(iii) later than five years;* *(b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date;* *(c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;* *(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;* *(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:* *(i) the basis on which*

		contingent rent payments are determined; *(ii) the existence and terms of renewal or purchase options and escalation clauses; and* *(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing."* *"40. Lease income from operating leases should be recognised 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 in which benefit derived from the use of the leased asset is diminished."* *"46. The lessor should, in addition to the requirements of AS 6, Depreciation Accounting and AS 10, Accounting for Fixed Assets, and the governing statute, make the disclosures for operating leases:* *(a) for each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet*

		date; and (i) the depreciation recognised in the statement of profit and loss for the period; (ii) impairment losses recognised in the statement of profit and loss for the period; (iii) impairment losses reversed in the statement of profit and loss for the period; (b) the future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods: (i) not later than one year; (ii) later than one year and not later than five years; (iii) later than five years; (c) total contingent rents recognized as income in the statement of profit and loss for the period; (d) a general description of the lessor's significant leasing arrangements; and (e) accounting policy adopted in respect of initial direct costs. *Provided that a Small and Medium Sized Company, as defined in th Notification, may not comply with sub-paragraphs (b) and (d).”*

4.	From the schedule of fixed assets given in the Annual Reports of some companies, it has been noted that 'Plant and Machinery' includes value of reported assets given on operating lease.	It was felt that from the available information, it could not be ascertained as to whether the reported value represents the Gross Value or the Written Down Value of the plant and machinery given on lease. Further, the accumulated depreciation on the same had also not been disclosed. It was also noted that the disclosures as required by paragraph 46 of Accounting Standard (AS) 19 'Leases', were not complied with as regards plant and machinery given on operating lease.
5.	From the schedules of 'Other Income' and 'Administrative and Other Expenses', it was noted that both income by way of lease rent as well as expenses in the nature of lease rentals were accrued/ incurred during the year.	It was viewed that receipt and payment of lease rentals indicates that the companies had given as well as taken certain assets on lease. However, in the absence of any other information viz the accounting policy or other disclosures, the nature of such leases was also not clear. It was viewed that non-disclosure of relevant disclosures as required under Accounting Standard (AS) 19 'Leases', and the accounting policy as adopted by the companies for recognition of such revenues and expenses are not in line with AS 19 as well as paragraph 24 of AS 1.
6.	Under the Notes to Accounts given in the Annual Report of a company, the following notes have been stated regarding	It was observed from the stated notes to accounts that certain assets had been given on operating lease. Accordingly, the

	leased assets: "Assets subject to operating leases are included under fixed assets or current assets as appropriate. Lease income is recognised in the Profit and Loss Account on a straight-line basis over the lease term. Costs, including depreciation, are recognised as an expense in the Profit and Loss Account."	company was required to comply with the disclosure requirements of paragraph 46 of Accounting Standard (AS) 19, 'Leases', which provides as follows: *"46. The lessor should, in addition to the requirements of AS 6, Depreciation Accounting and AS 10, Accounting for Fixed Assets, and the governing statute, make the following disclosures for operating leases:* *(a) for each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet date; and* *(i) the depreciation recognised in the statement of profit and loss for the period;* *(ii) impairment losses recognised in the statement of profit and loss for the period;* *(iii) impairment losses reversed in the statement of profit and loss for the period;* *(b) The future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:* *(i) not later than one year;* *(ii) later than one year and*

		not later than five years; *(iii) later than five years;* *(c) total contingent rents recognised as income in the statement of profit and loss for the periods;* *(d) a general description of the lessor's significant leasing arrangements; and* *(e) accounting policy adopted in respect of initial direct costs."*

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Observations on Accounting Standard (AS) 20: Earnings per Share

S. No.	Matters Contained in Annual Report	Observations of the Board
1.	In the Annual Reports of some companies/banks, it has been noted that while in some cases, the disclosures related to basic and diluted earning per share had been given in the Notes to the Accounts, no information was given on the face of the Profit and Loss Account, in other cases, neither any information was given on the face of the Profit and Loss Account nor in the Notes to Accounts.	As per paragraphs 8 and 48 of Accounting Standard (AS) 20, 'Earnings Per Share': *"8. An enterprise should present basic and diluted earnings per share <u>on the face of the statement of profit and loss</u> for each class of equity shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented."* (Emphasis added) *"48. In addition to disclosures as required by paragraphs 8, 9 and 44 of this Standard, an enterprise should disclose the following:* *(i) where the statement of profit and loss includes extraordinary items (within the meaning of AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies), the enterprise should disclose basic and*

		diluted earnings per share computed on the basis of earnings excluding extraordinary items (net of tax expense); and *(ii) (a) the amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;* *(b) the weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and* *(c) the nominal value of shares along with the earnings per share figures."* It was noted from the above that an enterprise should present basic and diluted earnings per share on the <u>face</u> of Profit and Loss Account and the details as required under paragraph 48 should be disclosed in the notes to accounts. Accordingly, omission of either of the above information or both is a non-

		compliance of AS 20. Further, it was also viewed that when a company states its earnings per share in a statement prepared in pursuance to Part IV, Schedule VI to the Companies Act, 1956 but omit to disclose any information in the Profit and Loss Account or Notes to Accounts, it is again a non-compliance of AS 20.
2.	In the Annual Reports of some banks, it has been noted that the disclosures related to basic and diluted earnings per share had been given in the Notes to the Accounts, but no information was given on the face of the Profit and Loss account.	It may be noted that paragraph of relevant Master Circular - Disclosure in Financial Statements - Notes to Accounts issued by RBI relating to applicability of various accounting standards on banks provides as follows: "Other Accounting Standards Banks are required to comply with the disclosure norms stipulated under the various Accounting Standards issued by the Institute of Chartered Accountants of India." Accordingly, it was noted from the above, that the banks are also required to comply with the disclosure requirements of earning per share as stated in paragraph 8 of Accounting Standard (AS) 20, 'Earnings Per Share' i.e. to disclose the basic and diluted earnings per share on the <u>face</u> of the profit and loss account.

		It was viewed that although the banks have disclosed the details relating to computation of earnings per share in the notes to accounts, they have omitted to disclose the basic and diluted earnings per share on the face of the Profit and Loss Account which is a non-compliance of AS 20.
3.	From the Profit and Loss Account as well as Notes to the Accounts of an Annual Report, it has been noted that only basic earnings per share had been disclosed in both of them and there is no mention about diluted earnings per share.	As per paragraph 8 of Accounting Standard (AS) 20, 'Earnings Per Share': *"8. An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented."* (Emphasis added) It was felt that if the company has not issued any instruments that have dilutive effect then both the basic and diluted earnings per share will remain the same and as per aforesaid requirements, separate disclosure is essential to confirm the stated condition. Accordingly, omission of information with regard to diluted earnings per share is a non-compliance of AS 20.

4.	From the Reports of some companies, it has been noted that they have simply reported the Earning per Share in the Profit and Loss Account without stating whether it is basic or diluted earnings per share.	It was observed that as per the requirements of paragraph 8 of Accounting Standard (AS) 20, 'Earnings Per Share', both basic and diluted earning per share are to be presented separately. Further, it was noted that the company has issued certain redeemable convertible cumulative preference shares which are overdue for redemption/ conversion. It was, accordingly, viewed that such convertible preference shares may have dilutive effect, which should have been considered to determine the diluted earnings per share. However, disclosure of only 'Earnings Per Share' indicates that convertible preference shares have not been considered for determination of earnings per shares. Accordingly, it was viewed that the requirements of AS 20 have not been complied with.
5.	From the schedule of Share Capital given in the Annual Report of a company, it has been noted that equity shares had been allotted to the shareholders in accordance with a composite scheme of arrangement and amalgamation. The following note has also been	It may be noted that paragraph 18 read with paragraph 22 of Accounting Standard (AS) 20, 'Earnings Per Share', provides as follows: "18. Equity shares issued as part of the consideration in an amalgamation in the nature of purchase are included in the

	stated in the Notes to the Accounts: "Though the consideration payable in the form of Equity shares to the shareholders of the Company has been reflected under share suspense account and were allotted to the share holders subsequent to the Balance Sheet date, the same has been considered for the purpose of calculation of number of weighted average number of ordinary shares in issue applicable to Basic and Diluted Earning per Shares, though the consideration was allotted as equity shares to the shareholders subsequent to the Balance Sheet date."	weighted average number of shares as of the date of the acquisition because the transferee incorporates the results of the operations of the transferor into its statement of profit and loss as from the date of acquisition. Equity shares issued during the reporting period as part of the consideration in an amalgamation in the nature of merger are included in the calculation of the weighted average number of shares from the beginning of the reporting period because the financial statements of the combined enterprise for the reporting period are prepared as if the combined entity had existed from the beginning of the reporting period. Therefore, the number of equity shares used for the calculation of basic earnings per share in an amalgamation in the nature of merger is the aggregate of the weighted average number of shares of the combined enterprises, adjusted to equivalent shares of the enterprise whose shares are outstanding after amalgamation." *"22. The weighted average number of equity shares outstanding during the period and for all periods presented should be adjusted for events, other than the conversion of*

		potential equity shares, that have changed the number of equity shares outstanding, without a corresponding change in resources." It was noted that the company has allotted certain shares of Re/-1 each to the shareholders in accordance with the composite scheme of arrangement and amalgamation, which has been reflected under share suspense account on the face of Balance Sheet, thus indicating that during the reporting period, equity shares were pending issuance as part of the consideration pursuant to amalgamation scheme. In view of aforesaid requirements of AS 20, such equity shares pending to be issued against amalgamation should have been included in the weighted average number of shares for determining the basic earning per share of all previous periods that were presented. However, it was noted that during the previous periods that were presented, the equity shares pending for issue as consideration for amalgamation have been considered only for computation of 'Diluted Earnings per Share' and not for 'Basic Earnings per Share' which is not in line with the aforesaid requirements of AS 20.

6.	From the Annual Reports of some companies, it has been noted that the nominal value of shares has not been provided either on the face of the Profit and Loss Account or in the Notes to the Accounts.	It may be noted that paragraph 48 (c) of Accounting Standard (AS) 20, 'Earnings Per Share', *interalia*, requires the enterprise to disclose *"the nominal value of shares along with the earnings per share figures."* It was noted that although the various disclosures in relation to basic and diluted earning per share have been made by the companies both on the face of the Profit and Loss Account as well as in the Notes to Accounts but they omit to disclose the nominal value of the shares as required by paragraph 48 (ii)(c) of AS 20. Accordingly, it was viewed that the requirements of AS 20 has not been complied with.
7.	From the Annual Report of a company, it has been noted that the excess provision for taxation of earlier years recognised in current year were excluded to determine the profits attributable to equity shareholders.	It may be noted that paragraph 12 of Accounting Standard (AS) 20, 'Earnings per Share', define the nature of income and expenses which should be included for the net profit or loss attributable to equity shareholders, which *interalia*, states as follows: "12. All items of income and expense which are recognised in a period, including tax expense and extraordinary items, are included in the determination of the net profit or loss for the period unless an Accounting Standard requires or permits otherwise *[see*

		Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies]. The amount of preference dividends and any attributable tax thereto for the period is deducted from the net profit for the period (or added to the net loss for the period) **in order to calculate the net profit or loss for the period attributable to equity shareholders.**" (emphasis added) It was observed that excess provision for taxation of earlier years have been recognised in the current year, therefore, it is an income which should be considered for calculating the net profit or loss attributable to equity shareholder. Accordingly, exclusion of such excess provision for taxation of earlier years while calculating Net Profit for the period attributable to equity shareholders is not in line with the requirement of AS 20.
8.	From the schedule of Share Capital given in the Annual Report of a company, it has been noted that although certain equity shares had been issued during the year, the number of equity shares used as denominator for determination of earnings per share were those outstanding as at the end of the year.	It may be noted that paragraphs 15 and 48 (ii) (b) of Accounting Standard (AS) 20, 'Earnings Per Share', provide as follows: ***"15. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity***

		shares outstanding during the period". *"48... an enterprise should disclose the following:* (*b*) *the weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and* …" It was observed from above that the weighted average number of equity shares should be used as denominator for calculating basic and diluted earnings per share. Further, the issuance of equity shares during the year also indicates that there would be difference in the figure of 'weighted average number of equity shares' and 'outstanding number of equity shares at the end of the year'. Hence, determination of the earnings per share based on outstanding numbers was incorrect. Accordingly, it was viewed that the requirements of AS 20 have not been complied with.
9.	From the Profit and Loss Account given in the Annual Report of a company, it has been noted that	It has been noted that paragraph 9 of Accounting Standard (AS) 20, 'Earnings Per Share',

	Basic and Diluted Earnings per Share as well as Cash Earning per Share were reported at NIL value.	provides as follows: *"9. This Standard requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share)."* It was viewed that aforesaid requirement also envisages the value of basic and diluted earnings per share in negative. Accordingly, in case the company has incurred a loss during the year, the basic and diluted earnings per share should have been reported as negative figures rather than reporting at nil value. Incidentally, it was also noted that AS 20 does not define cash earnings per share. Accordingly, disclosure of cash earning per share and omission of basic and diluted earnings per share is not in line with AS 20.
10.	From the Notes to Accounts given in the Annual Reports of some companies, it has been noted that although they had issued instruments such as warrants which are considered as dilutive, the basic and diluted earnings per share have been stated at the same value.	Paragraph 4.5 of Accounting Standard (AS) 20 'Earnings Per Share', defines share warrants as follows: *"4.5 <u>Share warrants</u> or <u>options</u> are financial instruments that give the holder the right to acquire equity shares."*

