# A STUDY ON COMPLIANCE OF FINANCIAL REPORTING REQUIREMENTS

Financial Reporting Review Board

**The Institute of Chartered Accountants of India**

*(Set up by an Act of Parliament)*

**New Delhi**

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| Edition | : | January 2010 |
| Committee/ Department | : | Financial Reporting Review Board |
| Email | : | frrb@icai.org |
| Website | : | www.icai.org |
| Price | : | Rs. 225 |
| ISBN | : | 978-81-8441-300-7 |
| Published by | : | The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Box No. 7100, Indraprastha Marg, New Delhi-110 002 |
| Printed at | : | Sahitya Bhawan Publications, Hospital Road, Agra-282 003. January/2010/1,000 Copies |

# Foreword

As a proactive measure to check the compliance level with the Generally Accepted Accounting Principles and Generally Accepted Auditing Principles, the Institute through the Financial Reporting Review Board (FRRB) has been reviewing the general purpose financial statements of certain enterprises and auditors' report thereon.

Continuing with its rich tradition of maintaining integrity and independence, the Institute has been referring the instances of material non-compliances on the part of the Management of those enterprises to the appropriate Regulators. The Institute has also been taking the disciplinary action against the auditors, if there are material non-compliances on the part of the auditors of the concerned enterprise.

I am glad to note that the FRRB has brought out this publication containing pertinent observations of the Board during the review process focusing on Accounting Standards, Schedule – VI of Companies Act, 1956 and CARO – 2003. It is my sincere hope that this endeavour of the FRRB would be another step in the right direction to further improve the overall quality of external financial reporting.

I am sure that this publication would be extremely beneficial not only to the members of the Institute but also to others concerned.

January 12, 2010 **CA. Uttam Prakash Agarwal**
New Delhi *President*

# Preface

It is my sincere belief that a regulatory framework – like GAAPs apart from prescribing the regulatory requirements have to ensure effective and efficient compliance with the prescriptions and continuously educate all, the concerned, about the need of such effective and efficient compliance.

The Financial Reporting Review Board (FRRB) apart from publishing the major non-compliances observed by it in the journal of the Institute, has started taking other initiatives such as Workshops and Training Programmes to sensitise the enterprises as well as the auditing community at large about the areas wherein the compliance level need to be improved.

I believe such an interactive communication by way of dissemination of the instances of non-compliance with the regulatory requirement would go a long way in improving the overall quality of financial reporting. It is my pleasant privilege before the members of the Institute and others concerned to present this publication containing pertinent observations of the Board on compliance aspects of various Financial Reporting Requirements. The said observations of the FRRB have been classified according to the Accounting Standards, Schedule – VI of Companies Act, 1956 and CARO – 2003 for easy reference and appreciation of issues involved.

I wish to place on record my sincere gratitude to the Past Chairman of the Board, CA. Jayant Gokhale, who had initiated this publication, and members of the FRRB, both past and present members, for their valuable inputs during the meeting which has become basis of the publication. 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.

January 12, 2010
New Delhi

**CA. Mahesh P Sarda**
*Chairman*
Financial Reporting Review Board

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# 1
# INTRODUCTION

The Institute of Chartered Accountants of India, continuing with its endeavours to improve the financial reporting practices in the country, has constituted the Financial Reporting Review Board (FRRB). The Board reviews the general-purpose financial statements of the enterprises with a view to determine, to the extent possible:

(a) Compliance with the generally accepted accounting principles in the preparation and presentation of the financial statements;

(b) Compliance with the disclosure requirements prescribed by the regulatory bodies, statutes and rules and regulations relevant to the enterprise and

(c) Compliance with the reporting obligation of the enterprise as well as the auditors.

As per the Terms of Reference of the Board, in case of material non-compliance and/or non-compliance affecting the true and fair view of financial statements, the Board refers the case to the Director (Discipline) of the Institute of Chartered Accountants of India for initiating action against the auditor under the Chartered Accountants Act, 1949. Insofar as the management of the enterprise is concerned, pending the grant of relevant powers to the FRRB by the Government of India, the FRRB would inform irregularity to the regulatory body relevant to the enterprise.

This publication has been compiled from the records of FRRB and contains pertinent observations of the Board on compliance aspects of various Financial Reporting Requirements. This is an initiative of the Board to enhance the knowledge of preparers of the financial statements and auditors through this publication. Readers should

make a note of the observations of Board in the overall interest of maintaining sound external financial reporting and to promote the interests of the stakeholders of the enterprise.

It may be mentioned that the present study represents collection of the observations in the review proceedings conducted by the Board. Further, these observations are based on the information contained in the general-purpose financial statements of an enterprise for a particular Financial Year and the auditor's report thereon and were made keeping in mind the applicable Accounting, Auditing Standards and Guidance Notes; and relevant Laws and Statutes in force for that particular Financial Year. The observations must, therefore, be read in the light of any subsequent amendments and/ or other developments.

This publication is intended for general guidance only. Readers are presumed to have a thorough understanding of the relevant pronouncements and should refer to the text of the pronouncements, as necessary, in considering particular observation. It is not a substitute for an understanding of the relevant pronouncements themselves and the exercise of judgement. It is stressed that the original pronouncements must be referred to for the exact and complete requirements. The Institute does not accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material contained in this publication.

# 2
# A STUDY ON COMPLIANCE OF FINANCIAL REPORTING REQUIREMENTS

(Compiled from the records of Financial Reporting Review Board)

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

| S. No. | Matter contained in Annual Report | Observations |
|---|---|---|
| 1. | In the Annual Reports of the Companies for the Financial Years 2002-03/2003-04, accounting policy regarding sales provided as below, the observations on the same are quite similar as provided adjacent to them:<br>■ Revenue is recognised in the books on the basis as stipulated under AS 9 issued by ICAI.<br>■ Sales include Excise Duty but exclude Sales Tax. Export sales are accounted at F.O.B. Value.<br>Sales, other than export sales, are inclusive of excise duty and shown net of returns and discounts. | It was noted that the accounting policies do not indicate the timing of recognition of revenue.<br>It was also felt that the policy regarding timing of recognition of revenue arising from sales, interest, royalty or dividend would be one of the most important accounting policies for any organisation. However, the companies have not disclosed the same, which is contrary to AS 1, Disclosure of Accounting Policies. |

| S. No. | Matter contained in Annual Report | Observations |
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| 2. | In one of the Schedules to the Balance Sheet regarding Closing Stock given in the Annual Report of a Company for the Financial Year 2003-04, the company has included stock of land as an item of closing stock (inventory). | It was noted that the company has not disclosed the method of valuation of land in the policy regarding valuation of inventories.<br>It was felt that the inclusion of land as a separate item in the closing stock schedule indicates that the land was also a significant item of inventory for the company. Not giving accounting policy regarding valuation of the land is a violation of AS 1, Disclosure of Accounting Policies. |
| 3. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Foreign Exchange Transactions, inter alia, provides as below:<br>"Transactions which have been completed during the year are accounted for at prevailing rates. Year end balances of foreign currency transactions are translated at the year end rates and the corresponding effect is given to the respective accounts." | It appears that all assets and liabilities relating to foreign currency transactions are translated at the year-end rates. This is contrary to Paragraph 7(a) of AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates, which requires only assets and liabilities in the nature of monetary items to be converted at the closing exchange rate.<br>It is not clear as to what is meant by the words 'respective accounts' i.e. the policy does not clarify as to |

| S. No. | Matter contained in Annual Report | Observations |
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| | | where the corresponding effect of translation of foreign currency transaction is given. As per AS 11 (revised 1994), exchange differences arising on foreign currency transactions should be recognised as income or as expense in the period in which they arise, except those arising on the liabilities incurred for the purpose of acquiring fixed assets. It was felt that in absence of specific mention to this aspect, it appears that the company may not have complied with AS 11 (revised 1994). In any case, the company has not made appropriate disclosure of its accounting policy on the matter which is a violation of AS 1, Disclosure of Accounting Policies. |
| 4. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has incurred a net loss of Rs. 343,453 thousands during the year ended 31st March, 2004 (Previous year Rs. 2,223,565 thousands); the accumulated losses of the company as on the date are | It may be noted that AS 1, Disclosure of Accounting Policies, explains the going concern as below:<br>"The enterprise is, normally, viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of |

| S. No. | Matter contained in Annual Report | Observations |
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| | Rs. 13,614,600 thousands; the current liabilities of the company exceed its current assets; and the company is having a negative net worth of Rs. 11,023,494 thousands on the balance sheet date.<br><br>It was observed that one of the Notes to Accounts provides as below:<br><br>"The accounts have been prepared on going concern basis as the company's operations for the manufacturing of Pig Iron and Power unit at Plant X continue at reasonable level of operations. In view of the management, the continued losses, erosion of net worth and uncertainty associated with Integrated Steel Plant at Y and Sinter Plant project at X, subsequent to recall of loans by the financial institutions causing abandonment of these projects are unlikely to affect the continuity of the business of the company and the operations of the Pig Iron Plant and power unit of the company. Further, the management is | liquidation or of curtailing materially the scale of the operations."<br><br>It was viewed from the facts that the company has been continuously incurring losses, its net worth has become highly negative, etc. and the impact of various non-provisions by the company clearly indicates that despite financial restructuring, relief and other measures, the company may not be able to continue its operations. The note referred herein also indicates that even if the company is able to continue some of its operations, it will be required to curtail its operations materially.<br><br>Accordingly, it was felt that it is not appropriate for the company to prepare its financial statements on a going concern basis. |

| S. No. | Matter contained in Annual Report | Observations |
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| | making efforts for overall financial restructuring of its pig iron unit. In view of reference/ appeals filed by the company u/s 15/ u/s 25 of SICA (Sick Industrial Companies Special Provision) Act, 1985, the company is hopeful of a scheme for financial restructuring, relief and other preventive, ameliorative and remedial measures being granted to the company." | |
| 5. | From the Annual Reports of Companies, for the Financial Year 2005-06, it has been noted that certain companies omit to disclose significant accounting policies, as adopted by them, with regard to the following:·<br>• Borrowing Costs<br>• Valuation of Inventories<br>• Accounting for Investments<br>• Impairment of Assets<br>• Provisions, Contingent Liabilities and Contingent Assets | It was observed that company in general, may have borrowed funds, inventories, investments and assets which may be subject to impairment. Further, there is always a need to carry certain provisions for meeting the contingent liabilities.<br>It may be noted that Paragraph 24 of AS 1 requires that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.<br>Therefore, subject to circumstances, a company is expected to disclose the |

| S. No. | Matter contained in Annual Report | Observations |
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| | | accounting policies as adopted by it with regard to Borrowing Costs, Valuation of Inventories, Accounting for Investments, Impairment of Assets and Provisions, Contingent Liabilities and Contingent Assets. |
| 6. | From Schedule of Investments given in the Annual Report of a Company for the Financial Year 2005-06, it was noted that the capital employed in the investments held by the company is more than 50% of its net worth.<br><br>Further, it was noted from Schedule of Other Income that the dividend income constituted a significant portion of the total income. | It may be noted that Paragraph 24 of AS 1, Disclosure of Accounting Policies, provides as follows:<br><br>**24.** ***All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed***.<br><br>It was felt that since significant amount of funds were involved in the investments and large amount of dividend income was arising from such investments, therefore, a separate accounting policy in respect of dividend income should have been disclosed under the Significant Accounting Policies as adopted by the company. Non-disclosure of the same was not in line with AS 1. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In the Annual Report of a Company for the Financial Year 2003-04, one of the accounting policy regarding customs duty, provides as below:<br>"Custom Duty payable on raw material, stores and spares and machinery are accounted for on clearing of the goods from Custom Warehouse." | It was viewed that customs duty was a cost incurred in bringing the goods to its present location and condition, i.e., importing the goods and the liability to pay this duty arises as soon as the goods enter the territorial waters of the country.<br>Keeping this in view, the company was required to create a provision for customs duty payable on the goods lying in the warehouse and include the said amount in cost of respective inventories or fixed assets, as per the requirements of AS 2, Valuation of Inventories, and AS 10, Accounting for Fixed Assets, respectively. This aspect has also been explained in the Expert Advisory Opinion (No. 14, page 57, Volume XXI). |
| 2. | In the Annual Reports of the Companies for the Financial Years 2003-04/2005-06, different accounting policies relating to valuation of inventories had been | It was felt that the stated accounting policies are not as per AS 2, Valuation of Inventories. It may be noted that Paragraph 5 of AS 2 requires that inventories |

| S. No. | Matter contained in Annual Report | Observations |
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| | adopted by them. An illustrative list of which is provided as below:<br>■ Raw materials components, stores and spares parts, goods in progress and by-products were valued at cost/ estimated cost.<br>■ Raw materials, stores, spares & tools are valued at cost (Cost formula FIFO basis).<br>■ Stock of food and beverages, operating supplies and engineering stores are valued at weighted average cost.<br>■ Work in progress was valued at estimated cost to the company.<br>■ Stores, Spares and Packing Materials; Raw Material and Components and Finished Goods in Transit have been valued at cost.<br>■ Raw materials, stores and spares are valued at cost under FIFO Method. Finished goods and work-in- | should be valued at the lower of cost and net realisable value (instead of realisable value). As per AS 2, net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.<br>In case, where it is stated that the finished goods are valued at lower of cost and realisable value, it appears that the company may not be reducing estimated costs from the estimated selling price for the valuation of finished goods which is contrary to AS 2. |

| S. No. | Matter contained in Annual Report | Observations |
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| | progress and newsprint waste are valued at the estimated realisable value.<br>■ Rough diamonds, polished diamonds and stores and consumable are valued at cost.<br>■ Finished goods have been valued at cost or market value, whichever is lower.<br>■ Finished stocks are valued at cost or realisable value whichever is lower. In the case of item A stocks, to the extent these are considered saleable, valuation is done at Raw Materials cost plus Packing Charges or realisable value whichever is lower.<br>■ Process stocks are valued at or below cost.<br>■ Stores, Spares and Raw Materials on hand are valued at weighted average cost and those in transit at cost.<br>■ Inventories are valued at cost except for finished | |

| S. No. | Matter contained in Annual Report | Observations |
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| | goods, stock-in-process and waste. Cost is determined on weighted average basis and includes all costs incurred in bringing the inventories to their present location and condition. Finished goods and stock-in-process are valued at lower of cost and net realisable value and waste at net realisable value.<br>■ Semi-finished goods are valued at cost and work-in-process relating to contracts are valued at estimated net realisable value.<br>■ Software under development is shown as work-in-progress and valued at cost.<br>■ Inventories are valued at cost inclusive of custom duty and other landing costs in respect of imported goods.<br>The observations on the above are quite similar in all the cases as provided adjacent to them. | |

| S. No. | Matter contained in Annual Report | Observations |
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| 3. | In the Annual Report of a Company for the Financial Year 2003-04, one of the accounting policy regarding inventories, states that raw materials, store and spares and work-in-progress are valued at the lower of cost and the net realisable value. | It was felt that the company has not disclosed the cost formula used for valuation of inventories, which is required to be disclosed as per Paragraph 26(a) of AS 2, Valuation of Inventories. |
| 4. | From the Annual Reports of the Companies for the Financial Years 2003-04/ 2004-05/2005-06, similar non- compliances were observed in the accounting policy relating to valuation of inventories. An illustrative list of which is provided as below:<br>■ Inventories are valued at cost inclusive of custom duty and other landing costs in respect of imported goods.<br>■ The cost formula used is either FIFO or Average Cost, as applicable.<br>■ The cost formula used is either FIFO or Specific Identification Method, as applicable.<br>The observations on the above, are quite similar | In certain cases, the companies have merely stated the nature of the cost that has been included for valuation of Inventory. However, they omit to provide any cost formula used for the same, whereas in other cases, the companies have not brought out the exact cost formula used for the valuation of inventories.<br>Therefore, it was felt that the disclosure made by the companies was not a sufficient compliance with Paragraph 26(a) of AS 2 which requires that the cost formula used to determine the cost of inventory should be disclosed in the financial statements. |

| S. No. | Matter contained in Annual Report | Observations |
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| | in all the cases as provided adjacent to them. | |
| 5. | From the Annual Report of the Companies for the Financial Year 2003-04/ 2004-05/2005-06, similar non compliance was observed in the note regarding Excise Duty. An illustrative list of such observation is provided as below, the observation on the same are quite similar as provided adjacent to them:<br>■ Guidance Note on Accounting Treatment for Excise Duty issued by the ICAI requires that the closing stock of finished goods should also include excise duty element and a provision for the liability to be made as the duty liability accrued on manufacture. However, inventory is valued at net of excise duty and provision for excise duty liability is, thereby, not considered necessary as there is no impact on profit and loss account. | It may be noted that as per AS 2, Valuation of Inventories, the cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Further, as per the Guidance note on Accounting Treatment for Excise Duty, excise duty is a cost incurred in bringing the inventories to their present location and condition. Keeping this in view, the Guidance Note requires a provision to be created for excise duty payable on the goods manufactured during the year and lying in the warehouse. Accordingly, it was felt that non - creation of a provision for excise duty was contrary not only to the Guidance Note on Accounting Treatment for Excise Duty but also a violation of AS 2.<br>It was viewed that even if non-provision of excise duty does not affect the net profit |

| S. No. | Matter contained in Annual Report | Observations |
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| | ■ Excise duty on the finished goods lying in factory premises and not cleared from excise bonded warehouse on 31st March, 2004 has not been provided and hence not included in inventory valuation. However, there is no affect on profit or loss for the year on the account of above treatment of excise duty.<br>■ Excise duty is accounted for on the clearance of goods wherever it is related to sales and on accrual basis wherever there is no such relation.<br>■ Excise duty on liquor is payable in the state where these are consumed and hence, it was not possible to ascertain the liabilities in this respect against stocks held in the bonded warehouses and at the factories. Accordingly, as per practice consistently followed, excise duty against such stocks has | or loss for the period, the financial position of the company is getting affected since it results in understatement of the value of inventory as well as liabilities of the company by the same amount.<br>It may be noted that the Guidance Note on Accounting Treatment for Excise Duty specifically recommends that in case the company has not created a provision for excise duty payable, the auditor should qualify his audit report in respect of the above matter.<br>It may further be noted that as per Paragraph 23 of AS 1, Disclosure of Accounting Policies, a disclosure cannot remedy a wrong or inappropriate treatment of the items in the accounts. Accordingly, it was felt that despite the disclosure in the notes to accounts, the treatment accorded by the companies continues to be contrary to AS 2 and the Guidance Note.<br>It may also be mentioned that Section 209(3)(b) of the Companies Act, 1956 |

| S. No. | Matter contained in Annual Report | Observations |
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| | neither been provided for nor included in the valuation of such stocks.<br>■ Central excise duty payable on finished goods is accounted for on clearance of the goods from the factory. | requires that the books of account be kept on "accrual basis." Non-provisioning of the Excise Duty liability would also be in violation of this Section. |
| 6. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding inventory provides as below:<br>"Stock of material sold by one unit to other is valued at transfer price." | It was viewed that the stock of material sold by one unit to the other is valued at transfer price. This may result in the recognition of unrealised profits in the financial statements, which is against the concept of prudence and the generally accepted accounting principle of not recognising any unrealised gains in the financial statements. |
| 7. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Inventories provides the following basis of valuation:<br>**Raw Materials:** Valuation is at monthly average purchase cost.<br>**Finished Goods:** Valuation is at monthly average selling price. (Selling price basis of valuation is adopted | It was felt that the accounting policy is not as per AS 2, Valuation of Inventories.<br>It may be noted that as per AS 2, inventories, including raw materials and stores & spares, should be valued at the lower of cost and net realisable value.<br>It was felt that the view of the company that the cost of each type of product cannot be determined is not appropriate. |

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| | because the cost of each type of wheat product derived from the grinding of wheat cannot be separately determined nor can a standard margin be applied.)<br>**Stores and Spares**: Valuation is at cost. | It may be noted that Paragraph 10 of AS 2 provides the following with regard to determination of the cost of joint products:<br>"10. A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by- products as well as scrap or waste materials, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the |

| S. No. | Matter contained in Annual Report | Observations |
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| | | main product is not materially different from its cost."<br>It was viewed that using the guidance provided in the Paragraph, the company should have determined the cost of each product and valued the same at lower of cost and net realisable value. |
| 8. | From the Schedule of Inventory given in the Annual Report of a Company for the Financial Year 2005-06, it has been noted that amongst other items, it was also holding the real estate, as part of its inventories. Further, it has been noted that such real estate had been valued at revalued cost of land and construction thereon at cost. | It may be noted that Paragraph 5 of AS 2 requires that inventories should be valued at the lower of cost and net realisable value. It was noted that the inventory of real estate included land at revalued cost. It was felt that, unlike AS 10, there is no provision for revaluation of inventories in AS 2.<br>The company had neither considered the cost nor the net realisable value for the valuation of land included in real estate.<br>It indicates that the accounting policy as adopted by the company to value land is not in line with AS 2. |
| 9. | From the Schedule of 'Current assets, loans and advances' given in the Annual Report of a Company for the Financial | It may be noted from the clarification given for Guidance Note on 'Audit of Inventories' that the use of expression 'as valued and |

| S. No. | Matter contained in Annual Report | Observations |
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| | Year 2004-05, it has been noted that inventories were described "as taken, as valued and certified by the management." | 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.<br><br>Therefore, usage of such words indicates that there is a disclaimer for inventories which should be avoided.<br><br>It may be mentioned that in the clarification, it has also been suggested that the auditors may advise his client to omit the words "as valued and certified by the management", when describing inventories in the financial statement. |
| 10. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted from Significant Accounting policies that the accounting policy on valuation of inventories has not been disclosed. | It may be noted that Paragraph 26 (a) of AS 2 requires that a company should disclose the accounting policies adopted in measuring inventories, including the cost formula used, in its financial statements.<br><br>It was felt that although the company had shown the |

| S. No. | Matter contained in Annual Report | Observations |
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| | | value of inventories as held by it at the end of the accounting period, however it had omitted to disclose the accounting policy on valuation of inventories, which is a non-compliance of both AS 1 and AS 2. |
| 11. | From Schedule to Balance Sheet regarding Inventories given in the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the amount of MODVAT credit receivables as well as Excise duty on finished goods was shown as separate item under the head of Inventories. | It may be noted that as per Paragraph 6 of AS 2, Valuation of Inventories, the cost of Inventories should comprise of costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Further, the Guidance note on Accounting Treatment for Excise Duty provides that the excise duty should be considered as a manufacturing expense and like other manufacturing expenses should be considered as an element of cost for inventory valuation.<br><br>Therefore, it was viewed that 'Excise duty on finished goods' should be included in the value of finished goods instead of separately disclosing the same under the head of Inventory. |

| S. No. | Matter contained in Annual Report | Observations |
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| | | Further, Paragraph 16 of Guidance note on Accounting Treatment for Excise Duty provides that the debit balance in MODVAT/ CENVAT Credit Receivable (Inputs) Account should be shown as asset under the head of 'Advances'.<br><br>Hence, it was felt that the disclosure of MODVAT credit recoverable under the head of inventory is not correct. |

## Observations on Accounting Standard (AS) 3: Cash Flow Statement

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | From the Annual Report of a Company for the Financial Year 2002-03, it was noted that in the Cash Flow Statement, the company had disclosed foreign exchange variations as an extraordinary item under the heading 'Cash Flow from Operating Activities'. | It was viewed that this was not as per AS 3, Cash Flow Statements. It may be noted that Paragraph 25 of AS 3, dealing with foreign currency cash flows, provides as below:<br>"25. ***Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's 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 cash flow. A rate that approximates the actual rate may be used if the result is substantially the same as would arise if the rates at the dates of the cash flows were used. The effect of changes in exchange rates on cash and cash equivalents held in a*** |

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| | | ***foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period."***<br>As per the Paragraph, exchange rate variations arising from cash flows transactions in a foreign currency get adjusted in the relevant head and do not give rise into any separate disclosure whereas the exchange rate variations relating to cash and cash equivalents held in a foreign currency are reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period. Further, as per Paragraph 28 of AS 3, only those items should be disclosed as extraordinary item in the cash flow statement which have been disclosed as such in profit and loss account. Since exchange rate variation had not been disclosed as an extraordinary item in the profit and loss account, the disclosure of the same as an extraordinary item in the cash flow |

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| | | statement was totally inappropriate. |
| 2. | From the Annual Reports of the Companies for the Financial Years 2002-03/ 2003-04, the following was noted in the cash flow statement, the observations on the same, are quite similar as provided adjacent to them:<br>■ Financial Expense/ Interest paid is shown as cash flow from operating activities.<br>■ Interest received is shown as cash flow from financing activities.<br>■ Interest paid as well as interest received is shown as cash flow from operating activities.<br>■ Fixed deposits with banks are shown as cash flow from financing activities. | ■ Financial expenses/ interest paid is shown as the cash flow from operating activities. It was felt that this is not as per AS 3, Cash Flow Statements. Paragraph 30 of AS 3 requires that interest paid/ Financial expenses (which include interest paid) to be shown as the Cash Flow from Financing Activities.<br>■ Interest received is shown as the cash flow from financing/operating activities. It was viewed that this is not as per AS 3. Paragraph 30 of AS 3 requires that the interest received should be shown as the Cash Flow from Investing Activities.<br>■ Fixed deposits with banks are shown as the cash flow from financing activities. It was felt that this is not as per AS 3. It was viewed that in case the fixed deposits were convertible into cash in a short period of time, these should have been |

