Books of Accounts etc. to be kept by the Company (Sec 128) (Part-1)

1. Legislative background

The notes on clauses to the Companies Bill, 2011 read as follows:

"This clause corresponds to section 209 of the Companies Act, 1956 and seeks to provide that every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statements annually which give a true and fair view of the state of the affairs of the company and its branch offices. However, if Board decides to keep books and other papers at any other place in India, a notice to this effect shall be given to the Registrar and relevant books and paper can also be kept in electronic mode. For branch offices of the company in India or outside, it shall be deemed to have complied with the provisions of this section, if summarised returns are sent periodically to the registered office. The books of account and other books and papers maintained by the company shall be open for inspection by any director. The inspection of books of account of subsidiary companies can be done only by a person duly authorised by the board. This clause further provides that books of account of every company shall be kept in good order for eight years. In case, an investigation has been ordered, the Central Government shall have power to ask the company to keep the books of accounts for a period longer than eight years. The clause also provides penalty for the Managing director, Whole time director, Chief finance officer or any other person charged by board with a duty to comply with the provisions and if he does not comply with."

2. Meaning of 'Books of Accounts'

The Companies Act, 1956 referred to the expression "books of account" in section 209 by listing the books required to be kept by the company. The expression is now defined in clause (13) of section 2 of the Act which provides an inclusive definition of the books of accounts. As per definition, it includes records maintained in respect of

a. all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;

b. all sales and purchases of goods and services by the company;

c. the assets and liabilities of the company; and

d. the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;

Further, clause (12) of section 2 of the Act defines the term "book and paper" and "book or paper" to include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form. The word 'record' has been defined in Black's Law Dictionary *[4th Edition, Page 1513]* as "A written account of some act, transaction, or instrument, drawn up, under authority of law, by a proper officer, and designed to remain as a memorial or permanent evidence of the matters to which it relates" or *[8th Edition, Page 3989]* "Information that is inscribed on a tangible medium or that, having been stored in an electronic or other medium, is retrievable in perceivable form." It is to be noted that just records in respect of all sums of money received and expended by a company shall not be sufficient but records evidencing genesis/ trail of such receipt/ expenditure shall also be required to be maintained. Under the new Act the maintenance of records in respect of sales/purchase of services by the company has also been mandated in addition to records in respect of sales/purchase of goods by the company.

Further the requirement of maintenance of books of accounts under any other law viz. Income Tax Act, 1961 is in addition to the provisions of the Act. Therefore if Income Tax Act, 1961 requires for maintenance of books of accounts in a particular manner/form, the company shall be required to maintain books of accounts to fulfil the requirement of both laws.

3. Preparation and keeping of books of account and other relevant books and papers

The scope of preparation and keeping of books of account has been substantially enhanced under the Act, in comparison to the provisions under section 209 of the Companies Act, 1956 as the Act now requires keeping "other relevant books and papers" in addition to the books of account. Which means now that all the deeds, vouchers, writings, documents, minutes and registers to the extent relevant shall also be required to be prepared and kept by the company. Sub-section (1) of section 128 of the Act, requires every company to prepare and keep books of account and other relevant books and papers and financial statement for every financial year. Key features of such books of account, books and papers, financial statements are as under:

(i) It gives a true and fair view of the state of the affairs of the company;

(ii) It explains the transactions effected both at the registered office and its branch(s), if any; and

(iii) Such books shall be kept on accrual basis and according to the double entry system of accounting.

In the accrual basis of accounting, the effects of transactions and other events are recognised and recorded when they occur (and not as cash or a cash equivalent is received or paid) and are reported in the financial statements of the periods to which they relate. In J. K. Industries Ltd. & Anr vs Union Of India & Ors *[(2008) 143 Com Cases 325]* It was held that the Supreme Court explained the concept of 'accrual accounting' as follows:

"In the conventional sense, amounts which become receivable/recoverable are shown as income actually received and the liabilities incurred are shown as amounts actually disbursed in a given year. Therefore, under the aforestated system of accounting, entries are posted in the books of accounts on the date of the transaction, i.e., on the date on which rights accrue or liabilities are incurred, irrespective of the date of payment. In such cases, a company has to account for its income or loss as per the above system and not otherwise, if that company has adopted mercantile system of accounting which is also known as accrual system of accounting. However, accrual does not mean confinement of items of revenue/expenditure to a given year. As stated above, mergers and acquisitions are undertaken to defer revenue expenditure over future years by invoking matching principles. Therefore, the said principle forms an important part of accrual accounting."