		It may be noted that paragraph 26 of AS 20 provides that : *"26. For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares."* It was noted from the Schedule of Share Capital that during the year, the company had issued certain share warrants convertible into equity shares. It was viewed that since share warrants are financial instruments that give the holders the right to acquire equity shares, they are considered as potential equity shares which should be considered for the purpose of determining diluted earnings per share. However, it was noted from the disclosures given in relation to earnings per share that the basic as well as diluted earnings per share have been reported at the same value, which clearly indicates that share warrants have not been considered for determination of diluted earnings per shares. Accordingly, it was

		viewed that the requirements of AS 20 have not been complied with.
11.	From Schedule of Share Capital given in the Annual Reports of some companies, it has been noted that during the year, number of equity shares were increased due to share split.	It may be noted that paragraph 44 of Accounting Standard (AS) 20, 'Earnings Per Share', provides as follows: *"44. If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed".* It was noted from the above that if number of equity shares increases, then the calculation of basic and diluted EPS should be, accordingly, adjusted for all the

		periods presented. However, it was noted from the details of the basic as well as diluted earnings per share of the previous period that the weighted average number of shares used as denominator have not been adjusted for the increase in the number of equity shares due to share split which is not in line with the requirements of paragraph 44 of AS 20.
12.	From the Annual Report of a company, it was noted that the company had issued bonus shares subsequent to the date of the Balance Sheet date but before the financial statements were approved by the Board of Directors, however, the same is not considered for the computation of earning per share of the period.	It may be noted that paragraph 44 of Accounting Standard (AS) 20, 'Earnings Per Share', *interalia* provides as follows: *"44. ...If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares..."* It was viewed that the shares issued subsequent to the Balance Sheet date but before the financial statements were approved by the Board of Directors should also be considered for the calculation of earning per share. Thus, the

		impact of issue of bonus shares post the financial year end should be factored into the computation of earnings per share as per the requirement of paragraph 44 of AS 20.
13.	From the Annual Report of a company, it has been noted that there was difference in the figure of Profit after tax reported in the Profit and Loss Account and that used for determination of EPS. It has also been noted that such difference was due to fringe benefit tax expense charged off in the Profit and Loss Account.	It may be noted that paragraph 12 of Accounting Standard (AS) 20 'Earnings Per Share', provides as follows: "12. All items of income and expense which are recognised in a period, including tax expense and extraordinary items, are included in the determination of the net profit or loss for the period unless an Accounting Standard requires or permits otherwise. The amount of preference dividends and any attributable tax thereto for the period is deducted from the net profit for the period (or added to the net loss for the period) in order to calculate the net profit or loss for the period attributable to equity shareholders." It was noted from the Profit and Loss Account that although fringe benefit tax has been recognised for determining the net profit of the year, while determining Earnings Per Share, the fringe benefit tax was excluded for determining the net profit attributable to equity shareholders.

		It was viewed that fringe benefit tax is also an expense of the period, therefore, omission of such expense while determining net profit attributable to equity shareholders is against the aforesaid requirement of AS 20.

19

Observations on Accounting Standard (AS) 22: Accounting for Taxes on Income

S. No.	Matter contained in Annual Report	Observations
1.	In the Balance Sheet given in the Annual Reports of some companies, the deferred tax assets and liabilities had been presented in any of the following manner: • Deferred tax Liability is shown as a part of 'Loan Funds'. • Deferred tax (net) is shown after the head 'Net Current Assets'. • Deferred tax Liability is shown after the head 'Net Current Assets', as a deduction from the 'Application of Funds'. • Deferred tax Liability is shown as a part of 'Shareholders Funds'. • Deferred tax Liabilities is shown as distinct sub-head under the Schedule of Provisions. • Deferred tax Liability (Net) is shown after the head 'Shareholders Funds'. • Deferred tax Assets is shown under the head 'Current Assets, Loan & Advances'.	It may be noted that explanation to paragraph 30 of Accounting Standard (AS) 22, 'Accounting for Taxes on Income' requires that deferred tax liabilities should be disclosed on the face of the Balance Sheet separately after the head 'Unsecured Loans' and deferred tax assets should be disclosed on the face of the Balance Sheet separately after the head 'Investments'. Accordingly, it was felt that the stated presentations of deferred tax liabilities and assets are not in line with the requirement of paragraph 30 AS 22.

	• Deferred tax Assets is shown after the head 'Current Assets, Loan & Advances'. • Deferred tax Assets is shown under the head of 'Net Current Assets'.	
2.	From the Profit and Loss Account given in the Annual Report of a company, it has been noted that provision for current tax and deferred tax have been clubbed and disclosed under the single head of 'provision for taxation'. In other words, the provision for current tax and provision for deferred tax have not been shown separately.	It may be noted that paragraph 30 of Accounting Standard (AS) 22, 'Accounting for Taxes on Income', *interalia* provides as follows: ***"30. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period…"*** From the above, it was noted that provision for current tax and provision for deferred tax are required to be shown separately and they cannot be clubbed together to give the aggregate amount of provision for taxation in the Profit and Loss Account. Accordingly, it was viewed that the requirement of AS 22 has not been complied with.
3.	In the Annual Reports of some companies, the disclosure in relation to deferred tax assets/ liabilities were limited to the following extent: • The deferred tax assets/ liability that had been brought forward were adjusted against	It may be noted that paragraph 31 of Accounting Standard (AS) 22, 'Accounting for Taxes on Income' requires that: ***"31. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective***

	the amount provided for during the year to determine the final balance shown in the balance sheet. • The net balance of deferred tax assets/ liability (net) was shown in the Balance Sheet. • The 'deferred tax assets' recognised in context of other timing differences, were deducted to determine the net balance of deferred tax liabilities.	*balances should be disclosed in the Notes to Accounts."* However, it was noted from the stated facts that neither of the companies had disclosed the break-up of deferred tax liability/ deferred tax assets in the Notes to the Accounts. In case, where the 'deferred tax assets' was recognised in context of 'other timing differences', it was viewed that the details of 'other timing differences' with regard to which deferred tax assets was recognised, were not disclosed which is not in compliance with requirement of AS 22.
4.	In the Annual Report of a company, one of the Notes to the Accounts providing details of deferred tax liability states as follows:- "…the company has recognised a deferred tax liability of Rs. XX lacs accumulated in respect of earlier years relating to Depreciation, Gratuity & Earned Leave."	It may be noted that paragraph 31 of Accounting Standard (AS) 22, 'Accounting for Taxes on Income' provides as follows: *"31. The break-up of deferred tax assets and deferred tax liability into major components of the respective balances should be disclosed in the notes to accounts".* In view of the above, the balance of deferred tax liability or asset, as the case may be, is required to be disclosed. From the stated note, it was observed that only the aggregate amount of deferred tax liabilities and the three heads

		viz. Depreciation, Gratuity & Earned Leave in relation to which such liabilities were recognised had been indicated without giving the amounts in respect of each. It was viewed that such disclosure cannot be considered to disclose the complete break up of deferred tax liability balances. Hence, there is a non-compliance of AS 22.
5.	From the Annual Reports of some companies, it has been noted that the companies often disclose the break-up of the deferred tax assets or deferred tax liabilities that had been credited or debited to the Profit and Loss Account rather than disclosing the break up of balances as disclosed in the Balance Sheet.	Paragraphs 31 of Accounting Standard (AS) 22, 'Accounting for Taxes on Income', provide as follows: *"31. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts."* It may be noted that paragraph 31 requires the break-up of deferred tax assets and deferred tax liabilities *balances,* accordingly, it was viewed that the term 'balances' signifies that paragraph 31 requires the break-up of deferred tax assets or deferred tax liabilities as shown in Balance Sheet rather than that of the expense recognised in the Profit and Loss Account. Accordingly, disclosure of break-up of balances debited/credited for deferred tax assets/liabilities in the Profit and Loss Account is

		not in line with the requirements of paragraph 31 of AS 22.
6.	From the Annual Report of a company it was noted that they had unabsorbed depreciation as well as carry forward business losses. Further, they had also recognised deferred tax assets but omit to disclose the accounting policy as adopted by it for recognition of the deferred tax asset.	It was noted that if the company has unabsorbed depreciation or carry forward business losses, then the provisions of paragraph 17 of Accounting Standard (AS) 22, 'Accounting for Taxes on Income' would be applicable to it. However, in the absence of accounting policy regarding the nature of the evidence, based on which deferred tax assets had been recognised is not clear i.e. whether the same had been recognised based on evidence supporting reasonable certainty or virtual certainty that sufficient future taxable income will be available. Accordingly, recognition of deferred tax asset without disclosure of the accounting policy is against the requirement of AS 1 and AS 22.
7.	From the Annual Reports of some companies, it has been noted that in context of current tax, the 'advance tax paid' and 'provision for income tax' have been shown simultaneously in the schedules of 'Current Assets, Loans and advances' and 'Current liabilities and provisions' respectively.	It was noted that paragraph 27 of Accounting Standard (AS) 22, 'Accounting for Taxes', *inter alia*, provides as follows: *"27. An enterprise should offset assets and liabilities representing current tax if the enterprise:* *(a) has a legally enforceable right to set off the*

		recognised amounts; and *(b) intends to settle the asset and the liability on a net basis."* It was observed that while the schedule of 'Current Assets, Loans and Advances' includes Advance Tax paid and schedule of 'Current Liabilities and Provisions' includes Provision for Income Tax, which *prima facie* indicates that the advance tax paid has not been set off against the provision for income tax. It was viewed that the companies have a right to set off the advance tax paid against the provision for taxation, and accordingly, they should have been set off against each other as per the requirements of paragraph 27 of AS 22.
8.	From the Annual Reports of some companies, it has been noted that the companies had simultaneously shown the 'deferred tax liability' on the liabilities side of the Balance Sheet and the 'deferred tax asset' on the asset side of the Balance Sheet.	It was felt that such presentation is not in accordance with the requirement of paragraph 29 of Accounting Standard (AS) 22, 'Accounting for Taxes' which is provides as follows: *"29. An enterprise should offset deferred tax assets and deferred tax liabilities if :* *(a) the enterprise has a legally enforceable right to set off assets against liabilities*

		representing current tax; and *(b) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws."* From the above, it was viewed that either the 'Deferred Tax Assets' or the 'Deferred Tax Liabilities' should be disclosed on the face of the Balance Sheet after off-setting the two balances against each other unless they relate to different tax jurisdictions. However, it was noted that in the stated cases, the 'Deferred Tax Assets' and 'Deferred Tax Liabilities' were simultaneously shown on the face of Balance Sheet without offsetting against each other, which is not in compliance with requirements of paragraph 29 of AS 22.
9.	From the Annual Reports of some companies, it has been noted that the companies having unabsorbed depreciation and carry forward business losses recognised the deferred tax assets, the accounting policy of which states as follows: • Deferred Tax Asset is recognised, subject to	It may be noted that paragraph 17 of Accounting Standard (AS) 22, 'Accounting for Taxes' provides as follows: *"17. Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual*

	consideration of prudence, on timing differences, being difference between taxable and accounting income/ expenditure that originate in one period and are capable of reversal in one or more subsequent period(s). The management is of the opinion that sufficient future taxable income will be available against which, such deferred tax assets will be realised. • Deferred tax assets are recognised only if there is virtual certainty supported by convincing evidence that such deferred tax assets can be realised against future taxable profits. From the Notes to the Accounts, it was noted that "based on the future profitability projections, the Company is virtually certain that there would be sufficient taxable income in future, to claim the above tax credit."	*certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised."* From the above, it was viewed that if an enterprise has unabsorbed depreciation or carry forward losses, deferred tax assets should be recognised to the extent it is virtual certain supporting by convincing evidence that sufficient future taxable income would be available to realise it. It was noted from the stated accounting policies that while in the former case, deferred tax asset was recognised subject to the consideration of prudence. In other words, it is not clear whether there exists virtual certainty supported by convincing evidence that future taxable income would be available against which such deferred tax can be realised. Accordingly, such accounting policy is contrary to the requirement of AS 22. Further, it was noted that in the latter case, the deferred tax asset was recognised based on virtual certainty evident from future profitability projections. It may be noted that as per explanation to paragraph 17 of