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| | | classified as a part of cash and cash equivalents. In case these were not convertible into cash in a short period of time, these were of the nature of investment and should have been disclosed as Cash Flow from Investing Activities. In any case, it is not appropriate to disclose these as Cash Flow from Financing Activities. |
| 3. | In the Annual Report of a Company for the Financial Year 2003-04, the company had disclosed the 'Proceeds from General Reserve' as the cash flow from financing activities and this amount is a negative figure. | It was felt that no direct cash flow receipt/ payment takes place on account of general reserve and, therefore, there may not be any proceeds from general reserve, which required a disclosure in the cash flow statement. |
| 4. | From the Annual Report of a Company for the Financial Year 2003-04, it was noted that in the Cash Flow Statement, the company has shown an increase in share capital as the cash flow from investing activities. | It was felt that this is not as per AS 3, Cash Flow Statements. As per Paragraph 17 of AS 3, the cash proceeds from issuing shares should be a part of financing activities. |
| 5. | From the Annual Report of a Company for the Financial Year 2003-04, it was noted that in the Cash Flow | It was felt that in case the item was extra-ordinary, it should have been disclosed as such in the profit and loss |

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| | Statement, the company has disclosed an extraordinary item under the heading 'Cash Flow from Operating Activities'.<br>In the profit and loss account, this amount was disclosed as a 'prior period adjustment'. | account also. It is not appropriate to recognise a 'prior period adjustment' as an 'extra ordinary item' in the cash flow statement. This is contrary to AS 3, Cash Flow Statements. As per Paragraph 28 of AS 3, only those items should be disclosed as extraordinary items in the cash flow statement, which have been disclosed as such in the profit and loss account. |
| 6. | From the Annual Report of a Company for the Financial Year 2004-05, it was noted that in the cash flow statement the company has classified all cash flows into four categories, viz., operating activities, investing activities, financing activities and others. | It was viewed that this is not as per AS 3. Paragraph 8 of AS 3 requires that cash flow statement should report cash flows during the period classified into three categories only, viz., operating, investing and financing activities. |
| 7. | From Schedule to the Profit & Loss Account regarding 'Interest and finance charges' given in the Annual Report of a Company for the Financial Year 2004-05, it was noted that the company has disclosed interest received separately. However, the company has | This is an apparent violation of AS 3, Cash Flow Statements, which requires the interest received to be shown separately under the head 'cash flow from investing activities'. |

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| | not disclosed the same in the Cash Flow Statement. | |
| 8. | From the Annual Report of a Company for the Financial Year 2005-06, it was noted that the cash inflow arising due to Proceeds from Borrowings were significantly less than the aggregate increase in the value of Secured Loans and Unsecured Loans that had taken place during the year. Further, it was noted from Schedule of Secured Loans & Unsecured Loans that such loans were obtained, mainly, by way of loans taken from banks, fixed deposits and debentures. | It was felt that since, the reported increase had occurred due to borrowings which always involve flow of cash; therefore, such significant difference should not exist in the figures of borrowings as reported in the Schedule, from that of Cash Flow Statement. |
| 9. | From the Cash Flow Statement given in Annual Report of a Company for the Financial Year 2005-06, it was noted that in the Cash Flow Statement 'Net Proceeds from Borrowings' were reported under Cash Flow from financing activities. | It has been observed that Paragraph 21 of AS 3, Cash Flow Statements, provides as follows:<br>***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.*** |

| S. No. | Matter contained in Annual Report | Observations |
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| | | However, in the Cash Flow Statement, proceeds from long term borrowings as well as repayment of these borrowings have been reported at net figure under the head of 'Net proceeds from Borrowings' which is contrary to the requirements of AS 3. |
| 10. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the company has shown Cash flows from issue of Initial Public Offer and from Premium received on such issue as Cash flows from investing activities. | It was felt that the company should disclose the Cash flows from issue of Initial Public Offer and from Premium thereon under the head of Cash flows from Financing Activities instead of disclosing the same under the head of Cash flows from Investing Activities, as per the requirement of AS 3. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In one of the points in the Annexure to the Auditors' Report, pursuant to the Companies (Auditor's Report) Order, 2003 given in the Annual Report of a Company for the Financial Year 2003-04, the auditor had mentioned that a total amount of Rs. 6,78,664 for income-tax had not been deposited because of the disputes. As compared to this, under the heading 'contingencies and commitments' in the notes to accounts, the company had mentioned the amount of Rs. 105,685 only for contingencies in respect of income-tax. | It was felt that the total amount of income tax, which had not been deposited on account of disputes, was a contingency as per AS 4 Contingencies and Events Occurring After the Balance Sheet Date, which was applicable at that time. Accordingly, the company should have disclosed the total amount of Rs. 6,78,664 for income tax, under the heading 'Contingencies and commitments', unless the remaining amount had already been provided for in the books.<br><br>It was viewed that from the financial statements, it did not appear that the company had provided the remaining amount in the financial statements. Accordingly, the company was required to disclose the total amount of Rs. 6,78,664 towards income tax not deposited on account of disputes as contingencies. Disclosing the lower amount in this regard was a clear violation of AS 4. |

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| 2. | In the Annual Report of a Company for the Financial Year 2003-04, one of the Notes on Accounts provides as below:<br>"No provision in respect of claim liability of the company for the year ended 31.03.2004 has been made as the company has decided to charge the payment only when the liability is finally settled and paid. Liability of such claims lodged during the year and remaining unpaid/ unsettled is Rs. 43.47 lacs (Rs. 105 lacs) approximately based on the settlement patterns in past." | It was felt that the company was required to estimate the loss in respect of claim liability and to create a provision in respect thereof. Recognising the liability only when it was finally settled and paid was contrary to the accrual basis of accounting which was a requirement under the Companies Act, 1956 and AS 4 Contingencies and Events Occurring After the Balance Sheet Date. |
| 3. | From the Annual Reports of the Companies for the Financial Year 2003-04 / 2004-05, following adjustments has been noted:<br>■ No Provision was made in the accounts for book debts considered doubtful of recovery in view of adequate reserves. The company had initiated legal proceedings against various parties for | It was viewed that the companies had identified the doubtful debts, which clearly indicates that the companies may not be able to recover these dues. Keeping in view, the requirements of AS 4, Contingencies and Events Occurring After the Balance Sheet Dates, the companies were required to estimate the loss for bad and doubtful debts and to create a provision in respect of full amount considered doubtful. |

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| | recovery of dues and such legal proceedings are at different stages as at the date of Balance Sheet and are expected to materialise in recovering the dues in the future. Management was hopeful of their recovery. In the opinion of the management adequate balance was lying in general reserve to meet the eventuality of these accounts being irrecoverable.<br>■ In a Schedule of 'Current Assets, Loans and Advances', the company had created lower provisions as against the amounts considered doubtful.<br>The observations on the above are quite similar as provided adjacent to them. | Accordingly, it was felt that the creation of short provision/ no provision in respect of doubtful debts/advances is contrary to the requirements of AS 4.<br>Non-provisioning also impacts the profit or loss for the period and such non-provision may not give a true and fair view of the profit or loss of the company for the period. |
| 4. | In the Annual Report of a Company for the Financial Year 2003-04, one of the Notes to Accounts provides as below:<br>"In a joint meeting of all participating Financial Institutions, Banks, State | It was felt that since the amount due to the Y Bank has not been settled and the bank has not waived its right to interest, the interest accrued on the loan was a liability of the company. Accordingly, the company |

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| | Government and other concerned with the company, a consensus was arrived at with regard to the package for long term revival of the company. Accordingly, X Bank had agreed to accept the company's offer of Rs. 325 lacs as one time settlement (OTS) in full and final settlement of all their dues and Y Bank had agreed in principal for Rs. 1080 lacs as OTS amount against all its dues subject to approval of their competent authority. Subsequently, due to the refusal of said parties to honour the commitments, the company has filed a writ petition before Hon'ble High Court. However, X, Z & B had accepted the OTS in full and final settlement of all their dues in previous years and were paid accordingly. The matter concerning dues of Y Bank is yet to be adjudicated by Hon'ble High Court and consequently the interest to be provided/ waived thereon, if any, is not ascertainable at this stage and not provided for. Y | was required to estimate the interest due and create a provision in respect thereof. The company cannot avoid making a provision for interest on the ground that the amount was not ascertainable since the companies are creating provisions for various other expenses also on an estimated basis. Non-creation of the provision for interest is contrary to AS 4, Contingencies and Events Occurring After the Balance Sheet Date. |

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| | Bank has filed recovery proceedings before Debt Recovery Tribunal. The company has challenged the maintainability of the proceedings before Debt Recovery Tribunal and the same are presently stayed in terms of the order of the Hon'ble High Court." | |
| 5. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Doubtful Debts/ Advances' provides as below:<br>"Provision is made in the accounts for debts/ advances which in the opinion of the management are considered doubtful of recovery."<br>In one of the notes regarding overdue debts given in the notes to accounts, the company has mentioned the following:<br>"Other overdue debts, loans and advances from certain companies whose net worth has been partially/ substantially eroded as per their latest audited balance sheet aggregate to Rs. 4,819.98 lacs (as at 30th | It was viewed that the erosion in the net worth of the companies from whom the debts are due indicates that the company may not be able to recover its dues fully and in such cases, a strategic involvement may also not be able to ensure full recovery. It was felt that keeping this in view, the company was required to estimate the loss for bad and doubtful debts and to create a provision in respect thereof. The company cannot avoid making provisions for a loss that has taken place merely on the ground that the amount was not ascertainable since the companies are creating a provision for certain other expenses also on the estimated basis. Non-creation of the provision for bad and doubtful debts is contrary to |

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| | September, 2003 Rs. 4382.41 lacs) net of provision of Rs. 1076.12 lacs (as at 30th September, 2003, Rs. 1076.02 lacs). However, no provision is considered necessary for these overdues as the company's involvement in these companies is of a strategic and long term nature and irrecoverable amounts, if any, are presently not ascertainable." | the accounting policy stated to have been followed by the company as well as AS 4 ,Contingencies and Events Occurring After the Balance Sheet Date. |
| 6. | In one of the points of the Auditor's Report given in the Annual Report of a Company for the Financial Year 2003-04, the auditor has drawn the attention to a note regarding excess utilisation of sales tax incentive amounting to Rs. 1,122.59 lacs and a note regarding the overdue outstanding from debtors amounting to Rs. 1,758.86 lacs considered good and recoverable by the management, without making them a subject matter of qualification.<br>It was observed that one of the notes to accounts provides as below: | It may be noted that as per AS 4, Contingencies and Events Occurring After the Balance Sheet Date, contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue, which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.<br>It was felt that it does not appear that there is a virtual certainty that certificate for additional sales tax exemption will be received. Accordingly, sales tax exemption in excess |

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| | "The Company has set up its plant in a State and the Industries Commissioner of the State, has issued a provisional certificate for an adhoc amount of Rs. 1,506.00 lacs under the Incentive Scheme issued in 1995 by the State Government. Against this, the Company has availed sales tax exemption of Rs. 2,628.59 lacs till 31.03.2004 as per its eligibility and in anticipation for the issue of final eligibility certificate, as it has complied with all the requirements for this purpose. In case the certificate is not issued or is deficient in amount, the company may be liable to pay the amount utilised in excess of the eligibility finally granted with consequential interest, if any."<br><br>It has also been noted that a Note provides as below:<br><br>"Sundry debtors include overdue outstanding from various parties aggregating to Rs. 1,766.59 lacs. The company is following up with the concerned | of the eligibility certificate received is a contingent gain of the company, which cannot be recognised. Accordingly, recognising sales tax exemption in excess of the eligibility certificate received is contrary to AS 4.<br><br>It was viewed that the management has not indicated the reason for which it considers all overdue outstanding debtors to be fully recoverable. It was felt that in the absence of such a justification, the management's opinion that debts are good and fully recoverable does not seem to be tenable. In view of this, the company was required to estimate the loss for bad and doubtful debts and to create a provision in respect thereof. Non-creation of provision in respect of this loss is contrary to AS 4. |

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| | parties and the management is of the opinion that the overdue outstanding debtors are fully recoverable. Hence, the amount is considered good and recoverable." | |
| 7. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Revenue Recognition states as below:<br>"Discounts, claims, and rebates payable are accounted as and when settled." | It was viewed that this policy of the company relates only to discounts, claims, and rebates payable and not to the principal items of revenue.<br>It was felt that the accounting for discounts, claims, and rebates payable only on settlement is contrary to the accrual basis of accounting, which is a requirement under the Companies Act, 1956 and AS 4, Contingencies and Events Occurring After the Balance Sheet Date. |
| 8. | In the Annual Report of a Company for the Financial Year 2003-04, one of the paragraph of the Auditor's Report provides as below:<br>"We have placed reliance on the management's perception and judgement on the following matters:<br>■ The recoverability of debts (including loans | It was viewed that the net worth of the company has eroded, indicates that the amount due may not be fully recoverable. Keeping this in view, the management was required to create a provision for irrecoverable amount.<br>Non-creation of the provision is contrary to the requirements of AS 4, |

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| | and advances) owed to the Company by an erstwhile subsidiary whose net worth has been eroded, aggregating Rs. 694.13 lacs;<br>■ ————<br>In our Opinion and to the best of the information and according to the explanation given to us, the said Accounts, subject to limitation expressed by us in Para above, read …" | Contingencies and Events Occurring After the Balance Sheet Date. |
| 9. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Warranties states as below:<br>"Liability in respect of warranty cost is reckoned in the year in which the liability is incurred." | It was viewed from the policy that the company is recognising the liability in respect of warranty cost in the year in which the claim actually arises, i.e., the company is not creating any provision for warranties given on the products sold, the claim in respect of which may arise in future. It was felt that the liability in respect of warranty arises as soon as the company sells the product. This has been also felt that not creating any provision for warranties given on the products sold, the claim in respect of which may |

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| | | arise in future is contrary to the accrual basis of accounting which is a requirement under the Companies Act, 1956 and AS 4, Contingencies and Events Occurring After the Balance Sheet Date. |
| 10. | In the Annual Report of a Company for the Financial Year 2003-04, one of the notes to accounts provides as below:<br>"An amount of Rs. 1468.49 lacs (as at 31st March, 2003 Rs. 1,471.39 lacs) is due from this firm (AP Joint Venture in which company is a partner). The firm has made claims aggregating to Rs. 1,666.23 lacs (as at 31st March, 2003 Rs. 1,666.23 lacs) against its clients that are subject matters of arbitration where it expects favourable results. No provision has been made for the amount, if any, that would ultimately become irrecoverable, as it cannot be quantified." | It was viewed that the amount due from the firm may not be fully recoverable. However, the company has not created a provision in this regard since the amount cannot be quantified. It was felt that the company cannot avoid making provisions for a loss that has taken place merely on the ground that the amount was not ascertainable since the companies are creating a provision for certain other expenses also on the estimated basis. It was also felt that the company was required to estimate the loss for bad and doubtful debts and to create a provision in respect thereof. Non-creation of the provision in respect of this loss is contrary to AS 4, Contingencies and Events Occurring After the Balance Sheet Date. |

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| 11. | In the Annual Report of a Company for the Financial Year 2003-04, the following accounting policy has been stated regarding Doubtful Debts and Advances:<br>"Provision is made in accounts for debts and advances which in the opinion of the management are considered doubtful of recovery."<br>It has also been noted that one of the notes to accounts given in the Annual Report provides as below:<br>"No provision has been made for doubtful debts and advances, aggregating to Rs. 1314.64 lacs (as at 31st March 2003 Rs. 1,541.94 lacs). Out of these, substantial amounts are subject matters of arbitration/ litigation where the company expects favourable results and, hence, the amounts, if any, that would ultimately become irrecoverable cannot be quantified." | It was viewed that in Schedule regarding 'Sundry Debtors' and 'Loans and Advances', the company has identified doubtful debtors Rs. 1024.87 lacs and doubtful advances Rs. 289.77 lacs, respectively. However, no provision has been created in the financial statements in this regard.<br>It was felt that the company has identified the amounts as doubtful clearly indicates that the company may not be able to recover these dues. Accordingly, keeping in view the requirements of AS 4, Contingencies and Events Occurring After the Balance Sheet Date, and the accounting policy stated to have been followed by the company, the company was required to create a provision in respect of the amounts considered doubtful. In such a case, it does not make any difference that the amount of loss was not ascertainable since the companies are creating provisions for certain other expenses also on an estimated basis. It was further felt that non-creation of the |

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| | | provision in respect of doubtful debts and advances is contrary to AS 4. |
| 12. | In the Annual Report of a Company for the Financial Year 2003-04, one of the notes to accounts provides the following:<br>"The company received subsequent to the year-end arbitration awards (unanimously decided) pertaining to earlier years, aggregating to Rs. 1,869.00 lacs (including interest of Rs. 454.31 lacs) which are subject to appeals, the ultimate outcome of which is not ascertainable." | It was felt that the note is not clear as to whether the awards are in favour of the company or against the company. In case the arbitration awards are against the company, the amount is a contingent loss for the company. Since the decision has been received through an arbitration process, the occurrence of such a loss is probable. Also, because the award is related to the earlier years, it is an adjusting event within the meaning of AS 4, Contingencies and Events Occurring After the Balance Sheet Date. Accordingly, the company, keeping in view the requirements of AS 4 concerning creation of provisions for contingent losses and concerning events occurring after the balance sheet date, is required to create a provision in respect of the loss. Non-creation of a provision for the loss is contrary to AS 4. |
| 13. | From the Schedule regarding Loans and | It may be noted that as per AS 4, Contingencies and |

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| | Advances given in the Annual Report of a Company for the Financial Year 2005-06, it has been noted that all loans and advances had been considered as 'Good'. In other words, no loans and advances had been considered as 'Doubtful'. It was further noted that still a provision had been made against the advances to the subsidiaries which had also been declared as good. | Events Occurring After the Balance Sheet Date, the company could not make a provision for an unknown liability and it may further be noted that as per Schedule VI to the Companies Act, 1956, the company has to bifurcate loans and advances into — those considered as good, and those considered as bad or doubtful loans; so that a provision be adjusted against loans and advances that are considered as doubtful or bad.<br>It was felt that the company has not complied with the requirements of Schedule VI to the Companies Act, 1956 as well as Accounting Standard (AS) 4. |
| 14. | One of the significant accounting policy regarding Events occurring after Balance Sheet date given in the Annual Report of a Company for the Financial Year 2005-06, provides as below :<br>"It is the Company's Policy to take into account the impact of any significant event that occurs after Balance Sheet date but | It may be noted that Paragraph 3.2 of AS 4, Contingencies and Events Occurring After the Balance Sheet Date, provides that events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are ***approved by*** |

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| | before the finalisation of accounts." | ***the Board of Directors*** in the case of a company, and, by the corresponding approving authority in the case of any other entity.<br>It was felt that the date of finalisation of accounts could not be construed as the date when the financial statement has been approved by the Board unless the date of sigining the Auditors' Report is considered as the date of finalisation of accounts. Otherwise, the accounting policy as adopted by the company was considered to be not in line with AS 4. |
| 15. | One of the Notes on Accounts given in the Annual Report of a Company for the Financial Year 2004-05, provides the information as given below:<br>"Sundry Creditors, Receivables, and Loans and Advances included certain items for which confirmations were yet to be received and included certain long outstanding balances which were considered payable/ realisable, as the case may | It was viewed that non-creation/less creation of provision in respect of doubtful debts is contrary to AS 4 and accrual basis of accounting.<br>It may be noted that the provision for bad and doubtful debts represents impairment of receivables which is covered by AS 4, Contingencies and Events occurring after the Balance Sheet Date. Paragraph 13 of AS 4 provides that these costs are usually incurred |

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| | be. Provision for doubtful debts, if any, in respect of above and the consequential adjustment, arising out of reconciliation would be made at the appropriate time."<br><br>Further, it was noted from Schedule of Sundry debtors that a nominal provision had been made against the huge amount due from debtors which were outstanding for the period exceeding six months. | frequently, and experience provides a means by which the amount of the liability or loss can be estimated with reasonable precision although the particular transactions that may result in a liability or a loss are not identified. Provisions for these costs results in their recognition in the same accounting period in which the related transactions took place. Further, the definition of Accrual basis given in Guidance Note issued by ICAI regarding 'Terms used in Financial Statements' provides as under:<br><br>"The method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts in the period in which they accrue. The 'accrual basis of accounting' includes consideration relating to deferrals, allocation, depreciation and amortisation. This basis is also referred to as mercantile basis of accounting."<br><br>Thus, the practice of carrying old outstanding is not correct. Further, it was noted that the |

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| | | note provided two aspects of amount due from debtors, one was unconfirmed party balances and another was old outstanding balance with respect to payables and receivables. It was noted that although, it was mentioned that for long outstanding unconfirmed debtors or receivables, provision for doubtful debts would be made at appropriate time, however, the event or time when such provision would be made had not been specified. |

## 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 |
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| 1. | In the Annual Report of a Bank for the Financial Year 2002-03, one of the Notes to Accounts regarding leave encashment provides as below:<br>"The liability for leave encashment to employees was hitherto accounted for on 'pay-as-you go' basis. During the year, the said liability for the period upto 31st March, 2002 determined at Rs. 15.55 crores on actuarial basis has been charged to revenue reserves as per RBI guidelines. The incremental liability for the year Rs. 2.57 crores actuarially valued has been charged to revenue. …" | ■ It may be noted that Paragraph 5 of the AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, provides as below:<br>"All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise."<br>It was viewed that the liability for leave encashment accrued upto 31st March, 2002 is also an item of expense. It may be noted that since AS 15, does not contain any specific provision permitting the charging of amount accrued prior to adoption of the standard to revenue reserves, the amount should have been recognised in the determination of the net |

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| | | profit or loss for the period, i.e., it should have been charged to the profit and loss account for the year. It was felt that the recognition of the expense relating to the liability of previous years directly to revenue reserves is a violation of AS 5.<br>■ It may be noted that the RBI has issued circular No. DBOD No. BP.BC. 89/21.04.018/2002-03, dated March 29, 2003, regarding 'Guidelines on compliance with Accounting Standards by banks'. The Circular, in respect of the Guidelines concerning AS 15, provides as below:<br>"Banks are required to account for the liability arising out of leave encashment on retirement on an accrual basis. As the Standard does not provide for any transition period to enterprises that are yet to achieve full compliance, it would be unavoidable for the statutory auditors to make |

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| | | a qualification until the Accounting Standard has been fully complied with. With a view to ensuring that the qualification by the auditor does not arise, banks, which are yet to fully comply with the Standard, are required to provide for the accrued liability for leave encashment on retirement as on 31st March 2003 by charging the same to their profit and loss account for the year ending on that date. However, considering the financial implication of the accounting for the past requirements in the current year's income, banks have the option to charge the liability for leave encashment on retirement accrued up to 31st March 2002 to the revenue reserves. …" So, it is clear that though RBI has given the banks an option to charge the liability for leave encashment accrued up to 31st March 2002 to the revenue reserves, it also admits that the auditors |

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| | | would be required to qualify their audit reports if the amount was not charged to the profit and loss account (presumably on account of the requirements of AS 5). |
| 2. | ■ From the Annual Report of a Bank for the Financial Year 2002-03, it has been noted that as per 'Reserves and Surplus' schedule and 'Fixed Assets' schedule, the bank has charged the excess depreciation arising due to revaluation of premises directly to capital reserves without routing it through the profit and loss account.<br>■ From the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Depreciation, inter alia, provides as below:<br>"The depreciation charged to the profit and loss account is net off depreciation on revalued amounts being the | It was viewed that depreciation on assets (including the portion arising due to revaluation of assets) is an item of expense and, accordingly, was required to be charged to the profit and loss account as per Paragraph 5 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'. Charging any part of depreciation directly to the capital/ revaluation reserves, without routing it through the profit and loss account, is a violation of AS 5.<br>It was viewed that only net depreciation (i.e., depreciation on revalued amount less amount of depreciation transferred from capital/ revaluation reserve) has been charged to the profit and loss account. Charging only net depreciation to the profit and |

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| | recoupment from the revaluation reserve representing the difference between the depreciation for the year on the revalued amount of assets and depreciation calculated on their original cost."<br>■ From the 'Reserves and Surplus' schedule given in the Annual Report of another Company for the Financial Year 2003-04, it has been noted that the company had reduced the excess depreciation arising due to revaluation of fixed assets from the capital reserves. It has also been observed that note to Fixed Assets schedule given in the Annual Report provides as below:<br>"Depreciation for the year, on write up of assets made in the year ended 30-9-87 and 31-3-95 as aforesaid, has been provided at SLM rates as per Schedule XIV of the Companies Act 1956, amounting to | loss account was a violation of AS 5.<br>It may be noted that the 'Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets', issued by the ICAI, provides a specific guidance on the treatment to be followed in case of revaluation of fixed assets which is in consonance with the requirements of AS 5. Paragraph 9 of the Guidance Note, inter alia, provides as below:<br>"… depreciation is required to be provided with reference to the total value of the fixed assets as appearing in the account after revaluation. However, for certain statutory purposes e.g., dividends, managerial remuneration etc., only depreciation relatable to the historical cost of the fixed assets is to be provided out of the current profits of the company. In the circumstance, the additional depreciation relatable to revaluation may be adjusted against "Revaluation Reserve" by transfer to Profit and Loss Account. In other words, as per the |

