

ACCOUNTING AND THE COMPANIES ACT

As we are well aware, there are no statutory obligations on individuals, partnerships, etc. to maintain books of accounts. Though in India *Income Tax Act, 1961* requires partnerships and individuals etc. having large businesses to maintain proper books of accounts. It is more for managerial need and taxation point of view that it is advisable for almost everyone to maintain books of accounts.

The Companies Act, 1956 lays down the requirements relating to maintenance and disclosure of accounts, preparation of annual financial statements, audit by professional accountants, and circulation of these statements to shareholders.

The philosophy behind disclosure is that a company should have a proper accounting system and disclose results for the information of its shareholders and creditors. This basic philosophy is contained in the various provisions of the Companies Act.

The requirements relating to maintenance of accounts are basically link to those of preparing annual Balance Sheets and Profit And Loss Accounts. This period, under certain circumstances, can be extended to 15 months.

The requirements affecting the Balance Sheet and the Profit and Loss Account are prescribed under Companies Act.

Recently, the Companies Act has also made it mandatory for large companies to publish its '*cashflow statement*'. Cashflow statement is nothing else but a summary of sources and uses of funds during the year under review.

After the accounts are prepared, they are required to be adopted by the Board of Directors who are expected to attach a report with regard to:

- a. state of the company's affairs,
- b. allocation to reserves and retained earnings,
- c. quantum of dividend,

- d. material changes affecting the financial position of the company since the end of the financial year for which the accounts have been prepared.

In order to prevent manipulations, the law has provided that the accounts of the company should be audited by competent professional accountants who act as “watch-dogs” for the shareholders.

The position of the auditors is much guarded by the statute. They have legal powers to have access to all books of accounts and vouchers of the companies audited by them. They are required to seek such explanations and clarifications that might be necessary for verification and audit of these accounts.

On the basis of scrutiny and verification of accounts, and on the basis of information and explanations provided to them by the officers of the Company, the auditors are required to make a report to the shareholders of the company as to whether the balance-sheet shows a true and fair view of the state of affairs of the company and that the profit & loss account gives true and fair view of financial position for the year.

Within a specified time, the Directors are supposed to circulate the audited Balance-Sheet, Profit & Loss Account, and the Auditors’ Report along with their comments to the shareholders. Directors should also give their comments on every qualification made by the auditors in their report.

Section 227 requires the Auditors to make certain specific comments to further ensure that proper scrutiny is carried out by them. They are supposed to certify that the accounts circulated are:

- a. Prepared on commercial accounting system (the one we discussed earlier).
- b. All the relevant transactions are reflected in the accounts that are circulated.
- c. Generally accepted accounting principles are followed.
- d. The auditors got access to all the informations that were needed and was provided proper explanations wherever required.
- e. The auditor has applied his professional knowledge and skill expected from him.

- f. Finally the auditor certifies that the profit and loss account for the period under review and the Balance Sheet as on the given date reflect true and fair status.

One always finds a large number of notes accompanying the annual accounts. These notes are essentially explanatory notes about the particular treatment adopted while preparing the accounts. Some notes are related to statutory compliance provided for in different statutes.

The auditor many times may not agree with the Profit and Loss Account, Balance Sheet and the notes attached thereto, In that case if the issue is material in nature, he is supposed to qualify his report. Please keep in mind that the preparation of final accounts along with the note is the primary duty of the management and the auditor through his report only expresses his opinion thereon.

It is with this in the background that we have to look at the Balance-Sheet and the Profit & Loss account. As mentioned earlier, ‘*true and fair*’ are the words which can have a very wide interpretation.

It should be noted that the Income Tax Act, 1961 has laid down its own method of computing taxable profits. Their definition of expenses and revenues are at times different from the ‘*Generally Accepted Accounting Principles*’. Profits as shown in the published profit and loss account may therefore be quite different from the taxable profits.

Points to Ponder

1. What are these GAAPs? What are auditing and accounting standards? What is US, GAAP, UK, GAAP, Indian GAAP, IAS?
2. How does one ensure that the Balance Sheet and profit and loss account of a business concern give a ‘true and fair’ view?
3. Why inventories are generally valued at lower of the cost or the market price?
4. Should the auditors highlight ‘window-dressing’? How?
5. What are the different types of audit?