Books of Accounts etc. to be kept by the Company (Sec 128) (Part-2)

(Continued from Geeta Saar 75)

4. Meaning of true and fair view (*Continued*)

Reliability

To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading. For example, if the validity and amount of a claim for damages under a legal action against the enterprise are highly uncertain, it may be inappropriate for the enterprise to recognize the amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

Faithful Representation

To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the enterprise at the reporting date which meet the recognition criteria.

Most financial information is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias, but rather to inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and vents. In certain cases, the measurement of the financial effects of items could be so uncertain that enterprises generally would not recognise them in the financial statements; for example, although most enterprises generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably. In other cases, however, it may be relevant to recognise items and to disclose the risk of error surrounding their recognition and measurement.

Substance over Form

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, where rights and beneficial interest in an immovable property are transferred but the documentation and legal formalities are pending, the recording of acquisition/disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into.

Neutrality

To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Prudence

The preparers of financial statements have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of receivables, the probable useful life of plant and machinery, and the warranty claims that may occur. Such uncertainties are recognised by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would then not be neutral and, therefore, not have the quality of reliability.

Completeness

To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Comparability

Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position, performance and cash flows. Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and cash flows. Hence, the measurement and display of the financial effects of like transactions and other events must be carried out in a consistent way throughout an enterprise and over time for that enterprise and in a consistent way for different enterprises.

An important implication of the qualitative characteristic of comparability is that users be informed of the accounting policies employed in the preparation of the financial statements, any changes in those policies and the effects of such changes. Users need to be able to identify differences between the accounting policies for like transactions and other events used by the same enterprise from period to period and by different enterprises. Compliance with Accounting Standards, including the disclosure of the accounting policies used by the enterprise, helps to achieve comparability. The need for comparability should not be confused with mere uniformity and should not be allowed to become an impediment to the introduction of improved accounting standards. It is not appropriate for an enterprise to continue accounting in the same manner for a transaction or other event if the policy adopted is not in keeping with the qualitative characteristics of relevance and reliability. It is also inappropriate for an enterprise to leave its accounting policies unchanged when more relevant and reliable alternatives exist.

Users wish to compare the financial position, performance and cash flows of an enterprise over time. Hence, it is important that the financial statements show corresponding information for the preceding period(s)."

Application of appropriate accounting standards

The expression "true and fair view" has been interpreted in various judicial pronouncements and it is well settled that true and fair view does not limit to arithmetical accuracy only and requires consideration of substance over the form. The concept was discussed at length in J. K. Industries Ltd. &Anr vs Union of India & Ors *[(2008) 143 Com Cases 325]*. The relevant excerpts are given below:

"The insertion of the concept of true and fair view in place of true and correct has been made to do away with the view that accounts should disclose arithmetically accuracy. Adherence to the disclosure requirements as per Schedule VI is subservient to the overriding requirement of true and fair view as regards the state of affairs. Therefore, the annual financial statements should convey an overall fair view and should not give any misleading information or impression. All the relevant information should be disclosed in the balance-sheet and the P&L a/c in such a manner that the financial position and the working results are shown as they are. There should be neither an overstatement nor an understatement. Further, the information to be disclosed should be in consonance with the fundamental accounting assumptions and commonly accepted accounting policies. Therefore, failure to make provision for taxation would not disclose true and fair view of the state of affairs. ... Thus, the Accounting Standards prescribed by the Central Government are now mandatory qua the companies and non-compliance with these Standards would lead to violation of Section 211 inasmuch as the annual accounts may then not be regarded as showing a true and fair view. .... Under section 209(3)(a) every company is required to maintain books of accounts necessary to provide a true and fair view of the state of affairs of the company and its accounts. In our view, books of accounts do not include balance-sheet and P&L a/c. However, as stated above, there is a difference between true and correct accrual and true and fair accrual. In the past, what prevailed was true and correct accrual.

5. Place of keeping books of accounts

All books of account and other relevant books and papers and financials statements of a company are required to be kept at the registered office of the company. In case of a company having a branch office or offices, the company is required to keep proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns periodically sent by the branch office(s) at the registered office or at other place where the books are maintained. The returns are required to be sent periodically as against the provision of sending quarterly returns under the Companies Act, 1956. By removing the word 'quarterly', option is given to the company to decide the frequency of returns from the Indian branch office. Rule 4, on the other hand, prescribes quarterly summarized returns for foreign branches. Further, for foreign branches, the returns are required to be sent to the registered office as per rule 4 (1). There is no format prescribed for the returns. Hence, a comprehensive format may be designed by the company as per the nature of the transactions carried out at the branch office to comply with the criteria of 'proper' summarised returns.

However, a company may keep all or any of the books of account and other relevant papers at such other place in India as the board may decide. In such a case, the company shall file with the Registrar, a notice in Form AOC-5, giving the full address of that decided place within 7 days of such decision taken by the board. It looks like the time period provided under section 403 may not be available to file AOC-5 by additional fee. Further, 'all or any' the books of accounts may be maintained at such other place. Hence, any of the records may be maintained at such other place. Books of accounts for earlier period may be kept at one place and other books for the latest period at registered office. However, a book cannot be maintained in part at more than one place.

Another question arises whether such places can be more than one. A reading of the term 'at such other place' and the context suggests that such other place may not be more than one. However, the sub-section (2) of section 128 indicates the possibility of having only one place (either registered office or any other place) where the books are kept.

(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.