		AS 22, a projection of the future profits made by an enterprise cannot, in isolation, be considered as convincing evidence. Accordingly, it was viewed that the policies as adopted for the recognition of deferred tax asset are not in line with the requirements of paragraph 17 of AS 22.
10.	From the Annual Reports of some companies, it was noted that companies having unabsorbed depreciation or carried forward business losses, state that deferred tax asset has been recognised only to the extent of virtual certainty supported by convincing evidence but omit to provide the nature of the evidence on which such virtual certainty has arisen.	Paragraphs 32 of Accounting Standard (AS) 22, 'Accounting for Taxes on Income', provides as follows: *"32. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws."* It was viewed that in terms of disclosure requirement of paragraph 32 of AS 22, if a company has unabsorbed depreciation or carry forward of losses under tax laws, the nature of the evidence supporting the recognition of deferred tax assets should be disclosed, however, the companies often omit to disclose the nature of the evidences relied upon.
11.	In the Annual Report of a company, it was noted that the accounting policy for recognition	It may be noted that paragraphs 15 and 17 of Accounting Standard (AS) 22, 'Accounting for Taxes on

	of deferred tax states as follows: "Deferred Tax is recognised on the timing difference and accounted at the current rate of tax. Deferred tax asset is recognised only if there is virtual certainty of its realisation." However, another note to accounts in relation to deferred tax states as given below: "…Deferred tax asset has been recognised to the extent where the management is reasonably certain that the realisation is more likely than not."	Income' provide as follows: *"15. Except in the situations stated in paragraph 17, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised."* *"17. Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised…"* It was observed from the stated accounting policy that deferred tax asset was recognised only if there was virtual certainty of its realisation. However, in the Notes to the Accounts, it was stated that deferred tax asset had been recognised to the extent where 'management is reasonably certain that realisation is more likely than not'. Thus, the stated accounting policy is inconsistent with the Notes to the Accounts in

		respect of deferred tax asset. Such contradictions raise doubt in relation to compliance of AS 22. .
12.	From the schedules of deferred tax liability and security premium account as given in the Annual Report of a company, it has been noted that while deferred tax asset was recognised for 'effect of public issue expenses', the public issue expenses were adjusted against the Securities Premium account.	It may be noted from paragraph 2 and 3 of the Announcement titled 'Tax effect of expenses/ income adjusted directly against the reserves and/or Securities Premium Account' issued by ICAI, which *inter alia,* provide as follows: "2. …any expense charged directly to reserves and/ or Securities Premium Account should be net of tax benefits expected to arises from the admissibility of such expenses for tax purposes." It was noted that in the extant case, deferred tax asset had been recognised for "effect of public issue expenses" which indicates that public issue expense adjusted against the Securities Premium Account are on gross basis which is against the principles enunciated in the above Announcement. It was observed that due to such accounting treatment, the profits for the year was overstated and the balance in the Securities Premium Account, was understated.
13.	In the Annual Reports of some	It may be noted that paragraph 13

	companies, the accounting policy states that recognise the deferred tax assets are recognised simply on the consideration of prudence.	of Accounting Standard (AS) 22, 'Accounting for Taxes on Income' prescribes recognition of deferred tax asset based on the principles prescribed in paragraphs 15-17 of AS 22. It may be further noted that whereas paragraph 15 of AS 22 prescribes recognition of deferred tax assets on the basis of reasonable certainty, in some cases, companies have unabsorbed depreciation and carry forward business losses, deferred tax assets have been stated to be recognised only to the extent of virtual certainty that sufficient future taxable income will be available to realise it. In other words, recognition of deferred tax asset simply on the consideration of prudence is not sufficient. Further, existence of reasonable certainty or virtual certainty, as the case may be, should also be necessary for recognition of deferred tax assets. Thus, it was viewed that such accounting policy cannot be considered to be complete in view of the requirements of AS 22.
14.	From the Annual Report of a company, it has been noted that the Deferred Tax Asset and provision for wealth tax as reflected in the Consolidated Balance Sheet of the company were lower than that stated in the Stand alone Balance Sheet of the	It was observed that reporting lower amount in the Consolidated Balance Sheet vis-à-vis the Standalone Balance Sheet *prima facie* indicates that deferred tax liabilities / provision for wealth tax of subsidiaries were offset against the deferred tax asset/ wealth tax

	company.	asset of the holding company. It was observed that since the subsidiaries and holding companies are different legal entities, they do not have an enforceable right to set off the assets of one entity against the liabilities of the other entity. Hence, adjustment, if any, of such nature has been made is contrary to the requirements of paragraph 29(a) of Accounting Standard (AS) 22, 'Accounting for Taxes on Income' which provides as follows: *"29. An enterprise should offset deferred tax assets and deferred tax liabilities if :* (a) *the enterprise has a legally enforceable right to set off assets against liabilities representing current tax ; and* *..."*
15.	From the Schedule of Deferred Tax Assets given in the Annual Report of a company, it has been noted that deferred tax was recognised on account of provision for diminution in value of investments.	It may be noted that explanations 2(a) and 2(b) to paragraph 17 of Accounting Standard (AS) 22, 'Accounting for Taxes on Income', provide as follows: *"2(a) As per the relevant provisions of the Income-tax Act, 1961 (hereinafter referred to as the Act), the 'loss' arising under the head 'Capital gains' can be carried forward and set-*

		off in future years, only against the income arising under that head as per the requirements of the Act *(b) <u>Where an enterprise's statement of profit and loss includes an item of 'loss' which can be set-off in future for taxation purposes, only against the income arising under the head 'Capital gains' as per the requirements of the Act, that item is a timing difference to the extent it is not set-off in the current year and is allowed to be set-off against the income arising under the head 'Capital gains' in subsequent years</u> subject to the provisions of the Act. In respect of such 'loss', deferred tax asset is recognised and carried forward subject to the consideration of prudence. Accordingly, in respect of such 'loss', deferred tax asset is recognised and carried forward only to the extent that there is a virtual certainty, supported by convincing evidence, that sufficient future taxable income will be available under the head 'Capital gains' against which the loss can be set-off as per the provisions of the Act. Whether the test of virtual certainty is fulfilled or not would depend on the facts and circumstances of each case.*

		The examples of situations in which the test of virtual certainty, supported by convincing evidence, for the purposes of recognition of deferred tax asset in respect of loss arising under the head 'Capital gains' is normally fulfilled, are sale of an asset giving rise to capital gain (eligible to set-off the capital loss as per the provisions of the Act) after the balance sheet date but before the financial statements are approved, and binding sale agreement which will give rise to capital gain (eligible to set-off the capital loss as per the provisions of the Act." (Emphasis added) From the above, it was observed that a loss under the head 'Capital Loss' can be recognised as deferred tax asset only to the extent that there is a virtual certainty, supported by convincing evidence that future taxable income will be available under the head 'Capital Gains' against which the loss can be set-off as per the provision of the Income Tax Act. In the absence of disclosure of the nature of the evidence supporting the recognition of deferred tax asset for capital loss as required by paragraph 32 of

		AS 22, it was not verifiable whether there existed any binding sale agreement with regard to investments or the company had sold any investment before the financial statements were authorised for issue that gave rise to Capital gain to set-off the Capital loss in the subsequent period. Accordingly, it was observed that *prime facie* the recognition of deferred tax asset on provision for diminution in value of investment was not in accordance with the requirement of paragraph 32 of AS 22.
16.	From one of the Notes to the Accounts regarding deferred tax as given in the Annual Report of a company, it has been noted that the company had adjusted the MAT credit entitlement against the deferred tax liability.	Paragraph 5 of 'Guidance Note on Accounting for Credit Available in respect of Minimum Alternative Tax' issued by the Institute while describing the nature of MAT credit entitlement in context of deferred tax states as follows: "5. From the above, it is noted that payment of MAT, does not by itself, result in any timing difference since it does not give rise to any difference between the accounting income and the taxable income which are arrived at before adjusting the tax expense, namely, MAT. In other words, under Accounting Standard (AS) 22 'Accounting for Taxes on Income' deferred tax asset and deferred tax liability arise on account of differences in the items of income and

		expenses credited or charged in the Profit and Loss Account as compared to the items of income that are taxed or items of expense that are allowed as deduction, for the purposes of the Act. Thus, deferred tax assets and deferred tax liabilities do not arise on account of the amount of the tax expense itself. In view of this, it is not appropriate to consider MAT credit as a deferred tax asset for the purposes of AS 22". Further, it was noted from paragraph 13 of the said Guidance Note that MAT credit entitlement should be recognised as an asset and should be presented under the head of 'loans and advances' only if there is a convincing evidence of the realisation of the asset. In other words, such entitlement is of the nature of a pre-paid tax, which could be adjusted against the current tax. Accordingly, it was viewed that the adjustment of MAT credit entitlement against deferred tax liability is contrary to the requirements of the 'Guidance Note on Accounting for Credit Available in respect of Minimum Alternative Tax'.

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Observations on Accounting Standard (AS) 23: Accounting for Investments in Associates in Consolidated Financial Statements

S. No.	Matter contained in Annual Report	Observations
1.	From the Related Party Disclosures given in the Annual Report of a company, it has been noted that it had an associate company, but company's share of the profits or losses in such associate company was not disclosed separately in the Consolidated Financial Statements of the Company.	It may be noted that the paragraph 23 of Accounting Standard (AS) 23, 'Accounting for Investments in Associates in Consolidated Financial Statements' provides as follows: *"23. Investments in associates accounted for using the equity method should be classified as long-term investments and disclosed separately in the consolidated balance sheet. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss. The investor's share of any extraordinary or prior period items should also be separately disclosed."* From the above, it was viewed that the investments in an associate company and the investors' share of the profits or losses in such an associate company should be disclosed

		separately in the Consolidated Balance Sheet and Profit and Loss Account respectively. Omission of such information is a non-compliance of the requirement of AS 23.

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Observations on Accounting Standard (AS) 26 : Intangible Assets

S. No.	Matter contained in Annual Report	Observations
1.	From the Annual Reports of some companies, it has been noted that amalgamation expenses/ preliminary expenses/share issue expenses/miscellaneous expenses have been capitalised under the head of 'Deferred revenue expenditure'/ 'Miscellaneous expenditure' and amortised over a period of 3-5 years.	It may be noted that paragraphs 6.2 and 56 of Accounting Standard (AS) 26, 'Intangible Assets' provide as follows: *" 6.2. An <u>asset</u> is a resource:* *(a) controlled by an enterprise as a result of past events; and* *(b) from which future economic benefits are expected to flow to the enterprise.*" "56. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is always considered as an expense when it is incurred (see paragraph 41). Examples of other expenditure that is recognised as an expense when it is incurred include: (a) expenditure on start-up activities (start-up costs), unless

		this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs); …” From the above, it was viewed that in case expenditure meets the definition of the term ‘asset’ and the recognition criteria thereof, the same should be capitalised as part of the cost of that asset, otherwise, such expenditure should be expensed in the Profit and Loss Account in the year in which the expenditure is incurred. It was noted that amalgamation expenses, preliminary expenses, share issue expenses, new launch expenses and miscellaneous expenses had been treated as deferred revenue expenditure which are being amortised over a reasonable period of time. With regard to ‘share issue expenses’, it was noted that it has

		been specifically excluded from the scope of AS 26 vide paragraph 5 of AS 26 but paragraph 56 of the Standard lays down a general rule for expenditure which is incurred to provide future economic benefits but no intangible asset or 'other asset' is acquired or created. It was viewed that those expenses do not meet the criteria of the term 'assets', since such expenditure does not give rise to any resource which can be controlled by the enterprise, and therefore, should be expensed as and when incurred. Accordingly, it was viewed that all such expenses viz amalgamation expenses, preliminary expenses, share issue expenses, new launch expenses may be providing benefits in future but they do not give rise to a resource controlled by the enterprise. Hence, amortisation of such expenses is not in accordance with the generally accepted accounting principles.
2.	In the Annual Reports of some companies, different accounting policies relating to 'Research and Development Expenditure' had been observed to be adopted by them. An illustrative list of which is given below: • Revenue expenditure on	It may be noted that paragraphs 40 and 44 of Accounting Standard (AS) 26, 'Intangible Assets' provide as follows: "40. If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an

	research and development is charged to Profit and Loss Account in the year of incurrence except in case of development of new products undertaken when the same are deferred and expensed out over a reasonable period for which the benefit is received after commercial development of the products. • The expenses incurred on development of special variety FIBC bags (inclusive of Foreign Travel and testing charges) are treated as Deferred Revenue Expenditure and the same will be amortised on commercial exploitation. • Research and Development expenses of revenue nature, if any are charged to the Profit and Loss Account in the year in which it is incurred. Expenditure of capital nature, if any is being capitalised. • Revenue expenditure on research and development is charged to the Profit and Loss Account. Capital expenditure on research and development is shown as an addition to fixed assets. • Revenue expenditure on research and development is charged to the Profit and Loss Account as incurred. Capital	intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only." *"44. An Intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:* *(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;* *(b) its intention to complete the intangible asset and use or sell it;* *(c) its ability to use or sell the intangible asset;* *(d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;* *(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and*

	expenditure on research and development is given the same accounting treatment as applicable to other capital expenditure. • Revenue expenditure relating to Research and Development is charged out in the year in which it is incurred. Capital expenditure incurred for Research and Development is capitalised. The observations on the above are quite similar in all the cases as provided adjacent to them.	*(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably."* In view of above, the expenditure on research and development phase should be classified as expenditure on research phase and expenditure on development phase instead of classifying the total expenditure on the basis of their nature viz. revenue and capital expenditure. The expenditure on research phase should be expensed as and when it is incurred and the expenditure on development phase should be capitalised if, and only if, such expenditure meets the conditions laid under paragraph 44 of AS 26. However, it was noted from the stated policies that the revenue expenditure on Research and Development had been charged to the Profit and Loss Account and capital expenditure on Research and Development had been either capitalised or deferred and amortised over a reasonable period *without considering the difference between the research and development phase,* which is contrary to AS 26. With regard to recognising

