



## **“LEGAL ASPECTS OF CORPORATE GOVERNANCE AND COMPARATIVE ANALYSIS OF ACCOUNTING TREATMENT UNDER COMPANIES ACT 1956 AND 2013”**

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### **ABSTRACT**

Good governance encompasses all actions aimed at providing its citizens, a good quality of life. With the rapid change in the business environment and emergence of new regulations by world bodies like EEC, WTO, OECD, World Bank etc. the concept of Corporate Governance (CG) is introduced and also been impetus. Corporate governance provides the fundamental value framework for the culture of an organization, which ensures efficient functioning of enterprise on sound ethical values and principle. It focuses on appropriate management and control structure of a company. The Companies Act, 1956 (“1956 Act”) has been in existence, the corporate and business environment has evolved significantly and hence there was a need to revamp the legislation governing companies. The Companies Act, 2013 (“Act of 2013”) was enacted on 29th August 2013 after President’s assent; however, it will come into effect only upon the notification by the Central Government. The exposure draft of the rules pertaining to the Act of 2013 is expected to be out for public comments very soon.

The Act of 2013 is more of a rule-based legislation containing only 470 sections, which means that the substantial part of the legislation will be in the form of rules. It is expected that the Act of 2013 will become applicable and the corresponding portion of 1956 Act will be repealed in a phased manner.

The Act of 2013 intends to promote self-regulation and has also introduced some progressive concepts like One- Person Company, Small Company, Dormant Company, E-governance, etc. The concept of Corporate Social Responsibility has also been introduced to encourage a socially, environmentally and ethically responsible behavior by companies.

Taking into account, the need of the hour, Accounting Standards Board (ASB) also tries to adopt International Accounting Standards/International Financial Reporting Standards. The Board is continuously issuing accounting standards in various areas as applicable to business houses. Thus the present research paper performs a comparative analysis of various facts and figures related with accounting treatment under companies act 1956 and 2013.

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**Keywords:** *Accounting, Corporate Governance Law, Financial Ratio Analysis, Liquidity ratio, Comparative study.*



## **1. INTRODUCTION**

Corporate governance is a concept rather than an instrument. It focuses on appropriate management and control structure of a company. Most definitions related to control of a company or managerial conduct. The Cadbury report (UK) states; “corporate Governance is the system by which businesses are directed and controlled”. OECD Definition says, “Corporate Governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performances are determined.” “Corporate Governance is not just corporate management; it is something much broader to include a fair, efficient and transparent administration to meet some well defined objectives. To state simple terms, corporate governance relates to a code of conduct, the management of a company observes while exercising its powers. Quality Corporate Governance not only serves the desired corporate interest, but is also a key requirement in the best interests of the corporate themselves. Though the terms governance, good governance and corporate governance is increasingly used in development literature since recent times, the concept of governance is not new.

However people in the west stated feeling the need for good corporate governance in early 80s as the corporate misdemeanors increased. Business failure, limited role of auditors, weak accounting standards culminated in loss of control.

The Cadbury committee was set up by the London Stock Exchange to address the dreary financial aspect of corporate performance. The two other committees came afterwards – the King Committee, and the Hampel Committee to diagnose the issues of corporate governance. The Asian financial crisis, recent scandals in US, Italy, India have triggered fresh initiatives of thinking towards good governance. Corporate governance has been much talked in India particularly after 1993.

SEBI in India has taken the initiative in framing new rules and laws to strengthen corporate governance. Committees like Kumar Mangalam Birla committee (2000), Naresh Chandra Committee (2002) brought out reports on corporate governance. SEBI has also constituted a committee on corporate governance under the chairmanship of Shri N R Narayana Murthy.

Presently corporate India is going through a great churning phase, as companies are doing business with global ambition, placing a lot of emphasis on governance and transparency. Recent corporate failures and scandals involving mis-governance and unethical behavior on the part of corporate rocked the corporate sector all over the world, shook the investor confidence in stock markets, and caused regulators and others to question the assumption that most companies do the right thing most of the time. Globally the objective of corporate governance is to maximize long term shareholders value. With the assumption that capital and financial markets are working properly, anything that maximizes shareholder value will necessarily maximize corporate prosperity.