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| | Rs. 15,84,428 (Rs. 16,42,694) and equal amount has been transferred from Capital Reserve account to Profit and Loss Accounts by way of reducing actual depreciation for the year as per note 3 (B) showing in profit and loss account only net amount Rs. 1,72,30,981 (Rs. 149,96,203)."<br>The observations on the above are quite similar as provided adjacent to them. | requirements of Part II of Schedule VI to the Companies Act, 1956 the company will have to provide the depreciation on the total book value of the fixed assets (including the increased amount as a result of revaluation) in the Profit and Loss Account of the relevant period, and thereafter the company can transfer an amount equivalent to the additional depreciation from the Revaluation Reserve. Such a transfer from Revaluation Reserve should be shown in the Profit and Loss Account separately and an appropriate note by way of disclosure would be desirable. …" |
| 3. | In the Profit and Loss Account given in the Annual Report of a Company for the Financial Year 2002-03, a company has charged an amount of Rs. 573.83 lacs towards 'Provision for Depreciation' as an extraordinary item. One of the notes provides the following explanation in this regard:<br>"Based on the Report dated | It may be noted that AS 5 'Net Profit and Loss for the Period, Prior Period Items and Changes in Accounting Policies', has defined the term 'Extraordinary Items' as below:<br>"Extraordinary items are income or expenses that arise from the events or transactions that are clearly distinct from the ordinary activities of the enterprise |

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| | 14th July, 99 obtained from a Registered Valuer, the residual life of the machinery installed at X as on 1st July, 99 is determined as 30 years. The Company is of the opinion that the depreciation should be charged, based on the residual life and not at the rate prescribed under Schedule XIV of the Companies Act, 1956. The Company has applied to the Central Government under Section 205(2) (c) of the Companies Act, 1956, for its permission to charge depreciation in the accounts on the basis of residual life and not as per the rates provided in Schedule XIV of the Companies Act, 1956. Therefore, the difference between the depreciation as per Schedule XIV and as per residual life amounting to Rs. 573.86 lacs is considered as an extraordinary item and is disclosed separately in the accounts." | and, therefore, are not expected to recur frequently or regularly."<br>From the note given by the company (referred herein), it appears that the company has applied to the Central Government under Section 205(2)(c) of the Companies Act, 1956, for its permission to charge depreciation at rates which are lower than the rates provided in Schedule XIV to the Companies Act, 1956. Since the permission was not received till date, the company has disclosed the difference between the depreciation as per Schedule XIV and as per residual life as an extraordinary item. This is contrary to the definition of the term 'extraordinary item' given in AS 5, since till the permission was received, the company was required to charge depreciation at the rates specified in Schedule XIV to the Companies Act, 1956. |
| 4. | From the Annual Report of a Company for the Financial Year 2003-04, it has been | It was felt that all losses on the sale of businesses may not necessarily be an extra-ordinary item and, therefore, |

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| | noted that the company has disclosed the loss on the sale of business as an extraordinary item. | an explanation, regarding the nature of the loss disclosed as an extra-ordinary item was required to be provided in the notes to accounts. However, no explanation as to the nature of this item has been provided in the financial statements. This is contrary to AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. |
| 5. | In the Annual Reports of the Companies for the Financial Years 2003-04/ 2005-06, the companies had disclosed the following information with regard to Prior period adjustments:<br>■ Prior period expenses and Income are included in respective heads of expenses and income in the profit and loss account.<br>■ Prior Period Adjustment (Net) was shown under the head of Other Income without mentioning the nature of expenses.<br>The observations on the above are quite similar as | It may be noted that Paragraph 15 of AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, requires that 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.<br>It was also felt that as per the requirements, 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 which is contrary to AS 5. |

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| | provided adjacent to them. | It may be noted that AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines the term 'Extraordinary Items' as below: |
| 6. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has included an extra-ordinary item in the profit and loss account. Further, it has been noted that one of the notes to accounts, provided the following explanation in this regard:<br>"Superintendent Central Excise Range,_____vide _____dated_____ raised a demand on the company for Rs. 28,07,288.00 for service tax in respect of goods transportation and commissioning on clearing and forwarding for the period 16/11/1997 to 02/06/1998. The company has paid the same and shown as an extra ordinary expenditure in current year." | "Extraordinary items are income or expenses that arise from the events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly."<br>It was felt that the amount represents service tax paid by the company in respect of goods transportation and commissioning on clearing and forwarding. It was viewed that goods transportation and commissioning on clearing and forwarding is an ordinary activity for the company. Thus, the service tax paid in this connection was also a part of the ordinary activities of the company and it does not make any difference that the amount was paid pursuant to a demand raised by the concerned authority or otherwise. Disclosing this |

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| | | amount as an extraordinary item is contrary to AS 5. |
| 7. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has shown excise duty provision as a deduction from the value of finished goods.<br>It has also been noted that the above deduction had the effect of closing stock being valued at net of excise duty. | The deduction of excise duty from the closing stock value had the effect of an expense being deducted from the cost of the finished goods which should otherwise have been charged to the profit and loss account. This is contrary to Paragraph 5 of AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, **which requires all expenses to be charged to the profit and loss account.** |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Depreciation, inter alia, provides as below:<br>"Depreciation is being calculated on straight line method based upon the rates and in the manner specified in Schedule XIV (as amended) of the Companies Act, 1956 and on the amount added on revaluation, depreciation is provided on residual life as estimated by the valuers." | It may be noted that Paragraph 26 of AS 6, Depreciation Accounting, provides as follows:<br>***"26. Where the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful lives of such assets. ..."***<br>It was felt that as per the above Paragraph of AS 6, in case of revaluation of fixed assets, depreciation on total revalued amount is required to be provided on one single basis, i.e., the remaining useful lives of assets concerned. However, the company has not followed this requirement and it has provided depreciation on the revalued amount on two different bases (i) on original amount at the rates specified in Schedule XIV to the Companies Act, 1956 and (ii) on the amount added on revaluation, over the residual |

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| | | life as estimated by the valuers. It was viewed that this was not the correct accounting treatment.<br>It may be noted that Schedule XIV to Companies Act, 1956 and AS 6 require that depreciation rates or useful lives of the assets should be disclosed, if they are different from the principal rates specified in the Schedule. It was viewed that the company has used different rates of depreciation for the amount added on revaluation. However, it has not disclosed the depreciation rates or useful lives of the assets which is contrary to Schedule XIV to the Companies Act, 1956 and AS 6. |
| 2. | In the Annual Reports of the Companies for the Financial Year 2003-04/2004-05, the accounting policy regarding 'Depreciation', provides as below, the observations on the same, are quite similar as provided adjacent to them:<br>■ Depreciation on fixed assets has been calculated on Straight Line method on pro-rata | It was felt that the company in case of plant and machinery and another company in case of Crude oil refining and marketing infrastructure for petroleum products and on fixed bed catalyst have charged depreciation at a rate which is different from the rate prescribed in Schedule XIV to the Companies Act, 1956. It may be noted that Schedule |

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| | basis at the rates specified in Schedule XIV of the Companies Act, 1956. However, in case of plant and machineries higher depreciation rates has been charged based upon residual useful life.<br>■ Depreciation on fixed assets has been provided on written down value method at the rate and in the manner prescribed in the Schedule XIV to the Companies Act, 1956 except on fixed assets pertaining to crude oil refining and marketing infrastructure for petroleum products, depreciation has been charged over its residual life on straight line method (SLM); on fixed bed catalyst depreciation has been provided over its useful life ranging from 2 to 9 years…….. | XIV to the Companies Act, 1956 and 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. However, they have not disclosed the same which is a violation of Schedule XIV to the Companies Act, 1956 and AS 6. |
| 3. | From the Profit and Loss Account given in the Annual Report of a Company for the Financial Year 2003-04, | It may be noted that Paragraph 21 of AS 6, Depreciation Accounting, requires that any deficiency |

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| | it has been noted that an amount of Rs. 255,617 thousands has been transferred from general reserve to the profit and loss account, above the line. It has also been noted that one of the notes to accounts provides the following in this regard:<br>"The amount of available free general reserves of Rs. 2556.17 lacs (Rs. 255,617 thousands) has been transferred to the profit and loss account on account of differential depreciation pertaining to earlier years on change in the method of charging depreciation." | or surplus arising from retrospective re-computation of depreciation should be adjusted in the statement of profit and loss. It was felt that the treatment followed by the company has, in substance, the effect of negating this requirement of AS 6 since the company has not affected the profit and loss account for the year by the amount of deficiency arising from retrospective re-computation of depreciation; rather, it has withdrawn an equivalent amount from the general reserves and credited the same to the profit and loss account, above the line. This was not the correct accounting treatment. |
| 4. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Depreciation', inter alia, provides that depreciation on plant and machinery for shut down period is not provided.<br>It was further noted that one of the notes to accounts provides as below:<br>"The company has not | It may be noted that as per the definition of the term 'Depreciation' given in the AS 6, Depreciation Accounting, depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. …<br>Keeping in view the above, it |

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| | provided depreciation on plant and machinery for shut down period of the plant during the year, as a result where of profits for the year has increased by Rs. 11.03 lacs(previous year Rs. 14.89 lacs)." | was felt that the company was required to provide depreciation for the shut down period also. Non-provision of depreciation for this period is contrary to AS 6. |

## Observations on Accounting Standard (AS) 7: Construction Contracts (revised 2002)

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | From the Annual Report of a Company which is engaged in the service sector for the Financial Year 2005-06, it has been noted that the Schedule of Inventory included an item of Job in progress also. | It may be noted that Paragraph 39 of AS 7, Construction Contracts, provides as follow:<br>***"39. An enterprise should disclose the following for contracts in progress at the reporting date:***<br>***(a) the aggregate amount of costs incurred and recognised profits (less recognised loses) up to the reporting date;***<br>***(b) the amount of advances received ; and***<br>***(c) the amount of retentions."***<br>It was observed that the company had not made the required disclosures regarding Job in Progress, which lead to non compliance of AS 7. |

## Observations on Accounting Standard (AS) 9: Revenue Recognition

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In the Annual Reports of the Companies for the Financial Years 2003-04/2004-05, the disclosures with regard to sales as shown on the face of the Profit and Loss Account are noted as below:<br>• 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 a Schedule to the profit and loss account by way of narration only, i.e.; gross sales are not disclosed either in the schedule or on the face of the profit and loss account.<br>• Sales including excise duty are shown on the face of the profit and loss account. The excise duty is shown as an expense in the Schedule 'Manufacturing, | It was viewed that this was contrary to the ASI 14, 'Disclosure of Revenue from Sales Transactions' (Re. AS 9, Revenue Recognition). ASI 14 requires that the amount of turnover should be disclosed in the following manner on the face of the statement of Profit and Loss:<br>Turnover (Gross) xx<br>Less: Excise Duty xx<br>Turnover (Net) xx<br>It was viewed that the sales should have been net of excise duty on the face of Profit & Loss a/c. Further, the authority of this accounting standard interpretation (ASI) is the same as that of the Accounting Standards to which it relates. |

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| | Administrative and Selling Expense'.<br>• Domestic sales as reported in the Profit and Loss Account are exclusive of excise duty, sales tax and the net of trade discounts.<br>The observations on the above are quite similar as provided adjacent to them. | |
| 2. | In the Annual Reports of the Companies for the Financial Years 2002-03/2004-05, the accounting policy regarding Investments provides as below:<br>"Long Term Investments are stated at cost. Dividends are accounted for as and when received." | It was viewed that the policy of accounting for dividends on investments was contrary to AS 9, Revenue Recognition as well as accrual basis of accounting. AS 9, which is based on the accrual basis of accounting, requires that the dividends from investments should be recognised when the investor's right to receive the dividend is established. |
| 3. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Revenue Recognition' provides as below:<br>"Revenue is recognised when no significant uncertainty as to | It may be noted that Paragraph 11 of AS 9, Revenue Recognition lays down the conditions of (i) transfer of all significant risks and rewards of ownership to the buyer; and (ii) the seller retains no effective control of the goods transferred, for |

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| | determination and realization exists."<br>It has also been noted from the profit and loss account and Schedule regarding Other Income given in the Annual Report that the company is having revenue, inter alia, from (i) turnover (sale of goods), and (ii) royalty income and rent from property, which are covered by the requirement of AS 9, Revenue Recognition. | recognition of revenue arising from the sale of goods. However, from the policy followed by the company, it is apparent that the company has not considered these conditions for the recognition of the revenue. This is a clear violation of AS 9. With regard to recognition of the revenue arising from royalty and rent received, Paragraph 13 of AS 9 states that it should be recognised on accrual basis in accordance with the terms of the relevant agreement. However, from the policy, it is clear that the company has not considered this requirement of AS 9. This is also contrary to AS 9. |
| 4. | From the Profit and Loss Account given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has deducted a consolidated figure of excise duty and import fee from sales. | It was viewed that while the excise duty is required to be shown as a deduction from sales as per the ASI 14, 'Disclosure of Revenue from Sales Transactions' (Re. AS 9, Revenue Recognition), no pronouncement of the Institute requires import fees to be shown as a deduction from sales.<br>It was felt that import fees are an expense of the company and should have been shown |

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| | | as an expense in the profit and loss account. Showing import fees as deduction from sales is contrary to the generally accepted accounting principles. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In a Schedule regarding Fixed Assets given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has added an amount of Rs. 1,67,81,646 on account of revaluation of assets in total amount of assets. | It was felt that this is not as per AS 10, Accounting for Fixed Assets. It may be noted that as per AS 10, each individual asset is revalued and stated at revalued amount. The company appears to have retained the value of fixed assets at their cost and surplus on revaluation has been added to total amount of all fixed assets without changing the carrying amounts of individual assets, which is not as per AS 10. |
| 2. | From the Schedule of Reserve & Surplus given in the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the company had the same balance of Revaluation Reserve both in the given year as well as in the immediately preceding financial year. | It may be noted from Paragraph 9 of 'Guidance Note on Treatment of Reserve created on Revaluation of Fixed Assets', that the additional depreciation which represents the depreciation on the increased value should be adjusted against the Revaluation Reserve through Profit and Loss Account.<br><br>It was viewed that certain fixed assets had been revalued but no amount of depreciation relating to such |

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| | | revalued fixed assets had been adjusted against the Revaluation Reserve. |
| 3. | From the Schedule of Other Income given in the Annual Report of a Company for the Financial Year 2004-05, it has been noted that the company had transferred an amount from Revaluation Reserve to Other Income in the profit and loss account. | It may be noted from the Paragraph 9 of 'Guidance Note on Treatment of Reserve created on Revaluation of Fixed Assets' which provides that the company should provide the depreciation on the total book value of the fixed assets (including the increased amount as a result of revaluation) in the Profit and Loss Account of the relevant period, and thereafter, the company can transfer an amount equivalent to the additional depreciation from the Revaluation Reserve. ***Such transfer from Revaluation Reserve should be shown in the Profit and Loss Account separately and an appropriate note by way of disclosure would be desirable.***<br>It was noted that an amount equivalent to additional depreciation had been transferred from revaluation reserve to other income. It was felt that such transfer |

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| | | from revaluation reserve to other income had inflated the figures of other income which was not correct. Further, it was noted that no disclosure had been made for such transfer. It was viewed that such transfer should be adjusted against the total amount of depreciation and an appropriate note by way of disclosure should have been made as required under Paragraph 9 of 'Guidance Note on Treatment of Reserve created on Revaluation of Fixed Assets'. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | As per the accounting policy of the company regarding Foreign Currency Transactions given in the Annual Report of a Company for the Financial Year 2003-04, imports and exports were recorded by the company at the prefixed rates. | It was viewed that the policy for recording imports and exports was not as per AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates which was applicable during the year 2003-04. It may be noted that as per AS 11, a transaction in a foreign currency should be recorded 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. |
| 2. | In the Annual Reports of the Companies for the Financial Years 2002-03/ 2003-04, the accounting policy relating to Foreign Currency Transactions provides as below, the observations on the same, are quite similar as provided adjacent to them:<br>■ Current Assets and Current Liabilities are converted at the forward | It was felt that the policies were not as per AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates. It may be noted that Paragraph 7(a) of AS 11 requires monetary items (and not Current Assets and Current Liabilities) to be converted at the closing exchange rate.<br>Further, it was viewed that being a monetary item, the |

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| | exchange contract rates wherever taken or at the exchange rates prevailing at the year end. The resultant gain or loss is recognised under the revenue heads of accounts.<br>■ Year end balances of foreign currency transactions (other than forward contract transactions) are translated at the year end rates and the corresponding effect is given in the respective Accounts.<br>■ Foreign exchange transactions are recorded at rates of exchange on the dates of the respective transactions. Assets and liabilities designated in foreign currency are converted in rupees at the rates of exchange prevailing as on the balance sheet date or at rate contracted and corresponding adjustments made to the relevant income, expenditure and assets. | short term loans should also be converted at the exchange rate prevailing on balance sheet date.<br>Further, Paragraph 26(i) of AS 11 requires a disclosure of the amount of exchange differences included in the net profit or loss for the period. It was felt that the companies had not made any disclosure of the amount of exchange differences as foreign exchange gain or loss in the Profit and Loss Account as per the requirement of AS 11. |

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| | ■ Current assets and liabilities denominated in foreign currency as at the Balance sheet date are converted at exchange rate prevailing on balance sheet date except in case of short term loans in foreign currency. Exchange differences are recognised as income or expense in the profit and loss account. | |
| 3. | In the Annual Reports of Companies for the Financial Year 2003-04, the accounting policy regarding 'Foreign Currency Transactions', provides as given below:<br>■ Transactions in foreign currencies are recorded at the exchange rates prevailing on the date of transaction. Current assets and current liabilities are translated at the year end rate.<br>■ Current Assets / Current foreign currency transactions are recorded at the exchange rates prevailing on the date of | It was viewed that the accounting policies were not as per AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates. It appears from the policy that all assets and liabilities related to foreign currency transactions, other than those relating to fixed assets and those covered by forward exchange contracts, are translated at the year end rates. This is contrary to Paragraph 7(a) of AS 11 which requires only assets and liabilities in the nature of monetary items (and not current assets and current liabilities) to be converted at the closing exchange rate. |

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| | settlement of the transaction or at the year end rate whichever is applicable.<br>■ Transactions in foreign currency are recorded at exchange rates prevalent at the time of transaction. Foreign currency assets and liabilities are restated at the exchange rate prevailing at the date of balance sheet and at forward contract rates wherever so covered.<br>■ Foreign currency transactions are accounted at the exchange rate on the transaction date. Outstanding year-end balances are translated at the forward contract rates or year-end exchange rate, as applicable.<br>■ Assets and Liabilities denominated in foreign currencies are stated at the exchange rate prevailing on the date of the Balance Sheet except that in case of forward contracts, they | |

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| | are stated at the forward cover rate.<br>The observations on the above are quite similar as provided adjacent to them. | |
| 4. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Foreign Currency Transactions' provides as below:<br>"Gains/ losses arising out of fluctuations in the foreign exchange rates are accounted for in the Profit and Loss Account at the time of realisation or at the year end rates as the case may be." | It may also be noted that Schedule VI to the Companies Act, 1956 and AS 11 require the exchange differences related to loans taken for acquisition of fixed assets to be adjusted in the carrying amounts of the relevant assets. However, the company had dealt with all the differences in the Profit and Loss Account, which was contrary to Schedule VI and AS 11. |
| 5. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Foreign Currency Transactions' provides as follows:<br>"Foreign currency transactions<br>i. In respect of export of goods and services, the transactions in foreign currency are recorded in rupees by applying to | ■ It was viewed that the accounting policy of the company regarding import and export of goods and services is confusing and points no. (i) and (ii) of the policy contradict point no. (iii). From points no. (i) and (ii), it appears that the company is not translating creditors and debtors arising from foreign currency transactions at the balance sheet date |

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| | the foreign currency amount the exchange rate prevailing on the date of the transaction. Any excess or shortfall at the time of actual realisation is credited or debited to the exchange difference account.<br>ii. In respect of import of goods and services, the transactions in foreign currency are recorded in rupees by applying to the foreign currency amount the exchange rate prevailing on the date of the transaction. Any excess or shortfall at the time of actual payment is debited or credited to the exchange difference account.<br>iii. Assets and liabilities related to foreign currency transactions other than for fixed assets remaining unsettled at the end of the financial year are translated at the contract rate, when covered by forward exchange contracts, and | since it is recognising excess and shortfalls arising on foreign currency translations on actual payment/ realisation in the exchange difference account. However, from point no. (iii), it appears that the company is translating all foreign currency assets and liabilities, including debtors and creditors arising from export and import of goods and services, except those covered by the forward exchange contracts, at the exchange rate prevailing on the balance sheet date. Keeping in view the requirements of AS 11 (revised 1994), 'Accounting for the Effects of Changes in Foreign Exchange Rates', the company was required to translate debtors and creditors arising from export and import of goods and services at the exchange rate prevailing on the balance sheet date.<br>■ From point no. (iii), it appears that all assets and liabilities relating to foreign |

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| | at year-end rates in other cases. The gains or losses arising on foreign exchange transactions other than those relating to fixed assets are recognised in the profit and loss account.<br>iv. In respect of import of capital goods, the transaction in foreign currency is recorded in rupees by applying to the foreign currency amount the exchange rate prevailing on the date of transaction. The liabilities incurred and loans taken for acquiring fixed assets remaining unsettled at the end of the financial year are translated on the basis of exchange rate prevailing at the end of accounting year. Exchange differences in respect of liabilities incurred and loans taken to acquire fixed assets are adjusted to the carrying amount of the respective fixed assets or in capital | currency transactions, other than relating to fixed assets and except those covered by the forward exchange contracts, are translated at the year-end rates. This is contrary to Paragraph 7(a) of AS 11 (revised 1994) which requires only assets and liabilities in the nature of monetary items to be converted at the closing exchange rate. |

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| | work-in-progress/ capital advances." | |
| 6. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that one of the notes provides as below :<br>"During the previous year, in respect of import of raw materials, where the Company was required to make advance payments, the transaction in foreign currency was recorded in rupees by applying to the foreign currency amount, the exchange rate of actual remittance instead of accounting the same on the basis of the exchange rate prevailing on the date of transaction, as required by AS 11, Accounting for the Effects of Changes in Foreign Exchange Rates, issued by the Institute of Chartered Accountants of India. Impact of the above on the loss for the previous year and value of inventories (Raw materials, Work-in-progress and Finished goods) and accumulated losses as at 31st March, 2003 could not be ascertained." | It was viewed that the company itself has admitted that the treatment given by it is not as per AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates. It may also be noted that as per Paragraph 23 of AS 1, Disclosure of Accounting Policies, a disclosure cannot remedy a wrong or inappropriate treatment of the items in the accounts. It was also felt that despite the disclosure in the notes to accounts, the treatment accorded by the company continues to be contrary to AS 11 (revised 1994). |

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| 7. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy relating to 'Conversion of Foreign Currencies' provides as below:<br>"The export sales are accounted with reference to the Mate's Receipt. The foreign currency loans and current assets outstanding on the date of Financial Statements are stated at the relevant exchange rates prevailing at the close of the year. The exchange differences arising from foreign currency transactions are dealt with in the Profit and Loss Account." | It was felt that the policy is not as per AS 11(revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates. It may be noted that as per Paragraph 5 of AS 11, the export sales should have been converted by applying the rate existing on the date of transaction and not any other rate.<br>It may also be noted that Schedule VI to the Companies Act, 1956 and AS 11 require the exchange differences related to loans taken for acquisition of fixed assets to be adjusted in the carrying amounts of the relevant assets. However, the company has dealt with all the differences in the Profit and Loss Account, which is contrary to Schedule VI and AS 11. |
| 8. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Foreign Currency Translations provides as below:<br>"In case of export sales, those that are realised/ negotiated during the year | It was viewed that the policy of the company regarding export sales realised/ negotiated during the next year is contrary to AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates. As per AS 11, these amounts would be monetary items |

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| | are accounted at equivalent rupee earned or contracted and those realised/ negotiated during the next financial year are accounted provisionally at rates at which packing credits are availed." | which as per Paragraph 7(a) of the AS 11 are required to be converted at the closing exchange rate. |
| 9. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Foreign Currency Transactions' provides as below:<br>"All payments and receipts are translated at the exchange rate ruling on the date of transaction." | It was felt that the accounting policy of the company is incomplete and is not clear, i.e., it does not indicate as to how foreign currency assets and liabilities on the balance sheet date are translated and how exchange differences arising on the translation are dealt with. In absence of specific mention to this aspect, it appears that the company may not have complied with AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates in this regard. In any case, the company has not made appropriate disclosure of its accounting policy on the matter which is not as per AS 1, Disclosure of Accounting Policies. |
| 10. | In the Annual Report of a Company for the Financial Year 2003-04, the | It was viewed that the accounting policy of the company regarding foreign |