Double-entry system, in accounting, is a system of book keeping wherein every entry to an account requires a corresponding and opposite entry to a different account. For instance, recording earnings of Rs. 2000 would require making two entries: a debit entry of Rs.2000 to an account called “Cash” and a credit entry to an account called “Revenue”

Companies (Amendment) Act, 1965

Sub-Section (4A) of Section 209 of Companies Act 1956 has been amended vide the Companies (Amendment) Act (31 of 1965) with effect from 15.10.1965 with regard to the preservation of Vouchers, records, papers etc., and as per the Joint Select Committee’s Report constituted for the purpose of carrying the amendments stated that “The object of the amendment of sub-section (4A) of section 209 is that “the books of account will also include vouchers which should be made available for inspection and investigation and should be preserved for a period of 8 years”.

Further rule 4A inserted vide of the Companies (Accounts) Second Amendment Rules, 2015 vide Notification No. G.S.R.680(E) dated 04.09.2015, provides that the financial statements shall be prepared in the form specified in Schedule III to the Act in compliance with Accounting Standards or Indian Accounting Standards as may be applicable. The items contained in the financial statements shall also be prepared in accordance with the definitions and other requirements specified in the Accounting Standards or the Indian Accounting Standards, as the case may be.

(iv) **Meaning of true and fair view**

The expression “true and fair view” though not defined in the Act, but has been used in four sections relating to books of account under sub-section (1) of section 128, subsection (1) of section 129, clause (c) of sub-section (5) of section 134 and sub-section (2) of section 143. Sub-section (1) of section 128 and sub-section (1) of section 129 cast an obligation regarding preparation of books of accounts and financial statements to give true and fair view of state of affairs of the company. Clause (c) of sub-section (5) of section 134 requires the board to include directors responsibility statement in the Board report stating that the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period. Further, sub-section (2) of section 143 casts an obligation on the auditors of the company to confirm that the financial statements prepared by the company give true and fair view of the state of affairs of the company.

It is mentioned at para 46 of Framework for Preparation and Presentation of Financial Statements released by Institute of Chartered Accountants of India (ICAI) as follows:

“Financial statements are frequently described as showing a true and fair view of the financial position, performance and cash flows of an enterprise. Although this Framework does not deal directly with such concepts, the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of such information.”

As per above para there are two basic principles: qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability. Above frame works narrates the said principles as follows from para 26 to 42:

"**Understandability**

An essential quality of the information provided in financial statements is that it must be readily understandable by users. For this purpose, it is assumed that users have a reasonable knowledge of business and economic activities and accounting and study the information with reasonable diligence.

Relevance

To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

The predictive and confirmatory roles of information are interrelated. For example, information about the current level and structure of asset holdings has value to users when they endeavour to predict the ability of the enterprise to take advantage of opportunities and its ability to react to adverse situations. The same information plays a confirmatory role in respect of past predictions about, for example, the way in which the enterprise would be structured or the outcome of planned operations.

Information about financial position and past performance is frequently used as the basis for predicting future financial position and performance and other matters in which users are directly interested, such as dividend and wage payments, share price movements and the ability of the enterprise to meet its commitments as they fall due. To have predictive value, information need not be in the form of an explicit forecast. The ability to make predictions from financial statements is enhanced, however, by the manner in which information on past transactions and events is displayed. For example, the predictive value of the statement of profit and loss is enhanced if unusual, abnormal and infrequent items of income and expense are separately disclosed.

Materiality

The relevance of information is affected by its materiality. Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality depends on the size and nature of the item or error, judged in the particular circumstances of its misstatement. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.

(To be continued…)

Contents of Geeta Saar, as extracted from ICSI Premier on Company Law, is as per notified law as on 30th September, 2016.