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GUIDANCE NOTE ON AUDIT REPORTS/CERTIFICATES ON FINANCIAL INFORMATION IN OFFER DOCUMENTS*

Contents

Paragraph(s)

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Foreword

Investors' confidence is an important pre-requisite for the sustained development of capital markets to ensure economic development of a country. One of the confidence building measures is the provision of detailed relevant information to the investors for taking well-informed investment decisions. In this context, an offer document for corporate securities is like a window through which the prospective investors get authentic details about the prospects of a company. Recognising this, the Securities and Exchange Board of India (SEBI) had issued Guidelines for Disclosure and Investor Protection which require, inter alia, more transparent, detailed, and dependable offer documents which will promote investor confidence to maintain a conducive investment atmosphere in Indian capital market.

From time to time, SEBI has been issuing clarifications to the aforesaid Guidelines with a view to, inter alia, enhancing the qualitative characteristics of offer documents. Much of the information contained in an offer document is financial in nature. To impart credibility to the financial information, Schedule II to the Companies Act, 1956, requires some important financial information to be contained in the auditor's report and the report of the accountant which are included in the offer document. By virtue of the recently issued Clarifications XIII and XIV by SEBI, the financial information required to be contained in the auditor's report and the report of the accountant in Schedule II now has to be adjusted for amounts in respect of the qualifications in the report of the auditor on annual accounts, previous year adjustments, change in accounting policies etc., so as to provide a uniform trend of profit in the statement of profit to the prospective investors. The said clarifications also require additional financial information to be disclosed in the offer document, e.g., accounting ratios. These new requirements have increased the responsibility of the reporting auditors and accountants

It is indeed heartening to note that in an endeavour to provide increasingly credible financial information the chartered accountants' profession has been assigned the leading role. Since many of the requirements introduced by SEBI's clarifications are intricate in nature, SEBI itself, in Clarification XIV, stated that guidance in this regard would be issued by the Institute of Chartered Accountants of India. Pursuant to this, I am happy that the Research Committee of the Institute prepared this Guidance Note on Audit Reports/Certificates on Financial Information in Offer Documents which has also been approved by the Council of the Institute. I acknowledge my deep *appreciation of the efforts put in by Shri K.S. Mehta, Chairman of the Research Committee and other members of the Committee in the preparation of this Guidance Note. I also acknowledge the contribution made by the officers of the Technical Directorate in this endeavour. I am confident that this Guidance Note will immensely help our members in discharging their duties in the changed scenario.*

New Delhi	**T.S. Vishwanath**
October 4, 1996	*President*

Preface

In view of the changing scenario of our capital markets in recent years, the Securities and Exchange Board of India (SEBI) constituted, sometime back, a Committee under the Chairmanship of Shri Y.H. Malegam, our distinguished past President, to, inter alia, review the disclosure requirements in offer documents and recommend additions thereto and modifications therein for the purpose of protecting the interests of investors and to promote healthy development of capital markets in our country. The report of the Committee was submitted in 1995.

Based on the recommendations of the above Committee, SEBI issued Clarifications No. XIII and XIV to Guidelines for Disclosure and Investors Protection. One of the significant requirements of Clarification XIV is that all financial information contained in the offer document shall be audited. SEBI, in that clarification, has also stated that the Institute would provide guidance. Accordingly, this Guidance Note on Audit Reports/Certificates on Financial Information in Offer Documents was prepared by the Research Committee and thereafter approved by the Council of the Institute.

One of the crucial areas on which the Guidance Note provides guidance is on identification of the financial information to be included in the auditor's reports, the report of the accountant and auditor's certificate on profit forecasts.

Another category of financial information suggested in the Guidance Note relates to financial information which is not covered by the aforementioned categories, and, therefore, is a subject matter of a separate audit report to be included in the offer document. The Guidance Note then goes on to provide detailed guidance on the practical problems likely to be encountered by the auditor/accountant in respect of each requirement considered as financial information, such as, adjustments in the statements of profit and loss and assets and liabilities for qualifications in statutory auditor's report, previous year's items, change in accounting policy, incorrect accounting polices, material changes in activities, and transactions with companies in promoter group.

Guidance has also been provided regarding the audit of additional financial information such as tax shelters, accounting ratios, capitalisation statement, basis of issue price, disclosure of project expenditure, etc. Certification of *financial forecasts is another important area dealt with in detail in the Guidance Note.*

Apart from providing detailed guidance in respect of aforesaid aspects, this Guidance Note contains by way of annexures the text of the relevant clarifications issued by SEBI and suggested formats of auditors' report on other financial information (to be submitted separately to the management) and certificate on profit forecast.

