COMPANY ACCOUNTING STANDARDS

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International Accounting Standards were prescribed for the purpose of following uniform accounting practices globally. These Accounting Standards were adapted by various countries to suit their respective States. The Institute of Chartered Accountants of India (ICAI) being a member of International Accounting Standards Board has issued 28 Accounting Standards (ICAI-AS).

The Income Tax Department (ITD) and the Department of Companies Affairs (DCA) wished to formulate their own Accounting Standards. In the process the Income Tax was amended Section 145(2) in 1995, enabling ITD to notify Accounting Standards. Accordingly ITD had notified two Income-tax Accounting Standards (IT-AS) on 25th Jan 1996. Fortunately both the IT-AS are in line with the AS issued by the ICAI. Similarly the DCA in accordance with Section 210A and Section 211 has notified the "Companies (Accounting Standards) Rules, 2006" on 7th Dec 2006 vide GSR No. 739(E). Fortunately again, these Company Accounting Standards (CO-AS) are on the same lines as the ICAI-AS. Let us walk through these Companies (Accounting Standards) Rules, 2006 ("the Rules" or "CO-AS") to know its frame and structure.

Need for Accounting Standards:

The Companies Act 1956 ("Act") has recognized the need for companies to follow Accounting Standards with effect from 31st Oct 1998 by the Companies (Amendment) Act 1999 and inserted Section 210A and Sub-section (3A) to (3C) in Section 211.

According to Section 211(3A), "every Profit & Loss Account and Balance Sheet of the company shall comply with the Accounting Standards". Thus it is mandatory for all companies to follow Accounting Standards. In case a company is not following the Accounting Standards in its financial statements, Section 211(3B) requires the company to disclose that its financial statements are in deviation from accounting standards, the reason for such deviation and the financial affect on financial statements as a result of such deviation. The Amendment Act 1999 has inserted Clause (d) in Section 227(2) of the Act whereby the Auditor’s Report shall disclose "Whether, in his opinion, the Profit & Loss Account and Balance Sheet complied with the Accounting Standards referred to in sub-section (3C) of section 211". Further by the Amendment Act 2000 sub-section (2AA) was inserted in Section 217, whereby the Directors Report shall include a "Directors’ Responsibility Statement" and this Statement shall disclose that proper Accounting Standards were followed in preparation of annual accounts.

National Advisory Committee on Accounting Standards:

As per Sec.210A of the Act the Central Govt. shall constitute the National Advisory Committee on Accounting Standards ("the Committee"). As per Proviso to Sec.211(3C) Accounting Standards specified by the Institute of Chartered Accountants of India (ICAI) shall be deemed to be the Standards till the Central Government prescribes the AS in consultation with the Committee. Thus until the notification of the Rules on 7th Dec 2006, it was mandatory for all companies to follow the ICAI-AS.

While framing these Rules the Committee has almost reproduced the ICAI-AS. As a result the company, the accountants and the auditors need not learn the AS under the Rules afresh. They may note the changes in the CO-AS under the Rules vis-à-vis the ICAI-AS.

Applicability:

- These Rules are applicable to all the companies incorporated under the Act. They are applicable from the date of their notification i.e. 7th Dec 2006. After framing these Rules the companies are required to follow the CO-AS. The Companies need not follow the ICAI-AS.
- As per Rule 4(2) CO-AS shall be followed in the preparation of General Purpose Financial Statements.
- As per Rule 2(1)(d) "General Purpose Financial Statements" (GPFS) include the Balance Sheet, the Profit & Loss Account, the Cash Flow Statement (where
applicable) and other statements and explanatory notes which form part thereof (i.e. Notes on Accounts).

- The Rules have not specified whether the AS prescribed under the Rules are mandatory in respect of every financial statement prepared by the company. However it is opined that every company preparing GPFS u/s 210 read with Sec 211 is required to follow the CO-AS. Similarly an auditor discharging his attest function u/s 227 shall ensure that the GPFS are in accordance with the CO-AS.

- However, it is desirable that even in respect of Financial Statements prepared not in accordance with Sec. 210 read with Sec. 211 these Rules are followed for the sake of uniformity and comparison by the stakeholder.

**Structure of Rules:**

The Rules are mainly divided into 3 parts.

- Rules (i.e. 5 Rules) - Defining and explaining various terms under the Rules.
- Annexure-A : General Instructions - to be followed in application of CO-AS.
- Annexure-B : The Accounting Standards.

**Structure of CO-AS:**

- Central Government has adopted all the 28 ICAI-AS. As per Rule 3(1) ICAI-AS 1 to 7 and 9 to 29 were notified as Standards under Annexure-B to the Rules. ICAI-AS-8 "Accounting for Research and Development" was withdrawn by ICAI itself.
- CO-AS under Rules are also numbered in the same manner as ICAI-AS.
- Accounting Standard Interpretations (ASIs) issued by ICAI are mostly incorporated as Explanations in the respective CO-AS.
- Various examples given under in the ICAI-AS were also adopted in the CO-AS under the Rules.

**General Instructions (GI):**

The Rules have specified some general instructions. These General Instructions are applicable with every Standard. Hence each Standard has to be read along with these General Instructions. This point has time and again been specified at the opening each Standard.