		'development expenditure' as 'deferred revenue expenditure', it was viewed that as per AS 26 if such expenditure meets the criteria of paragraph 44 of AS 26, it should be recognised as an 'intangible assets' else should be recognised as and when it is incurred. Hence recognising the same as 'deferred revenue expenditure' is not in line with the requirement of AS 26.
3.	From the Annual Reports of some companies, it has been noted that it has recognised intangible assets in their Balance Sheet viz. computer software, technical know-how, development expenditure and right in time sharing holiday resort but no other information relating to such assets has been provided in the financial statements.	It may be noted that paragraph 90 of Accounting Standard (AS) 26, 'Intangible Assets', *interalia,* provides as follows: *"90. The Financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:* *(a) the useful lives or the amortsation rates used;* *(b) the amortisation methods used* *..."* It was noted that although companies possess certain intangible assets, that had simply been shown in the Balance Sheet. In the absence of any related information in the financial statements, it was not clear whether such intangible assets

		were internally generated or otherwise. Further, information relating to their (a) useful life and (b) amortisation method as adopted for such intangible assets had not been disclosed which is against the requirements of paragraphs 90 (a) and (b) of AS 26.
4.	From the accounting policy of depreciation and amortisation given in the Annual Report of a company, it has been noted that intangible assets had been amortised at the rates prescribed in Schedule XIV to the Companies Act, 1956.	It was observed that the company had indicated that the intangible assets had been amortised over the useful lives of such assets provided under Schedule XIV to the Companies Act, 1956. However, it was noted that no separate rate of amortisation has been specified in Schedule XIV to the Companies Act, 1956 for any of the 'intangible assets'. Accordingly, it was felt that in the given case, the useful lives of the assets had not been disclosed, which is not in line with the requirements of paragraph 90 (a) of AS 26.
5.	From the Annual Reports of some companies, it has been noted that the Directors' Reports give the following information with regard to Research and Development expenditure: • Expenditure on research and development is not separately allocated and identified. • Research and development is carried out in house as well as with the help of external source	It may be noted that paragraph 96 of Accounting Standard (AS) 26 'Intangible Assets', provides as follows: *"96. The financial statements should disclose the aggregate amount of research and development expenditure recognised as an expense during the period."*

	also and the expense incurred on this are booked under general accounting head. The observations on the above are quite similar in all the cases as provided adjacent to them.	From Annexure to Directors' Report it was noted that although the companies had incurred expenditure in the nature of research and development expenditure but omit to separately disclose the amount of research and development expenditure, recognised as an expense during the period either in the schedule or in the notes to accounts. It is not in line with the requirement of paragraph 96 of AS 26.
6.	From the Annual Report of a company, it has been noted that the amount of research and development expenditure as reported under Directors' Reports is different from that reported in the financial statements.	It was felt that such contradictions should be avoided or should be properly explained.
7.	In the Annual Reports of some companies, the following information had been disclosed with regard to miscellaneous expenditure: • Expenses on Mines Development/ overburden removal is deferred and amortised over a period of Lease/extraction from Mines. • The company has incurred Rs. xx lakhs on installation of xx KV electric line for getting uninterrupted power from the State Electricity Board with an understanding that such electric lines would become	It was noted that the companies incurred certain expenditure on mines development/overburden removal/installation of electric lines which had been capitalised in the Balance Sheet and amortised over a period of time. It was viewed that AS 26 does not permit the amortisation of "deferred" expenditure. In case such expenditure incurred meets the definition of the term 'intangible asset,' it should be treated as such and capitalised; otherwise, it should be expensed. Accordingly, it was viewed that

	the property of the Electricity Board. Hence, this expenditure is written off in five annual installments equally from this year of installation of the lines. The observations on the above are quite similar in all the cases as provided adjacent to them.	the treatment of expenses on mines development / overburden removal/ installation of electric lines, as adopted by the companies is not in accordance with the requirement of AS 26.
8.	From the Annual Report of a company, it has been noted that the amortisation period for intangibles viz. Brands and Goodwill is stated to be 20 years.	Paragraph 94 (a) of Accounting Standard (AS) 26, 'Intangible Assets', *interalia* provides as follows: *"94. The financial statements should also disclose:* *(a) if an intangible asset is amortised over more than ten years, the reasons why it is presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the asset;* ..." It was noted that the Brands and goodwill were being amortised over a period of 20 years. It was viewed that since the said intangible assets were being amortised over a period

		exceeding 10 years, as per the aforesaid requirement, the reason for such assumption was required to be disclosed. In the absence of such disclosure, it was viewed that the requirement of paragraph 94 (a) of AS 26 has not been complied with.
9.	From the Annual Report of a company, it has been noted that consideration paid for license of a hotel had been treated as deferred revenue expenditure being amortised over a period of time.	It may be noted from paragraph 7 of Accounting Standard (AS) 26, 'Intangible Assets' provides as follows: "7. Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, ***licenses***, intellectual property, market knowledge and trademarks (including brand names and publishing titles)…" (Emphasis added) It was viewed that the expenditure incurred for acquiring license of a hotel, is an identifiable non-monetary asset without physical substance which is held for use in supply of services. Further, paragraph 7 of AS 26, explicitly classifies 'licenses' as an intangible asset. Hence, expenditure incurred on its acquisition should be treated as intangible assets and amortised

		over its useful life. Accordingly, recognising the same as deferred revenue expenditure is not in accordance with the requirement of paragraph 7 of AS 26.
10.	From the Annual Report of a company it has been noted that the accounting policy also states as follows: "…Modifications that enhance the operating performance or extend the useful life of fixed assets used but not owned by the company are also capitalised, where there is certainty of deriving future economic benefits from the use of such assets."	An 'asset' has been defined in paragraph 6.2 of Accounting Standard (AS) 26 'Intangible Assets' as follows: "6.2. *An <u>asset</u> is a resource:* *(a) controlled by an enterprise as a result of past events; and* *(b) from which future economic benefits are expected to flow to the enterprise.*" It was noted from the stated accounting policy that the expenditure incurred on the modifications that enhance the operating performance or extend the useful life of fixed assets *which are not owned by the company* had been capitalised. It was viewed that expenditure on modifications of assets not owned by the company cannot be considered to be a 'resource' being controlled by the company. Thus, these expenses do not meet the criteria of the term 'asset'. Hence, such expenditure neither gives rise to any 'tangible' or 'intangible' asset of the company.

		Therefore, its capitalisation is not in accordance with AS 10 and AS 26.
11.	The accounting policy of 'Intangible Assets - Computer Software' given in the Annual Report of a company has been stated as follows: "Costs incurred towards purchase of computer are depreciated on written down value method pro-rata to the period of use of assets, at the annual depreciation rates stipulated in Schedule XIV to the Companies Act, 1956."	It was noted that while the accounting policy has been stated for 'computer software', the accounting policy refers to 'purchase of computer' and stated to have been depreciated at rates specified in Schedule XIV to the Companies Act, 1956. It was further viewed that even if the stated policy is presumed to be referring to 'computer software', it may be noted that no specific rate of depreciation has been specified for computer software in Schedule XIV of the Companies Act, 1956. Accordingly, it was viewed that such contradiction should be avoided which raise doubt on compliance of AS 26.

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Observations on Accounting Standard (AS) 27: Financial Reporting of Interests in Joint Ventures

S. No.	Matter contained in Annual Report	Observations
1.	From the Related Party Disclosures given in the Annual Reports of some companies, it has been noted that the companies had interest in joint ventures, however, no disclosures have been made in relation to the same.	It may be noted that paragraphs 49, 50, 51, 52 and 53 of Accounting Standard (AS) 27, 'Financial Reporting of Interests in Joint Ventures', require venturer to disclose certain information in respect of the joint ventures in the separate financial statement as well as in consolidated financial statement. The requirements of the stated paragraphs are reproduced below: *"49. A venturer should disclose the information required by paragraphs 50, 51 and 52 in its separate financial statements as well as in consolidated financial statements.* *50. A venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:* *(a) any contingent liabilities that the venturer has incurred in relation to its*

		interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers; *(b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and* *(c) those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.* *51. A venturer should disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:* *(a) any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and* *(b) its share of the capital commitments of the joint ventures themselves.* *52. A venturer should disclose a list of all joint ventures and description of interests in*

		significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence. *53. A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities."* It was, therefore, viewed that if the company has interest in the joint venture(s), it should comply with the disclosure requirements of paragraphs 49, 50, 51, 52 and 53 of AS 27.
2.	One of the Notes forming part of Accounts given in the Annual Report of a company, states as follows: The Company's interest and share in Joint Venture in jointly controlled activities are as follows: (a) X Ventures: The Company, by virtue of an Agreement has entered into a Joint Venture with 'ABC Developers Pvt. Ltd.' by forming	It may be noted that paragraph 53 of Accounting Standard (AS) 27, 'Financial Reporting of Interests in Joint Ventures' provides as follows: *"53. A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities."*

	an Association of Persons named X Ventures. The Company has agreed to contribute an amount of Rs. xx lakhs towards initial capital and has agreed to contribute further capital as and when needed for Joint Venture. The company has contributed Rs. xxx Lakhs. (b) Y Venture:- The Company, by virtue of an Agreement has entered into a Joint Venture with 'PQR Developers Pvt. Ltd.' by forming an Association of Persons named 'Y Venture'. The Company has agreed to contribute an amount of Rs. yy lakhs towards initial capital and has agreed to contribute further capital as and when needed for Joint Venture. The Company has contributed Rs. yyy lakhs."	It was noted from Notes to Accounts that although the name of joint venture and the amount contributed to those joint venture had been disclosed, but information relating to its interest in the assets, liabilities, income and expenses of such joint venture companies as required under paragraph 53 of AS 27 had not been disclosed. Accordingly, it was viewed that the disclosure requirements of paragraph 53 of AS 27 has not been complied with.

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Observations on Accounting Standard (AS) 28: Impairment of Assets

S. No.	Matter contained in Annual Report	Observations
1.	From the Annual Reports of some companies, it has been noted that the statement on accounting policies does not contain any accounting policy on impairment of assets. Further, there is no information given either in the Schedule or Notes to Accounts to indicate if the said companies had conducted any impairment tests.	It may be noted that paragraph 124 read with paragraph 6 of Accounting Standard (AS) 28 'Impairment of Assets', provides as follows: *"124. On the date of this Standard becoming mandatory, an enterprise should assess whether there is any indication that an asset may be impaired (see paragraphs 5-13)…"* *"6. An enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset."* In view of the aforesaid requirements, it was viewed that an enterprise is required to identify the assets that may be impaired by conducting an impairment test at each Balance Sheet date, whether any impairment loss has occurred or not. Further, whether or not such

		test has been conducted should also be disclosed either by way of Notes to Accounts or by disclosing its accounting policy with respect to same. However, it was noted that the companies had neither disclosed the accounting policy in respect of impairment of assets nor they had reported the fact as to whether they had conducted any impairment test or not, which is not in line with the requirement of AS 28.

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Observations on Accounting Standard (AS) 29: Provisions, Contingent Liabilities and Contingent Assets

S. No.	Matter contained in Annual Report	Observations
1.	From the Annual Report of a company, engaged in mining industry, it has been noted that no provision had been reported for mining restoration costs under the Schedule of Current Liabilities and Provisions.	It has been noted that paragraph 14 of Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets', provides as follows: *"14. A provision should be recognised when:* *(a) an enterprise has a present obligation as a result of a past event;* *(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and* *(c) a reliable estimate can be made of the amount of the obligation.* *If these conditions are not met, no provision should be recognised."* Considering the nature of the industry, it was observed that it is obligatory for a company to restore the site of the mines at the expiry of the leased period. Accordingly, it was viewed that

		due to existence of such obligation, a provision for the Mining Restoration should have been made in terms of paragraph 14 of AS 26. Non-providing for such obligations may result into understatement of liabilities.
2.	Under the Schedule of Provisions given in the Annual Reports of some companies, it has been noted that certain provisions have been recognised viz provision for warranty, etc. but no related disclosures have been made.	It may be noted that paragraphs 66 and 67 of Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets', provide as follows: *"66. For each class of provision, an enterprise should disclose:* *(a) the carrying amount at the beginning and end of the period;* *(b) additional provisions made in the period, including increases to existing provisions;* *(c) amounts used (i.e. incurred and charged against the provision) during the period; and* *(d) unused amount reversed during the period."* *Provided that a Small and Medium-sized Company, as defined in the Notification, may not comply with paragraph 66 above.* *67. An enterprise should disclose the following for each class of provision:*

		(a) a brief description of the nature of the obligation and the expected timing of any resulting outflow of economic benefits; *(b) an indication of uncertainties about those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, as addressed in paragraph 41; and* *(c) the amount of any expected reimbursement, stating the amount of any assets that has been recognised for that expected reimbursement.* *Provided that a Small and Medium-sized Company, as defined in the Notification, may not comply with paragraph 67 above."* It was felt that although provisions had been made by the companies, the above-mentioned disclosure requirements of paragraphs 66 and 67 of AS 29 in respect of such provisions had not been complied with either in the schedule or in the Notes to the Accounts.
3.	One of the Notes to the Accounts given in the Annual Report of a	It may be noted that paragraph 46 of Accounting Standard (AS) 29,

	company states as follows: "The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier."	'Provisions, Contingent Liabilities and Contingent Assets', provides as follows: *"46. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision."* It was noted from the stated note that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. It was viewed that the provision for warranty should have been made as required by AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company as stated in paragraph 46 of AS 29 rather than omitting the disclosure of such liability. Accordingly, it was viewed that the accounting treatment as

		adopted by the company is not in accordance with the requirement of AS 29.
4.	One of the Notes to the Accounts as given in the Annual Report of a company states as follows: "Cases have been filed by some of the buyers for damages, quality differences, etc., which have been disputed by the Company. Pending disposal of these cases, liability, if any, could not be determined and hence provision thereof could not be made".	Paragraph 68 of Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets', provides as follows: *"68. Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:* *(a) an estimate of its financial effect, measured under paragraphs 35-45;* *(b) an indication of the uncertainties relating to any outflow; and* *(c) the possibility of any reimbursement.* 69. In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfill the requirements of paragraphs 67 (a) and (b) and 68 (a) and (b). Thus, it may be appropriate to treat as a single class of provision

		amounts relating to warranties of different products, but it would not be appropriate to treat as a single class amounts relating to normal warranties and amounts that are subject to legal proceedings." It was noted that although the description with regard to the nature of the contingent liability had been given in the Notes to the Accounts, the other disclosures like financial effect thereof, an indication of the uncertainties relating to any outflow and the possibilities of any reimbursement, in terms of paragraph 68 of AS 29 had not been disclosed under the relevant note. It was further viewed that paragraph 69 requires only the fact to be disclosed in cases where it is not practicable to disclose the information required in paragraph 68. However, in the extant case, the company has not disclosed the financial effect as required under paragraph 68 on the pretext that disposal of cases is still pending. It was viewed that pending cases itself indicates contingent liability but it cannot be considered one of the reason for not estimating the liability.
5.	From the Auditor's Report given in pursuance to the requirements of paragraph 4(ix)(b) of the Companies (Auditor's Report), 2003 (CARO 2003), it has been	It may be noted that paragraphs 10.4 and 68 of Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets', provide as

	noted that the company had not deposited the dues of Income Tax with the appropriate authorities on account of pending dispute with them whereas while disclosing the 'contingent liabilities', the following note was observed which states as follows: "In respect of certain disallowances and additions made by the Income Tax Authorities, appeals are pending before the Appellate Authorities and adjustment, if any, will be made after the same are finally determined."	follows: *"10.4. <u>A contingent liability</u> is:* *(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the enterprise; or* *(b) a present obligation that arises from past events but is not recognised because:* *(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or* *(ii) a reliable estimate of the amount of the obligation cannot be made."* *"68. Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:* *(a) an estimate of its financial effect, measured under paragraphs 35-45;* *(b) an indication of the uncertainties relating to*

		any outflow; and *(c) the possibility of any reimbursement."* It was observed that non-depositing of dues of income tax on account of pending dispute with appropriate authorities are possible obligations, which will be confirmed only on the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. These are, therefore, in the nature of contingent liabilities as defined in paragraph 10.4 of AS 29. However, it was observed from the stated note that the estimated financial effect of pending appeals had not been indicated while disclosing the contingent liabilities. It was viewed that mere description of the nature of contingent liability is not a sufficient compliance of AS 29. The estimated financial effect should also be disclosed to comply with the disclosure requirements of paragraph 68 of AS 29.