I am confident that this Guidance Note will prove to be of immense help to our members and others concerned in discharging their duties.

.	**K.S. Mehta**
New Delhi	Chairman
October 4, 1996	Research Committee

In the context of the growth of the capital markets in India in the recent years and the consequent need for providing relevant and timely information to investors, the Securities and Exchange Board of India (SEBI) has issued Clarifications XIII[1] and XIV[2] (given as Appendix I and Appendix II respectively) as a part of the 'Guidelines for Disclosure and Investor Protection' which include, *inter alia*, certain financial information to be disclosed in addition to the requirements of Schedule II to the Companies Act, 1956. This information is required to be audited by chartered accountants. This Guidance Note is meant to provide guidance to chartered accountants undertaking this task.

The existing Guidance Note on Reports in Company Prospectuses, issued by the Institute of Chartered Accountants of India, is now in the process of revision. Till the revision is completed, such recommendations of that Guidance Note as are not inconsistent with the recommendations of this Guidance Note will continue to remain operative. Hence, it is recommended that members should consult both these documents appropriately.

In the following paragraphs, the requirements under the law/guidelines as per clarifications are reproduced first, in italics, followed by the guidance on the relevant guideline.

Requirement Regarding Audit of Financial information in Offer Documents

1. Para 4 of Part A.I. of Clarification XIV requires that all financial information given in the offer document including accounting ratios shall be audited.

2. The existing Schedule II to the Companies Act, 1956, (hereinafter called the Act) specifies 'financial information' to be mandatorily included in a Prospectus. Some further information is required to be disclosed in an offer document as per the Guidelines for Disclosure and Investor Protection and clarifications thereto, more particularly Clarifications XIII and XIV, issued by SEBI. These clarifications specify some additional 'financial information', certain adjustments and, in some cases, the method of computation. Of the

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[1] RMB (DIP Series) Circular No. 4(95-96) Dated 12-10-1995, issued by the Primary Market Department, Securities and Exchange Board of India.

[2] Issued in March, 1996.

information contained in the aforesaid documents, following is required to be audited/reported upon since it is in the nature of financial information.

(A) **Financial information required to be contained in the report of the company's auditor incorporating therein the 5 years' statement of profit or loss and statement of assets and liabilities as on a specified date** (See Annexure 'A' to this Guidance Note). The requirements to disclose this financial information are contained in Schedule II to the Act and in Clarifications XIII and XIV which require a number of adjustments as well as additional information. The financial information in this category is required to be given by the auditor of the issuer company in his report for inclusion in the offer document.

(B) **Financial information which is required to be contained in a report by an 'accountant'.** (See Annexure 'B' to this Guidance Note). Schedule II to the Act requires the inclusion of an 'accountant's report' in the prospectus in certain circumstances. This report can be given by any 'accountant' as defined in Part III of Schedule II.

(C) **Other financial information required to be included by the management and which should be reported upon by the company's auditor by way of a separate report to the management.** (See Annexure 'C' to this Guidance Note.) Clarifications XIII and XIV require other financial information to be disclosed in the offer document. The management should get this information audited by the company's auditor and obtain an audit report in respect thereof. This audit report should also be reproduced in the offer document separately.

(D) **Financial information which is the subject-matter of the auditor's certificate regarding certain aspects of profit forecast.** (See Annexure 'D' to this Guidance Note.)

Information required to be disclosed as per Schedule II to the Companies Act, 1956, and as per Clarifications XIII and XIV, which is not covered in the aforesaid categories is, therefore, not required to be audited/reported upon.

Each of the above four categories are discussed below:

(A) Financial information Required to be Contained in the Report of the Company's Auditor

3. The financial information under this category is required to be contained in the report of the auditor of the company for inclusion in the offer document. Financial information in this regard is contained in Annexure 'A'. With regard to the guidance on financial information to be contained in the offer document in the report of the company's auditor as per the requirements of Part II.B. ('Financial Information') of Schedule II to the Companies Act, 1956, a reference may be made to the Guidance Note on Reports in Company Prospectuses to the extent it is not modified by the guidance given in this Guidance Note pursuant to the requirements of the Guidelines contained in Clarifications XIII and XIV issued by SEBI. The discussion following hereinafter is, therefore, basically with regard to the aforesaid Clarifications.