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| | Accounting Policy regarding 'Translation of Foreign Currency Transactions' provides as follows:<br>"Foreign currency loans in respect of fixed assets are translated at exchange rates prevalent on that day. Any loss or gain arising out of such transaction at the time of payment is added/ deducted from the cost of the fixed assets and depreciation is also charged/ adjusted on such differences. Exchange differences arising on Foreign Currency Transactions in respect of revenue items are considered in the Profit & Loss Account." | currency loans in respect of fixed assets is not as per AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates as the company is not translating loans at the balance sheet date. It is recognising loss or gain arising out of such transactions only at the time of payment.<br>It was felt that the accounting policy of the company regarding other items is not clear. For instance, from the last sentence it is not clear as to how the company is recording transactions initially and how the various foreign currency assets and liabilities are converted at each balance sheet date. In absence of specific mention to this aspect, it appears that the company may not have complied with AS 11 (revised 1994). In any case, the company has not made appropriate disclosure of its accounting policy on the matter, which is not as per AS 1, Disclosure of Accounting Policies. |

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| 11. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Inventories' provides, inter alia, the following with regard to imported inventory:<br>"Stocks, for which payments were still outstanding on 31st March, 2004 are accounted for at the applicable exchange rates prevailing on that date." | It was viewed that it is apparent that the company has adjusted exchange differences relating to imported inventories, which were not paid till 31st March 2004 as a part of the cost of related inventories.<br>It was felt that this is contrary to AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates. It may be noted that AS 11 requires the exchange differences related to loans taken for acquisition of fixed assets to be adjusted in the carrying amounts of the relevant assets. Apart from this, all other exchange differences are required to be charged to the profit and loss account. Thus, the treatment followed by the company is not as per the requirement of AS 11. |
| 12. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Foreign Exchange Transactions' provides as follows:<br>"Realised gains and losses on foreign exchange | It was viewed that the company is recognising only realised gains and losses on foreign exchange transactions, other than those relating to fixed assets, in the profit and loss account. This is also contrary to AS 11 (revised 1994) which requires all |

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| | transactions other than those relating to fixed assets are recognised in the profit and loss account." | exchange differences arising on foreign currency transactions, except those relating to fixed assets, to be recognised immediately in the profit and loss account. From the accounting policy of the company, it has been felt that the treatment of unrealised gains and losses on foreign exchange transactions is not clear. Thus, the accounting policy of the company is incomplete to this extent. It was also viewed that the company has not disclosed the amount of exchange differences included in the net profit or loss for the period, which are required to be disclosed as per AS 11 (revised 1994). |
| 13. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Sales' provides as below:<br>"Sales are inclusive of income from services, excise duty, export incentives and exchange fluctuation on export sales and net of trade discounts." | It may be noted that Paragraph 26(i) of AS 11 (revised 1994), Accounting for the Effects of Changes in Foreign Exchange Rates, requires a disclosure of the amount of exchange differences included in the net profit or loss for the period. It was felt that as per the requirements of this Paragraph, the company has not made any disclosure of the amount of exchange differences. |

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| 14. | In the Annual Report of a Company for the Financial Year 2004-05, the accounting policy regarding 'Foreign Currency Translations' provides as below:<br>"The Foreign currency balances receivable/payable as at the year end are converted at the closing rate and the exchange difference has been recognised in the profit and loss or adjusted in the value of fixed assets, as applicable." | It has been viewed that the accounting policy of the company regarding foreign currency translation is incomplete. The company has not disclosed the policy regarding initial recognition of foreign currency transactions. This was an important part of accounting policy regarding foreign currency transactions and the company should have disclosed the same.<br>Further, it was felt that it was not clear from the policy that in which case foreign exchange differences are adjusted to the cost of fixed assets. In the absence of specific mention, it is possible that all exchange differences arising from the liabilities related to fixed assets are adjusted in the cost of fixed assets. It may be noted that as per AS 11 (revised 2003), read with the Announcement on 'Treatment of Exchange differences under Accounting Standard (AS 11) (revised 2003), The effects of changes in Foreign Exchange rates vis-à-vis Schedule VI to the Companies Act, 1956, only exchange differences related |

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| | | to liabilities incurred for acquisition of fixed assets from a country outside India can be capitalised as a part of the cost of fixed assets. In case the company has capitalised any other exchange differences also, it would be contrary to AS 11 (revised 2003). It was also viewed that in any case, the accounting policy of the company on the matter is not clear which is a violation of AS 1, Disclosure of Accounting Policies. |
| 15. | In the Annual Report of a Company for the Financial Year 2005-06, the accounting policy relating to Commodity Hedging Transactions is stated, as below:<br>"The Company has adopted a policy to minimise the risks associated with fluctuation in the price of oils by hedging contracts. However, the company does not conduct speculative business operations in the future markets. The results of oil hedging are recorded at their settlement as a part of | It was felt that the accounting treatment as adopted by the company for recognising foreign exchange fluctuation arising due to hedging contracts is not in line with AS 11.<br>It may be noted that Paragraph 36 of AS 11, Changes in Foreign Exchange Rates, deal with accounting for a forward exchange contract or any other financial instrument that is in substance intended for hedging purposes states that "an enterprise may enter into a forward exchange contract or another financial |

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| | material cost.” | 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 (emphasis added).** 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.”<br><br>It was noted that the company had recorded the effects of these Commodity hedging transactions as a part of the material cost instead of showing it as Gain or Loss due to foreign exchange fluctuation separately in the Profit and Loss Account. |

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| | | Further, the premium or discount that arose during the inception of such contract had not been dealt by the company to reflect the true and fair view of foreign exchange fluctuation. |
| 16. | In the Annual Report of a Company for the Financial Year 2005-06, the accounting policy regarding Revenue Recognition provides as below:<br>"Net Sales are exclusive of VAT, Central Sales Tax and include exchange difference on sales transactions."<br>Further, it was noted that the gain / loss arising due to exchange fluctuation had been disclosed under Schedule of 'Other Income'. | It may be noted that as per Paragraph 4.1 of AS 9 that 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, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends."<br>Further, it was noted that paragraph 13 of AS 11, provides that the "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 |

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| | | exception of exchange differences dealt with in accordance with paragraph 15."<br><br>It was observed that the inclusion of gain or loss, arising due to exchange fluctuation, separately under the head of 'Other Income', is in line with AS 9 and AS 11. However, it may be stated that the accounting policy adopted for revenue recognition is neither in line with AS 9 nor with AS11.<br><br>It was viewed that since foreign exchange fluctuations arising due to sales are monetary items, therefore, as per paragraph 13 of AS 11, it cannot be construed as a part of revenue. |
| 17. | In the Annual Report of a Company for the Financial Year 2004-05, the company had provided the accounting policy regarding Foreign Currency Transactions and the additional information given in notes to accounts also contain the disclosures pertaining to the value of imported & exported goods, expenditure in foreign currency, consumption of | It may be noted that paragraph 40 (a) of AS 11, The Effects of Changes in Foreign Exchange Rates, provides that an enterprise should disclose the amount of exchange differences, included in the net profit or loss for the period.<br><br>It was observed that as the company was engaged into foreign currency transactions due to which exchange |

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| | imported raw materials and stores & spares. | difference would arise. However, no disclosure of the same had been made in the Profit and Loss Account. It was also viewed that in case, if there had been null effect due to foreign exchange fluctuation then the same should have been stated rather than omitting the same from the financial statements. |
| 18. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the company was involved in voluminous transactions of foreign currency which included export of finished goods, import of raw material, revenue expenditure as well as capital expenditure. | Considering the volume of transactions, it was felt that the company may have incurred the gain/loss on account of foreign exchange transaction, however, it had not disclosed any gain or loss on such foreign exchange fluctuation in the Profit and Loss Account.<br><br>Keeping in view of above, it was felt that the company was required to report the gain/ loss on account of foreign currency transaction and non reporting of the same is contrary to the generally accepted accounting principle. Hence, it was viewed that the Profit and Loss Account might not be giving a true and fair view of the financial statements of the company. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | From the Profit and Loss Account given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has clubbed 'subsidy on fertilisers' with the sales amount. | It was felt that this is contrary to paragraph 15 of AS 12 Accounting for Government Grants, which provides the following with regard to recognition of government grants related to revenue: ***"15. Government grants related to revenue should be recognised on a systematic basis in the profit and loss statement over the periods necessary to match them with the related costs which they are intended to compensate. Such grants should either be shown separately under 'other income' or deducted in reporting the related expense."*** |

## Observations on Accounting Standard (AS) 13: Accounting For Investments

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding investments provides as below:<br>"Investments are stated at the cost of acquisition. Provisions for diminution in the value of Investments are made only if such decline is other than temporary, in the opinion of the management." | It was viewed that as per AS 13, Accounting for Investments, this policy is required to be followed for the valuation of long-term investments. It may be noted that as per paragraph 31 of AS 13, current investments should be carried in the financial statements at the lower of cost and fair value. It was felt that the accounting policy of the company is not as per AS 13 to the extent it relates to the current investments.<br>It may be noted that as per paragraph 26 of AS 13, an enterprise should disclose current investments and long-term investments distinctly in its financial statements. However, the company has not made this disclosure in the Investments schedule. |
| 2. | As per the accounting policy regarding Investments given in the Annual Report of a Company for the Financial Year 2003-04, the Investments were stated at cost. | It was felt that the policy for valuation of Investments was not as per AS 13, Accounting for Investments. It may be noted that as per AS 13, investments classified as current investments should be carried in the financial |

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| | | 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. Investments classified as long term investments should be carried in the financial statements at cost. However, the provision for diminution should 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. |
| 3. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Investments provides as below:<br>"Current investments are valued at lower of cost and fair value and Long-term investments are valued at cost. Provision is made for any permanent diminution in the value of investments." | It was viewed that the policy regarding valuation of long-term investments was not as per AS 13, Accounting for Investments.<br>It may be noted that paragraph 32 of AS 13 requires that long term investments should be carried in the financial statements at cost. However, the provision for diminution should be made to recognise a decline, other than temporary, in the value of the investments. It was felt that there was a difference between |

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| | | '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. |
| 4. | The accounting policy regarding Investments given in the Annual Report of a Company for the Financial Year 2003-04, provides as below:<br>"Investments are considered as long term and stated at cost. Provisions for diminution in value of long-term investments are made, if the diminution is other than temporary."<br>It has also been noted that a note given under the notes to accounts provides as below:<br>"Investments in 6% non cumulative redeemable preference shares amounting to Rs. 156,441 (Rs. 194,644), of its various distribution companies (network management companies) are valued at cost, keeping in view its strategic business interest in | It was viewed that the companies were having negative net worth clearly indicating that the diminution in the value of investments was other than temporary. Accordingly, the company was required to create a provision in respect thereof as per the requirements of AS 13, Accounting for Investments, as well as the accounting policy stated to have been followed by the company. In such a case, it did not make any difference that business interests in these companies were strategic.<br>Non-creation of a provision for decline in the value of investments was contrary to AS 13 as well as the accounting policy stated to have been followed by the company. |

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| | these distribution companies, though these companies have a negative net worth." | |
| 5. | In the Schedule of Investments given in the Annual Reports of the Companies for the Financial Years 2003-04/2004-05 / 2005-06, Investments were classified in different ways, an illustrative list of which is provided as given below:<br>■ Long term investments and trade investments<br>■ In Government Securities (unquoted)<br>In Shares and Bonds<br>Quoted<br>Unquoted<br>■ Investment in Subsidiary<br>The observation on the above are quite similar as provided adjacent to them. | It was viewed that the stated classification of investments neither meets the requirements of Schedule VI to the Companies Act, 1956, nor AS 13, Accounting for Investments.<br>It may be noted that Part I, Schedule VI to the Companies Act, 1956, requires investments to be bifurcated into trade and non-trade investments. It may also be noted that paragraph 26 of AS 13 requires that an enterprise should disclose current investments and long-term investments distinctly in its financial statements.<br>Thus, it was viewed that the companies had not complied with the requirements of AS 13 as well as Part I, Schedule VI to the Companies Act, 1956 with regard to Investment. |
| 6. | From a Schedule to the Profit and Loss Account regarding Other Income given in the Annual Reports | It may be noted that Paragraph 3(xi) (a) of Part II, Schedule VI to the Companies Act, 1956, |

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| | of Companies for the Financial Years 2003-04/ 2005-06, it has been noted that the companies had reported only one figure under the head of 'Other Income' instead of bifurcating the same into the Interest Income and Dividend income. | requires that the amount of income from investments should be shown distinguishing between those arising from trade investments and other investments and Paragraph 3(xi) (b) of Part II, Schedule VI to the Companies Act, 1956 requires that the amount and the nature of income by way of interest, should be disclosed in the Profit & Loss Account. It may also be noted that, Paragraph 35(c)(i) of AS 13, Accounting for Investments, requires that the interest or dividend income from investments should be shown separately for long-term and current investments. It was viewed that by reporting the clubbed figure of interest and dividend income, the company has not made disclosures as per the requirements of Schedule VI to the Companies Act, 1956 and AS 13. |
| 7. | In the Annual Report of a Company for the Financial Year 2003-04, one of notes to accounts, *inter alia*, provides as below:<br>■ "Exceptional Items | It was viewed that in the circumstances indicated in the notes, the amounts due from the XYZ Ltd. not seem to be recoverable. Rather, as per the scheme of |

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| | written off:<br>(a) …<br>(b) In pursuance to Board for Industrial & Financial Reconstruction (BIFR) interim directions under a newly formulated Scheme for (XYZ), the company has written back Rs. 15,24,88,838 against the earlier provision made towards Loans & Advances given to XYZ. On receipt of the final sanction of BIFR, the company shall convert these Loans and Advances into Equity Shares/ Cumulative Redeemable Preference Shares of the equivalent amount.<br>■ In terms of Tripartite Agreement, the Company had issued Equity Shares, Debentures and made payments to Financial Institutions and Banks towards One Time Settlement (OTS) of (XYZ). The Company, however, has entered into an 'Agreement to | reconstruction of XYZ submitted to the Board for Industrial and Financial Reconstruction (BIFR), these amounts were to be converted into Equity Shares/ Cumulative Redeemable Preference Shares. It was felt that after making all these conversions, the net worth of XYZ would be positive, was also merely an opinion of the management. It was further viewed that even if the amount of loans & advances got converted into Equity Shares/ Cumulative Redeemable Preference Shares and the XYZ's net worth actually became positive as opined by the management, only a part of the value of these shares would be represented by the assets since, at present, net worth of XYZ was negative. It was felt that in these circumstances, the writing back of the provisions made by the company was not justified.<br>It was also felt that pursuant to the scheme, which was yet to be sanctioned by BIFR, the company expected to receive Equity Shares/ Cumulative |

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| | Sell' for Purchase of Assets of XYZ and shown as Capital Advances.<br>■ The Company has further receivables amounting to Rs. 15,24,88,838 lacs from XYZ on account of loans, advances, interest and claim receivables. XYZ has submitted a technically feasible and economically viable revival scheme with BIFR. The scheme, inter alia, includes conversion of these Capital Advances, Loans and Advances into Equity Shares/Cumulative Redeemable Preference Shares of the XYZ pursuant to the terms of the Scheme to be approved by BIFR. In the opinion of the management upon such conversion, XYZ's net worth would be positive.In terms of the requirement of section 372A(1) of the Companies Act, 1956, | Redeemable Preference Shares of XYZ against the Loans and Advances granted by the company. Since the scheme was not sanctioned by BIFR till the date, it was inappropriate for the company to take cognisance of the same and reverse the provision, which had already been recognised. Without prejudice to the above, it was also viewed that even if it was presumed that Loans and Advances would get converted into shares, it may be noted that paragraph 29 of AS 13, Accounting for Investments, provided the following with regard to the cost of investments acquired against another asset:<br>**"....if an investments acquired in exchange for another asset, the acquisition cost of the investment should be determined by reference to the fair value of the asset given up. Alternatively, the acquisition cost of the investment may be determined with reference to the fair value of the investment may be** |

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| | the conversion has been approved by the members of the Company in the last Annual General Meeting which was held on 24.09.2003." | **determined with reference to the fair value of the investment acquired if it is more clearly evident."**<br>It was felt that in absence of specific mention to this effect, it did not seem likely that the fair value of shares of XYZ would be more clearly evident or these would have value at least equal to their face value, particularly for the reason that XYZ was a loss making company and having negative net worth. It was also viewed that in such circumstances, as per AS 13 the company would be required to recognise shares of XYZ with reference to the fair value of Loans and Advances, which would be net of provisions. Accordingly, it was not appropriate for the company to reverse the provision on Loans and Advances and it would be contrary to AS 13 also. |
| 8. | In the Investment Schedule given in the Annual Report of a Company for the Financial Year 2003-04, the company has disclosed 283 Ordinary Shares of M/s XYZ Industries Limited of Rs. 10 | It was felt that the company has sold 1,150 shares during the year, which included all the shares that were purchased by the company. The shares remaining at the year-end have been received |

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| | each (Bonus) for a value Rs. Nil. The previous year figures in respect of these shares indicate that the number of shares held at the end of the previous year was 1,433 and their value was Rs. 57,840. | as Bonus Shares. It was also viewed that the company has followed the FIFO method of valuation in this regard.<br>It was felt that this is contrary to AS 13, Accounting for Investments. It may be noted that paragraph 22 of AS 13 requires that when disposing of a part of the holding of an individual investment, the carrying amount to be allocated to that part is to be determined on the basis of the average carrying amount of the total holding of the investment. |
| 9. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Investments provides as below:<br>"Investments are stated at cost inclusive of all expenses incidental to acquisition. Provision for diminution in value of investments other than permanent, are determined for each investment individually which is credited in Investment Fluctuation Reserve by transfer from | It was felt that the policy is not as per AS 13, Accounting for Investments. It may be noted that paragraph 31 of AS 13 requires that current investments should be carried in the financial statements at the lower of cost and fair value. Further, paragraph 32 requires that long term investments should be carried in the financial statements at cost. However, a provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments. It may be |

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| | Profit & Loss Appropriation Account." | noted that AS 13 does not require a provision to be created in respect of other than permanent decline either in respect of current investments or in respect of long term investments.<br><br>It was viewed that the company is not charging diminution in value of investments to the Profit and Loss Account. Rather, the company is transferring an equivalent amount from the Profit and Loss Appropriation Account to the Investment Fluctuation Reserve. This treatment is not as per AS 13. It may be noted that paragraph 33 of AS 13 requires that any reduction in the carrying amount of investments should be charged to the Profit and Loss Account. It was felt that the incorrect treatment followed by the company is resulting in overstatement of value of investments as well as in overstatement of reserves by an equal amount. Further, from the 'Reserves and Surplus' Schedule, it was also viewed that the company has created the Investment Fluctuation |

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| | | Reserve of Rs. 645,755,440 in this manner which is totally incorrect and violative of AS 13. |
| 10. | From the Profit and Loss Account in the Annual Report of a Company for the Financial Year 2003- 04, it has been noted that the company has credited Rs. 15.12 lacs toward 'Provision for diminution in value of Investment written back' after determination of profit after tax for the year, i.e., below the line. | It was felt that this is not as per AS 13, Accounting for Investments. It may be noted that paragraph 33 of AS 13 requires any reversal of reduction in the carrying amount of an investment should be credited to the Profit and Loss Account, i.e., above the line. |
| 11. | From the Schedule of Investments given in the Annual Report of a Company for the Financial Year 2004-05, it was noted that the company had invested in various units and bonds but omitted to provide the accounting policy as adopted by it to determine the value of such investments. | It may be noted from the paragraph 35 of AS 13, Accounting for Investments, interalia, it also requires to disclose:<br>***"35. (a) the accounting policies as adopted by the company for determination of carrying amount of investments;"***<br>It was noted that although the company holds certain investments in Schedule of Investments but the accounting policy for determination of their carrying cost had not been disclosed which is contrary to the requirements of AS 13. |

## Observations on Accounting Standard (AS) 15: Accounting for Retirement Benefits in the Financial Statements of Employers

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Retirement Benefits relating to gratuity and leave encashment provides as follows:<br>"Gratuity and leave encashment are charged to Profit & Loss Account through a provision for accruing liabilities based on the assumption that such benefits are payable to eligible employees at the end of the accounting year." | It may be noted that as per paragraph 17(i) of the AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers (issued 1995), the policy adopted by the company can be followed only by those enterprises which employ only a few persons.It was noted that the company's turnover for the year 2003-04 was more than 110 crores and its expenses on salary and bonus were in excess of Rs. 4 crores. It was viewed that the company was not covered by paragraph 17(i) of AS 15 and, therefore, as per AS 15, it was required to create a provision for gratuity and leave encashment based on the actuarial valuation. |
| 2. | In the Annual Reports of the Companies for the Financial Years 2002-03/2003-04/ 2004-05, the accounting policy regarding Retirement Benefits, provides as given below:<br>• The Company | It may be noted that Paragraph 31 of AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers (issued 1995), requires the following disclosures to be made in the financial |

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| | contributes towards provident and pension fund which is administered by the Central Government and are charged against revenue every year.<br>• Gratuity in respect of existing employees is provided on the basis of actuarial valuation.<br>• The liability for gratuity is assessed actuarially by LIC and the deficiency, if any, in the fund balance as compared to the actuarial liability is provided for.<br>• The liability in respect of Leave Encashment on retirement and Post Retirement Medical Benefits is determined on the basis of actuarial valuation and provided for.<br>• The Provident Fund Scheme is a defined contribution plan for which the contribution accruing during each year as per the scheme is expensed. | statements:<br>**"31. The financial statements should disclose the method by which retirement benefit costs for the period have been determined. In case, the costs related to gratuity and other defined benefit schemes are based on an actuarial valuation, the financial statements should also disclose whether the actuarial valuation was made at the end of the period or at an earlier date. In the latter case, the date of the actuarial valuation should be specified and the method by which the accrual for the period has been determined should also be briefly described, if the same is not based on the report of the actuary."**<br>It was viewed that certain companies had neither disclosed the method of determination of the cost of retirement benefit nor had they disclosed the date of valuation. In other cases, although the liability for retirement benefit was determined on the basis of |

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| | The observations on the above are quite similar as provided adjacent to them. | actuarial valuation, however, the companies had not disclosed as to whether the actuarial valuation was made at the end of the period or at an earlier date as required by Paragraph 31 of AS 15. |
| 3. | The accounting policy regarding 'Retirement Benefits' on the leave encashment/gratuity given in the Annual Reports of the Companies for the Financial Year 2003-04 provides as below, the observations on the same, are quite similar as provided adjacent to them:<br>■ The liability in respect of leave encashment as determined on the basis of accumulated leave to the credit of employees as at the year-end is charged to the Profit and Loss Account.<br>■ Leave encashment benefit is provided on the basis of actual liability as at the year end depending on the last drawn salary and the un-availed leave, subject to the maximum ceiling prescribed, to the | It was viewed that the companies have not determined the liability for leave encashment/ gratuity on actuarial basis, which is contrary to AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers (issued 1995). |

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| | credit of each eligible employee.<br>■ In accordance with Accounting Standard 15 "Accounting for Retirement Benefits in the Financial Statements of Employers", the company has made provisions for gratuity and leave encashment on accrual basis. The gratuity liability as on 31.03.2004 has been provided based on the assumption that such benefits are payable to all eligible employees at the end of the accounting year. The provision for leave encashment has been made based on current salary for the entire unavailed leave balance as at the balance sheet date. | |
| 4. | The accounting policy regarding Retirement Benefits given in the Annual Reports of the Companies for the Financial Year 2003-04, provides as below, the observations on the same, | It was viewed that the treatment followed by the companies were contrary to AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers (issued 1995) as |

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| | are quite similar as provided adjacent to them:<br>■ Post-retirement medical benefits were accounted for on the basis of actual eligible claims passed. No provision was made on this account during the tenure of service of employees.<br>■ Leave encashment benefit is accounted for on a cash basis.<br>■ No provision has been made for employee retirement benefits like gratuity. They will be charged to the Profit and Loss Account in the year of actual payment. | well as accrual basis of accounting as mandated under Section 209(3)(b) of the Companies Act, 1956. |
| 5. | In the Annual Reports of the Companies for the Financial Year 2003-04, the accounting policy regarding 'Retirement Benefits', provides as given below:<br>■ Company's contributions to Provident Fund are charged to profit and loss account. Leave encashment is provided in terms of contractual obligations as per company's Rules. The | It was noted that the companies had neither disclosed the method of determination of the cost of retirement benefit nor it had disclosed the date of valuation which is contrary to paragraph 31 of AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers (issued 1995). Further, in the absence of a specific mention to this effect (method of |

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| | liability towards Gratuity in respect of eligible employees is covered by a Group Gratuity Scheme with Life Insurance Corporation of India. The premium paid during the year under the Scheme is being charged to Profit and Loss Account.<br>■ Superannuation Scheme is a defined benefit plan, which is funded with the Life Insurance Corporation of India (LIC) and the annual contributions to the fund is expensed. | valuation), it appeared that the companies had not determined the liability for retirement benefit related to defined benefit schemes, on actuarial basis, which is also contrary to AS 15.<br>It was felt that the companies had not indicated in the accounting policy as to whether the contribution made to LIC/ funded by LIC, was the appropriate accrual of the liability for the year or not. The companies had also not indicated as to whether group gratuity scheme of LIC covers all past as well as present liabilities or it covers only the present liability for the current year. It was viewed that in the absence of specific mention to this effect, it is possible that the group gratuity scheme of LIC did not cover past liabilities and/ or that the contribution made was not the appropriate accrual of the liability for the year. It was further felt that in such cases, the companies were required to create a provision for past liability in the books and/ or additional liability for the year, as |