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Observations on the Companies Act, 1956

S. No.	Matter contained in Annual Report	Observations
1.	From the Annual Reports of some companies, it has been noted that the accounting policies often state as follows: • Expenditure in foreign currency incurred during the year had been reported on cash basis. • Gratuity and leave salary are accounted on cash basis. • Interest and other income are accounted for on accrual basis except items of non-recurring nature which are accounted when received.	It may be noted that Section 209(3)(b) of the Companies Act 1956, provides as follows: "209… (3) For the purposes of sub-sections (1) and (2), proper books of account shall not be deemed to be kept with respect to the matters specified therein , - (a) … (b) If such books are not kept on accrual basis and according to the double entry system of accounting." It was observed that accounting of certain items on cash basis instead of on accrual basis is contrary to the aforesaid requirements of the Companies Act, 1956 as well as AS 1.
2.	From the Schedule of Fixed Assets as well as the accounting policy on depreciation as given in the financial statements of some companies, the following have been noted: • The rate of depreciation as applied on Theatre assets-furniture and fittings, was 18.1 %.	In the former case, it was observed that Schedule XIV to the Companies Act, 1956, prescribes the depreciation rate @ 25.88 percent rate for the furniture and fitting of cinema houses, theatre etc. Accordingly, adoption of lower rate i.e. 18.1 % than that specified in Schedule XIV to the Companies Act, 1956 is its non-compliance.

	• The 'Miscellaneous Assets' had been disclosed as a separate asset under the Schedule of Fixed Assets and the accounting policy on its depreciation states that the depreciation is provided on straight line method at the rates prescribed under Schedule XIV of the Companies Act, 1956.	In the latter case, it was noted Schedule XIV does not specify any separate rate of depreciation for assets in the nature 'Miscellaneous assets'. Accordingly, stating that such assets have been depreciated at the rates specified in Schedule XIV to the Companies Act, 1956 is a wrong disclosure.
3.	From the Accounting Policy of depreciation as given in the Annual Report of a company, it has been noted that the depreciation on fixed assets is provided pro-rata on the straight-line method with double shift rates as prescribed under the Companies Act, 1956.	It may be noted that the note 6 of Schedule XIV to the Companies Act, 1956 *interalia* states as follows: "…The extra shift depreciation shall not be charged in respect of any item of machinery or plant which has been specifically, excepted by inscription of the letter "N.E.S.D." (meaning "No Extra Shift Depreciation") against it…" While comparing the item of assets as specified under the schedule of fixed assets with those given under Schedule XIV to the Companies Act, 1956, it was observed that all items given in the schedule of fixed assets fall within the category of fixed asset inscripted by "N.E.S.D" i.e. "No extra shift depreciation" items, which indicates that depreciation policy of the company to depreciate fixed assets at using double shift rate is in contradiction to the

		requirements of Schedule XIV to the Companies Act, 1956.
4.	From the Schedule of Fixed Assets given in the Annual Report of a company, it has been noted that items of fixed assets costing less than Rs. 5000 had been depreciated at the rate specified under Schedule XIV to the Companies Act, 1956 in relation to that class of assets.	Paragraph 8 of Schedule XIV to the Companies Act, 1956, requires as follows: "Notwithstanding anything mentioned in this Schedule, depreciation on assets, whose actual cost does not exceed five thousand rupees, shall be provided deprecation at the rate of hundred percent." It was felt that the assets which were acquired during the year and costs less than Rs. 5000 should be depreciated at the rate of hundred percent. Accordingly, the depreciation method adopted was not in line with the requirements of Schedule XIV to the Companies Act, 1956.
5.	The Annual Reports of some companies states as follows: • The financial statements are prepared to comply in all material aspects with applicable accounting principles in India, the Accounting Standards ***issued by Institute of Chartered Accountants of India*** and the relevant provisions of the Companies	It may be noted that in exercise of powers conferred by clause (a) of sub-section (1) of Section 642 of the Companies Act, 1956, read with sub-section (3C) of Section 211 and sub-section (1) of Section 210A of the said Act, the Central Government, in consultation with National Advisory Committee on Accounting Standards, issued a notification wherein the Accounting Standards have been

	Act, 1956. (Emphasis added) • The accounts are prepared on accrual basis under the historical cost convention and comply with the mandatory accounting standards ***issued by the Institute of Chartered Accountants of India*** and the disclosure requirements of Schedule VI to the Companies Act, 1956. (Emphasis added)	defined as follows: "3. Accounting Standards.- (1) The Central Government hereby prescribes Accounting Standards 1 to 7 and 9 to 29 as recommended by the Institute of Chartered Accountants of India, which are specified in the Annexure to these rules. (2) The Accounting Standards shall come into effect in respect of accounting periods commencing on or after the publication of these Accounting Standards." In view of above, the Accounting Standards have now become a part of Companies Act vide Notification No. G.S.R. 739 (E) dated 7th December, 2006. Accordingly, it was viewed that after such notification, Accounting Standards for companies cannot be referred to as those issued by the Institute. Instead, it should be referred as 'notified under Companies (Accounting Standards) Rules, 2006.
6.	From the Annual Report of a company, it has been noted that a dividend of 20% has been recommended by the directors on the transfer of an amount to	It may be noted that Section 205(2A) to the Companies Act, 1956 provides as follows: "{(2A) Notwithstanding anything

	general reserve which is approx 2.6% of current year's profit.	contained in sub-section (1), on and from the commencement of the Companies (Amendment) Act, 1974, no dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), except after the transfer to the reserves of the company of such percentage of its profits for that year, not exceeding ten per cent, as may be prescribed: Provided that nothing in this sub-section shall be deemed to prohibit the voluntary transfer by a company of a higher percentage of its profits to the reserves in accordance with such rules as may be made by the Central Government in this behalf.}" As per requirements of clause 2(iii) of Companies (Transfer of Profits to Reserves) Rules, 1975, where the dividend proposed exceeds 15 per cent, but does not exceed 20 percent of the paid-up capital, the amount to be transferred to the reserves shall not be less than 7.5 per cent of the current profits. It was observed that the proportion of amount transferred to general reserve is lower than

		the stated statutory requirement of Section 205 of the Companies Act, 1956. Accordingly, it was viewed that the requirement of Companies Act, 1956 has not been complied with.
7.	From the information given in pursuance of the requirements of clauses (iii)(a) & (b) of CARO, 2003 and the information given in the Schedule of Current Assets, Loans and Advances given in the Annual Report of a company, it has been noted that the interest-free unsecured loans had been granted to X Ltd., a 100% subsidiary company as well as to Y Ltd., one of the related parties, which is not a wholly-owned subsidiary.	It may be noted that sub-sections 3 and 8(c) of Section 372A of the Companies Act, 1956, provide as follows: "372A Inter corporate loans and advances 3. No loan to anybody corporate shall be made at a rate of interest lower than the prevailing bank rate, being the standard rate made public under Section 49 of the Reserve Bank of India Act, 1934. ... 8. Nothing contained in this section shall apply, (a)... (b)... (c) to any loan made by a holding company to its wholly owned subsidiary;" It was observed that while interest free loan to wholly owned subsidiary is exempted from the provisions of sub-section 3 of Section 372A of the Companies Act, 1956, the interest-free loan cannot be granted to Y Ltd.

		which is not a wholly-owned subsidiary of the company. It is contrary to the said requirements of the Companies Act, 1956.
8.	From the Annual Reports of some listed companies, it has been noted that the company had provided only the standalone financial statements although it had certain subsidiaries.	It may be noted that as per Clause 32 of the Listing Agreement, the publication of consolidated financial statements along with standalone financial statements of the company is mandatory. Accordingly, it was viewed if a company has subsidiary, it should also publish consolidated financial statements to comply with the requirements of Clause 32 of the listing agreement.

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Companies (Auditor's Report) Order (CARO), 2003

S. No.	Matters Contained in the relevant Annual Report	Observations of the Board
1.	While reporting in pursuance to the requirements of clauses 4 (i)(b) and (iv) of CARO, 2003, the auditor has expressed his opinion using the phrase 'we are informed' as reproduced below: "(i) (b) The Management has conducted physical verification of the fixed assets during the year and **we are informed** that discrepancies noticed were not material." "(iv) The company has maintained proper records showing full particulars including quantitative details and situation of fixed assets. **We are informed** that the fixed assets have been physically verified by the management at reasonable intervals and that no material discrepancies were noticed."	It may be noted that paragraph 45 (f) of the Institute's Statement on CARO, 2003, *interalia*, provides as follows: "...The Auditor has, therefore, to use his judgment to determine whether a discrepancy is material or not...." It was noted that the auditor has used the words "We are informed that…" which *prima facie* creates an impression that no documentary evidence was available to substantiate the verification and that the auditor has relied wholly on the management's representation. In other words, a duty has been cast upon the auditor to express his opinion and not just disclose the information given by the management. However, it was observed that the auditor may have simply relied on the explanation of the management and had not used his own judgment to comment on this paragraph. This is not as per the requirement of CARO, 2003. The

		reporting should have been, "According to the information furnished to us…" which would suggest that the auditor has formed his opinion based on the information furnished to him and that he has not merely relied on the information given to him by the management without forming his opinion.
2.	In pursuance to the requirements of clause 4(i)(b) of CARO, 2003, the auditor has reported as follows:- "Physical verification of the fixed assets is covered under a scheme of verification over a period of three years. No serious discrepancy was noticed on such verification during the period."	It may be noted that clause 4(i)(b) of CARO, 2003, requires the auditor to report on the following: *"Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account."* It was noted that although the auditor has provided his comment in context of period of verification and discrepancy, he has omitted to comment on the reasonableness of the frequency of physical verification of fixed assets as conducted by the management. Therefore, it was felt that the auditor has not strictly complied with the reporting of above-mentioned requirement of CARO, 2003.
3.	In pursuance to the requirements of clause 4(i)(b) of CARO, 2003,	It was noted that the requirements of clause 4(i)(b) of CARO, 2003,

	the auditor has reported as follows:- "The company has maintained proper records showing full particulars, including quantitative details and situation of fixed assets. According to the information and explanations given to us, most of the fixed assets have been physically verified by the management during the year. In our opinion, the frequency of such physical verification is reasonable having regard to the sizes of the company and the nature of its assets no material discrepancies were noticed on such verification **as compared to the available records**. There was no disposal of fixed assets during the year." (Emphasis added)	physical verification should be conducted and compared with properly 'maintained records' and not with 'available records'. The usage of phrase 'available records' is ambiguous. On the one hand, the auditor has stated that proper records have been maintained, on the other hand, he refers to 'available records' which leads to ambiguity. Such reporting should be avoided.
4.	In pursuance to the requirements of clause 4(ii)(c) of CARO, 2003, the auditor has reported as follows: "The company has maintained proper records of inventory. No material discrepancies were noticed on physical verification of inventory except as recorded by excise department as per note…" It has further been noted from the stated note that there is shortage of stock at few units of the company.	It was noted that clause 4(ii)(c) of CARO, 2003, *inter alia*, requires the auditor to comment on whether the discrepancies if any, noticed have been adequately dealt with. In the extant case, the auditor has reported on discrepancies indirectly by referring to the given note. However, he has omitted to comment on whether those discrepancies were properly dealt with in books of accounts. Hence, it was viewed that the auditor has not complied with reporting requirements specified in clause 4(ii) (c) of CARO 2003.
5.	In pursuance to the requirements	It may be noted that pursuant to

	of clause 4 (iii) (a) / (e) of CARO, 2003, the auditor has reported about the number of parties as well as the amount involved in the transaction of loans granted/ taken.	the requirement of clauses 4(iii) (a) and 4 (iii) (e) of CARO, paragraphs 50(f) and 54 (c) of the Institute's Statement on CARO, 2003 state as follows: "Apart from reporting the number of parties, the auditor is also required to disclose the "amounts involved. Since the Order does not clarify what constitutes "amount involved" it would be proper if the auditor discloses the **maximum amount involved** during the year in the transactions covered by this clause. While commenting upon this clause, the auditor may also consider whether the **year-end balance** should also be disclosed in his audit report." (emphasis added) It was noted that although an amount has been stated, it has not been disclosed whether the stated amount is the maximum amount involved or it is the year-end balance as per aforesaid requirements of clauses 4 (iii) (a) and (e) of CARO, 2003. Hence, it was viewed that the given report of the auditor cannot be considered to be complete. A separate disclosure of the maximum balance as well as the year-end balance should be made under the stated clauses.
6.	In pursuance to the requirement of clause 4 (iii) of CARO 2003	It was noted that although the auditor has commented on clauses

	the auditor has reported as follows: "(iii) The Company has not taken/granted any loans, secured or unsecured from/to Companies, firms or other parties listed in the register maintained under Section 301 of the Companies Act, 1956, except loans granted on current account to its subsidiaries, the rate of interest and terms and conditions were not prima-facie prejudicial to the interest of the Company. The outstanding dues as at the year end from Subsidiary Company amounted to Rs. XXX."	4 (iii) (a) and (b) of CARO, 2003 but he has omitted to comment on clause 4(iii)(c) which requires the auditor to report on: *"Whether receipt of the principal amount and interest are also regular."* Accordingly, it was viewed the reporting made in pursuance to clause 4(iii) of CARO, 2003 can not be considered to be complete.
7.	In pursuance to the requirements of clauses 4 (iii) (a) and (e) of CARO, 2003 the auditors have reported in either of the following ways: • There are loans given to the companies listed in the register maintained under section 301 of Companies Act, 1956, as there is no stipulation made for the repayment of loans, we are not in a position to make any specified comments. • According to the information and explanation given to us, there are companies or parties of the nature required to be covered in the register maintained under section 301	It was observed that while reporting pursuant to the requirements of clauses 4(iii) (a) and (e) of CARO, 2003, the auditor has simply stated that the company has granted/taken loans to the parties covered under Section 301 of the Companies Act, 1956 or directors of the company. The 'number of the parties' and 'amount involved in the transaction' have not been reported as required by clauses 4(iii) (a) and (e) of CARO, 2003. Hence, the requirements of CARO 2003 were considered to have not been strictly complied with.