Adjustments in Statements of Profit or Loss and Assets and Liabilities

4. Clause 20 of Part III of Schedule II to the Companies Act, 1956 requires that *any report required by Part II of this Schedule shall either –*

(a) indicate by way of note any adjustments as respects the figures of any profits or losses or assets and liabilities dealt with by the report which appear to the persons making the report necessary;

or

(b) make those adjustments and indicate that adjustments have been made.

Clause B.I (b) of Part II of Schedule II to the Companies Act, 1956, *inter alia*, requires that the statements of profits or losses or assets and liabilities *may indicate the nature of provisions or adjustments made or are yet to be* made**.**

Para 1 of Part A.I of Clarification XIV issued by the Securities and Exchange Board of India requires as follows:

Wherever statements of assets and liabilities and profit and loss or any other financial information is qualified by the notes of an auditor, all necessary adjustments wherever quantification is possible, shall be made in the statements itself. In particular, the following rectifications adjustments shall be made:

(i) Adjustments/rectification for all incorrect accounting practices or failures to make provisions or other adjustments which resulted in audit qualifications;

(ii) Material amounts relating to adjustments for previous years shall be identified and adjusted in arriving at the profits of the years to which they relate irrespective of the year in which the event triggering the profit or loss occurred;

(iii) Where there has been a change in accounting policy, the profits or losses of the earlier years (required to be shown in the offer documents) and of the year in which the change in the accounting policy has taken place shall be recomputed to reflect what the profits or losses of those years would have been if a *uniform accounting policy was followed in each of these years. However, if an incorrect accounting policy is being followed, the recomputation of the financial statements would be in accordance with correct accounting policies;*

(iv) Statement of profit or loss shall disclose both the profit or loss arrived at before considering extraordinary items and after considering the profit or loss from extraordinary items. An illustrative format of *the disclosure of profits and losses on this basis is given at Annexure 'A* '[3].

Objective of the adjustments

5. It should be recognised that the main purpose of statements of profit or loss and assets and liabilities in an offer document is somewhat different than that in case of the corresponding statements in the annual accounts. Whereas, the objective of the Profit and Loss Account and the Balance Sheet in the annual accounts, (being general purpose statements), is to provide a true and fair view of the actual profit (loss) for the accounting period and of the state of affairs as at the closing date, respectively, the prime objective of the corresponding statements in an offer document, (being special purpose statements), is to provide adequate data, on uniform basis, for making an evaluation of the enterprise for the purpose of reaching rational investment decisions. For example, such data may provide indications of the profit trends. In view of this difference in objectives, certain items may be treated differently in the two sets of documents. For example, the impact of the prior

[3] Reproduced as Annexure 'E' to this Guidance Note.

period items is required to be reflected in the current statement of profit and loss in the annual accounts, so that its impact on the current year's profit or loss can be perceived and a final figure of the current year's profit can be arrived at. On the other hand, such prior period items are required to be adjusted in the statement of profit or loss for the year to which they relate as far as the offer document is concerned.

General considerations

6. It is clear from the requirements contained in para 1 of Part A.I of Clarification XIV that the statements of profit or loss and of assets and liabilities required to be included in the offer document would now require a number of adjustments. The auditor should obtain from the management of the issuer, the adjusted Statements of profit or loss and assets and liabilities as approved by the Board of Directors. The Statements should be supported by detailed notes showing how the figures have been arrived at. The auditor should examine the audited accounts, the adjusted statements and the detailed notes prepared by the management regarding the required adjustments and make such further adjustments as deemed necessary by him.

7. On a reading of the requirements in para 1 of Part A.I of Clarification XIV reproduced in para 4 above, it appears that the adjustments should be made by the auditor in respect of the items (i) to (iv), only if the said items form the subject matter of qualifications in auditor's report. However, on a harmonious interpretation of the aforesaid requirement it is apparent that the adjustments in the statements of profit or loss and assets and liabilities would also have to be made in respect of adjustments for previous years and changes in accounting policies even if these do not form the subject of qualifications in the auditor's report on annual accounts. This is because these adjustments are necessary to present the statements of profit or loss and assets and liabilities on uniform basis. Similarly, the disclosure of profit or loss before and after considering extraordinary items has nothing to do with the qualifications in the auditor's report. Thus, adjustments on account of audit qualifications pertain only to item (i) of the requirement, i.e., qualifications in respect of incorrect accounting practices or failure to make provisions or other adjustments contained in the auditor's report on annual accounts.