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| | | appropriate. However, in case the companies had ignored this aspect, then it would be contrary to AS 15 as well as accrual basis of accounting. |
| 6. | From an Annexure to the Profit and Loss Account regarding 'Personnel Expenses' given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the amount of gratuity expenses charged to the Profit and Loss Account during the current year is almost 10 times of the gratuity expenses charged during the previous year. The gratuity expenses charged to the Profit and Loss Account during the current year is Rs. 12,547,953 as compared to previous year expenses of Rs. 1,247,091 only.<br><br>It has been further observed that the accounting policy of the company regarding Gratuity states as follows:<br><br>"The company has constituted a Gratuity Cum Life Assurance Fund Scheme w.e.f. 01.06.80 for the employees and full | It has been noted that in a sharp contrast to this, other employee related expenses continue to be almost constant and have increased only by a negligible amount.<br><br>It was felt that in a scenario where other employee related expenses are constant, almost 10 times increase in gratuity expenses during the year makes the same of such an incidence which would require a separate disclosure as per the paragraph 12 and 13 of AS 5, Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies. It was also viewed that to meet the requirements of the above paragraphs, the company should have, *inter alia,* disclosed the exact nature of increase in expenses, i.e., the reason for increase. However, the company has not disclosed the same, which is contrary to AS 5.<br><br>Regarding the liability covered |

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| | amount of premium due during the year has been charged to Profit and Loss Account. However, a separate provision is made in the accounts for the liability towards gratuity for employees which are not covered under the above scheme."<br><br>Further, one of the notes to accounts provides as below:<br><br>"During the year the company has made a provision for gratuity liability for a sum of Rs. 11,274,500 in respect of Gratuity cum Life insurance fund scheme determined by Life Insurance Corporation of India." | by the Gratuity Cum Life Assurance Fund Scheme, it was noted that the company has stated that the amount of premium due during the year has been charged to the Profit and Loss Account. However, the company has not mentioned as to whether the said premium is the appropriate accrual of the liability for the year or not. The company has also not indicated as to whether the scheme covers all past as well as present liabilities or it covers only the present liability for the current year. It was felt that in the absence of specific mention to this effect, it is possible that the scheme does not cover past liabilities and/ or that the premium charged is not the appropriate accrual of the liability for the year. It was viewed that in such a case, the company was required to create a provision for past liability in the books and/ or additional liability for the year, as appropriate. However, in case the company has ignored this aspect, then it would be contrary to AS 15, |

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| | | Accounting for Retirement Benefits in the Financial Statements of Employers (issued 1995) as well as accrual basis of accounting. Regarding the gratuity liability not covered by the Gratuity Cum Life Assurance Fund Scheme, it may be noted that the company has neither disclosed the method of determination of the cost of gratuity not covered by the scheme nor it has disclosed the date of valuation as per the requirements of the paragraph 31 of AS 15. It was viewed that in the absence of a specific mention to this effect, it appears that the company has not determined the liability on actuarial basis which is also contrary to AS 15. |
| 7. | In the Annual Report of a Company for the Financial Year 2003-04, one of the notes to account provides as below:<br>"The present value of accrued gratuity liability valued by the Life Insurance Corporation of India on the annual renewal date i.e. 01-04-2004 amounted to | It was viewed that under provision of liability towards gratuity to the extent of Rs. 41.33 lacs is a clear violation of AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers (issued 1995). |

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| | Rs. 442.86 lacs. As against these funds available with LIC on renewal date amounted to Rs.1.53 lacs. Therefore, an amount of Rs.441.33 lacs is un-provided. The company expects to meet this liability in due course with enhanced funding of the contribution." | |
| 8. | In the Annual Report of a company for the Financial Year 2004-05, the accounting policy regarding Retirement Benefits provided the method by which the Gratuity and Leave encashment had been recognised in the financial statements. Further, it has been noted from Schedule of expenses that there was a contribution to the provident fund and other funds. | It may be noted that Paragraph 31 of AS 15 (issued 1995), Accounting for Retirement Benefits in the Financial Statements of Employers, which provides that<br>**"31. The financial statements should disclose the method by which retirement benefit costs for the period have been determined……"**<br>It was observed that the company had not disclosed the accounting policy, according to which contribution to schemes such as Provident Fund and other funds had been recognised in the financial statements. It was not as per the requirement of AS 15. It may |

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| | | also be mentioned that Schedule VI requires separate disclosure of Contribution to Provident and Other Funds. |
| 9. | In the Annual Report of the Company for the Financial Year 2004-05, the accounting policy regarding Retirement Benefits states that the provision for gratuity is made on accrual basis. However, it has been noted that in the relevant schedule to accounts no separate provision had been made towards retirement gratuity. | It was felt that the information contained in the accounts is not in line with accounting policy as is stated by the company. Therefore, it was viewed that the account had not been presented as per the accounting policy disclosed by the company, thus, affecting a true and fair view of accounts. |

## Observations on Accounting Standard (AS) 16: Borrowing Costs

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Borrowing Costs provides as below:<br>"Borrowing costs are recognised in the Financial Statements except in respect of specific borrowing raised for acquisition of capital assets until such time the asset is ready to be put to use for its intended purpose, which are added to carrying cost of such assets." | From the policy, it appears that the borrowing costs incurred on any general borrowing used for the acquisition of qualifying assets are expensed. It was viewed that this is contrary to the requirements of AS 16, Borrowing Costs.<br>It may be noted that as per the Standard, all borrowing costs (including those related to general borrowings) that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as a part of the cost of that asset. It may further be noted that paragraph 12 of AS 16 provides the following with regard to determination of borrowing costs relating to general borrowings, eligible for capitalisation:<br>**"12. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for** |

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| | | **capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period."** |
| 2. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Inventories' provides the following with regard to the valuation of finished goods:<br>"Finished goods are valued at lower of cost or net realisable value; costs include depreciation, | It may be noted that paragraph 12 of AS 2, Valuation of Inventories provides that interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories. |

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| | interest (excluding interest on discounting of bills) and direct expenses to the point of stocking, excise duty but excludes administration and selling expenses." | It may further noted that paragraph 5 of AS 16, Borrowing Costs provides that those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Accordingly, as per AS 16, no borrowing cost (interest) can be capitalised as a part of the cost of the inventory. The interest can be capitalised as a part of the cost of inventories only in those cases where these necessarily take a substantial period of time to get ready for sale.<br><br>It was felt that the company appears to have capitalised interest as a part of the cost of finished goods without considering whether it necessarily takes a substantial period of time to get ready for sale or not, which is contrary to AS 2 as well as AS 16. |
| 3. | In the Annual Reports of the companies for the Financial Year 2004-05, the accounting policy relating to Borrowing Cost was stated, | It may be noted that Paragraph 23 of AS 16 provides that the financial statements should disclose the accounting policy adopted |

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| | as given below:<br>■ Capitalisation of borrowing costs in respect of qualifying assets was considered in the case of Modernisation Project for the time lag between acquisition and commissioning of those assets. All other borrowing costs have been charged to revenue accounts.<br>■ Specific borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as a part of the cost of the asset. Other borrowing costs are recognised as an expense in the period in which they are incurred.<br>■ The fixed assets are stated at the cost of acquisition/ construction less accumulated depreciation. In case of fixed asset acquired for new projects/ expansion, interest cost on borrowings and other | for borrowing costs and the amount of borrowing costs capitalised during the period.<br>It appears 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, so capitalised, during the year had not been disclosed as per the requirement of Paragraph 23 of AS 16. |

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| | related expenses up to the date of completion of projects incurred towards acquiring the fixed assets are capitalised.<br>The observation on the above are quite similar as provided adjacent to them. | |
| 4. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the company has secured term loans as at the end of the year and the accounting policy regarding fixed assets provides as below:<br>"Fixed Assets are stated at cost less accumulated depreciation. All expenses incidental to the purchase/ construction/ installation and commissioning including **financial charges** are added to the cost of fixed assets." | It was felt that the disclosure of accounting policy as adopted by the company is not as per AS 16. It may be noted that Paragraph 23 of AS 16 requires that the financial statements should disclose the accounting policy adopted for borrowing costs and the amount of borrowing costs capitalised during the period. It was felt that although the company had added certain financial charges to the cost of fixed assets, however, it had not complied with the disclosure requirements of Paragraph 23 of AS 16. |

## Observations on Accounting Standard (AS) 17: Segment Reporting

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has followed the following policy for the identification of segments:<br>"The Company's operating businesses are organized and managed separately according to the nature of products and services provided, with each segment representing a strategic business unit that offers different products and services. The analysis of geographical segments is based on the geographical locations of the customers."<br>It was further noted that a note regarding Segment Information provides as below in respect of business segments:<br>"The Company produces various types of Automobiles Lock Kits, Barrels and Switches. Since the company's business activity falls within a single business segment, there | It was felt that there is an apparent contradiction between the accounting policy and the note to accounts regarding business segments. In the policy, the company has stated that it is having more than one segment whereas in the notes to accounts, the company has stated that it is having only one business segment.<br>It was also viewed that in case the company is not having separate business segments, it should have treated its geographical segments as primary segments and, accordingly, made disclosures as per paragraph 40 of AS 17, Segment Reporting. It was felt that the company has not made disclosures as per this paragraph but has made disclosures required for secondary segments only which are less than the disclosures required for primary segments. |

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| | are no additional disclosures to be provided under Accounting Standard 17 'Segment Reporting' other than those already provided in the Financial Statements."<br><br>Regarding the Geographical Segments, it was noted that the company has segregated them into domestic market and overseas market and disclosed the information regarding sales and debtors only in respect of these segments. Further, the company has mentioned that the company has common assets for producing goods for domestic market and overseas market. Hence, separate figures for additions to assets cannot be furnished. | |
| 2. | In the Annual Report of a Company for the Financial Year 2003-04, the company had given the segment information on the basis of separate financial statements. | It was felt that this was contrary to paragraph 4 of AS 17, Segment Reporting.<br><br>It was viewed that since the Annual Report of the company contained both consolidated financial statements and the separate financial statements, the |

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| | | company was required to present segment information on the basis of the consolidated financial statements whereas the company had presented the information on the basis of separate financial statements only. |
| 3. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company was having a turnover of more than 50 crores.<br>It was further noted from the Sales Schedule that the company was having sales from (i) Oil Division, (ii) Rice Division and (iii) other sales. | It was felt that these divisions would constitute separate business segments for the company. However, the company had not given segment information, as required by AS 17, Segment Reporting. |
| 4. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has allocated certain financial expenses to the 'Tyres and tubes' segment and the remaining expenses have been shown as un-allocable. | It was felt that this is not as per AS 17, Segment Reporting. It may be noted that the definition of 'Segment expense', given in AS 17, clearly provides that segment expense does not include interest expense.<br>It may further be noted that the ICAI has issued ASI 22, Treatment of Interest for Determining Segment Expense (Re. AS 17, Segment Reporting). As per |

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| | | ASI 22 also, interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories as per AS 16 read with AS 2. The ASI also requires that in the later case, the amount of such interest and the fact that the segment result has been arrived at after considering such interest should be disclosed by way of a note to the segment result.It was viewed that apparently, the operations of 'Tyres and tubes' segment are not of financial nature and the nature of operations of this segment does not seem to be of the nature where the company would be required to include interest as a part of cost of inventories. In any case, the company has not made a disclosure required to be made by ASI 22 in a footnote to the segment result. It was felt that the treatment made by the |

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| | | company is not as per AS 17 read with ASI 22 which has the same authority as that of AS 17 to which it relates. |
| 5. | From the Segment Information given by a Company in its Annual Report for the Financial Year 2004-05, it was noted that instead of separately reporting the assets and liabilities of the reportable segment, the company had disclosed only the value of capital employed for its reportable segments. | It was felt that this is not as per the disclosure requirement as specified in paragraph 40(c) and (d) of AS 17, Segment Reporting, which requires as follows:<br>***"40. An enterprise should disclose the following for each reportable segment:***<br>***(c) total carrying amount of segment assets;***<br>***(d) total amount of segment liabilities;"***<br>It was viewed that the disclosure of capital employed for the reportable segment in place of reporting total carrying amount of segment assets and total amount of segment liabilities cannot serve the purpose of the disclosure requirements of AS 17. |
| 6. | From the Annual Report of a Company for the financial year 2005-06, it has been noted that the company was having a turnover of more | It was felt that there were business segments of the company as was evident from the Management Discussion and Analysis Report given in |

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| | than 50 crores. It was further noted from the 'Management Discussion and Analysis Report', that the company had given a segment wise and product wise performance report. | the Annual Report. However, the company had not given segment information as required by AS 17, Segment Reporting. |
| 7. | From the Annual Report of a Company for the Financial Year 2004-05, it has been noted that due to reasons cited below the company had not provided any segmental information:<br>"ASI 20 clarifies that in case, by applying the definitions of "business segment" and "geographical segment" given in AS-17, it is concluded that there is neither more than one business segment nor more than one geographical segment, segment information as per AS-17 is not required to be disclosed."<br>It has been noted from Director's Report that the company was engaged into a wide range of business. Further, in the Management Discussion & Analysis Report the management had separately discussed | Considering the facts given in the Director's Report, it was felt that the stated argument of the management for not giving any segmental information that there is neither more than one business segment nor more than one geographical segment, was not correct.<br>Further, in view of the information provided in the Management discussion and Analysis Report, it was noted that primary segment of business existed and segment reporting on the same should have been disclosed.<br>Further, from the Schedule of sales, it was noted that the existence of significant sales out side India and sales within India, reflects the existence of different economic & political environment, exchange control regulations and risk & returns. Hence, it |

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| | the performance of each business, from which it was apparent that the each business had separate risk and returns.<br><br>Further, from Schedule of Sales it has been noted that there were both the sales outside India and sales within India, which were independently more than 10% of the total turnover. | was viewed that the secondary segment also existed and the reporting on the same should have also been disclosed. |
| 8. | From the Segment Reporting given by a company in its Annual Report for the Financial Year 2004-05, it has been noted that the company had clubbed together the details of the geographical segments and business segments to give a single segment report. In other words, it had not made any distinction between geographical segments and business segments to give primary segmental reporting. | It may be noted that Paragraph 19 of AS 17 provides that the dominant source and nature of risks and returns of an enterprise should govern whether its primary segment reporting format will be business segments or geographical segments. If the risks and return of an enterprise are affected predominantly by differences in the products and services it produces, its primary format for reporting segment information should be business segments, with secondary information reported geographically. Similarly, if the risks and returns of the enterprise are affected predominantly by the fact that it operates in |

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| | | different countries or other geographical areas, its primary format for reporting segment information should be geographical segments, with secondary information reported for group of related products and services. However, if risks and returns of an enterprises are strongly affected both by differences in the products and services it produces and by differences in the geographical areas, then the enterprise should use business segments as its primary segment reporting format and geographical segments as its secondary reporting format.<br>In view of above, it was felt that the company had not clearly identified the reportable segments i.e. primary and secondary segments. |

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

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| 1. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company had disclosed certain transactions with the relatives of key management personnel as related party transactions without mentioning the names of such relatives in the list of related parties. | It was felt that this was contrary to AS 18, Related Party Disclosures. It may be noted that paragraph 23 of AS 18, *inter alia*, requires a list of all related parties to be given with whom any transaction has taken place during the year. |
| 2. | In the Annual Report of a Company for the Financial Year 2003-04, the company had disclosed related parties under three categories, viz., key management personnel, relatives of key management personnel and other related parties. | It was noted that in the third category, i.e., other related parties, a description of relationship was not given. It was felt that this was contrary to AS 18, Related Party Disclosures. It may be noted that paragraph 23 of AS 18, *inter alia*, requires a description of the relationship between the parties to be given.<br>It was further viewed that the company had disclosed certain transactions with related parties in the notes whose nature was not clear. For example, the company had disclosed lease rent and share application money as |

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| | | related party transactions, without indicating whether these were paid or received. It was viewed that the disclosure made by the company did not bring out the nature of the transaction and was not in compliance with AS 18. It was further observed that the company had disclosed Rs. 1,160,204 as the sale of fixed assets in the note. As compared to this, the sale of fixed assets shown in the Fixed Assets schedule given in the Annual Report was Rs.121,635 only. It was felt that in any case, the company could not sell fixed assets to related parties which were more than total sale of fixed assets. Such inconsistencies affect the credibility of financial statements and should not be there. |
| 3. | From the Related Party Disclosures given in the Annual Report of a Company for the Financial Year 2003-04, it was noted that the company has mentioned names of two companies, viz., XY Limited and AB Limited as Associates and Joint Ventures. | It may be noted that AS 18, Related Party Disclosures, requires, *inter alia*, the name and nature of related party relationship to be disclosed. Since associate and joint venture are two different types of related party relationship, clubbing joint ventures and associates together, is contrary to AS 18. |

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| 4. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the company has not disclosed the name of 'Key Management Personnel' under the disclosures made in pursuance to AS 18 although the information contained therein provides that the management includes a managing director who had the authority and responsibility for planning, directing and controlling the activities of the company. | It may be noted that Paragraph 21 of AS 18, Related Party Disclosures, requires that the 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 the related parties.<br>Further, as per the definition of 'Key Management Personnel' given under Paragraph 10 of AS 18, the 'Managing Director' may also be a 'Key Management Personnel'. Hence, the managing director can be regarded as a related party and the name of such personnel along with the nature of the relationship, transaction, if any, entered by the company with such personnel during the year is required to be disclosed as per Paragraph 21 of AS 18. |
| 5. | From the Related Party disclosure given in the Annual Report of a Bank for the Financial Year 2005-06, it was noted that details of transactions entered with each related party had been | It was felt that the information was not given as per the requirement of clause no. 4.5 of Master Circular of the RBI no./2005-06/290/OBOD.BP. BC No. 59/21.04.018/2005-06 dated January 30, 2006 with |

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| | provided under the names of each such party without specifying either the nature of transaction or the nature of relationship which exists between the company and such party. | regard to Disclosures in Balance Sheet. It provides that under AS 18, Related Party Disclosure, a Bank should disclose the year end outstanding as well as the maximum amount outstanding at any time during the year for each of the following classifications:<br>1. Borrowings<br>2. Deposits<br>3. Placement of Deposits<br>4. Advances<br>5. Investments<br>6. Non-funded Commitments<br>7. Leasing<br>8. Purchase of fixed assets<br>9. Sale of fixed assets<br>10. Interest Paid<br>11. Interest Received<br>12. Rendering of Services<br>13. Management Contracts<br>Thus, instead of providing party wise information, a bank is required to classify all related party transaction on the basis of the nature of transactions and the nature of relationship that the bank has with the related party. |

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| 6. | From the Report on Corporate Governance given in the Annual Report of a Company for the Financial Year 2005-06, it was noted that the Company had paid remuneration to its Managing Director during the year but no such transaction had been reported under Related Party Disclosures. | It may be noted that Paragraph 14 of AS 18, Related Party Disclosures, define Key Management Personnel as below:<br>**"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**."<br>It was noted from the note relating to 'Related Party Disclosures', given in Notes to Accounts, that the company had not disclosed any transaction between the company and key |

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| | | management personnel, although the Directors' Report stated to have paid the remuneration to the Managing Director.<br>It was felt that the company had not strictly complied with the requirements of AS 18. |

## Observations on Accounting Standard (AS) 19: Leases

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In a Schedule regarding Secured Loans given in the Annual Report of a Company for the Financial Year 2003-04, the company has disclosed Rs. 58,53,042 (previous year Rs. 15,63,794) as Hire Purchase Finance. | From the Schedule, it was viewed that the amount of Hire Purchase Finance has increased during the year which indicates that the company has taken new asset(s) on hire purchase during the year. The accounting for such assets is covered by AS 19, Leases. The company has, however, not made relevant disclosures as per AS 19 in this regard and has also not disclosed the assets purchased through hire purchase separately. It was felt that the company has not followed AS 19 for accounting for such assets. |
| 2. | In a note relating to Schedule regarding Fixed Assets given in the Annual Report of a Company for the Financial Year 2003-04, the company has mentioned that assets worth Rs. 85,853,728 (previous year Rs. 21,016,890) have been given on an operating lease. | It was viewed that the disclosures as required by paragraph 46 (b), (c) and (d) of AS 19, Leases, are not given in the financial statements. |
| 3. | In the Annual Report of a Company for the Financial Year 2003-04, one of the | It was viewed that the accounting for the assets mentioned in the note |

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| | notes to accounts regarding Lease Payments provides as follows:<br>"Total future lease rent on industrial shed, plant, equipment and machinery (collectively called manufacturing unit) taken on lease for a period of 5 years commencing from 1.1.2002 is Rs.132 lacs." | (referred herein) was covered by AS 19, Leases. The company had, however, not made relevant disclosures as per AS 19 in this regard. It was felt that the company had not followed AS 19 for accounting for such assets.<br>It was felt that from the note given by the company, it was not clear as to whether the lease was a finance lease or an operating lease. It was further felt that in case the lease was a finance lease, the company was required to make the disclosures required by paragraph 22 of AS 19. In case, it was an operating lease, the company was required to make disclosures required by paragraph 25 of AS 19. |
| 4. | In the Annual Report of a Company for the Financial Year 2003-04, a Note on Leases provides as below:<br>"Finance Lease: The company had expensed out the lease rental for the assets acquired on lease prior to 01.04.2001 as permitted under AS19, Leases . . ...." | It was viewed that the note gives an impression that AS 19, Leases permits expensing of lease rentals for the assets acquired on lease prior to 01.04.2001, which is not correct. It may be noted that AS 19 does not deal with the assets leased on or before 1.4.2001.<br>Accounting for such leases is governed by the Guidance Note on Accounting for |

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| | | Leases. The said Guidance Note provides the following with regard to accounting for finance leases in the books of a lessee:<br>**"25. Lease rentals should be accounted for on accrual basis over the lease term so as to recognise an appropriate charge in this respect in the profit and loss account, with a separate disclosure thereof. The appropriate charge should be worked out with reference to the terms of the lease agreement, type of the asset, proportion of the lease period to the life of the asset as per the technical / commercial evaluation and such other considerations. The excess of lease rentals paid over the amount accrued in respect thereof should be treated as prepaid lease rental and vice versa."** |

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| | | It was viewed that the accounting policy of the company is also not in compliance with the above paragraph of the Guidance Note. |
| 5. | From the Schedule of Fixed Assets given in the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the "Plant and Machinery" includes assets given on operating lease.<br>It was further noted from the Schedule of Other Income which includes the revenue arising from lease rent also. | It was viewed that the disclosures with regard to assets given on operating lease, as required by Paragraph 46 of AS 19, Leases, were not given in the financial statements.<br>Further, it was observed that the company has also not disclosed the accounting policy as adopted by the company for recognition of the revenue received as Lease rent. It was felt that it was not in line with Paragraph 24 of AS 1, Disclosure of Accounting Policies, which requires disclosure of all significant accounting policies. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | ■ From the Annual Report of a Bank for the Financial Year 2002-03, it has been noted that the Bank's equity shares were listed on recognised stock exchanges, including the National Stock Exchange (NSE) and the Stock Exchange, Mumbai (BSE).<br>■ From the Statement pursuant to Part IV of Schedule VI to the Companies Act, 1956 given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has disclosed Earning per Share in the statement.<br>■ From the Notes to Accounts given in the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the details of basic and diluted earning per | It may be noted that as per AS 20, Earnings Per Share, read with ASI 12 on 'Applicability of AS 20' (Re. AS 20, Earnings Per Share), the company is required to disclose the basic as well as diluted earnings per share on the face of the statement of profit and loss.<br>It was felt that in certain cases, the Banks/Companies had not disclosed the basic and/or diluted earnings per share on the face of the Profit and Loss Account. In other cases, the companies had disclosed the details relating to computation of basic and diluted earning per share in the Notes to Accounts, however, the same was not disclosed on the face of Profit and Loss Account, which is contrary to AS 20. |

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| | share had been disclosed in one of the Notes to Accounts attached to the financial statements.<br>The observations on the above are quite similar as provided adjacent to them. | |
| 2. | From the Profit and Loss Account given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has included an extraordinary item in the Profit and Loss Account. | The company has, however, not disclosed the Earnings Per Share excluding the extraordinary item, in addition to the Earnings Per Share including the extraordinary item.<br>It was felt that this is contrary to the General Clarification (GC) – 10/2002 on 'Disclosure of Earnings Per Share figures in case of Extraordinary Items', issued by the ASB of the ICAI, which was applicable at that time (The Institute has now incorporated this requirement in AS 20 itself). |
| 3. | In the Annual Report of a Company for the Financial Year 2003-04, it has been noted that although the company had disclosed Earnings Per Share on the face of the Profit and Loss Account but omitted to | It may be noted that Paragraph 48 of AS 20, Earnings Per Share provides that a company should disclose the following:<br>***"……..***<br>**(*a*) *the amounts used as*** |