	of the Companies Act, 1956 to whom the company has granted advances in the nature of loans. • The Company has not taken any loans secured or unsecured from the Companies covered in the register maintained under section 301 of the Act other than interest free unsecured loan from the Directors of the Company. The observations on the above are quite similar in all the cases as provided adjacent to them.	
8.	From the Annexure to the Auditor's Report of a company, it has been noted that the auditor has commented in pursuance to the requirements of clause 4 (iii) of CARO 2003 as follows: "Wherever interest has been stipulated, the rate of interest in respect of the aforesaid loans is prima facie not prejudicial to the interest of the Company. There are no other terms and conditions stipulated in respect of these loans."	It may be noted that clause 4(iii)(b) of CARO, 2003, requires the auditor to report on: *"Whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima facie prejudicial to the interest of the company."* It was noted that although the auditor has commented on loans wherein interest has been stipulated, he has omitted to comment on terms and conditions of loans wherein interest has not been stipulated. It was viewed that the auditor is supposed to report on all loans given to parties covered under section 301 of the

		Companies Act, 1956. Accordingly, the stated report was considered to be not in line with the requirements of clause 4(iii)(b) of CARO, 2003.
9.	In pursuance to the requirement of clause 4 (iii) (b) of CARO 2003, the auditor has reported as follows: "In case of outstanding amount from one of the subsidiaries, interest for the year has been waived by the Management. In our opinion and according to the information and explanations given to us, the rate of interest (on the loan other than the referred before) and other terms and conditions on which said loans have been granted are not, prima facie, prejudicial to the interest of the Company."	It was noted that reporting in pursuance to clause (4)(iii) (b) of CARO, 2003, the auditor should have explicitly stated as to whether waiver of interest from a subsidiary by the management is prejudicial to the interests of the company or not. Thus, the comment provided by auditor is considered to be ambiguous and not meeting the reporting requirements of CARO, 2003.
10.	In pursuance to the requirement of clause 4(iii)(c) of CARO, 2003, the auditor has reported as follows: "The Company is regular in repaying the principal amount."	It may be noted that as per clause 4(iii)(g) of CARO, 2003, the auditor is required to report on the following: *"Whether payment of the principle amount and the interest are also regular."* It was observed that under the stated clause the auditor is required to comment on the regularity of payment of principal amount and interest. However, the

		auditor, in the extant case, has reported on only one aspect. Accordingly, it was viewed that the auditor has not strictly complied with the reporting requirements of CARO, 2003.
11.	In pursuance to the requirements of clauses 4 (iii) (c) and (d) of CARO, 2003, the auditor has reported as follows: "(c) The parties to whom loans have been given by the Company are repaying the principal amounts as stipulated and interest thereon wherever applicable. (d) in case of overdue amounts exceeding Rs. 1 Lakh reasonable steps have been taken by the Company for recovery of the principal amount and interest thereon and necessary provisions have been made wherever such amounts appear to be doubtful of recovery;"	It was observed that the stated comments are providing contradictory information. It was viewed that if the parties are regular in repaying the principal as well as interest then question of overdue amounts does not arises. It was felt that the comments made by the auditor relating to clauses 4 (iii) (c) and (d) of CARO, 2003 are contradictory to each other. Such contradictory statements should be avoided.
12.	In pursuance to the requirements of clause 4 (iii) of CARO, 2003, it was noted that although the auditor had reported that the company had not granted or taken any loans, secured or unsecured to / from companies, firms or other parties in the register maintained u/s 301 of the Act, in pursuance to the other sub clauses of the stated clause,	It was viewed that the stated report is giving contradictory information which should be avoided.

	it has been reported to be not prejudicial to the interest of the company, payment of principal and interest were regular and overdue amounts did not exceed one lakh in any case.	
13.	In pursuance to the requirement of clause 4 (iii) of CARO, 2003 the auditor has reported that the company had not taken any loans, secured or unsecured, from companies, firms or other parties as covered in the register maintained under section 301 of the Companies Act, 1956 and hence, the provisions of other sub-clauses were not applicable on it. It has further been noted from the Schedule of Unsecured Loans that the company had taken unsecured loans from directors in previous year which were outstanding as at the end of the current year.	It may be noted that paragraph 50 (b) of the Institute's Statement on CARO, 2003 guides about the period of transactions that should be reported under the stated clause. It *interalia* states as follows: "50 (b) The auditor is required to disclose the requisite information in his report in respect of all parties covered in the register maintained under section 301 of the Act irrespective of the period to which such loan relates. The clause covers not only the loan granted during the year but covers all loans including opening balances…" Accordingly, it was viewed that reporting under the stated clause should not be restricted to the loans granted during the current year but should also report on loans granted in previous periods which are outstanding as at reporting date. It may be noted that by virtue of paragraph 54 (d) of CARO, 2003, similar reporting practice should be followed in context of loans taken also. Hence, it was viewed that the

		comments as provided by the auditor under the stated clause are incorrect.
14.	In pursuance to the requirements of clause 4 (iv) of CARO, 2003, the auditor often report in one of the following ways: • ... there are adequate **internal control procedures** commensurate with the size of the company… • In our opinion and according to the information and explanation given to us during the course of audit, there are adequate **internal control procedures** commensurate with the size of the company … • In our opinion and according to the information and explanations given to us, there are adequate **internal control procedures** commensurate with the size of the company and nature of its business with regard to the purchase of inventory and fixed assets and for the sale of goods… • In our opinion and according to the information and explanation given to us, there are adequate **internal control procedures** commensurate with the size of the Company and the nature of its business for the	It may be noted that as per clause 4(iv) of CARO, 2003, the auditor is required to report on the following: *"Is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system."* It was noted that the auditor has used the term '**Internal Control procedure**' instead of '**Internal Control System**'. It may further be noted that paragraph 57 (c) of the Institute's Statement on CARO, 2003 defines "Internal Control System" as "the **policies** and **procedures** (internal controls) adopted by the management of an entity to assist in achieving management's objective ..." It was accordingly, viewed that the 'System' refers to both 'policies' and 'procedures'. Thus, it is a broader term than the term 'procedures'. Therefore, reporting only on 'procedures' cannot be considered to comply with the reporting requirement of clause

	purchase of inventory and fixed assets … • In our opinion and according to the information and explanations given to us, there are adequate **internal control procedures** commensurate with the size and nature of the business for the purchase of plant and machinery equipment and other assets. During the course of our audit, we have not observed any continuing failure to correct major weaknesses in internal control. (emphasis added) The observations on the above are quite similar in all the cases as provided adjacent to them.	4(iv) of CARO, 2003.
15.	In pursuance to the requirements of clause 4 (iv) of CARO, 2003, the auditor has reported as follows:- "In our opinion and according to the information and explanation given to us during the course of audit, there are adequate internal control procedures commensurate with the size of the company and nature of its business with regard to the **purchase of inventory and fixed assets** ...". (emphasis added).	It may be noted that as per clause 4(iv) of CARO, 2003, the auditor is required to report on the following: *"Is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system."* It was noted that in the 'extant case', the auditor has only

		reported in context of purchases of inventory and fixed asset but has omitted to report on the adequacy of internal control system with respect to sale of goods and services. Accordingly, it was viewed that the reporting requirements of clause 4(iv) of CARO, 2003 has not been strictly complied with.
16.	In pursuance to the requirements of clause 4 (iv) of CARO, 2003, the auditors have reported in either of the following ways: • In our opinion, there is an adequate internal control procedure commensurate with the size of the Company and nature of business, for purchase and sale of stores, raw materials including components, plant and machinery, equipment and similar assets. • There are adequate internal control procedures commensurate with the size of the company and the nature of its business for the purchase of the stores raw materials, including components, plants and machinery, equipment and other assets and for the sale of the goods. • In our opinion and according	As per clause 4 (iv) of CARO, 2003, the auditor is required to comment on the following: *"Is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system."* It was noted that under the above mentioned clause the auditor is required to report on two aspects. The first aspect requires the auditor to comment on the adequacy of the internal controls in regard to purchase of inventory and fixed assets and for the sale of goods and services whereas the second aspect requires him to comment whether there was a continuing failure to correct major

	to the information and explanation given to us, there are adequate internal control procedures commensurate with the size of the Company and nature of its business. The observations on the above are quite similar in all the cases as provided adjacent to them.	weakness in such internal controls. It was viewed that since these two aspects are not related to each other, it cannot be construed that if no major weakness was reported during the period covered by the audit report, the internal control system is adequate. Thus, in all the reported cases, it was noted that whilst the auditors have commented on first part of clause 4 (iv) of CARO, 2003, they have omitted to report on the second aspect. Accordingly, it was viewed that the reporting requirement of clause 4(iv) of CARO, 2003 has not been complied with.
17.	In pursuance to the requirements of clause 4 (iv) of CARO, 2003, the auditor has reported as follows:- “The Company does not have any Inventory, therefore, the question of reporting does not arise.” However, it was further noted from the schedule of Balance Sheet that the company was holding the ‘stock in process’.	It was viewed that as per the definition of inventories as given in AS 2, Valuation of Inventories, ‘stock- in- process’ are a part of inventories, therefore, the stated auditor’s report on CARO was found to be in contradiction to the information given in the Balance Sheet. Such contradictions should be avoided.
18.	From the Notes to the Accounts given in the Annual Report of a company, it has been noted that the company has paid legal and professional fees to a firm in	It was noted that a contract to avail legal and professional services from a firm in which a director is interested falls within the purview of Section 299 of the Companies

	which a director is interested still the auditor has reported in pursuance to clause 4 (v) (a) of CARO, 2003 as follows: Further, the following has been noted from the Annexure to the Auditors' Report: "According to the information and explanations provided by the management, there has been no contract or arrangement the particulars of which are required to be entered into the register maintained under section 301 of the Companies Act, 1956."	Act, 1956. Accordingly, such a contract should have been entered in the register maintained under Section 301 of the Companies Act, 1956. Thus, the stated report was considered to be incorrect considering the information as contained in the financial statements.
19.	In pursuance to the requirement of clause 4(vi) of CARO, 2003 it has been noted that the auditor has reported on the compliance with the provisions of Sections 58A and 58AA of the Companies (Acceptance of Deposits) Rules, 1975 but has omitted to state on other relevant provisions of the Act and Rules framed there under.	It may be noted that pursuant to clause 4(vi) of CARO, 2003, an auditor is required to report on the following: *"In case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of sections 58A, 58AA or any other relevant provisions of the Act and the rules framed there under where applicable have been complied with. If not, the nature of contraventions should be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal, whether the same has been complied with or not."*

		It was noted that under the stated clause the auditor is also required to report in context of directives issued by the Reserve Bank of India and any other relevant provisions or rules framed there under. Accordingly, it was viewed that the auditor has not strictly complied with the reporting requirements of clause 4(vi) of CARO, 2003.
20.	From the Annexure to the Auditor's Report in the Annual Report of a listed company, it has been noted that the auditor has not given any comment in pursuance to the requirements of clause 4 (vii) of CARO, 2003.	It may be noted that pursuant to clause 4(vii) of CARO, 2003, an auditor is required to report on the following: *"In the case of listed companies and/or other companies having a paid-up capital and reserves exceeding Rs.50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business."* It was noted that although the shares of the company have been listed on few stock exchanges, the auditor had not reported on the stated clause.
21.	In pursuance to the requirement of clause 4(viii) of CARO, 2003,	It was noted from the Cost Accounting Record Rules that

	the auditor has stated as follows: "As informed to us, the Central Government has not prescribed maintenance of cost records by small scale industry unit..."	these rules apply to all companies engaged in production, processing, manufacturing or mining activities, in respect of industries or products specified in the Cost Accounting Record Rules. However, it also mentions that these rules do not apply to a company – "wherein, the aggregate value of machinery and plant installed as on the last date of the preceding financial year, does not exceed the limit as specified for a small scale industrial undertaking under the provisions of Industries (Development and Regulation) Act, 1951 (65 of 1951); and the aggregate value of the turnover made by the company from sale or supply of all its products or activities during the preceding financial year does not exceed ten crores of rupees." It was noted from the figures of previous year as given in the financial statements that the aggregate value of investment made in plant and machinery and turnover as at the end of immediately preceding financial year exceed the specified limit of Rs. 1 crore and Rs. 10 crores respectively. Further, it was also noted that the company was engaged in the industry on which Cost Accounting Record Rules

		were applicable. Accordingly, it was viewed that the company under review does not fall within definition of SSI and thus the fact stated in the report was not correct.
22.	In the Annexures to the Auditor's Reports of some companies, it has been noted from the reports given in context of clause 4 (ix)(a) of CARO, 2003 that while commenting on regularity of depositing undisputed statutory dues, although the amount due for a period of more than six months has been mentioned, the name of the statute, nature of amount due and period to which it relates has not been reported.	It may be noted that pursuant to clause 4 (ix)(a) of CARO, 2003, the auditor is required to report on the following: *"Is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income Tax, Sales Tax, Wealth Tax, Service Tax, Custom Duty, Excise Duty, Cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor."* Further, it was observed that pursuant to the aforesaid requirements, paragraph 63(r) of Statement on the Companies (Auditor's Report) Order, 2003, issued by the Institute states that the information required under this clause be reported in the following format:

<table>
<tr>
<td></td>
<td></td>
<td>
Statement of Arrears of Statutory Dues Outstanding for More than Six Months
<table>
<tr>
<th>Name of the Statute</th>
<th>Nature of the Dues</th>
<th>Amount (Rs.)</th>
<th>Period to which the amount relates</th>
<th>Due date</th>
<th>Date of payment</th>
</tr>
</table>
Accordingly, it was viewed that as per the given format the name of the statute, nature of amount due and period to which such dues relate should also be disclosed.
</td>
</tr>
<tr>
<td>23.</td>
<td>
In pursuance to the requirement of clause 4(ix)(a) of CARO, 2003 the auditor has reported as follows:
"The company is regular in depositing undisputed statutory dues including Provident fund, investor education and protection fund, employees state Insurance, income tax, sales tax, wealth tax, custom duty, excise duty, Cess and other statutory dues with the appropriate authorities. Late deposit if any has been reported in the Form 3CD attached."
</td>
<td>It was noted that whereas CARO, 2003 requires disclosure of amount which are in arrears for the period of more than 6 months from the date they became payable the auditor has simply reported the means i.e. Form 3CD where such information is available. It was further viewed that Form 3CD is part of the Tax Audit Report and hence the requisite information was neither available in CARO report nor in the financial statements attached to it. Accordingly, it was viewed that the auditor has not complied with the reporting requirements of clause 4 (ix) (a) of CARO, 2003.</td>
</tr>
<tr>
<td>24.</td>
<td>In pursuance to the requirement of clause 4(ix)(a) of CARO, 2003 some auditors have reported as</td>
<td>It was noted that under clause 4 (ix) (a) the statement prescribes to report in context of dues payable</td>
</tr>
</table>

	follows: • The Company has been regular in depositing undisputed statutory dues, including Provident Fund, Employees State Insurance, Income Tax, Sales Tax, Customs Duty, Excise Duty, Cess and other statutory dues with the appropriate authorities during the year. • The company has been regular during the year in depositing undisputed dues with Provident Fund, Employees State Insurance, Income Tax, Sales Tax, Excise Duty and other statutory dues with the appropriate authorities. The observation of the above are quite similar in all the cases as provided adjacent to them.	under various laws which have also been explicitly stated in the said clause. From the given cases, it was viewed that the auditor has not reported on the regularity of depositing undisputed dues towards Investor Education and Protection Fund, Wealth tax and Service Tax. It was felt that in case, if the company is not regular in depositing these dues, the auditor should have reported on them. Hence, it was viewed that the auditor has not provided complete comment with respect to the requirements of clause 4(ix) (a) of CARO, 2003.
25.	In pursuance to the requirements of clause 4(ix) of CARO, 2003, it has been noted that the auditor has reported only in context of undisputed statutory dues and is silent on disputed statutory dues.	It was noted that in pursuance to the requirement of clauses 4(ix)(a) and (b) of CARO, 2003 the auditor is required to report in context of undisputed statutory dues and certain specific statutory dues that have not been deposited on account of dispute. It was viewed that the auditor should report on both of them. If there are no dues which have not been deposited on account of dispute then the auditor should explicitly report it under relevant clause rather than being silent on it. Omission of such

<table>
<tr><td></td><td></td><td>information is a non-compliance of the requirements of CARO, 2003.</td></tr>
<tr><td>26.</td><td>In pursuance to the requirements of clause 4 (ix) (b) of CARO, 2003, the auditor has reported only the amount of disputed statutory dues that has not been deposited on account of disputed but omit to report the forum and the period to which the amounts relates.</td><td>It may be noted that clause 4(ix)(b) of CARO, 2003, requires an auditor to report on the following:

"In case dues of Income tax/sales tax/service tax/custom duty/wealth tax/excise duty/cess have not been deposited on account of any dispute, then the amount involved and the forum where dispute is pending shall be mentioned."

Further, it was noted that pursuant to the aforesaid requirements, paragraph 64(g) of the Statement on Companies (Auditor's Report) Order, 2003 issued by the Institute states that the information required under this clause may be reported in the following format:

Statement of Disputed Dues
<table>
<tr><th>Name of the Statute</th><th>Nature of the Dues</th><th>Amount (Rs.)</th><th>Period to which the amount relates</th><th>Forum where dispute is pending</th></tr>
</table>

Accordingly, it was viewed that the members are advised that they should also report other details as suggested in the given format for the disputed statutory dues.</td></tr>
<tr><td>27.</td><td>From the auditor's report given in pursuance to the requirement of</td><td>It was noted that such contradictory information should</td></tr>
</table>

	paragraph (ix) (b) of CARO, 2003, it has been noted that at one place, the auditor has mentioned that there were no dispute on account of any statutory dues that were outstanding and simultaneously he has also furnished the details of disputed statutory dues that were not deposited till then.	be avoided.
28.	In pursuance to the requirement of clause 4(ix)(b) of CARO, 2003, the auditor has reported as follows: "Disputed excise duty demand has not been provided for, as the same being found not justified, stands stayed by the Customs, Excise and Service Tax Appellate Tribunal."	It was viewed that obtaining stay from a court of law against any demand of any statutory authority does not mean that the demand is annulled. Clause 4(ix)(b) of CARO, 2003 requires the disclosure in respect of statutory dues that have not been deposited on account of any dispute. In the extant case, it *prima facie* appears that there is a dispute on the amount of excise duty which should have been reported under clause 4(ix)(b) of CARO,2003.
29.	In pursuance to the requirement of clause 4(x) of CARO, 2003 the auditor's often report in the following manner: • As per records of the Company, the accumulated losses of the Company are more than fifty percent of its net worth. The Company has incurred cash losses during the current financial year. • The company has no accumulated and cash losses at the end of the	It may be noted that clause 4(x) of CARO, 2003 states as follows: *"Whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year* ***and in the immediately preceding financial year***." (Emphasis added) From the above, it was noted that

	financial year. The observations on the above are quite similar in all the cases as provided adjacent to them.	the auditor is required to report in context of accumulated losses as well as cash losses wherein the latter is to be reported for current financial year as well as immediately preceding year. In the stated cases, it was noted that the auditors have reported with regard to current financial year but have omitted to report about the status of cash losses **in the immediately preceding financial year** as required by clause 4(x) of CARO, 2003. Further, it was also noted that although the auditors have reported in context of accumulated losses but have omitted to report whether such losses were less than 50% of its net worth or not. Accordingly, it was viewed that in the said cases the auditors have not complied with the reporting requirements of clause 4 (x) of CARO, 2003.
30.	In pursuance to the requirement of clause 4(xii) of CARO, 2003 the auditor has reported as follows: "As informed to us, the Company had given Rs. XXX to certain companies under escrow agreements against which the original share certificates of the	It may be noted that clause 4(xii) of CARO, 2003 provides as follows: *"Whether adequate documents and records are maintained in cases where the company has granted loans* and advances *on the basis of security by way of pledge of shares, debentures and*

	face value of Rs. XXX had been deposited with the Company. As these shares had been suspended for trading for which the Company was required to relist the shares after reduction of share capital from Rs. xxx to Rs. xx each, the market value on 31.03.08 could not be determined. The value of the shares on the last traded date on 09.01.2008 was Rs. XX lacs. Out of the above, the advances amounting to Rs. XXX are given to the Companies under liquidation."	*other securities; If not, the deficiencies to be pointed out."* It was noted that the auditor has provided the information on adequacy of security rather than commenting on adequacy of maintenance of documents and records and deficiencies, if any, for required cases where the company has granted loans and advances against security by way of pledge of shares, debenture and other securities. Such reporting cannot be considered to be a sufficient compliance of stated clause.
31.	In pursuance to the requirement of clause 4(xv) of the CARO, 2003, the auditor has reported as follows: "According to the information and explanations given to us, the Company has not given any guarantee for loans taken by its subsidiaries and associates from banks or financial institutions."	It may be noted that clause 4(xv) of CARO,2003 requires an auditor to comment on the following: *"Whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company."* It was noted that in the stated report, the auditor has provided his comments only for guarantee for loans taken by its subsidiaries and associates, but he has not reported on any guarantee, if given, for loans taken by parties other than subsidiaries and associates. Accordingly, the auditor's report in context of clause 4(xv) of CARO,

		2003 is considered to be incomplete.
32.	In pursuance to the requirement of clause 4(xvii) of CARO, 2003, the auditor has reported as follows: "According to the information and explanations given to us and on an overall examination of the Balance Sheet of the Company, we report that temporary short-term funds have been used for long-term investment."	It may be noted that pursuant to clause 4(xvii) of CARO, 2003 an auditor is required to report on the following: *"Whether the funds raised on short-term basis have been used for long-term investment. If yes,* ***the nature and amount is to be indicated.****" (Emphasis added.)* It was observed that if short-term funds have been used for long-term investment, the auditor should also report the **nature and amount** of short-term funds that have been so deployed. Therefore, the comment, so provided, cannot be considered to be providing complete in context of proviso of clause 4(xvii) of CARO, 2003.
33.	In pursuance to the requirement of clause 4(xviii) of CARO, 2003, the auditor has reported as follows: 3. "According to the information and explanation given to us, the company had made the preferential allotment of shares to parties and companies covered in the register maintained under section 301 of the Act, i.e. as under. XYZ Pvt. Ltd. 11,00,000 Shares"	It may be noted that as per clause 4(xviii) of CARO,2003, the auditor is required to report as follows: "*Whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under section 301 of the Act, and if so whether the price at which shares have been issued is prejudicial to the interest of the company."* It was observed that the auditor

		has, in extant case, not reported on the second aspect of the clause i.e. as to whether the price at which such shares had been issued was prejudicial to the interest of the company. Therefore, it was felt that the auditor has not properly complied with the requirements of clause 4(xviii) of CARO, 2003.
34.	From the Annual Report of a company, it has been noted that certain debentures have been issued against which security has been created by mortgaging the assets of the company. However, the auditor has not reported on clause 4 (xix) of CARO, 2003.	It may be noted that clause 4(xix) of CARO, 2003, requires as auditor to report on the following: *"Whether security or charge has been created in respect of debentures issued?"* It was noted that firstly the auditor should report on each and every clause of CARO, 2003. Further, in the extant case, from the information available in the financial statement, it is evident that the stated clause was applicable on the company. Therefore, not reporting on it is a non-compliance of clause 4(xix) of CARO, 2003.
35.	In pursuance to the requirement of clause 4(xxi) of CARO, 2003, it was noted that some auditor's have reported as follows: ▪ According to the information and explanations given to us, no fraud on or by the	It was noted that the use of words 'during the course of our audit' indicates that the scope of the auditor was restricted only to frauds noticed or reported ***during the course of his audit***, whereas the auditor is required to report on any fraud noticed or reported on or

	company has been noticed or reported **during the course of our audit."** ▪ According to the information and explanations given to us, we report that no material fraud on or by the Company has been noticed or reported **during the course of audit."** (Emphasis added) The observations on the above are quite similar in all the cases as provided adjacent to them.	by the company ***during the year***. Accordingly, it was viewed that in extant case the auditor has not strictly complied with requirements of clause 4 (xxi) of CARO, 2003.
36.	In pursuance to the requirement of clause 4 (xxi) of CARO, 2003, the auditor has reported as follows: "In our opinion and according to the information and explanations given to us, no fraud on or by the company has been noticed or reported during the year, that causes the financial statements to be materially misstated".	It was noted that in the stated report, the auditor has given a conditional statement by reporting that if frauds have occurred, they do not materially misstate the financial statements. In other words, it appears that frauds have occurred for which he should have stated the nature of fraud and the amount involved as required under clause 4(xxi) of CARO, 2003.
37.	In one of the paragraphs in the Annexure to Auditor's Report, the auditor has referred to CARO, 2003 as "issued by the **Company Law Board** in terms of Section 227 (4A) of the Companies Act, 1956." (Emphasis added)	It may be noted that CARO, 2003 has been issued by the Central Government and not by the Company Law Board. It was viewed that such types of mistakes should be avoided.