8· It is suggested that adjustments as per para 1 of Part A.I of Clarification XIV should be made in respect of the amounts directly affected by the qualifications, previous year adjustments and changes/incorrect accounting policies. Thus, adjustments which may arise consequent to the aforesaid adjustments may not be made unless the impact is so substantial as to render the data meaningless.

9. The adjustments specified in para 1 of Part A.I of Clarification XIV are not mutually exclusive. An adjustment may arise, for example, due to change in an accounting policy as well as on account of qualification in auditor's report where the changed accounting policy is a subject matter of qualification by the auditor on annual accounts. Due care is required in such cases to ensure that appropriate adjustment(s) are made as per the requirements in the Clarification, particularly ensuring that the adjustment is not made twice for the same item.

10. Part II.B. of Schedule II to the Companies Act, 1956, also requires inclusion of financial information regarding profits and losses, and assets and liabilities of the subsidiaries of the company. Therefore, adjustments required in para 1 of Part A.I of Clarification XIV should also be made for the purpose of presenting aforesaid financial information of the subsidiaries. Accordingly, the recommendations contained in this Guidance Note in this regard are equally applicable to the financial information of subsidiaries included in the offer document.

11. It should be noted that in making the adjustments, regard should be had to the 'materiality' of the amounts involved in respect of various items of adjustments. The term 'materiality' is defined in Accounting Standard (AS) 1 on 'Disclosure of Accounting Policies', issued by the Institute of Chartered Accountants of India, as below:

"Financial statements should disclose all 'material' items, i.e., items the knowledge of which might influence the decisions of the user of financial statements."

In view of the above, adjustment of immaterial items is not warranted.

Adjustments/Rectifications on account of Qualifications in Auditors' Reports

12. The adjustments/rectifications on this account are required to be made in respect of such qualifications which were made because there were (a) incorrect accounting practices, or (b) failures to make provisions or other adjustments. Thus, such matters which represent incorrect accounting

practices or failures to make provisions/other adjustments are required to be adjusted/rectified if they form part of subject matter of a qualification by the auditors in their reports on annual accounts for period covered by the financial statements.

13. Adjusted/rectified statements of profit or loss for the five financial years and assets and liabilities as on the specified date, immediately preceding the issue of the prospectus should be prepared after considering the qualifications made by the auditors only in respect of those financial years.

14. Where it is not possible to make adjustments/rectifications, it should be specifically so stated, and the exact qualification should be reproduced by way of a note. For example, there may be a qualification regarding non-availability of significant information.

15. It is quite possible that the auditors have made a qualification in a particular period in the light of the information available at the time of finalisation of the audit report of that period. Subsequently, however, certain developments may provide objective information which, in the opinion of the auditor, renders the qualification unnecessary. No adjustment should be made in respect of such a qualification. For example, no adjustment may be made in case of a qualification regarding non-provision of a liability which was disputed in a court of law if the subsequent decision of the court is in favour of the company and, in the opinion of the auditor, the qualification is no longer necessary.

16. There can be some adjustments which, apart from having effect on the accounts of the year in which the qualification has been made, may also have effect on the accounts of the succeeding year(s). For example, an adjustment relating to valuation of closing stock of a particular year may have an impact on the Profit and Loss Account of the subsequent year. If it is so, then adjustments should be made in the figures relating to both the years.

Adjustments relating to Previous Years

17. It is required that adjustments related to previous years should be made in arriving at the profits of the years to which they relate irrespective of the years in which the event triggering the profit or loss occurred. Previous years' adjustments would cover the following:

(i) Prior period items, i.e., material charges or credits which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.

(ii) Material adjustments necessitated by circumstances which though related to previous periods are determined in the current period.

18. As per the requirement, in case a material error pertaining to the accounting year 1992-93 is shown as a prior period item in the accounts of the year 1993-94, for the purpose of the offer document, adjustment/rectification has to be made in the statement of profit or loss pertaining to the year 1992-93. This would also mean that as a corollary the statement of profit or loss for the year 1993-94 will have to be prepared after adjusting the effect of the aforesaid prior period item. Similarly, adjustments/rectifications will have to be made in respect of 'material adjustments' pertaining to each of the earlier years. For example, similar adjustments would be required in case of creation of a liability pertaining to earlier years due to a retrospective amendment of a law and in case of price fixation of a product with retrospective effect.