For sound governance, managers need to act as trustee of shareholders, prevent asymmetry of benefits between sections of shareholders, especially between owner-managers and the rest of shareholders. Investment analyst recommends a company based on strength or weakness of a company’s governance infrastructure.

Accounting, as an information system is the process of identifying, measuring and communicating the economic information of an organization to its users who need the information for decision making. It identifies transactions and events of a specific entity. A transaction is an exchange in which each participant receives or sacrifices value (e.g. purchase of



raw material). An event (whether internal or external) is a happening of consequence to an entity (e.g. use of raw material for production). An entity means an economic unit that performs economic activities.

### **Definition of Accounting**

#### **Definition by the American Institute of Certified Public Accountants (Year 1961):**

*“Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof”.*

#### **Definition by the American Accounting Association (Year 1966):**

*“The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by the users of accounting”.* In the past 57 years during which the Companies Act, 1956 (“1956 Act”) has been in existence, the corporate and business environment has evolved significantly and hence there was a need to revamp the legislation governing companies. The Companies Act, 2013 (“Act of 2013”) was enacted on 29th August 2013 after President’s assent; however, it will come into effect only upon the notification by the Central Government. The exposure draft of the rules pertaining to the Act of 2013 is expected to be out for public comments very soon.

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Further, the Act of 2013 aims to fortify investor protection & transparency by introducing terms like Insider Trading, Price Sensitive Information, Class Action Suits and other additional disclosures. It also intends to give greater responsibility to the auditors and to widen their role. A National Company Law Tribunal will also be a reality now and therefore the matters which used to linger in courts for years will be swiftly handled by this dedicated tribunal.

Taking cognizance of rapid globalization, provisions for cross-border mergers have been introduced. Merger between small companies, holding – subsidiaries and specified entities can now be done on a fast-track route.

The Act of 2013 is aimed at building a smooth and easy corporate environment along with the new and improved measures of strong investor protection norms and presents a model for other economies with similar characteristics to emulate following are some of the salient features of the new Companies Act, 2013.

Thus the current research endeavour analysis the comparative analysis of accounting treatment under companies act 1956 and 2013.



## 2. OBJECTIVES A OF RESEARCH

**Current research endeavor is focused to ascertain following research objectives:**

- (a) To analyze the Legal facets of Corporate Governance in India
- (b) To comparatively access the accounting treatment in companies act 1956 and 2013

## 3. RESEARCH METHODOLOGY

The current research study elucidates the comparative assessment of financial performance of selected public and private sector petroleum industries in India with help of the financial analysis like ratio analysis. Hence, it is essentially fact finding study.

- **Collection of data:** In present study data was collected from secondary sources which was published companies selected annuals reports and accounts as well as published literature. The financial statement will be redrafted as per the requirement of companies' act 2013.

## 4. RESULTS AND DISCUSSION

### MAJOR CHANGES OF FACTORS RELATED WITH ACCOUNTING UNDER COMPANY ACT 1956 AND 2013

#### Book of Accounts

**Major Changes in books of Accounts are depicted in table 4.1 below:**

**TABLE.1 MAJOR CHANGES IN BOOKS OF ACCOUNTS ( COMPANY ACT 1956 -2013)**

Companies Act 1956	Companies Act 2013
Section 2(8) provides definition of `book and paper` and `book or paper` whereas `books of accounts` have been defined in Section 209 of the Act.	Section 2(12) defines `book and paper` and `book or paper` whereas `books of accounts` have been defined in Section 2(13) of the Act.
Section 2(17) defines Financial year.	Section 2(41) defines financial year.
Section 209 to Section 223 governs provisions relating to accounts .	Section 128 to Section 137 governs provisions relating to accounts
Revised Schedule VI provides for general instructions for preparation of Balance sheet and Statement of Profit and loss.	Schedule III provides general instructions for preparation of Balance sheet and Statement of profit and loss of a Company
Schedule XIV to the Act provides the rates at which depreciation is to be provided on different class of assets ( on WDV or SLM basis)	Schedule II provides Useful Lives to compute depreciation on various assets and manner of computing depreciation
Section 350 providing ascertainment of depreciation	Section 123 (2)
Companies (Accounting Standard s) Rules 2006	Companies (Account) Rules 2014 inter alia, provides: a. Manner of keeping books of accounts.