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Observations on Standard on Auditing (SA) 700: The Auditor's Report on Financial Statements[8]

S. No.	Matter contained in Annual Report	Observations
1.	From the Annual Report of a company, it has been noted that the auditor has signed the Auditors' Report prior to the date when the financial statements were signed and authenticated by the directors of the company.	It was felt that this is not in line with the requirement of paragraph 26 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', which provides as follows: "26. Since the Auditor's responsibility is to report on the financial statements as prepared and presented by the management, the auditor should not date the report earlier than that the date on which the financial statements are signed or approved by management."
2.	In the Auditor's Report given on the financial statement of a company, while mentioning his membership number 'F' is prefixed to it.	It may be noted that paragraph 28 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', provides as follows: "28. The report should be signed by the auditor in his personal name. Where the firm is appointed as the auditor, the

[8] Subsequent to the observations of the Board, Standard on Auditing (SA) 700: The Auditors Report on Financial Statements has been split into three standards, namely– SA 700 (Revised), Forming an Opinion and Reporting on Financial Statements, SA 705, Modifications to the Opinion in the Independent Auditor's Report and SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report which is effective for audits of financial statements for periods beginning on or after April 01, 2011.

		report should be signed in the personal name of the auditor and in the name of the audit firm. The partner/proprietor signing the audit report should also mention the membership number assigned by the Institute of Chartered Accountants of India." It was noted that neither the Institute allots Membership Number to its members with any prefix like 'F' or 'A' nor SA 700 permits the use of such prefixes with the membership number in the Auditors' Report. Accordingly, such presentation of membership number was considered to be not in line with SA 700.
3.	From the Auditors' Report of a company, it has been noted that Opening paragraphs of the Auditors Report states to have "**examined** the attached Balance Sheet" (Emphasis added).	It was observed that the auditor in the extant case has stated to have 'examined' the financial statements instead of having 'audited' the same. It was felt that the term 'examined' signifies wider function than the actual responsibility of the auditor. It may, further, be noted that as per illustrative Auditor's Report given in paragraph 30 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', opening paragraph is suggested to be reported as follows: "30. We have **audited** the attached Balance Sheet of…" (Emphasis added) Accordingly, it was felt that the

		auditor should have used the word 'audited' rather than using the word 'examined' to reflect his correct responsibility.
4.	From the Auditors' Report of a company, it has been noted that the report was not addressed to anyone.	It was felt that it is not in line with the requirement of paragraph 8 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', which provides as follows: "8. The auditor's report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the auditor's report is addressed to the authority appointing the auditor." It was viewed that in a company, the members appoint the auditor hence, the Auditors' Report should be addressed to the members of the company.
5.	From the Annual Reports of some companies, it has been noted that membership number of the auditor was neither mentioned in the Auditor's Report nor in the Annexure to the Auditors' Report prepared in pursuance to Section 227(4A) of the Companies Act, 1956. In other cases, it was noted that the membership number of the auditor was not mentioned in the Balance Sheet and/or the Profit and Loss Account of the companies.	It may be noted that paragraph 28 of the Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', and provides that the report should be signed by the auditor in his personal name. Where the firm is appointed as the auditor, the report should be signed in the personal name of the auditor and in the name of the audit firm. The partner/proprietor signing the audit report should also mention the membership number assigned by the Institute of Chartered Accountants of

		India. Therefore, it was viewed that the auditor should mention his membership number assigned by the Institute while signing the Auditors' Report. Further, it was noted that as per Section 216 of the Companies Act, 1956, the Balance Sheet and the Profit and Loss Account are the documents attached/annexed to the Auditors' Report. Accordingly, it was viewed that since the Balance Sheet and the Profit and Loss Account are attached to the Auditor's Report and it contains opinion on the Balance Sheet and the Profit and Loss Account, the auditor should have also signed and authenticated these statements also in a similar manner, i.e. with his membership no.
6.	From the Auditors' Report given in the Annual Report of some companies, it has been noted that although the auditors had properly reported in context of the Balance Sheet and the Profit and Loss Account of the company in the Auditor's Report no reference was made to the Cash Flow Statement in the same. Further, in other cases, it was noted that although the Auditors' Report referred to the Cash Flow Statement in the opening or the introductory paragraph of the	It may be noted that paragraph 9 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', provides as follows: **"9. The auditor's report should identify the financial statements of the entity that have been audited, including the date of and period covered by the financial statements."** It may also be noted that the term 'financial statements' as used in paragraph 9 of SA 700, has further been clarified vide a footnote which

	Auditors' Report, the opinion paragraph omitted to report on it.	states that: "The Council of the Institute has made Accounting Standard (AS) 3, Cash Flow Statements, mandatory for certain entities in respect of accounting periods commencing on or after 1.4.2001. Further, the Council has also decided that AS 3 should also be treated as a "specified" accounting standard for the purpose of section 211 of the Companies Act, 1956 thereby making the Cash Flow Statements a part of the Balance Sheet and Profit and Loss Account. However, irrespective of the fact that the cash flow statement is considered to be a part of the Balance Sheet and Profit and Loss Account, the opening or the introductory paragraph of the auditor's report on financial statements of such companies and other entities for which AS 3 has been made mandatory, would also identify the Cash Flow Statement as a part of the financial statements audited apart from the Balance Sheet and the Profit & Loss Account. Similar reporting considerations would also apply to the entities which, though not required to comply with AS 3 in view of its not being mandatory for them, voluntarily prepare the cash flow statements. Further, in the above mentioned cases, *the auditor's report on financial statements would also contain an expression of opinion on the true and fair view of*

		<u>the cash flows for the period under audit</u> (refer to Appendix for an illustrative Auditor's Report on the financial statements in the case of a company for which AS 3 has been made mandatory)". (Emphasis added) In view of above, it was observed that the Auditors' Report on financial statements should not only contain reference to the Cash Flow Statement in its opening and introductory paragraph but also expresses opinion on the Cash Flow Statement for the period under audit. Accordingly, it was viewed that the reporting by the auditors in the said cases is not complete as per the requirements of SA 700.
7.	From the Auditors' Report given in the Annual Reports of some companies, it has been noted that although the auditors had qualified their report with regard to the non-compliance of certain accounting standards; but omitted to report the quantification of the possible effect either individually or in aggregate.	It may be noted that paragraph 41 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', provides as follows: "41. Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report. In circumstances where it is not practicable to quantify the effect of

		modifications made in the audit report accurately, the auditor may do so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements." From the above, it was viewed that while expressing opinions other than unqualified, the auditor should report the reasons for expressing such opinion and should also report the quantitative impact on the financial statements of each of such reason individually as well as aggregate. Where it was not practicable to quantify the same, the auditor should have quantified the same based on the estimates provided by the management. However, it was observed from the Auditors' Report that although the auditor had expressed qualified opinion, the quantification of the possible impact of the same on financial statements had not been disclosed as required by paragraph 41 of SA 700. In the absence of such information, it was viewed the Auditor's Report

		cannot be considered as complete and in line with the requirements of SA 700.
8.	While expressing opinion in the Auditors' Report of some companies the auditors often omit to state whether the statements prepared are in conformity with the financial reporting framework and statutory requirement relevant to the company as illustrated below: "In our opinion and to the best of our information and according to the explanation given to us, the said accounts read with the notes thereon, give the information required by the Companies Act, 1956 in the manner so required and give a true and fair view…"	It may be noted that paragraph 20 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', provides as follows: "20. The opinion paragraph of the auditor's report should clearly indicate the financial reporting framework used to prepare the financial statements and state the auditor's opinion as to whether the financial statements give a true and fair view in accordance with that financial reporting framework and, where appropriate, whether the financial statements comply with the statutory requirements." Further, it was noted that the Opinion Paragraph of the Auditors' Report as illustrated under paragraph 23 of SA 700 recommends the auditor to report as follows: "In our opinion and to the best of our information and according to the explanations given to us, the financial statements give and true a fair view *in conformity with the accounting principles generally accepted in India … (emphasis added)"*

		It was observed from the given Auditors' Reports of the companies that although the auditor had reported that the said accounts give the information required by the Companies Act, 1956, in the manner so required and give true and fair view but omitted to state as to whether such statements of accounts are in conformity with the accounting principles generally accepted in India. Accordingly, the stated reports were considered to be incomplete.
9.	From the Auditor's report on the financial statement of a company, it has been noted that the auditor had expressed opinion on the Balance Sheet, the Profit and Loss Account as well as on the accounts of the company 'subject to a note' stating change in an accounting policy.	It was noted from the given Auditors' Report that the auditors had repeatedly used the phrase 'subject to the note on change in method of depreciation' in various paragraphs of their report while expressing opinion on the financial statements of the company. It was further observed from Notes of the Accounts that although the company had made sufficient disclosure about the change in the method of depreciation during the year under audit, still the auditor expressed opinion subject to the note relating to change in depreciation method, which raises doubt on the note. It was felt that perhaps the auditors were not in agreement with the management for change in depreciation method; in that case, the subject matter of qualification is ambiguous or otherwise the usage of the phrase

		"subject to" is improper in the extant case. Hence, the expression of opinion by the auditors was observed to be neither clear nor in line with the requirement of paragraph 4, 29 or 38 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', as reproduced below: "4. The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole." "29. An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements…." "38. A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or limitation on scope is not so material and pervasive as to require a disclaimer of opinion. A qualified opinion should be expressed as being 'subject to' or 'except for' the effects of the

		matter to which the qualification relates.”
10.	The opening paragraph of the Auditors’ Report given in the Annual Report of a company states as follows: “We have audited the attached Balance Sheet of X Ltd. as at 31st March, XXXX and Profit & Loss Account for the year ended on that date annexed thereto. These financial statements are the responsibility of the Company's Management...”	It may be noted that paragraph 10 of Standards on Auditing (SA) 700, ‘The Auditor’s Report on Financial Statements’, provides as follows: **“10. The report should include a statement that the financial statements are the responsibility of the entity's management and a statement that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.”** It was noted from the Auditors’ Report that although the auditors had stated in the opening paragraph that the financial statements are the responsibility of the company’s management, they omitted to state that it is their responsibility to express an opinion on the financial statements based on the audit as required by paragraph 10 of SA 700.
11.	From the Auditors’ Report given in the Annual Report of a company, it has been noted that the auditors had qualified their report with regard to non-provision for debtors against which legal cases had been filed by the Company as well as for non-confirmation/non-reconciliation of certain debit/credit balances which may consequently impact revenue; however, as per the auditor such impact was not	It may be noted that Section 227(3)(e) of the Companies Act 1956, provides as follows: “227… 3. The auditors’ report shall also state- … (e) in thick type or in italic the observations or comments of the auditors which have any adverse effect on the functioning of the

	ascertainable.	company." It was observed that the stated qualifications/ comments may have an adverse effect on the functioning of the company, therefore, as per the aforesaid provision, it should have been written in thick/italic type. Thus, presenting such information in normal font cannot be considered to be correct auditor's report.
12.	From the Auditors report read with Annexure to Auditors Report as well as Notes to Accounts as given in the Annual Report of a Company, it has been noted that the auditor had reported that proper books of accounts have been maintained by the company subject to a paragraph of annexure to auditors report. In that paragraph, it had been reported that the auditor had broadly reviewed subject to one of the notes to accounts and non maintenance of proper inventory records at certain units. In the notes to accounts, it was stated that in the accounts of one of its units, various errors and inconsistencies have crept in, mainly in the areas of production and material accounting, valuation of inventories, creation of masters etc.	It was noted from paragraph 38 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', which *interalia*, provides as follows: "38. …A qualified opinion should be expressed as being 'subject to' or 'except for' the effects of the matter to which the qualification relates." It was noted from the Auditor's Report that the qualification with regard to non-maintenance of proper books of account, had not been specifically provided for. It was viewed that auditors should have qualified their report by specifically mentioning that note rather than routing it through various reports.
13.	One of the paragraphs of the	It may be noted that paragraph 38 of

	Auditors' Report given in the Annual Report of a company had drawn attention to the fact that the amounts recoverable from X Ltd. were doubtful, but the company had not provided for the same. Accordingly, the reported loss was understated by Rs. xxx lacs and Loans and Advances were overstated to that extent.	Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', provides as follows : "38. A *qualified opinion* should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or limitation on scope is not so material and pervasive as to require a disclaimer of opinion. A qualified opinion should be expressed as being 'subject to' or 'except for' the effects of the matter to which the qualification relates." It was observed that SA 700 prescribes that in case, an unqualified opinion cannot be expressed and the effect of any disagreement is not so material than the auditor should express a qualified opinion. In the extant case, the Auditors' Report states that a significant amount was considered to be irrecoverable; however, the auditors selected to only draw attention of the readers to that fact instead of expressing a qualified opinion. It was viewed that mere statement of fact does not mitigate his reporting obligation. Hence, expressing such opinion was considered to be not in line with the

		requirements of paragraph 38 of SA 700.
14.	From the Auditor's Report of companies, it is often noted that the auditors express their opinion on financial statement "Subject to accounting policies and notes to accounts" despite the fact that such reports do not contain any facts indicating qualified opinion.	It was viewed that firstly accounting policies and notes to accounts are integral part of financial statements. An auditor is supposed to give his independent opinion on the entire set. He cannot express an unqualified opinion making it subject to all accounting policies and notes to accounts. Such reporting raises doubt in the mind of the reader. Further, SA 700 prescribes the situation when the opinion can be expressed as "subject to" given in paragraph 38 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements'.
15.	While expressing qualified opinion on the financial statement, an abstract of Auditors' Report reads as follows: "Provision in respect of work done on sub-contracts is made on an estimated basis in respect of jobs in progress. The Company has a policy of recognising revenue on proportionate completion method as referred to in Significant Accounting Policies, on the basis of estimates and percentage of completion arrived at by the Company, we have relied the same being technical in nature. …subject to above points give a true and fair view…"	It may be noted that paragraph 41 of Standards on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', which states as follows: "41. Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report. In circumstances where it is not practicable to quantify the effect of modifications made in the audit report accurately, the auditor may do

		so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements". It was noted that the auditors had qualified the report for use of estimates in respect of jobs in progress as for recognising the revenue on the basis of estimates and percentage of completion. It was viewed that the auditors had qualified the report without providing a clear description of all the substantive reasons for qualifying the report, which is not in line with the requirement of paragraph 41 of SA 700. Further, it was observed that the quantification of the possible impact on the financial statements is also not reported which is again not in line with the requirement of paragraph 41 of SA 700.
16.	From the Annual Report of a company, it was noted that although there were several non-compliances in context of the	It may be noted that paragraph 20 of Standard on Auditing (SA) 700, 'The Auditor's Report on Financial Statements', provides as follows:

	requirements of Accounting Standards, notified under the Companies (Accounting Standards) Rules, 2006, the auditor had expressed that financial statements had complied with all the accounting standards.	"20. The opinion paragraph of the auditor's report should clearly indicate the financial reporting framework used to prepare the financial statements and state the auditor's opinion as to whether the financial statements give a true and fair view in accordance with that financial reporting framework, and where appropriate, whether the financial statements comply with statutory requirements." At times, it has been noted that although there are several non-compliances of various accounting standards which may have material impact on 'true and fair' view of the financial statement, still, auditors have reported as follows: "In our opinion, the balance sheet, profit and loss account and cash flow statement dealt with by this report comply with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956." and give an unqualified opinion. It was viewed that giving such information is wrong and it is a non-compliance of SA 700.