Change in Accounting Policy

19. The impact of a change in an accounting policy is required to be made with retrospective effect over the five years period under report so that the profits or losses of earlier years can be reflected on the basis of the changed accounting policy. The policy being followed in the last year under report would become the applicable policy for each of the five years. For instance, in case a company changes its accounting policy regarding method of depreciation from SLM to WDV in 1995-96, the profit or loss statements of earlier years would also have to be recast on the basis of the changed accounting policy. The purpose is to state the profits or losses of the earlier years on the basis of a uniform accounting policy as far as the offer document is concerned. Accordingly, even if the relevant accounting standards require the adjustment/disclosure of the impact of the change in the accounting policy in the profit and loss account of the current period, the figures in the offer document should be adjusted to show what the profits or losses in each of the five accounting periods would have been had uniform accounting policy been followed in each of these years.

20. In certain circumstances, it may not be possible to restate the figures in the statements of profit or loss and/or assets and liabilities in the offer document on the basis of the changed accounting policy. For example, if a company changes its method of inventory valuation from FIFO to weighted average cost in the fifth year, it may not have detailed data or documentation to adjust the figures in the earlier years (this is because the company may not have documentation required for the new method which was not followed in the earlier years). In such a case, the auditor may state that it is not possible to restate the figures. Where he does so, he should state the reason(s) also.

21. *Incorrect Accounting Policies*: It is, *inter alia*, required under para 1 (iii) of Part A.I of Clarification XIV that "if an incorrect accounting policy is being followed, the recomputation of the financial statements would be in accordance with correct accounting policies". It is noted that the requirement is in respect of the accounting policies being followed, which would normally mean that the accounting policies on the basis of which the accounts of the last year contained in the offer document are made. In such a situation, generally, the auditors would have qualified their reports on the said annual accounts. Accordingly, the adjustment on this account should be made as an adjustment arising from qualification in auditor's report. However, where the auditors did not qualify their report, the relevant adjustments should be made in the accounts under this para of the clarification if the reporting auditor is of the opinion that the accounting policy being followed by the company was incorrect. If an incorrect accounting policy as borne out from the Statement of Significant Accounting Policies forming part of the accounts, was followed in any of the five years in respect of which the statement of profit or loss appears in offer document, the accounts should be prepared as per the correct accounting policy for all the five years.

Extraordinary Items

22. It is required that profit or loss arrived at both before considering extraordinary items and after considering the profit or loss from extraordinary items should be disclosed. Extraordinary items are gains or losses which arise from events or transactions that are distinct from the ordinary activities of a company but which are both material and expected not to recur frequently, e.g., sale of a part of the undertaking.

23. It is noted from Annexure 'A' to the Clarification (reproduced as Annexure 'E' to this Guidance Note) that the amount of the 'Extraordinary Items' should be net of tax. It would mean that the taxation provisions and rate relevant to the extraordinary item should be considered for computing the tax payable on the extraordinary item. For instance, if profit on an extraordinary item is exempt from tax, obviously the gross amount and the net-of-tax amount in respect thereof would be same.

Material Changes in Activities

24. *Disclosure is required in the offer document in respect of changes (with quantification wherever possible) in the activities of the issuer which may have had a material effect on the statement of profit/loss for the five years. Disclosure of these changes in the activities of the company shall include discontinuance of lines of business, loss of agencies or markets and similar factors*. (Para 2 of Part A.I of Clarification XIV)

25. As per the above requirement, certain changes in the activities of the company are required to be disclosed (with quantification, wherever possible). In this regard, it may be mentioned that in every business a number of changes in business activities take place constantly. The intention behind this requirement is not to identify the impact of each such change which is a part of normal business activities, e.g., updation of technology, change in emphasis in markets, normal changes in product-mix, changes in ordinary agency relationships etc. The intention seems to be that only such changes that pertain to separate major lines of business, loss of major agencies or markets etc., which have material effect on profits or losses be identified and disclosed. An example would be a diversified company selling or abandoning one of its main lines of business.

26. The statement providing the disclosures specified in para 24 above has to be prepared by the management. The auditor would use his knowledge of the business of the company and satisfy himself that *prima-facie* the statement corresponds to his knowledge.

27. It is suggested that the following information be disclosed in case of a discontinued operation of the type covered in the above requirement:

(a) The nature of the discontinued operation.

(b) The effective date of discontinuance for accounting purposes.

(c) The manner of discontinuance [sale, abandonment etc.].

(d) Turnover of the discontinued operation. Where divisional accounts are maintained, the gain or loss on discontinuance and the accounting policies used to measure that gain or loss should be disclosed, e.g., the policy regarding allocation of overheads.