	<p>b. Maintenance and inspection of certain financial information by directors. As a transitory provision Accounting Standard rules 2006 continue to be in force till the time new rules are announced. (Rule 7)</p>
<p>Though the Companies Act, 1956 does not define 'Books of Account', but section 209(1) prescribed the manner of keeping books of account as :</p> <p>1) Every company shall keep at its registered office proper books of account with respect to:</p> <p>(a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place ;</p> <p>(b) all sales and purchases of goods by the company ;</p> <p>(c) the assets and liabilities of the company ; and</p>	<p>Section 2 (12) "book and paper" and "book or paper" include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form;</p> <p>Section 2(3) defining 'Books of accounts' as "books of account" includes records maintained in respect of—</p> <p>(i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;</p>
<p>(d) in the case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilization of material or labor or to other items of cost as may be prescribed, if such class of companies is required by the Central Government to include such particulars in the books of account :</p>	<p>(ii) all sales and purchases of goods and services by the company;</p> <p>(iii) the assets and liabilities of the company; and</p> <p>(iv) 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; yet to be notified.</p>

**Major Changes:**

(1) Definition of 'book and paper' and 'book or paper' is modified, so as to include minutes and registers and all documents maintained in electronics form also form part of it.

- Now 'books of account' are specifically defined.
- Companies (Account) Rules 2014 inter alia, provides manner of keeping books of accounts in electronic mode. It reads as;
- Manner of books of account to be kept in electronic mode.- (1) The books of account and other relevant books and papers maintained in electronic mode shall remain accessible in India so as to be usable for subsequent reference.

(2) The books of account and other relevant books and papers referred to in sub-rule (1) shall be retained completely in the format in which they were originally generated, sent or received, or in



a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.

(3) The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches.

(4) The information in the electronic record of the document shall be capable of being displayed in a legible form.

(5) There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law: Provided that the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis.

(6) The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement-

(a) The name of the service provider;

(b) The internet protocol address of service provider;

(c) The location of the service provider (wherever applicable);

(d) Where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider.

Explanation.- For the purposes of this rule, the expression "electronic mode" includes "electronic form" as defined in clause (r) of sub-section (1) of section 2 of Information Technology Act, 2000 (21 of 2000) and also includes an electronic record as defined in clause (t) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000) and "books of account" shall have the meaning assigned to it under the Act.

- Unlike The Companies Act 1956, now manner of maintenance of books of accounts under electronic mode have prescribed along with filling of the details of the service providers with its IP Address, Location of servers etc.
- It is also provided that vouchers be maintained in legible form.
- Audit committee or board is required to evolved a system for storage, retrieval and display of print out of electronic records and disposal thereof.

### • **Depreciation**

Companies are required to calculate depreciation as per Company Act as well as Income Tax Act. The methods and amount of depreciation differ under both the statutes. Companies are required to maintain two types of depreciation calculation – one for accounting purpose following Schedule II to the Companies Act, 2013 and the other for taxation purpose according to the provisions of Sec. 32 of Income Tax Act, 1961.

### **Schedule XIV to the Companies Act, 1956 V/s Schedule II to the Companies Act, 2013**

#### • **Basis for Depreciation Calculation**

As compared to Schedule XIV of the Companies Act, 1956, Schedule II of the Companies Act, 2013, instead of specifying the rates of depreciation for various assets, specifies that depreciation should be provided on the basis of useful life of an asset.



- **Prescriptive V/s Indicative**

Schedule XIV was prescriptive in nature as it specified minimum rates of depreciation. The Company was not permitted to charge lower rate of depreciation than specified in Schedule XIV. However, higher rate of depreciation were allowed provided sufficient technical evidence is provided with proper disclosure by way of a note in financial statements. Schedule II is indicative in nature as it indicates the useful lives of various assets. As per Schedule II Companies can adopt higher or lower life than those specified in the schedule supported by technical advice.

- **Rates V/s Useful Life**

Schedule XIV prescribed rates of depreciation under Straight Line Method and Written Down Value Method for various class of assets.