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| | disclose any related information either in Schedule or in Notes to Accounts. | ***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;***<br>***(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***<br>***(c) the nominal value of shares along with the earnings per share figures."***<br>It was observed that although the company had disclosed the value on basic and diluted Earning Per Share in the Profit and Loss Account, it omitted to disclose any further information as required under Paragraph 48 of AS 20, Earning Per Share either in Schedule or in Notes to Accounts of the aforesaid financial statements. |

| S. No. | Matter contained in Annual Report | Observations |
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| 4. | In the Profit and Loss Account given in the Annual Report of a Company for the Financial Year 2003-04, the company had disclosed one figure of Earnings Per Share without mentioning whether the same was basic or diluted earnings per share. | It may be noted that as per AS 20, Earnings Per Share the company was required to disclose the basic as well as diluted earnings per share on the face of the statement of profit and loss. The company had, however, not disclosed the basic and diluted earnings per share on the face of the Profit and Loss Account separately as per the requirements of AS 20.<br>It was viewed that even if there was no difference in the basic and diluted EPS, to comply with AS 20, the company should have mentioned on the face of the Profit and Loss Account itself that the EPS figure disclosed was basic EPS as well as diluted EPS. However, the company had not done this. |
| 5. | From the Profit and Loss Account given in the Annual Reports of the Companies for the Financial Year 2005-06, it has been noted that the company has disclosed the same figure of the Basic Earning per Share and Diluted Earnings Per Share.<br>However, the Schedule of Share Capital of such | It was viewed that both the shares kept in abeyance or share warrants which are convertible into equity shares issued during the year may have a dilutive impact and may result into a Diluted Earning per Share that would be different from the Basic Earning per Share. However, notes relating to computation |

| S. No. | Matter contained in Annual Report | Observations |
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| | companies has provided either of the following information as given below:<br>■ The allotment of Equity Shares which were kept in abeyance.<br>■ The Company had issued share warrants during the year which were convertible into equity shares at the option of the holder within certain specified time period from the date of allotment.<br>The observation on the above are quite similar as provided adjacent to them. | of Earning per Share clearly indicate that the companies had not considered this aspect. This is contrary to AS 20, Earnings Per Share. |
| 6. | From the Schedule of Share Capital given in the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the company had issued Bonus Shares during the year. Further, it has been noted that the number of shares were reduced as a result of Consolidation of shares (reverse share split). | It may be noted that Paragraph 24 of AS 20, Earning per Share, requires that in case of a bonus issue or a share split, the number of equity shares which were outstanding before the event, should be adjusted for the proportionate change in the number of equity shares outstanding, as if the event had occurred at the beginning of the earliest period reported. Further, Paragraph 44 of AS 20 requires that in such case |

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| | | the calculation of basic and diluted earnings per share should be adjusted for all the periods presented.<br>It was noted that the company had restated the total number of equity shares for previous year by giving effect of only reverse share split (consolidation of shares), but had not given any effect of bonus shares issued during the year which is not as per the requirement of AS 20. |
| 7. | In the Annual Reports pertaining to the Financial Years 2003-04/2004-05, the Companies had disclosed Earnings Per Share on the face of the Profit and Loss Account. | It was felt that the companies had not disclosed the nominal value of shares along with the figures of earnings per share which is required by Paragraph 48 of AS 20, Earnings Per Share.<br>It was also viewed that although the nominal value of equity share had been disclosed under the Schedule of Share Capital, still the disclosure of the same along with Earning per Share is required under AS 20. |
| 8. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the different values with respect to Basic | It may be noted that Paragraph 48(ii) (b) of AS 20, Earnings Per Share, *inter alia*, requires that an enterprise should disclose the weighted |

| S. No. | Matter contained in Annual Report | Observations |
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| | and Diluted Earning per Share had been disclosed on the face of the Profit and Loss Account. | average number of equity shares which is used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other.<br>It was observed that since the value of Basic and diluted earning per share is different, the company should have disclosed the reconciliation of the denominators which had been used for the calculation of Basic EPS and Diluted EPS under AS 20.<br>It was noted that the company had given all the disclosures as is required under Paragraph 48 (ii) (a) & (c), however it omitted to give aforesaid disclosure as required under Paragraph 48 (ii) (b) of AS 20. |
| 9. | From the Annual Report of a Company for the Financial Year 2004-05, it has been noted that basic earning per share was determined by dividing the net profit for the period attributable to equity shareholder by the number of equity shares outstanding at the beginning of the year.<br>Further, it has been noted | It was felt that this is contrary to AS 20. It may be noted that Paragraph 15 of AS 20, Earning per Share, requires that for calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period. |

| S. No. | Matter contained in Annual Report | Observations |
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| | from the Schedule of Share Capital that certain equity shares had been issued during the year. | It was felt that since certain equity shares had been issued during the year, the company should have considered the **weighted average number of equity shares**, as a denominator for determination of Earning per Share. |
| 10. | From the Annual Report of a Company for the Financial Year 2004-05, it has been noted that the company had issued the Redeemable Preference Shares along with Equity Shares. However, it has been noted from the Notes to accounts providing the details of computation of Earning per Share that the company had not reduced the liability for the dividend payable on Redeemable Preference Shares from the profit to determine the profit attributable to equity shareholders for the purpose of deriving the basic earning per equity share. | It may be noted that as per Paragraph 11 of AS 20 for the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period.<br>Hence, it was viewed that the company had not correctly calculated the net profit attributable to equity shares for the purpose of calculating earnings per equity share. |

## Observations on Accounting Standard (AS) 21: Consolidated Financial Statements

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | From the Consolidated Financial Statements given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the Consolidated Financial Statements includes consolidated balance sheet, consolidated profit and loss account, consolidated cash flow statement and statement of significant accounting policies which merely explained the basis of consolidation. | It may be noted that as per the requirements of paragraph 6 of AS 21, Consolidated Financial Statements read with ASI 15, Notes to the Consolidated Financial Statements (Re. AS 21, Consolidated Financial Statements), the company was also required to include the notes, other statements and explanatory material that form an integral part of the consolidated balance sheet, consolidated profit and loss account and consolidated cash flow statement and was required for presenting a true and fair view of the financial statement and/or were material in nature. The company had, however, not included these notes, etc., in the consolidated financial statements. |
| 2. | From the Consolidated Balance Sheet and the Consolidated Profit and Loss Account given in the Annual Report of a Company for the Financial Year 2004-05, it has been | It was noted that the company has not disclosed the previous year figures as required under AS 21, Consolidated Financial Statements. It may be noted that as per paragraph 30 of |

| S. No. | Matter contained in Annual Report | Observations |
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| | noted that on the face of these Consolidated Financial Statements, the company has disclosed separate line items for share of the assets, liabilities, income and expenses of the joint venture.<br>However, the company has not disclosed previous year figures in respect of the same. | AS 21 :<br>***"On the first occasion that consolidated financial statements are presented comparative figures for the previous period need not be presented. In all subsequent years full comparative figures for the previous period should be presented in the consolidated financial statements".*** |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In the Annual Report of the Companies for the Financial Years 2002-03/2004-05, the accounting policy regarding the recognition of Deferred Tax Assets states as given below:<br>■ The Deferred Tax Asset was recognised and carried forward only to the extent that there was a reasonable certainty that the asset would be adjusted in future. Further, in one of the notes to accounts, it had also been stated that the company was having unabsorbed depreciation and carry forward of business losses and there was a virtual certainty that the future taxable income would be sufficient against which such deferred tax asset could be realised.<br>■ The Deferred Tax Assets are recognised on carry forward of unabsorbed depreciation | It may be noted that the Paragraph 17 of AS 22, Accounting for Taxes on Income provides that where an enterprise has an unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is a virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised. Further, Paragraph 32 requires that 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 may also be noted that Paragraph 3 and 4 of ASI 9 on AS 22 provides that virtual certainty cannot be based merely on forecasts of performance such as business plans and it is not a matter of perception, it should |

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| | and tax losses only if there is virtual certainty that such deferred tax assets can be realised against future taxable profits. Further, one of the notes to accounts had stated that the management, based on the quarterly trend of profitability and also the future market scenario, had prepared profitability projections for the next few years. Even after carrying out sensitivity analysis, the management was confident that there would be sufficient taxable income in the future years to be able to fully utilise the above mentioned deferred tax asset. | be supported by convincing evidence which is available at the reporting date in a concrete form.<br>It was felt that the accounting policy regarding recognition of deferred tax asset was not as per the requirement of AS 22. The companies were recognising deferred tax asset in their financial statement if there exists virtual certainty, no matter whether such certainty was supported by convincing evidence or not. Further, the companies had not disclosed the nature of the evidence supporting the recognition of deferred tax assets, which is required to be disclosed as per AS 22. |
| 2. | In the Balance Sheet given in the Annual Reports of the Companies for the Financial Year 2003-04/2004-05/ 2005-06, the deferred tax assets and liabilities had been presented in either of the manner as given below:<br>■ Deferred tax Liability as a part of 'Loan Funds'. | It was felt that this is contrary to Accounting Standard Interpretation (ASI 7) on Disclosure of deferred tax assets and deferred tax liabilities in the balance sheet of a company (Re. AS 22, Accounting for Taxes on Income).<br>It may be noted that ASI 7 |

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| | ■ Deferred tax Liability as a deduction from the 'Application of Funds'.<br>■ Deferred tax Liability as a part of 'Shareholders Funds'.<br>■ Deferred tax Liabilities after the heading 'Reserve and Surplus'.<br>■ Deferred tax Liabilities under the Schedule of Provisions.<br>■ Deferred tax Asset (net) after the heading 'Net Current Assets'.<br>The observations on the same are quite similar as provided adjacent to them. | 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'. |
| 3. | In the Annual Report of a Company for the Financial Year 2003-04, the company has not disclosed the break-up of deferred tax liability in the notes to accounts. | It was noted that paragraph 31 of AS 22, Accounting for Taxes on Income requires that 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. |
| 4. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that a footnote in the Reserves and Surplus Schedule states that the | It was felt that the adjustment was not as per AS 22, Accounting for Taxes on Income. It may be noted that as per AS 22, the amount of deferred tax can be adjusted |

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| | addition to the General Reserve included the adjustment on account of the recognition of previously unrecognised deferred tax asset. | against the reserves only on the occasion when AS 22 was first applied by an enterprise. Subsequently, all deferred tax amounts, including those arising on the recognition of previously unrecognised deferred tax assets, were required to be adjusted in the Profit and Loss Account. |
| 5. | One of the notes to accounts given in the Annual Report of a Company for the Financial Year 2003-04 provides that the company is having unabsorbed brought forward losses and depreciation, etc. However, it has not recognised any deferred tax asset in respect of the same on the consideration of prudence. It was further noted that the company has recognised certain deferred tax liabilities in its financial statements. | It may be noted that paragraph 18 of AS 22, Accounting for Taxes on Income provides as below: ***"18. The existence of unabsorbed depreciation or carry forward of losses under tax laws is a strong evidence that future taxable income may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognises deferred tax assets only to the extent that it has timing differences the reversal of which will result in sufficient income or there is other convincing evidence that sufficient taxable income will be*** |

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| | | ***available against which such deferred tax assets can be realised. In such circumstances, the nature of the evidence supporting its recognition is disclosed."***<br><br>It was noted that as per the above paragraph, in case of unabsorbed depreciation or carry forward of losses under tax laws, an enterprise recognises deferred tax assets to the extent that it has timing differences the reversal of which will result in sufficient income (i.e., to extent of deferred tax liability) without considering any other evidence regarding future taxable income. However, in the instant case, the company has not recognised deferred tax assets even to the extent of deferred tax liability recognised in the financial statements, which is contrary to AS 22. |
| 6. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding Accounting for Taxes on Income, provides as below: | It may be noted that as per AS 22, 'Accounting for Taxes on Income' the recognition of deferred tax assets is subject to the consideration of prudence. However, the |

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| | "Accounting treatment followed for taxes on income is to provide for current tax and deferred tax. Current tax is the amount of income tax determined to be payable in respect of taxable income for the period. Deferred tax is the tax effect of timing differences."<br>From one of the notes to accounts, it was noted that the company has recognised deferred tax assets as well. | company has not mentioned this aspect in its accounting policy, which indicates that the company is not considering prudence in the recognition of deferred tax assets which is contrary to AS 22. In any case, the company has not made an appropriate disclosure of its accounting policy on the matter, which is a violation of AS 1, 'Disclosure of Accounting Policies'. |
| 7. | From the Schedule regarding Current Assets, Loans and Advances, and Schedule regarding Current Liabilities and Provisions given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has disclosed advance income tax paid (current tax asset) and provision for income tax (current tax liability) separately, i.e., it has not offset the amounts. | It was felt that this is contrary to AS 22 Accounting for Taxes on Income. It was noted that paragraph 27 of AS 22, *inter alia,* requires that an enterprise should offset assets and liabilities representing current tax if the enterprise:<br>***"……..***<br>**a)** ***has a legally enforceable right to set off the recognised amounts; and***<br>**b)** ***intends to settle the asset and the liability on a net basis."*** |

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| | | It was also noted that under the Income tax Act, 1961, advance tax representing current tax is paid against the provision for income tax representing current tax liability. Under the Act, an enterprise has a legal right to set off the two amounts and normally; the enterprise settles these amounts on net basis only. Keeping this in view, the enterprise should have offset advance income tax paid against the provision for income tax and shown only the net amount in the balance sheet. Disclosing two amounts separately is contrary to AS 22. |
| 8. | From the Profit and Loss Account given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has transferred an amount to Deferred Tax Liabilities from the Profit After Tax. | It was felt that this is contrary to AS 22, Accounting for Taxes on Income. As per the transitional provisions contained in AS 22, deferred tax amount can be charged to revenue reserves (which include General Reserve) only in the year in which AS 22 applies for the first time.<br>It may be noted that AS 22 became applicable to all companies from the accounting periods commencing on or after April |

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| | | 1, 2002. Since the enterprise under review is a company, AS 22 became applicable to it from the year 2002-03 onwards. In view of this, charging the amount to profit after tax in the current year is contrary to AS 22. |
| 9. | From the Profit and Loss Account and Reserves and Surplus Schedule given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has withdrawn an amount from the General Reserve towards deferred tax adjustment relating to earlier years. | It was felt that this is contrary to AS 22 'Accounting for Taxes on Income'. As per the transitional provisions contained in AS 22, deferred tax amount can be charged to revenue reserves (which include General Reserve) only in the year in which AS 22 applies for the first time.<br>Since the enterprise under reference is a listed company, AS 22 became applicable to it from the year 2001-02 onwards. In view of this, making adjustment to General Reserve in the current year is contrary to AS 22. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In 'Reserves and Surplus' Schedule to the Consolidated Balance Sheet given in the Annual Report of a Company for the Financial Year 2004-05, the company has disclosed the 'share in reserves of associates' as a separate item. | It was felt that it is not as per AS 23 Accounting for Investments in Associates in Consolidated Financial Statements which requires that an investment in an associate should be accounted for under the equity method.<br><br>It may be noted that under the equity method, all adjustments relating to profits, reserves, etc. are made in the value of the investment and these don't appear separately in the financial statements, accordingly, the treatment followed by the company is not as per AS 23. |

## Observations on Accounting Standard (AS) 26: Intangible Assets

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | From the Annual Reports of the Companies for the Financial Years 2003-04/ 2004-05/ 2005-06, it has been noted that the accounting policy regarding Research and Development provides as given below :<br>■ Current revenue expenditure incurred on research and development is charged to profit and loss account of the year, unless deferred. Capital expenditure on research and development is accounted as fixed assets.<br>■ Revenue expenditure is charged to the Profit and Loss Account and capital expenditure is added to the cost of fixed assets in the year in which it is incurred.<br>■ The R & D expenditure on revenue accounts had been capitalised under the head of fixed assets (Other Assets) and are being amortised | It may be noted that as per AS 26, Intangible Assets, the expenditure on research and development expenses is classified into the expenditure on research phase and on development phase. Expenditures on research should be recognised as an expense immediately and expenditure under development phase should be recognised as an intangible asset, if the recognition criteria given in Paragraph 44 of AS 26 are satisfied. Paragraph 40 of AS 26 provides that if an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise should treat the expenditure on that project as if these were incurred in the research phase only.<br>From the accounting policy of the companies, it was felt that no bifurcation had been done between research phase and development phase. Rather, |

| S. No. | Matter contained in Annual Report | Observations |
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| | over a period of 10 years. | it appeared that certain companies had either charged total revenue expenditure on research and development to the profit and loss account or capitalised the same under the head of fixed assets without considering the difference between the research and development phase, which is contrary to AS 26.<br><br>Further, it was felt, from the words 'unless deferred', (wherever mentioned) used in the accounting policy, that the company was treating certain revenue expenditure on research and development as deferred revenue expenditure which was not permissible under AS 26. As per AS 26, an expenditure of the research phase should be expensed immediately in the profit and loss account. An expenditure on development phase which met the recognition criteria should be recognised as an intangible asset and the expenditure which did not meet recognition criteria should be expensed immediately. |
| 2. | The accounting policy | Regarding the costs incurred |

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| | regarding 'Research and Development Expenses' given in the Annual Report of a Company for the Financial Year 2003-04 provides as below:<br>"In order to comply with the requirements of Accounting Standard on Intangible Assets (AS 26) which is mandatory w.e.f 1.4.2003, Research and Development Cost (other than the cost of fixed assets acquired) are charged as an expense in the year of incurring the expenses. However, expenses incurred upto 31st March 2003 have been amortised over a period of five years." | on or after 1.4.2003, it may be noted that as per AS 26, Intangible Assets, expenditure on research and development expenses are classified into the expenditure on research phase & development phase. Expenditures on research phase should be recognised as an expense immediately and the expenditure on development phase should be recognised as an intangible asset, if the recognition criteria given in paragraph 44 of AS 26 are satisfied. paragraph 40 of AS 26 provides that if an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.<br>From the accounting policy of the company it was viewed that it did not appear that the company had charged the expenditure on development phase to the Profit and Loss Account because it cannot |

| S. No. | Matter contained in Annual Report | Observations |
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| | | distinguish the research phase from the development phase. Rather, it appears that the company charges total revenue expenditure on research and development to the Profit and Loss Account without considering the difference between the research and development phase, which is contrary to AS 26.<br><br>It may be noted that the accounting for costs incurred upto 31st March, 2003, was governed by AS 8. As per AS 8, the expenditure on research and development should be deferred for amortisation over future periods only if the criteria prescribed in this regard were met. In all other cases, the expenditure on research and development was required to be recognised as an expense immediately.<br><br>It was felt that the criteria prescribed in AS 8 or deferment of expenditure were broadly the same as those prescribed in AS 26 for recognition of development expenditure as Intangible Assets. It was viewed that since the company had |

| S. No. | Matter contained in Annual Report | Observations |
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| | | mentioned that it has charged research and development expenses incurred on or after 1.4.2003 to the Profit and Loss Account to comply with AS 26, it appears that the company has deferred the expenditure on research and development incurred upto 31st March, 2003 contrary to AS 8. It was also felt that, the company has either violated AS 26 or AS 8. |
| 3. | The accounting policy regarding Depreciation given in the Annual Report of a Company for the Financial Year 2003-04, provides the following with regard to intangible assets:<br>"Intangible assets are amortised on written down value method. These assets are amortised over the estimated useful life of the assets." | It may be noted that AS 26, Intangible Assets, requires that the useful lives or the amortisation rates used should be disclosed. However, the company has not disclosed the same, which is an apparent violation of AS 26. |
| 4. | In the Annual Report of a Company for the Financial Year 2003-04, one of the notes to accounts provides as below:<br>■ In compliance with the mandatory Accounting Standard 26 on 'Intangible Assets' | It was viewed that in respect of intangible items appearing in the balance sheet on the date of AS 26, Intangible Assets, becoming mandatory, the application of AS 26 is limited only to paragraph 99 of AS 26. No other paragraph of AS 26 is applicable to such |

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| | issued by the Institute of Chartered Accountants of India, all the items reflected in Deferred Revenue Expenditure as on 31.03.2003 have been treated as Intangible Assets alongwith those which are recognised in the current Financial Year 2003-04.<br>■ Intangible Assets as on 31.03.2004 consist of:<br>(i) Rs.3,71,200 related to debenture issue expenses & expenses related to authorised capital and is under amortisation over a period of 5 years from 2001-02.<br>(ii) Rs. 42,11,706 related to VRS payment and is under amortisation over a period of 5 years from 2002-03.<br>(iii) Rs. 44,53,022 related to right issue expenses (including payment to auditors Rs.42,000 towards certification fees) and is under amortisation over a | items. Paragraph 99 of AS 26 deals only with the amortisation of such items. It does not require or permit capitalisation of such items as intangible assets. Thus, treating the items reflected in the deferred revenue expenditure as on 31.03.2003 as Intangible Assets is contrary to AS 26.<br>It may be noted that the expenses included in the intangible assets as on 31.03.2004 have been specifically excluded from the scope of AS 26 and are not intangible assets with in the meaning of AS 26. Rather, the items mentioned at b (i) and (iv) of the note are of the nature of borrowing costs, which are specifically covered by AS 16, Borrowing Costs. Thus, treating such items as intangible assets is contrary to AS 26 as well as other pronouncements, e.g., AS 16, covering the treatment for such items. |

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| | period of 5 years from 2003-04. However, right issue expenses incurred during the year amounting to Rs. 19,17,954 have been charged to the Profit and Loss Account.<br>(iv) Rs. 3,40,95,561 related to Premium on Restructuring of Long Term Debts and is under amortisation proportionately over the remaining life of debts. | |
| 5. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Miscellaneous Expenditure' provides as below:<br>Preliminary and pre-operative expenditure are amortised over a period of ten years in equal installments. Deferred revenue expenditure is amortised over a period of three years including the year of expenditure.<br>From the Miscellaneous Expenditure Schedule, it was noted that the company | It may be noted that pursuant to AS 26, Intangible Assets becoming mandatory, no new expenditure of the nature covered by the Standard can be deferred. It was viewed that the company has not specified the nature of the expenditure treated as deferred revenue expenditure in the financial statements and it is possible that the company may have treated the expenditure covered by AS 26 as deferred revenue expenditure which is contrary to AS 26. |

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| | has added new amount in the Deferred Revenue Expenditure during the year. | |
| 6. | In the Annual Report of a Company for the Financial Year 2005-06, the accounting policy regarding Depreciation/Amortisation of Goodwill, it was stated that no amortisation had been charged on Goodwill.<br><br>Further, it was also noted that the company had neither stated the nature of goodwill nor had given any reason for not amortising the same. | It was observed that the accounting treatment for amortisation of Goodwill is stated in two Accounting Standards viz. AS 14, Accounting for Amalgamations, when it arises due to amalgamation and AS 26, Intangible Assets, which provides treatment of Goodwill other than covered in AS 14 as well as Internally Generated Goodwill.<br><br>It may be noted from Paragraph 63 of AS 26, which requires that the depreciable amount of intangible assets should be allocated on a systematic basis over the best estimates of its useful life. Further, Paragraph 19 of AS 14 provides that Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life. It was felt that the stated accounting policy was not in line with AS 26 or AS 14. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In the Annual Reports of the Companies for the Financial Year 2003-04, one of notes to the Consolidated Financial Statements provides as below, the observations on the same, are quite similar as provided adjacent to them:<br>■ During the year, the company has disinvested a part of its share in an erstwhile joint venture namely, ABC Private Limited, an Indian body corporate. Consequent to this disinvestment, there is no effective joint control of the company and, therefore, financial statement of the said joint venture has not been consolidated. The details of the assets and liabilities included in the reported figures of the previous year are given below:<br>…….<br>……. | It may be noted that paragraph 39 of AS 27, Financial Reporting of Interests in Joint Ventures, provides as below:<br>"***39. A venturer should discontinue the use of proportionate consolidation from the date that:***<br>***(a) it ceases to have joint control over a jointly controlled entity but retains, either in whole or in part, its interest in the entity; or***<br>***…"***<br>It was viewed that as per the above paragraph, the companies were required to proportionately consolidate the joint venture upto the date of disinvestment/disposal. Since the companies had not consolidated the financial statements of the joint venture upto the date of disinvestment/disposal, this was a violation of AS 27.<br>In case of XYZ Industries Limited, it was further noted |

| S. No. | Matter contained in Annual Report | Observations |
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| | ■ XYZ Industries Limited has transferred under debt-asset swap / disposed off its investments in the joint venture companies and consequently the consolidation as required by AS 27 has not been done. | that the company has disclosed the names of Joint Ventures as a part of related party disclosures in the separate financial statements given in the Annual Report. It was felt that the company has not disclosed the fact regarding disposing off of the Joint Ventures in the separate financial statements which is misleading. It may be noted that as per the requirements of paragraph 54 of AS 27, the company has also not disclosed the proportionate share of its interest in the income and expenses of the joint venture companies upto the date of disposal. |
| 2. | From the Investments Schedule given in the Annual Report of a Company for the Financial Year 2003-04, it was noted that the company was having investment in a joint venture with the other company. | It was viewed that the company had not made disclosures as required by AS 27, Financial Reporting of Interests in Joint Ventures. |
| 3. | From the Related Party Disclosures given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has | It may be noted that paragraphs 50, 51, 52 and 53 of AS 27, Financial Reporting of Interests in Joint Ventures, require certain disclosures regarding joint ventures to be |

| S. No. | Matter contained in Annual Report | Observations |
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| | mentioned names of two companies, viz., A Limited and B Limited as Associates and Joint Ventures. | made in the Separate Financial Statements. It was viewed that the company has not made disclosures as per the requirements of AS 27. |
| 4. | In one of the notes to accounts regarding the disclosures of transactions with the related parties in separate financial statements given in the Annual Report of a Company for the Financial Year 2004-05, a list of subsidiary companies, associate companies and joint ventures were given. In the notes to accounts of Consolidated Financial Statements, the list of subsidiary companies and list of associate companies considered in the Consolidated Financial Statements were given. | It was apparent that the company has not considered joint venture companies in the preparation of the consolidated financial statements, which is an apparent violation of AS 27, Financial Reporting of Interests in Joint Ventures. It may be noted that paragraph 29 of AS 27 provides that in its consolidated financial statements, a venturer should report its interest in a jointly controlled entity using proportionate consolidation. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | From the Annual Report of a Listed Company for the Financial Year 2004-05, it was noted that no information had been given either in the Schedule or Notes to Accounts to indicate whether the company had conducted any impairment tests. | It may be noted that the Paragraph 124 of AS 28, Impairment of Assets, provides as follow:<br>**124. On the date of this Statement becoming mandatory, an enterprise should assess whether there is any indication that an asset may be impaired (see paragraph 5-13).**<br>It was noted that the company had neither disclosed the accounting policy in respect of impairment assets nor it mentioned whether the company had conducted any impairment test, which is not in line with the requirement of AS 28. |