Similar disclosures should be made in respect of loss of major agencies or markets etc.

28. A material change in activities of a company can also arise due to addition of new lines of business. Similar disclosures should be made in this regard also on the lines suggested in para 27 above, for the year in which the new activity was started.

Significant Accounting Policies

29. Disclosure shall be made in the offer document in respect of all *significant accounting policies followed in the preparation of the financial statements.* (Para 3 of Part A.I of *Clarification* XIV)

30. A general criterion for 'significant' accounting policies is that these are those policies which affect certain items of financial statements to a material extent or are critical for the purpose of determining the net profit (loss) and/or the financial position of the enterprise. In this context, reference may be made to Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', issued by the Institute of Chartered Accountants of India.

31. The accounting policies on the basis of which the last statements of profit or loss and assets and liabilities have been prepared, should be disclosed.

Transactions with Companies in Promoter Group

32. Disclosure is required to be made of *sales or purchase between companies in the promoter group when such sales or purchases exceed in value in the aggregate 10% of the total sales or purchases of the issuer and also disclose material items of income or expenditure arising out of transactions in the promoter group* (Para 10 of Part A.I of Clarification XIV).

33. It is significant to note that the requirement is both for particulars of sales and purchases as well as other transactions whether income or expenditure.

34. It would be relevant to note the definition of 'promoter group' as given in Explanation II to para A. 9 of the SEBI Guidelines for Disclosure and Investor Protection - Clarification XIII[4], which is reproduced below:

> 'Promoter Group' in relation to securities offered to the public for subscription, shall include –
>
> (a) the 'Promoter';
>
> (b) an immediate relative of the Promoter (i.e., any spouse of that person, or any parent, brother, sister or child of the person or of the spouse);
>
> (c) where the 'Promoter' is a corporate body:
>
> (i) a subsidiary or holding company of that body;
>
> (ii) any company in which the 'Promoter' holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the Promoter;)
>
> (iii) any corporate body in which a group of individuals or corporate bodies or combinations thereof who hold 20% or more of the equity capital in that company also hold 20% or more of the equity capital of the issuer company; and
>
> (d) where the 'Promoter' is an individual,
>
> (i) any company in which 10% or more of the share capital is held by the 'Promoter' or an immediate relative of the 'Promoter' or a firm or HUF in which the 'Promoter' or any one or more his immediate relative is a member:
>
> (ii) any company in which a company specified in (i) above, holds 10% or more, of the share capital;
>
> (iii) any HUF or firm in which the aggregate share of the Promoter and his immediate relatives is equal to or more than 10% of the total.

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[4] RMB (DIP series) Circular No. 4(95-96) Dated 12-10-1995, issued by the Primary Market Department, Securities and Exchange Board of India.

(e) all persons whose shareholding is aggregated for the purposes of disclosing in the prospectus 'shareholding of the promoter group'.

Note: The financial institutions and the mutual funds would be exempted from this definition if they get included merely on account of the fact that they hold 10% or more of the equity of the concerned company. This exemption would not apply to the subsidiaries or companies promoted by the financial institutions or to the companies which sponsor the mutual fund."

The term 'promoter' has been defined in Explanation I to para A.9 of Clarification XIII referred to above of the SEBI Guidelines as below:

"Promoters" in relation to securities offered to the public for subscription shall include -

(a) the person or persons who are in over-all control of the company;

(b) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public;

(c) the person or persons named in the prospectus as promoter(s)

Provided that a director/officer of the issuer company or a person, if they are acting as such in their professional capacity shall not be included in the above explanation.

35. The auditor should obtain a management representation regarding 'promoter' and 'promoter group'. It is suggested that relationships should be determined on the basis of the position as at the year-end of each of the years over the five years period, the data with regard to which are included in the offer document. The management representation should disclose the names and other particulars of the promoters and promoter group in respect of each period. The aforesaid representation should also list the particulars of the relevant transactions of sales and purchases and material items of other income or expenditure. The term 'materiality' as defined in Accounting Standard (AS) 1 on 'Disclosure of Accounting Policies', is reproduced in para 11 of this Guidance Note. The position should be determined on the basis of the aggregate transactions with the relevant parties throughout the year.