Some of these instructions are in respect of Small and Medium Sized Companies which are explained separately. Following are other General Instructions.

- GI-2 specifically prescribes that CO-AS are intended to be in conformity with the applicable laws. It further clarifies that, if at any point of time a Standard is not in conformity with the law, the financial statements shall be prepared in conformity with the provisions of the law. Thus naturally the law prevails over the Rules and the Standards.
- As per GI-3, materiality concept shall be followed and accordingly Standards are intended to be applicable to items which are material.
- As in ICAI-AS the Standard consist of two parts viz., the 'plain type' and the 'bold italic type'. GI-4 clarifies that both parts have equal authority. Paragraphs in 'bold italic type' emphasize the main principles. Each CO-AS has to be read in the context of the 'objective' wherever stated in any Standard.

**Small and Medium Sized Companies:**

- The Rules give certain exemptions or relaxations for the purpose of following the CO-AS in respect of Small and Medium Sized Companies ("SMC").
- The criteria of small and medium sized companies are not in line with "Micro, Small and Medium Enterprises Development Act, 2006".
- Under the Rules a Company can be "an SMC" or "not an SMC". The Rules have dispensed with the Level-I, Level-II and Level-III Enterprises defined by the ICAI. However the definition of SMC is in line with the Level-I Enterprises defined by the ICAI.
- For this purpose Rule 2(1)(f) has defined what constitutes an SMC. As per this Rule SMC shall not fall under any of the following categories:
  - Where the equity or debt securities of a company are listed in India or outside India;
  - Where the company is in the process of listing its equity or debt securities in India or outside India;
  - A Bank, a financial institute or an insurance company;
  - Where the turnover exceeds Rs 50 crores in the immediately preceding accounting year, for this purpose turnover excludes other income;
Article

- Where the borrowings exceeds Rs 10 crores in the immediately preceding accounting year, borrowings includes public deposits;

- Which is a holding company of a company which is not a SMC;

- Which is a subsidiary of a company which is not a SMC.

- As per Explanation to Rule 2(1)(f) a company shall qualify as an SMC only if the above conditions are satisfied as at the end of the relevant accounting period.

- If a company ceases to be a "non-SMC", it will not be able to avail the benefits of a SMC unless it remains to be SMC for two consecutive years.

- Exemptions or relaxations in respect of SMC are specified in the respective CO-AS.

- Following additional points need to be followed by the SMC as per the General Instructions to the Rules.

  - As per GI-1.1: Where a company being an SMC has availed the concession/ relaxation available to it, the same shall be disclosed in the Notes on Accounts as under: "The Company is a Small and Medium Sized Company as defined in the General Instructions in respect of Accounting Standards notified under the Companies Act, 1956. Accordingly, the Company has complied with the Accounting Standards as applicable to a Small and Medium Sized Company."

  - As per GI-1.2: Where an SMC graduates into a non-SMC company, it need not adjust the previous year figures in the financial statements. However, it has to disclose in the Notes on Accounts the fact that previous year figures are when the company was an SMC.

  - As per GI-1.3: If an SMC opts to forgo the concession available in respect of some Standards, but wish to avail the concession in respect of other Standards, it shall disclose the fact in the Notes on Accounts.

  - As per GI-1.4: If an SMC desires to disclose any information, which otherwise it is not required to disclose, it shall disclose such information in accordance with the relevant Standard.

- As per GI-1.5: An SMC is not permitted to avail partial concessions in following a Standard, since such practice may mislead the public.

Who is responsible?

- As per section 211 (3A) every Company shall follow the Accounting Standards.

- U/s 217 (2AA)(a), Board of Directors are responsible to follow the Accounting Standards and the Directors Responsibility Statement shall assert the fact that Standards were followed in the preparation of the annual financial statements.

- If a company has deviated from the Accounting Standards, it shall disclose in its financial statements u/s 211 (3B) the fact of deviation from Standards, the reason for such deviation and the financial affect on financial statements as a result of such deviation.

- Auditor shall in his report disclose whether the financial statements are in conformity with the Accounting Standards u/s 211(3C) of the Act.

- As per Rule 4(1) every company and its auditors shall comply with the CO-AS specified under these Rules. Thus the Rule specifies that not only the companies but also auditors are required to follow CO-AS henceforth.

Conclusion:

It is mandatory for all companies to follow Accounting Standards issued under the Companies (Accounting Standards) Rules, 2006. There is no doubt that the ICAI-AS are still valid in respect of non-corporate entities. It is time the ICAI issues a clarification as to the status of the ICAI-AS in respect of companies.

The accounting fraternity and the auditors have to keep in view that they are liable for various Accounting Standards in discharging their duties viz., Companies (Accounting Standards) Rules 2006, the Standards issued by the ICAI, the Standards issued by the Income Tax Department, US-GAAP, UK-GAAP, so on and so forth. No problem is envisaged as long as different standards are on the same parameters. Problem arises when there is contradiction between standards. Oh! God give us wisdom and strength to follow the right AS, at the right time, for the right stakeholder.