Schedule II prescribes useful life of an asset for the purpose of calculating depreciation. The useful life of an asset shall not be ordinarily different from the life specified in Part C of Schedule II. Company may adopt useful life separate from that specified in Part C provided it makes a proper disclosure in financial statements and provides justification supported with technical advice.

- **Methods of Depreciation**

Schedule XIV prescribed rates of depreciation primarily under Straight Line Method and Written Down Value Method for different class of assets. Schedule II specifies three methods of depreciation – Straight Line Method (SLM), Written Down Value Method (WDV) and Unit of Production Method (UOP) for calculating depreciation based on useful life of an asset.

- **Residual Value**

Schedule XIV specified that depreciation shall be calculated on historical cost less residual value. However, limit of residual value of an asset was not prescribed for the purpose of calculating depreciation. Schedule II specifies that the residual value of an asset shall not exceed 5% of its original cost. Company can adopt a residual value different from the limit specified above if it makes proper disclosure and provides justification supported by a technical advice.

- **Amortization of Intangible Assets**

No method was suggested for amortization of intangible assets in Schedule XIV except for amortization of intangible assets Toll Roads created under Build, Operate and Transfer or any other Public Private Partnerships.

Schedule II specifies that intangible assets shall be amortized as per the provisions of AS – 26 Intangible Assets. AS – 26 specifies that intangible assets should be amortized in the ratio of future economic life of the asset.

- **Depreciation on assets up to Rs.5000/-**

Schedule XIV specified 100% depreciation for assets whose cost does not exceed Rs.5000/- whereas Schedule II does not specify for 100% depreciation for assets whose cost does not exceed Rs.5000/-

- **Extra Shift Depreciation** Schedule XIV specified that depreciation for double and triple shift to be provided separately in proportion of number of days for which the company worked for double or triple shift bears to normal working days in a year.



Schedule II specifies for 50% increase in depreciation for the period for which the asset is used for double shift and 100% increase in depreciation for the period for which the asset is used for triple shift.

- **Component Accounting**

Schedule XIV specified that component accounting approach was optional. Company may adopt component accounting approach.

Schedule II has made component accounting mandatory. If the cost of a component is significant to total cost of an asset and the useful life of that component is different from the useful life of an asset, then the company will have to estimate useful life of the component separately and will have to provide for depreciation on significant components separately than the asset.

- **Transitional Provision under Schedule II**

From the date Schedule II comes into effect i.e. 1st April, 2014, the carrying amount of the asset as on that date

- ✚ Shall be depreciated over the remaining useful life of the asset
- ✚ After retaining the residual value, may be recognized in the opening balance of retained earnings or may be charged off to Profit and Loss account where the remaining useful life of an asset is nil.

Hence, the company will have to reassess the useful life of its existing fixed assets in accordance with Schedule II.

## **5. CONCLUSION**

From the independence the Companies Act, 1956 (“1956 Act”) has been in existence, the corporate and business environment has evolved significantly and hence there was a need to revamp the legislation governing companies. The Companies Act, 2013 (“Act of 2013”) was enacted on 29th August 2013 after President’s assent; however, it will come into effect only upon the notification by the Central Government. The exposure draft of the rules pertaining to the Act of 2013 is expected to be out for public comments very soon.

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Taking into account, the need of the hour, Accounting Standards Board (ASB) also tries to adopt International Accounting Standards/International Financial Reporting Standards. The Board is continuously issuing accounting standards in various areas as applicable to business houses.

At the same time, it also revise the existing Accounting Standards as per the need of changing scenario. So far the Accounting Standards Board has issued 32 Accounting Standards. Many of these Accounting Standards are mandatory in nature and are to be followed while



preparing and issuing Financial Statements by the business houses. Ensuring the compliance is the responsibility of the management of the enterprise.

At the same time, auditors have to confirm that all mandatory Accounting Standards are followed by the enterprise when he carries out the attest function. In last 7-8 Years the number of Accounting Standards has increased significantly and accordingly, it has also affected the preparation of financial statements by the companies. There are significant changes in reporting formats of financial statements of Companies as well in disclosure of policies.

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