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

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | From the notes relating to Contingent Liabilities given under the Notes on Accounts in the Annual Report of a Company for the Financial Year 2004-05, it was noted that the details of contingent liabilities inter alia also included the information relating to provisions, investment in short term deposits with banks, the progress of construction in different project. | It was viewed that the information relating to items other than contingent liabilities should be separately disclosed. Further, it may be noted that Paragraph 68 of AS 29, Provisions, Contingent Liabilities and Contingent Assets, requires that the following information of contingent liabilities should be disclosed in the balance sheet:<br>**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:***<br>***(a) an estimate of its financial effect, measured under paragraphs 35-45;*** |

| S. No. | Matter contained in Annual Report | Observations |
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| | | ***(b) an indication of the uncertainties relating to any outflow; and***<br>***(c) the possibility of any reimbursement."***<br>It was felt that the company had not complied with the aforesaid disclosure requirement of the Contingent Liabilities as required under AS 29. |
| 2. | In the Annual Reports of the Companies for the Financial Years 2004-05/2005-06, the notes to accounts gives the following information:<br>■ Custom Duty on import of Project material / equipment has been assessed provisionally and additional liability, if any, on this account will be provided on final assessment. Further, it was noted that the same is included under the head contingent liabilities.<br>■ Product warranty expenses are determined based on past experience and estimates and are accrued in the year of | It may be noted that as Per AS 29, Provisions, Contingent Liabilities and Contingent Assets the following information is required to be disclosed with regard to various provisions made in the financial statements:<br>***66. For each class of provision, an enterprise should disclose:***<br>***(a) the carrying amount at the beginning and end of the period;***<br>***(b) additional provisions made in the period, including increases to existing provisions;***<br>***(c) amounts used (i.e. incurred and charged against the provision)*** |

| S. No. | Matter contained in Annual Report | Observations |
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| | sale.<br>The observation on the same are quite similar as provided adjacent to them. | ***during the period; and***<br>***(d) unused amounts* reversed during the period.**<br>***67. An enterprise should disclose the following for each class of provision:***<br>***(a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;***<br>***(b) an indication of the 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***<br>***(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognized for*** |

| S. No. | Matter contained in Annual Report | Observations |
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| | | ***that expected reimbursement.***<br>It was felt that the companies had not complied with aforesaid requirements of Accounting Standard (AS) 29. It was viewed that as far as product warranties were concerned the amount of provision for the same should have been separately disclosed under the head "Current Liabilities and Provisions".<br>Further, in case where the note having the nature of provision, had been included in the contingent liabilities, it was viewed that the company should have disclosed the information as required by Paragraph 66 & 67 of AS 29. |

## Observations on Companies (Auditor's Report) Order, 2003

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | One of the paragraphs of the Annexure to the Auditors' Report pursuant to the Companies (Auditor's Report) Order, 2003, given in the Annual Report of a Company for the Financial Year 2003-04, provides as below:<br>"There is a regular programme for the verification of fixed assets, which in our opinion, is reasonable having regards to the size of the Company and the nature of its assets, though all the assets were not physically verified by the management during the year. The management is in the process of identifying discrepancies, if any, on such verification." | It has been noted that the point referred herein has been included in the Annexure pursuant to the requirements of paragraph 4(i)(b) of the CARO, 2003 which provides as below:<br>**"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."**<br>It was viewed that the sentence "the management is in the process of identifying discrepancies, if any, on such verification" indicates that the physical verification of even those assets which were taken for verification during the year is not complete at the end of the year which is a lapse.<br>It was felt that it is inappropriate to conclude that the company is having a |

| S. No. | Matter contained in Annual Report | Observations |
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| | | regular programme for verification of assets. |
| 2. | One of the paragraphs of the Auditor's Report given pursuant to the requirement of Paragraph 4 (i)(b) of the Companies (Auditor's Report) Order, 2003 (CARO 2003) in the Annual Report of a Company for the Financial Year 2004-05, provides as below:<br>■ As explained to us, all the assets have not been physically verified by the management during the year but there is a regular programme of verification. In our opinion, the same is reasonable having regard to the size of the company and the nature of its assets. The management has explained to us that no material discrepancies were noticed during such verification. | It may be noted that comment (f) to Paragraph 4(i) (b) of the Statement on the Companies (Auditor's Report) Order, 2003, issued by the Institute, requires that the Auditor should use his judgment to determine whether the discrepancy is material or not. In other words, the duty has been cast upon the Auditor to express his opinion.<br>However, it was observed that the auditor had 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. |
| 3. | One of the Paragraphs of the Annexure to the Auditors' Report pursuant to the Companies (Auditor's Report) Order, 2003, given | It may be noted that the Paragraph 4(i)(c) of Companies (Auditor's Report) Order (CARO) 2003 provides as below: |

| S. No. | Matter contained in Annual Report | Observations |
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| | in the Annual Report of a Company for the Financial Year 2003-04, provides as below:<br>"On account of demerging of X unit under the scheme of arrangement approved by Hon'ble High Courts, the concept of going concern is not affected." | **"If a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern."**<br>It was viewed that the Paragraph 4(i) (c) of CARO, 2003 is in the context of the sale of fixed assets and not in the context of demerger.<br>The auditor has, however, not made any reference at all to the sale of fixed assets. It was felt that keeping in view the specific requirements of the Clause, the auditor was required to make a specific mention to the sale of fixed assets. Making a reference to demerger does not fulfill the reporting obligations of the auditor. |
| 4. | One of the Paragraphs of the Annexure to the Auditors' Report pursuant to the Companies (Auditor's Report) Order, 2003, given in the Annual Report of a Company for the Financial Year 2004-05, provides as below:<br>"According to the information and explanations | It may be noted that under paragraph 4(iii) of the Companies (Auditor's Report) Order, 2003 an auditor is required to provide the information as to whether the company has granted or taken any loan, secured or unsecured, to/from the companies, firms or other parties covered in the register |

| S. No. | Matter contained in Annual Report | Observations |
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| | given to us, the company has not taken interest free unsecured loans from companies covered in the register maintained under Section 301 of the Act." | maintained under section 301 of the Act. If so, he is to state inter alia, their terms and conditions including rate of interest and whether the regular payment of principal and interest amount is occurring or not.<br><br>It was noted that the auditor had provided his comments only on the aspect as to whether the company had taken **interest free unsecured loans** from the companies covered in section 301 of the Act. However, they had neither given any comment as to whether the company had granted or taken any secured loan from the companies, firms or other parties covered in the register maintained under section 301 of the Act and whether it had taken any loan other than interest free.<br><br>It was viewed that the auditor was silent on the various provisions relating to the paragraph 4(iii) of CARO, 2003, which omits to provide a true and fair view of the affairs of the company. |
| 5. | One of the Paragraphs of the Annexure to the | It may be noted that Paragraph 4(iv) of CARO, |

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| | Auditor's Report pursuant to the Companies (Auditor's Report) Order, 2003, given in the Annual Report of a company for the Financial Year 2004-05, stated as below:<br>"According to the information and explanations given to us and in our opinion there is an adequate internal control procedure 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." | 2003 requires the auditor to comment on:<br>**"Is there an adequate internal control procedure commensurate with the size of the company and the nature of its business, for the purchase of fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system."**<br>It was noted that the auditors had commented only on the first aspect of the aforesaid paragraph but omitted to comment on the second aspect of the paragraph. It was felt that there are two distinct aspects of the paragraph. The first requires the auditor to comment on the adequacy of the internal controls in regard to purchase of inventories, purchase of fixed assets and sale of goods and services whereas the second aspect requires the auditor to comment whether there was a continuing failure to correct a major weakness in such internal controls. Since these |

| S. No. | Matter contained in Annual Report | Observations |
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| | | two aspects are not related to each other, it cannot be concluded that if no major weakness was reported during the period covered by the audit report, the internal control system is adequate or vice versa. Therefore, it was viewed that the auditor should comment on both aspects of the clause. |
| 6. | One of the Paragraphs of the Auditors Report given pursuant to the requirements of Paragraph 4 (iv) of the Companies (Auditor's Report) Order, 2003, in the Annual Report of a Company for the Financial Year 2004-05, reported as below:<br>"In our opinion and according to information and explanations given to us, during the course of our audit there are adequate internal control procedures commensurate with the size of the Company and the nature of its business for the purchases of inventory, fixed assets and for the sale of goods. During the course of our audit, we have not observed any continuing | It may be noted that according to the Paragraph 4(iv) to the Statement on the Companies (Auditor's Report) Order, 2003 an auditor is required to comment on:<br>**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?**<br>It was viewed that since the company was also generating revenue by way of 'Electricity Generation Income', therefore, the auditor should |

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| | failure to correct major weakness in such internal controls."<br>Further, it was also noted from Schedule of Sales and Other Income that the Company was also generating revenue in the form of 'Electricity Generation Income'. | have also commented on as to whether the adequate internal control system exists with respect to sale of services or not.<br>Accordingly, it was viewed that the given comment was not complete as per the requirement of Paragraph 4 (iv) to the Statement on the Companies (Auditor's Report) Order, 2003. |
| 7. | Paragraphs of the Annexure to the Auditor's Report which were given pursuant to the requirements of Paragraph 4 (iii)(a) and (v)(a) & (v)(b) of the Companies (Auditor's Report) Order, 2003 in the Annual Report of a Company for the Financial Year 2005-06, provides as below:<br>4(iii)(a) According to information and explanations given to us, the Company has granted loans during the year to a subsidiary company which are covered in the register under section 301 of the Companies Act, 1956. The maximum amounts involved during the year in respect | It may be noted that the Paragraph 4(v)(a) of CARO 2003 provides that;<br>**Whether the particulars of contracts/ arrangements referred to in section 301 of the Companies Act have been entered in the register required to be maintained under that section.**<br>It may also be noted that Section 301 of the Companies Act, 1956 requires that every company should keep one or more registers in which the particulars of all contracts or arrangement to which Section 297 or Section 299 applies, should be entered separately.<br>It was noted that in the Paragraph 4(iii) (a) the auditor |

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| | of such loans granted were Rs. 1950.00 lacs and balances at the year end were Rs. Nil."<br>4(v)(a) According to information and explanations given to us, there are no transactions that need to be entered into the register maintained under section 301 of the Companies Act, 1956.<br>(b) In view of (a) above, clause (v) (b) of this order is not applicable to the company." | had reported that the company had granted loans to parties covered under Section 301 of the Companies Act, 1956. Since, it was a transaction covered by Section 299 of the Companies Act, 1956, therefore, the comments as provided by the auditor under paragraph (v) (a) and (v) (b) of the Annexure to Auditors' Report appeared to be not correct. |
| 8. | One of the Paragraphs of the Auditor's Report given pursuant to the requirement of Paragraph 4 (vii) of the Companies (Auditor's Report) Order, 2003 (CARO 2003) in the Annual Report of a company for the Financial Year 2004-05, provides as below:<br>"The company has during the year set up in-house internal audit department. The company is in the process of setting up a formal internal audit system commensurate with the size of the company & nature of business". | It was noted that the stated information had been provided in pursuance to the following requirement of Paragraph 4(vii) of CARO 2003;<br>**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** |

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| | | **concerned, whether the company has an internal audit system commensurate with its size and nature of its business.**<br>It was noted that a confusing statement had been given by the auditor. In the first sentence, the auditor had reported that an internal audit department had been set up by the company during the year. In the second sentence, he had reported that the company was in the process of setting up a formal internal audit system.<br>It was viewed that without setting up an internal audit system, a company could not set up any department. Therefore, the two statements appeared to be contradictory to each other. |
| 9. | One of the Paragraphs of the Annexure to the Auditors' Report pursuant to the Companies (Auditor's Report) Order,2003, given in the Annual Report of a Company for the Financial Year 2003-04, provides as below:<br>"The company is generally | It was noted that Paragraph 4(ix)(a) of the Companies (Auditor's Report) Order, 2003, provides as below:<br>**"Is the company regular in depositing undisputed statutory dues including provident fund, investor education and protection fund, employees' state** |

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| | regular in depositing with appropriate authorities undisputed statutory dues (except for income tax) including provident fund, investor education protection funds, employees' state insurance, sales-tax, wealth tax, custom duty, excise duty, cess and any other material statutory dues applicable to it. There were some delays in depositing undisputed income-tax dues with appropriate authorities during the year." | **insurance, income-tax, sales-tax, wealth 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."**<br>It was felt that if the company is not regular in depositing undisputed statutory dues, the auditor is required to state the extent of arrears of statutory dues which have remained outstanding as at the last day of the financial year concerned for a period of more than six months from the date they became payable.<br>It was viewed that though the auditor has indicated that there were some delays in depositing statutory dues, he has not indicated as to whether there are any arrears of statutory dues which have remained outstanding as at |

| S. No. | Matter contained in Annual Report | Observations |
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| | | the last day of the financial year concerned for a period of more than six months from the date they became payable. It was further felt that to comply with its reporting obligations; the auditor was specifically required to comment on this aspect also. |
| 10. | One of the Paragraphs of the Auditor Report given pursuant to the requirements of Paragraph 4(ix)(a) of the Companies (Auditor's Report), 2003 (CARO 2003) in the Annual Report of a Company for the Financial Year 2003-04, provides as below:<br>"According to the information and explanations given to us, no undisputed amounts payable in respect of statutory dues including provident fund, employees' state insurance, income tax, sales tax, custom duty and cess were in arrears as at 31st March, 2004 for a period of more than six months from the date they became payable. However, payment of outstanding | It was noted that in the first sentence, the auditor has made a plain statement that no undisputed amounts payable in respect of statutory dues including provident fund, employees' state insurance, income tax, sales tax, custom duty and cess were in arrears as at 31st March, 2004 for a period of more than six months. In the second sentence, he has taken an exception to the first sentence and pointed out certain amounts, which were outstanding for a period of more than six months. It was viewed that the manner of reporting used by the auditor was not correct. |

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| | sales tax has been deferred by virtue of the order of the Board for Industrial and Financial Reconstruction and also under West Bengal Incentive Scheme, 1993 as indicated in Notes of one of the Schedule." | |
| 11. | One of the Paragraphs of the Auditor's Report given pursuant to the requirements of Paragraph 4(ix) of the Companies (Auditors Report), 2003 (CARO 2003) in the Annual Report of a Company for the Financial Year 2004-05, provides as below:<br>■ "According to the information and explanations given to us, there are no undisputed statutory dues payable in respect of Provident Fund, Investor Education and Protection Fund, Employees State Insurance Fund, Income Tax, Sales-tax, Wealth Tax, Customs Duty, Excise Duty, Cess which are outstanding as at 31st March, 2005 for a period of more than 6 | It may be noted from Paragraph 4(ix) (a) of CARO,2003, provides as below:<br>**Is the company regular in depositing undisputed statutory dues including provident fund, investor education protection fund, employees' State Insurance, Income tax, sales tax, wealth tax, service tax, custom duty, excise duty, cess and 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.**<br>It was noted that no comment had been given as to whether |

| S. No. | Matter contained in Annual Report | Observations |
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| | months from the date they became payable." | the company was regular in depositing undisputed statutory dues or not. Further, the stated paragraph was also silent about the amount involved and the forum where a dispute was pending relating to statutory dues pending on account of any dispute as required by the paragraph 4(ix)(b) of CARO, 2003. |
| 12. | One of the Paragraphs of the Auditor's Report given pursuant to the requirements of Paragraph 4(ix)(b) of the Companies (Auditor's Report), 2003 (CARO 2003)in the Annual Reports of the Companies for the Financial Year 2003-04/2005-06 provides as below:<br>■ According to the information and explanations given to us there are no dues of Income Tax, Custom Duty, Wealth Tax and Cess which have not been deposited as on 31st March, 2004 on account of any dispute. However, following statutory dues were not | It was noted that in the first sentence, the auditor had made a plain statement that there are no dues of Income Tax, Custom Duty, Wealth Tax and Cess, which have not been deposited on account of any dispute. In the second sentence, he had taken an exception to the first sentence and pointed out certain dues, which had not been deposited on account of dispute. It was felt that the manner of reporting used by the auditor was not correct. |

| S. No. | Matter contained in Annual Report | Observations |
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| | deposited on account of the dispute as on 31st March, 2004.<br>■ According to the records of the Company, there are no dues outstanding of sales tax, income tax, customs duty, service tax, wealth tax, and cess on account of any dispute. The following are the disputed amounts in respect of custom duty.<br>The observation on the above are quite similar in both the cases as provided adjacent to them. | |
| 13. | One of the Paragraphs of the Annexure to the Auditors' Report pursuant to the Companies (Auditor's Report) Order, 2003 given in the Annual Report of the Company for the Financial Year 2003-04, provides as below:<br>"According to the information and explanation given to us and as per the books and records examined by us, there are no dues of income tax, custom tax, wealth tax and | It may be noted that the Paragraph 4(ix)(b) of the Companies (Auditor's Report) Order, 2003 also requires the auditor to examine whether any amount of sales tax or excise duty has not been deposited on account of any dispute. If yes, then the auditor is required to mention the amount involved and the authority with which the dispute is pending.<br>It was viewed that in one of the notes on accounts given in the Annual Report, the |

| S. No. | Matter contained in Annual Report | Observations |
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| | cess which have not been deposited on account of any dispute." | company has mentioned that certain disputes relating to excise duty are pending.<br>The auditor has not commented on this aspect in the point (referred herein) of the Annexure to the Auditors' Report pursuant to the Companies (Auditor's Report) Order, 2003. |
| 14. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted that an Income Tax demand was issued by Assessing Officer against which company had filed an appeal before Income Tax Appellate Tribunal. Pending decision of Tribunal, no provision for the demand had been considered necessary. The said note further provided that there was another Income Tax demand also which was not paid on account of dispute. | It may be noted that Paragraph 4(ix)(b) of CARO 2003, requires an auditor to comment on;<br>**"In case dues of Income tax/ sales tax/ wealth tax/ service tax/custom duty/ excise duty/cess have not been deposited on account of any dispute, then the amount involved and the forum where dispute is pending may be mentioned."**<br>It was noted that despite certain income tax demand pending for payment on account of dispute, still the auditor had not made any disclosure regarding such disputed Income Tax demands in its report. It was felt that, keeping in view of the specific requirements of the Paragraph 4(ix), the |

| S. No. | Matter contained in Annual Report | Observations |
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| | | auditor should give the following:<br>(a) Name of the statute<br>(b) Nature of dues<br>(c) Amount<br>(d) Period to which the amount relates<br>(e) Forum where the dispute is pending |
| 15. | One of the Paragraphts of the Annexure to the Auditors' Report pursuant to the Companies (Auditor's Report) Order, 2003, given in the Annual Report of a Company for the Financial Year 2004-05, provides as below:<br>"The Company has disputed the dues of Income Tax, custom tax, and excise duty as mentioned in the notes of accounts. In case of Income Tax the appeal is pending before ITAT, in case of excise duty the case is pending before CESTAT and in case of custom duty the appeal is preferred before Supreme Court of India."<br>Further, it was noted that although other disputes had | It was viewed that the comment made by the auditor in Annexure to the Auditor's Report in pursuant to the Companies (Auditor's Report) Order, 2003, was not consistent with the notes to accounts annexed to the financial statements.<br>Such a contradiction should be avoided. |

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| | been reported under the note relating to contingent liabilities which had not been provided for, however, the dispute relating to custom duty had not been mentioned at all under the note of contingent liabilities. | |

## Observations on The Companies Act, 1956

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | In a Schedule regarding 'Share Capital' given in the Annual Report of a Company for the Financial Year 2003-04, it has been mentioned that 25,000 equity shares of Rs.10 each were issued as fully paid bonus shares in earlier years. | It was viewed that the company has not disclosed the source from which these shares were issued which is a violation of Schedule VI to the Companies Act, 1956. It may be noted that as per the requirements of Schedule VI, the source from which bonus shares are issued is required to be disclosed. |
| 2. | In a Schedule regarding 'Unsecured Loans' given in the Annual Report of a Company for the Financial Year 2003-04, the company had disclosed Rs.1,500.00 lacs as short-term loans. | It was viewed that the company had not given the break-up of these loans into (i) from banks, and (ii) from others, which is a requirement under Schedule VI to the Companies Act, 1956. |
| 3. | In a Schedule regarding 'Other Income' given in the Annual Report of a Company for the Financial Year 2003-04, the company had disclosed Dividend Receipts under the classification (i) from subsidiaries and (ii) from others. | It was viewed that the company had not given the break-up of the income from investment into (i) trade investments, and (ii) other investments, which is a requirement under Part II of the Schedule VI to the Companies Act, 1956. |
| 4. | From an Annexure to the Profit and Loss Account regarding 'Other Income' given in the Annual Report of a Company for the | It was felt that the amount should be gross since the gross amount is the revenue of the company as per AS 9, Revenue Recognition. It may |

| S. No. | Matter contained in Annual Report | Observations |
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| | Financial Year 2003-04, it has been noted that the company has shown dividends and interest on investments under this head, without mentioning whether these were gross or net. | be noted that Part II of Schedule VI to the Companies Act, 1956, requires the amount of tax-deducted to be disclosed in case the gross income is recognised in the Profit and Loss Account. However, the company has not disclosed the same. |
| 5. | In a Schedule regarding 'Share Capital' given in the Annual Report of a Company for the Financial Year 2003-04, the company had not indicated the number of shares for the previous year. | It was viewed that the Authorised and Issued Share Capital at the end of the year was different from the previous year. This indicated that there had been a change in the number of shares also. It may be noted that as per the requirements of Schedule VI to the Companies Act, 1956, previous year figures are required to be given for all items of the Balance Sheet and Profit and Loss Account.<br><br>It was felt that since the said Schedule was also a part of the Balance Sheet, the company was required to give the previous year figures for all items of the Schedule including the number of shares. Not giving previous year figures for number of shares was a violation of Schedule VI to the Companies Act, 1956. |

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| 6. | From a Schedule regarding 'Secured Loans' given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has obtained Term Loans from the Industrial Development Bank of India. | It may be noted that Part II of Schedule VI to the Companies Act, 1956, requires the interest on term loans to be disclosed separately. However, the company has not disclosed the same in Schedule to the Profit and Loss Account regarding 'Interest and Financial charges', which is a clear violation of Schedule VI to the Companies Act, 1956. It was viewed that the company has shown the interest received as deduction from interest paid in the Schedule to the Profit and Loss Account regarding 'Interest and Financial charges'. It was felt that this is also contrary to the requirements of Schedule VI to the Companies Act, 1956, which requires the interest received to be shown under the head 'Other income'. |
| 7. | One of the Schedule regarding 'Administration and Other Expenses' given in the Annual Report of a Company for the Financial Year 2003-04, states that :<br>i. The company has given only one figure of | Regarding Point (i), it may be noted that Schedule VI to the Companies Act, 1956 requires the following details to be provided in this regard:<br>1) Salaries, Wages and bonus<br>2) Contribution to |

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| | 'expenses on employees' in this Schedule.<br>ii. The company has disclosed only figure of 'RTO Tax and Insurance' in this Schedule.<br>iii. The company has disclosed only one figure of 'Repairs to assets' in the Schedule. | provident and other funds<br>3) Workmen and staff welfare expenses<br>Regarding point (ii), it may be noted that as per the requirements of Schedule VI to the Companies Act, 1956, insurance is required to be shown separately from taxes. Regarding point (iii), it may be noted that this is not as per Schedule VI to the Companies Act, 1956, which requires 'Repairs to buildings' to be disclosed separately from 'Repairs to machinery'. |
| 8. | From a Schedule regarding 'Unsecured Loans' given in the Annual Report of a Company for the Financial Year 2003-04, it has been noted that unclaimed fixed deposits have been included in the schedule. | It was felt that unclaimed fixed deposits were basically unpaid matured deposits, which as per Schedule VI to the Companies Act, 1956, are required to be disclosed under the heading 'Current Liabilities'. Thus, the disclosure made by the company is not in consonance with Schedule VI to the Companies Act, 1956. |
| 9. | From an Annexure to the Profit and Loss Account regarding 'Manufacturing Expenses' given in the Annual Report of a | It may be noted that Part II of Schedule VI to the Companies Act, 1956, requires the expenditure incurred on the consumption |