36. The representation made by the management with regard to the promoters and promoter group may be examined by the auditor in the light of similar information which is prepared for the purposes of MAOCARO and

under section 40 A (2) of the Income-tax Act, 1961, as this information may provide some indication of the details in the aforesaid management representations. The auditor should also refer to the register of contracts with parties in which directors are interested under section 301 of the Companies Act, 1956 and the registers maintained under sections 370 and 372 of the said Act.

Disclosure under the Heading 'Other Income'

37. *In modification of the existing requirements, the offer document shall disclose details of 'Other Income' in all cases where such income (net of related expenses) exceeds 20% of the net profit before tax, including:*

(i) *the sources and other particulars of such income; and*

(ii) *an indication* as *to whether such income is recurring or non-recurring, or has arisen out of business activities/other than the normal business activities.* (Para 1 of Part A.III of Clarification XIV)

38. The above requirement is a modification of the existing requirement in this regard contained in para 1.2 of Clarification VIII issued by SEBI on 11.10.1993.

39. 'Other income' constitutes all items of income other than the turnover. Turnover for the aforesaid purpose would be the aggregate amount for which sales are effected and/or services rendered.

40. The computation of 20 per cent has to be made in relation to the net profit or net loss before tax and extraordinary items. It may be noted that the concerned income and related expenses are to be netted off only for computing relevant 'other income' for the purpose of the above requirement. Thus, for the purpose of disclosure in the relevant statement of profit or loss, the incomes and expenses should be disclosed at gross amounts in the normal way.

41. The requirement stated at para 37 above has two aspects. Firstly, the items of 'other income' should be identified on the basis of criteria dealt with in paras 39 and 40 above. The second aspect is the disclosures to be made in this regard in the statement of profit or loss in the offer document. As per the requirement, the following disclosures should be made with regard to the 'other income':

(a) The source.

(b) The nature.

(c) The amount.

(d) Whether recurring or non-recurring.

(e) Whether on account of normal business activity or not.

Annexure 'E' to this Guidance Note illustrates the aforesaid disclosures in respect of a manufacturing and trading company.

Disclosure of Bifurcated Turnover

42. *The turnover disclosed in the Profit or Loss Statement shall be bifurcated into:*

(a) turnover' of products manufactured by the company;

(b) turnover of products traded in by the company; and

(c) details of products not normally dealt in by the company but included in (b) above, shall be mentioned separately. (Para A.4 of *Clarification* XIII).

43. Although, as per the above requirements, the turnover in respect of products manufactured and traded is required to be disclosed, it is recommended that separate disclosures should also be made in respect of turnover from services rendered. For this purpose, turnover of processed products should be clubbed with the turnover of manufactured products.

44. As per the requirement, separate disclosure is required of turnover of products 'not normally' dealt in by the company. What are the products that are not normally dealt in by the company should be determined on the basis of the actual facts and circumstances of each case. Those products should be considered to be not normally dealt in, dealings in respect of which are non-recurring in nature.

Statement of Assets and Liabilities

45. The statement of assets and liabilities prepared after deducting the amount of revaluation reserve from both fixed assets and reserves and the net worth arrived at after such deduction. (Para A.5 of Clarification XIII) ·

46. The statement of assets and liabilities referred to in the above requirement is the same as that required to be prepared under Schedule II to the Companies Act, 1956.

47. The Guidance Note on 'Terms Used in Financial Statements' issued by the Institute of Chartered Accountants of India, defines the term 'net worth' in terms of 'net assets' as below:

> "The excess of the book value of assets (other than fictitious assets) of an enterprise over its liabilities".

48. The term 'fictitious asset' has been defined in the aforesaid Guidance Note as follows:

> "Item grouped under assets in a balance sheet which has no real value (e.g., the debit balance of the profit and loss statement)."

49. The term 'book value' has been defined in the aforesaid Guidance Note as follows:

> "The amount at which an item appears in the books of account or financial statements. It does not refer to any particular basis on which the amount is determined, e.g., cost, replacement value, etc."

50. The requirement stated in para 45 has two aspects. Firstly, the book values of assets and liabilities should be adjusted to the extent of the corresponding revaluation reserves. The second aspect is the computation of net worth. For this purpose, all fictitious assets and revaluation reserves should be excluded.

(B) Financial Information to be Contained in the Report of the Accountant

51. Financial information to be contained in the report of the 'accountant', as given in Annexure 'B', has been prescribed in paras 4 and 5 of Part II.B. of Schedule II to the Companies Act, 1956. Guidance in this regard is contained in the Guidance Note on Reports in Company Prospectuses. It should be noted that the requirements dealt with in category 'A' above, from paras 3 to 50, would be applicable to the requirements of this category also, to the extent relevant.