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| | Company for the Financial Year 2003-04, it was observed that the company has not disclosed the expenditure incurred on the consumption of stores and spares separately. | of stores and spares to be disclosed separately. |
| 10. | In an Annexure to the Balance Sheet regarding 'Current Liabilities' given in the Annual Report of a Company for the Financial Year 2003-04, the company has disclosed only one figure of 'Sundry Creditors and Acceptances'. | It was viewed that this is not as per Schedule VI to Companies Act, 1956. Part I of Schedule VI to the Companies Act, 1956, requires acceptances to be disclosed separately from sundry creditors. |
| 11. | In the Annual Reports of the Companies for the Financial Year 2003-04, the following has been noted, the observations on the same, are quite similar as provided adjacent to them:<br>■ From a note regarding 'Deferred Taxes', it has been noted that the company has not indicated the previous year figures<br>■ The company in a note had given previous year figures for total column only and not for transactions with each | It may be noted that as per the requirements of Schedule VI to the Companies Act, 1956, previous year figures are required to be given for all items of the Balance Sheet and Profit and Loss Account.It was viewed that since the Notes/Schedule (referred herein) was also a part of the Notes to Accounts/Balance Sheet, the companies were required to give the previous year figures in the Note/ Schedule also. Not giving previous year figures is a violation of Schedule VI to the Companies Act, 1956. |

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| | type of related party, viz., subsidiary company, key management personnel and relatives of key management personnel.<br>■ In a Schedule regarding Fixed Assets the company has not indicated the previous year figures. | |
| 12. | From the Annual Report of a Company for the Financial Year 2003-04, it has been noted that the company has included the 'Forfeited Shares account' in the 'Reserves and Surplus' schedule. | It was felt that this is not as per Schedule VI to the Companies Act, 1956. It may be noted that Schedule VI to the Companies Act, 1956 requires that forfeited shares money is to be included in the 'Share Capital' schedule. |
| 13. | In the Secured Loans Schedule given in the Annual Reports of the Companies for the Financial Years 2003-04 / 2005-06, the companies had disclosed the information regarding securities given against those loans in the following manner:<br>■ The loans are secured against hypothecation of the assets purchased out of these loans.<br>■ The loans are secured | It may be noted that Part I, Schedule VI to the Companies Act, 1956, requires the nature of security to be specified in each case.<br>It was viewed that the disclosure about the nature of security should also cover the disclosure of the type of asset given as security, e.g., inventories, plant and machinery or land and buildings, etc. This is because the nature of these assets is not the same and the extent |

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| | by hypothecation of all stocks and current assets of the company and are further collaterally secured by a first charge on the fixed assets at Head Office and Factories and guaranteed by some of the Directors of the company.<br>The observations on such disclosures are quite similar as provided adjacent to them. | to which a loan is secured may vary depending upon the nature of asset against which it is secured. However, the note given by the companies do not bring out this aspect.<br>Hence, it was felt that the companies had not disclosed the nature of the security as per the requirements of Part I, Schedule VI to the Companies Act, 1956. |
| 14. | In the Annual Report of a Company for the Financial Year 2003-04, the accounting policy regarding 'Foreign Currency Transactions' provides as follows:<br>"Foreign currency transactions during the year are recorded at rates of exchange prevailing on the date of transaction. Foreign currency assets and liabilities are translated into rupees at exchange rate prevailing at the balance sheet date. The resulting gain/ loss is reflected in the Profit and Loss Account." | It appears that all assets and liabilities relating to foreign currency transactions are translated at the year-end rates. This is contrary to Paragraph 7(a) of AS 11, Accounting for the Effects of Changes in Foreign Exchange Rates (revised 1994), which requires only assets and liabilities in the nature of monetary items to be converted at the closing exchange rate.<br>It appears that the company is recognising all exchange gains and losses arising on translation, including on the liabilities incurred for the purpose of acquiring fixed |

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| | | assets, to the profit and loss account. It was viewed that this is contrary to AS 11 and Schedule VI to the Companies Act, 1956. As per AS 11 (revised 1994) and Schedule VI, exchange gains and losses arising on the liabilities incurred for the purpose of acquiring fixed assets should be adjusted to the cost of the relevant fixed asset. |
| 15. | From a Schedule regarding 'Fixed Assets' given in the Annual Report of a Company for the Financial Year 2003-04, it was observed that the company has included the capital work-in-progress in the schedule and has disclosed one figure of fixed assets, including capital work-in-progress, on the face of the Balance Sheet. | It may be noted that this is contrary to the Vertical Form of Balance Sheet as prescribed in Schedule VI to the Companies Act,1956, which requires the following disclosure to be made on the face of the balance sheet regarding fixed assets:<br>Fixed assets:<br>(a) Gross block<br>(b) Less: Depreciation<br>(c) Net block<br>(d) Capital work-in-progress |
| 16. | In the Annual Report of the Company for the Financial Year 2005-06, the Schedule of Share Capital states that the Authorised Capital as | It was noted that as per the information given in the note under the Schedule of Share Capital the equity shares of the nominal value of Rs. 10/- |

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| | well as Issued, Subscribed and Paid-up Capital for the nominal value of Rs. 2 each. However, under the note to schedule, it was stated that equity shares of the original value of Rs. 10/- each were allotted as fully paid up bonus shares by capitalisation of surplus in Profit and Loss account. | each were allotted as fully paid up bonus shares by capitalisation of surplus in Profit and Loss account. However, it was observed from the Schedule that the both Authorised Capital as well as Issued, Subscribed Capital comprises of shares with nominal value of Rs. 2/- each per share and not Rs.10/- per share. Therefore, it was viewed that either it was a typographical error with regard to the nominal value of the bonus shares or certain other information with regard to share split should have been disclosed by the company. |
| 17. | From the 'Share Capital' Schedule in the Annual Report of the Company for the Financial Year 2005-06, it was noted that the Company has not disclosed the amount of original paid up capital of the forfeited shares. | It was felt that the disclosure is not complete as per Schedule VI to the Companies Act, 1956. It may be noted that Part I of Schedule VI to the Companies Act, 1956 requires that the amount originally paid up should also be disclosed in case of forfeited shares. |
| 18. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the Share Capital | It may be noted that as per Part I of Schedule VI to the Companies Act, 1956, the period for which the dividends |

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| | of the company included Cumulative Redeemable Preference Shares. Further, from the profit and loss account of the Company, it was evident that no dividend was paid by the Company on the stated Preference Shares either in the current financial year or in the immediately preceding financial year. | are in arrear or if there is more than one class of shares, the dividends on each such class are in arrear should be separately stated.<br>It was viewed that neither the Company had made any provision for arrears of dividends nor it had provided any information by way of a note about the period for which such dividends were in arrears.<br>Thus, the Company had not complied with the requirements of Part I of Schedule VI to the Companies Act, 1956 which had also resulted in understatement of liabilities. |
| 19. | From the Schedule regarding 'Manufacturing and other expenses' given in the Annual Report of a company for the Financial Year 2005-06, it has been noted that the Company had paid branch audit fee during the stated year as well as previous year. | It was viewed that the audit of branch had been conducted by a person other than company's auditor. Further, it was noted from Section 227 (3) (bb) of the Companies Act, 1956 provides as below:<br>"3. The auditor's report shall also state –<br>(bb) whether the report on the accounts of any branch office audited under section 228 by a |

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| | | person other than the company's auditor has been forwarded to him as required by clause (c) of sub Section (3) of that section and how he has dealt with the same in preparing the auditor's report."<br><br>It was felt that the auditor had not made any comment regarding the branch audit report, as required by Section 227(3)(bb) of the Companies Act, 1956. |
| 20. | From the Schedule regarding, 'Finance Expenses given in the Annual Report of a Company for the Financial Years 2004-05/2005-06, it has been noted that the interest income had been deducted from interest expenses to report net finance expense on the face of the profit and loss Account. | It may be noted that Paragraph 3 of Part II, Schedule VI to the Companies Act, 1956, provides that the profit and loss account should set out the various items relating to the income and expenditure of the Company. Further, Paragraphs 3(v) and 3(xi) (b) of Part II, Schedule VI to the Companies Act, 1956 require that the interest expense and interest income should be disclosed separately.<br><br>It was viewed that netting off interest expense and interest income against each other is contrary to Part II, ScheduleVI of the Companies Act, 1956. |

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| 21. | From the Annual Report of a Company for the Financial Year 2005-06, some discrepancies have been noted, as given below:<br>1. The figure of closing stock of stores, chemicals, packing and scheme material as reported in the Schedule of Inventory was not talling with those reported in the Schedule of material consumed.<br>2. In the Balance Sheet, inventory included Goods – in – Transit which were not dealt with anywhere in profit and loss account. | It may be noted that Part I, Schedule VI to the Companies Act given under Vertical Form of the Balance Sheet states that:<br>"The Schedules, referred to above, accounting policies and explanatory notes that may be attached shall form an integral part of the balance sheet."<br>From the above, it may be construed that Schedules as well as notes to accounts being a part of the same financial statement therefore the information contained in the two documents should not contradict each other.<br>Considering the contradictions as reported in point 1 and 2 , it was felt that the financial statements had not been prepared in accordance with the requirement of Schedule VI to the Companies Act, 1956.<br>Further, it was viewed with regards to Goods in transit, that it should have been included in purchases and deducted from materials consumed as part of closing stock, which had not been done. |

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| 22. | In the Auditor's Report given in the Annual Reports of the Companies for the Financial Year 2004-05, the auditor's opinion as contained in its report include the following:<br>■ In our view the scope of areas covered in the internal audit needs to be widened in view of the growing operations at …… (Name of the Unit) of the company.<br>■ In our opinion, the Balance Sheet, Profit & Loss Account and Cash Flow statement dealt with this report comply with the Accounting Standards referred to in sub-section (3C) of Section 211 of the Companies Act, 1956; subject to Note No. A (a), (c iv), (w), B (1) and B (13) of the Notes forming part of Accounts.<br>■ In our opinion and to the best of our information and according to the explanations given to us, the said accounts read with Note No. A(a), (c iv), (w),B(1) and | It was felt that this is contrary to the requirement of Companies Act, 1956.<br>It may be noted that Section 227(3)(e) of the Companies Act, 1956, requires that the observations or comments of the auditors which have any adverse effect on the functioning of the Company, should be provided 'in thick type or in italic' in the Auditor's Report.<br>It was viewed that the observations as given by the auditors, may have an adverse effect on the functioning of the Company and therefore, it should have been given in thick or italics type so that it could be identified readily and clearly by the readers. |

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| | B(13), together with the Significant Accounting Policies and other notes thereon give the information required by the Companies Act, 1956 in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India.<br><br>The observation on the same are quite similar as provided adjacent to them. | |
| 23. | From Annexure to the Auditors Report prepared in pursuance to the Companies (Auditor's Report) Order, 2003, given in the Annual Report of a Company for the Financial Year 2004-05, it was noted that the said Report had been addressed to the Directors of the Company. | It may be noted that Section 227(2) of Companies Act, 1956 provides that the auditor should make a report to the **members of the Company** on the accounts examined by him, and on every balance sheet and profit and loss account and on every other document declared by this Act to be part of or annexed to the balance sheet or profit and loss account.<br><br>It was noted that the CARO Report is prepared in pursuance of Section 227 (4 A) of the Companies Act, 1956 and therefore, the said |

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| | | report is a part of the main auditor's report. Also, as per Section 227 (2), the auditor's report is made for the members of the Company. Accordingly, it was viewed that the CARO Report should also be addressed to the members of the Company and not the Board of Directors of the company. |
| 24. | In a Schedule regarding 'Operating and Other Expenses' given in the Annual Report of a Company for the Financial Year 2004-05, it has been noted that the total Auditor's Remuneration incurred during the financial year was disclosed in the Profit and Loss Account. However, no other disclosure had been made with regard to such remuneration in the notes to accounts. | It was felt that the disclosure with regard to Auditor's Remuneration was not made as per the requirement of clause 4B of Part II, Schedule VI to the Companies Act, 1956. It provides that the Profit and Loss Account should further contain or give by way of note detailed information in regard to amounts paid to the auditor:<br>a. as auditor<br>b. as advisor, or in any other capacity, in respect of -<br>(i) taxation matters<br>(ii) company law matters<br>(iii) management services; and<br>c. in any other manner<br>It was observed that the |

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| | | detailed information regarding to such Auditor's remuneration had not been disclosed either in the Schedule or in the notes to accounts. |
| 25. | In the Annual Report of the Company for the Financial Year 2005-06, only total amounts have been stated under the head of 'Current Assets, Loans and Advances' as well as 'Current Liabilities and Provisions', on the face of the Balance Sheet. | It was observed that this is contrary to the vertical form of Balance Sheet as prescribed in Part I, Schedule VI to the Companies Act, 1956. It provides that, in case vertical form of balance sheet is prepared, the following details should be disclosed on the face of the balance sheet;<br>*Current Assets, Loans and Advances*<br>(a) Inventories<br>(b) Sundry debtors<br>(c) Cash and bank balances<br>(d) Other current assets<br>(e) Loans and advances<br>*Less:*<br>*Current liabilities and provisions*<br>(a) Liabilities<br>(b) Provisions |
| 26. | In the Schedule regarding 'Reserve and Surplus' given in the Annual Report of a Company for the Financial Year 2005-06, the Company | It was viewed that this is contrary to Schedule VI to the Companies Act, 1956. It may be noted that Schedule VI to the Companies Act, 1956 |

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| | had adjusted the amount of Calls-in-arrears against the amount of Gross Premium given under the Share Premium Account. | requires that the amount of calls in arrears should be deducted from the Share capital on the face of the Balance Sheet and not from the Share Premium Account. |
| 27. | In the Schedule regarding 'Unsecured Loan' given in the Annual Report of a Company for the Financial Year 2005-06, the unsecured loans had been disclosed in following manner:<br>**Unsecured Loans**<br>From Director/ Shareholder<br>From Bank I<br>From Bank II<br>Add: Interest accrued & Due | It was viewed that this is not as per Part I, Schedule VI to the Companies Act, 1956 which requires that the unsecured loans should be bifurcated into Short Term Loans and Others Loans rather than bifurcating them on the basis of sources, from where such loans have been obtained. |
| 28. | In the Schedule regarding 'Current Liabilities and Provisions' given in the Annual Report of a Company for the Financial Year 2005-06, the Company had disclosed audit fee under the head of 'Provisions'. | It was felt that the audit fees is an ascertained liability, which as per Part I, Schedule VI of the Companies Act, 1956, are required to be disclosed under the head of Current Liabilities.<br>Thus, the disclosure made by the Company is not in consonance with Part I, Schedule VI to the Companies Act, 1956. |
| 29. | In the Annual Report of a Company for the Financial | It may be noted that as per the requirements of Part I, |

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| | Year 2005-06, the Company had disclosed advance Income Tax paid under the Schedule of 'Other Current Assets'. | Schedule VI to the Companies Act,1956, under the head 'Current Assets, Loans and Advances', the advances recoverable in cash or in kind or for value to be received should be separately disclosed under the sub – heads of Loans and Advances.<br>However, it was noted that the advance Income tax paid had been stated in the Schedule of 'Other Current Assets' instead of 'Loans and Advances' as required under Part I of Schedule VI to the Companies Act, 1956. |
| 30. | From one of the note relating to payments to Directors given under Notes to Accounts in the Annual Report of a Company for the Financial Year 2005-06, it has been noted that in pursuance of Paragraph 4A of Part II, Schedule VI to the Act the Company has given the breakup of the payments to Directors which also include the commission paid to them during the year. | It was noted that the Company had not strictly complied with the requirements of Part II, Schedule VI to the Companies Act, 1956 which provides that:<br>"The Profit and Loss account shall contain or give by way of a note a ***statement showing the computation of net profits*** in accordance with section 349 of the Act ***with relevant details of the calculation of the commission payable by way of percentage of such*** |

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| | | ***profits to the directors*** (including Managing Directors), [the managing agents, secretaries and treasurers] or manager (if any)." (emphasis added)<br>It was noted that the computation of net profit as required by Paragraph 4A of Part II, Schedule VI to the Companies Act, 1956 had not been disclosed by the Company. |
| 31. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the amount of audit fee stated in the Notes to Accounts, was different from the amount of audit fee mentioned in Schedule of 'Other Expenses'. | It was noted that the information relating to same expense as given in Schedule and related note, in Notes to Accounts, contradict each other.<br>Considering the contradictions, it was viewed that the financial statements had not been prepared in accordance with the requirement of Schedule VI to the Companies Act, 1956. |
| 32. | From the additional information provided in pursuant to the requirements of Paragraph 3, Paragraph 4 and Paragraph 4D of Part II, Schedule VI to the Companies Act, 1956, given in the Annual Report of a | It was felt that the Schedules, accounting policies and explanatory notes that are attached to the financial statements form an integral part of the statements. As such, Schedules and notes to accounts, being a part of the financial statement should not |

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| | Company for the Financial Year 2005-06, it has been noted that the figures of closing stock as given under Schedule of Inventory did not reconcile with the figures of closing stock as derived from the information (viz, actual production, opening stock, and turnover) given in notes to accounts. | contain the information that contradict each other.<br>It was felt that the value as well as quantity of closing stock as reported in the note to accounts should tally with the information given in Schedule of inventory and other related notes to accounts unless such a difference has occurred due to samples, wastages, capitalisation etc. Accordingly, significant differences in the figures may be viewed as non-compliance of Schedule VI to the Companies Act, 1956. |
| 33. | From the Schedule of Fixed Assets and Depreciation given in the Annual Report of a Company for the Financial Year 2005-06, it has been noted that the figures of freehold and leasehold properties were clubbed together to show a single item of fixed asset. | It was viewed that as per the requirement of Part I of Schedule VI to the Companies Act, 1956, freehold and leasehold properties of the same nature should be regarded as two separate items of fixed assets and, therefore, they should be disclosed separately instead of showing the same as single item of fixed asset. It is supported by the fact that lease hold land is a depreciable asset while freehold land is not. |

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| 34. | From the Annual Report of a Company for the Financial Year 2004-05, it has been noted that the balances in Receivables/Advances, which were long outstanding had been identified as not recoverable and debited to the Profit and Loss Account. Further, an equivalent amount had been withdrawn from the General reserve to offset this charge, on the pretext that it pertained to past years. | It was noted that the Company had expensed such bad debts by reducing an equivalent amount from General Reserve and net impact on the current year profits was shown as NIL. By adopting the aforesaid practice, the Company had overstated its profit before prior period adjustments as well as earning per share.<br><br>It may be mentioned that Clause 2 (b) of Part II, Schedule VI to the Companies Act, 1956 provides that the Profit and Loss account should disclose every material feature, including credits or receipts and debits or expenses in respect of non-recurring transactions or transactions of an exceptional nature.<br><br>It was viewed that such adjustment of bad debts from general reserve should have been stated below the line. |
| 35. | One of the notes to accounts given in pursuance to the provisions of Paragraphs 3, 4(c) and 4D of Part II, Schedule VI to the Companies Act, 1956, in the Annual Report | It may be noted that as per the requirements of Paragraph 4D (c) of Part II, Schedule VI to the Companies Act 1956, value of all imported as well as indigenous raw materials, |

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| | of a Company for the Financial Year 2005-06, it has been noted that the Company had disclosed only the quantity of indigenous raw material consumed during the year, although the accounting policy of foreign currency transaction indicated that the raw materials had been imported and the Schedule of 'Material and Manufacturing expenses' indicated that the stores and spares had been consumed by the Company during the reported period. | spare parts and components consumed during the financial year and the percentage thereof to the total consumption for each of the stated categories should be disclosed.<br>Considering the other facts given in the accounting policies as well as schedule to financial statements, it was viewed that the Company had not disclosed the value of all imported raw materials, spare parts and components consumed during the year and the percentage of each of them to the total consumption as per the requirement of Para 4D (c) of Part II of Schedule VI to the Companies Act 1956. |
| 36. | From the Schedule of Investment given in the Annual Report of a Company for the Financial Year 2004-05, it has been noted that the Company had shown the share application money paid by it, as a part of its investments. | It was viewed that the share application money paid by the Company is in the nature of advances and therefore, it should be shown under the head of 'Loans and Advances' instead of showing it under the head of 'Investments'. |
| 37. | From the Annual Report of a Company for the Financial Year 2004-05, it has been | It was felt that the Company had not properly disclosed the share application money in |

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| | noted that the share application money received on account of Redeemable Preference Shares had been shown under the Schedule of Share Capital. | the Balance Sheet. It may be noted that Paragraph 35 of Guidance Note on Audit of Capital and Reserves provides that Schedule VI to the Companies Act, 1956 does not prescribe the manner of disclosure of share application money. However, as a matter of prudence and better disclosure share application money should be shown separately between "Share Capital" and "Reserves & Surpluses" in the Balance sheet till the time share application money is transferred to the Share Capital Account. However, in the following situations, the share application money should be disclosed separately under the head "Current Liabilities" in the Balance Sheet:<br>• invalid or revoked applications;<br>• excess application money received due to over subscription; and<br>• when minimum subscription stated in the offer document is not received. |

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| 38. | One of the Notes to accounts given in the Annual Report of a Company for the Financial Year 2004-05, provides that:<br>"The Preference Shares are redeemable at a premium on maturity; hence no provision has been made for dividend." | It may be noted that Section 80 of the Companies Act, 1956 provides that the premium payable on redemption should be provided, for out of the profits or security premium account of the company, before the shares are redeemed. Further, where any such shares are redeemed otherwise than out of the proceeds of a fresh issue i.e. out of profits which would otherwise have been available for dividend, then a sum equal to the nominal amount of the shares redeemed should be transferred to a reserve fund, to be called the capital redemption reserve account.<br>It was viewed that no amount had been appropriated out of the profits, towards Preference Share Redemption Reserve and Premium payable on redemption. Further, the company had not made any provision for dividend on such preference shares and amortization of premium payable on redemption of the preference shares which is |

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| | | contrary to Section 80 of the Companies Act, 1956. |
| 39. | From the Annual Report of a Company for the Financial Year 2004-05, the accounting policy regarding Depreciation provides as below :<br>"Depreciation on fixed assets is being provided on straight – line basis in the manner & at the rates specified in Schedule XIV of the Companies Act, 1956 and on the revalued cost wherever applicable. The difference of the depreciation between the revalued cost and historical cost has been charged to Profit & Loss Account. | It may be noted from note 2 given under vertical form of Balance Sheet in Part I, Schedule VI to the Companies Act, 1956 that the Schedules, accounting policies and explanatory notes that may be attached shall form an integral part of the balance sheet.<br>From the above, it may be construed that the information given in two different schedules of the same balance sheet should not contradict to each other.<br>It was noted that the company has disclosed accounting policy for the depreciation on revalued fixed assets. As against it, the company has not given any information about such revaluation of fixed assets either in the Schedule or in the notes to accounts. Accordingly, it was felt that the accounting policy as adopted by the company is not in conformity with the information given under schedule to balance sheet or notes to accounts. |

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| 40. | From the Annual Report of a Company for the Financial Year 2005-06, it has been noted from the comment of the Auditor given in pursuance to paragraph 4(iii)(a) and 4(iii)(b) of the Companies (Auditor's Report) Order, 2003, that the company has not granted any loans to parties covered in the register maintained under Section 301 of the Companies Act, 1956. However, recurring transactions had been classified under advances and no interest was applicable to such types of inter company advances. | It may be noted that Part I of Schedule VI to the Companies Act, 1956, requires that advances and loans to subsidiaries should be shown distinctly under the sub-head of 'Advances and loans to subsidiaries'.<br>It was noted that although the company had made certain inter-company advances to subsidiaries as evident from the information given under the report pursuant to CARO, 2003 but the same had not shown separately as per the disclosure requirements of Part I of Schedule VI to the Companies Act, 1956. |
| 41. | In the Schedule regarding 'Manufacturing and other expenses' given in the Annual Report of a Company for the Financial Year 2005-06, the loss of stock due to accident had been reported at net figure. | It was viewed that the Insurance claim should have been deducted from the original cost of stock lost due to accident to derive the value of loss occurred thereon. It was felt that gross value of such stock had neither been reported in Schedule nor notes to accounts. |

## Observations on Auditing and Assurance Standard (AAS) 28: The Auditor's Report on Financial Statements

| S. No. | Matter contained in Annual Report | Observations |
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| 1. | From the Auditor's Report given in the Annual Report of the Company for the Financial Year 2005-06, it has been noted that although Auditor's Report had referred to Cash Flow Statement in the opening or the introductory paragraph, however, it had not contained any expression of opinion on the true and fair view of the Cash Flow Statement. | It may be noted from Paragraph 9 of AAS 28, The Auditor's Report on Financial Statements, that the auditor's report should identify the financial statements of the enterprises that have been audited, including the date and period covered by the financial statements.<br>It may also be noted that the term financial statements used in Paragraph 9 of AAS 28 has been further explained by the Council of the Institute, according to which for the purpose of Section 211 of the Companies Act, 1956 the Cash Flow Statements would be a part of the Balance Sheet and Profit and Loss Account.<br>Keeping in view of above, the auditor's report on financial statements should provide an expression of opinion on the true and fair view of the Cash Flow Statement for the period under audit. |
| 2. | From the Annual Report of a Company for the Financial | It was felt that this is not as per AAS 28. It may be noted |

| S. No. | Matter contained in Annual Report | Observations |
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| | Year 2004-05, it has been noted that membership number of the auditor had not been mentioned either in the Auditor's Report or in the Annexure to the Auditor's Report. | that Paragraph 28 of the Auditing and Assurance Standard (AAS) 28 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.**<br>Therefore, it was viewed that while signing the Auditor's Report, the auditor should also mention his membership number assigned by the Institute of Chartered Accountants of India. |