(C) Financial Information in respect of which the Auditor Should Give Separate Report to Management

52. It may be noted that apart from financial information contained in categories 'A' and 'B' dealt with above, there is some other financial information to be disclosed in the offer document. Such information has to be

provided by the management, but being in the nature of financial information, it has to be audited by the auditor of the issuer company. The report on this financial information submitted by the auditor should also be contained in the offer document. A suggested format of the audit report is given in Annexure 'F' to this Guidance Note. The guidance to the auditor on audit of financial information pertaining to this category is given in the following paragraphs.

Tax Shelters

53. Profits after Tax are often affected by the tax shelters which are available. Some of these are of a relatively permanent nature (for example, arising out of export profits) while others may be limited in point of time (for example, tax holidays for new undertakings). Tax provisions are also affected by timing differences which can be reversed in the future (for example, the difference between book depreciation and tax depreciation). For a proper understanding of the future tax incidence, these factors shall be identified and explained through proper disclosures. An illustrative format of Disclosure is given in Annexure 'B'[5]. (Para 7 of Part A.I of Clarification XIV)

54. The above requires a reconciliation between the income-tax as would have been applicable had it been based on profits as per the statement of profit or loss for the five years period included in the offer document (termed as 'tax at actual rate' in Annexure 'G') and the tax expense reflected as provision for taxation based on actual taxable income so that the incidence of various tax shelters (both temporary and permanent) is apparent. The auditor should examine whether income-tax is computed on the basis of actual rates on the profits after making adjustments for qualifications in auditor's report, previous year adjustments, changes in accounting policies etc.

55. 'Permanent differences' and 'timing differences' have been explained in the Guidance Note on Accounting for Taxes on Income, issued by the Institute of Chartered Accountants of India, as below:

> "3. The differences between 'tax profit' and 'accounting profit' can be classified into 'permanent differences' and 'timing differences'. 'Permanent differences' are those differences between tax profit and accounting profit for a period which originate in the current period and

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[5] Reproduced as Annexure 'G' to this Guidance Note.

do not reverse in the subsequent periods. Thus if, for the purpose of computing tax profit, the tax rules allow only Rs. 40,000 out of a total of Rs. 1,00,000 incurred on account of travelling, the disallowed amount of Rs. 60,000 would result in a 'permanent difference'.

4. A permanent difference would also arise where fixed assets have been revalued in the books of account, thereby producing amounts for depreciation different for accounting purposes than for tax purposes. Also gains or losses for tax purposes upon disposition of such assets may differ from those recognised for accounting purposes.

5. 'Timing differences', on the other hand, are those differences between tax profit and accounting profit for a period which arise because the period in which some items of revenues and expenses or the amounts thereof are included in tax profit do not coincide with the period in which such items of revenues and expenses or the amounts thereof are included in accounting profit. 'Timing differences' originate in one period and reverse in one or more subsequent periods. An example of a 'timing difference' would be a situation where, for the purpose of computing tax profit, the tax rules allow depreciation of the basis of the written down value method, whereas for the purpose of accounting in the profit and loss statement, the straight line method has been used."

56. It may be noted that all tax free incomes result in permanent differences.

57. For verifying the items of adjustments pertaining to tax shelters as illustrated in Annexure 'G', the auditor should examine the detailed computations made by the management to arrive at the figure of provision for taxation which has been disclosed in the annual accounts.

Accounting Ratios

58. Disclosure is required to be made of *the following accounting ratios for each of the accounting periods for which financial information is given:*

(a) *Earnings per share;*

(b) *Return on net worth and*

(c) *Net Asset Value per share.*

(Para 9 of Part A.I of Clarification XIV)

59. The above accounting ratios are required to be disclosed for each of the five financial years. The components of formulae should also be disclosed in the offer document.

60. The auditor should satisfy himself that for making various computations for the above accounting ratios, the various items of profit/loss and assets/liabilities have been adjusted as per the requirements relating to qualifications in auditor's report, previous years' items etc., as per the discussions in an earlier section of this Guidance Note.

Earnings Per Share (EPS)

61. Earnings per share may be either –

(a) basic earnings per share, or

(b) diluted earnings per share.

62. Basic earnings per share is the amount of net profit for the period attributable to each equity share. The disclosure of basic earnings per share is considered useful because:

(a) basic earnings per share relates the net profit or loss for the period to the equity shares outstanding and thus gives an objective amount of net profit per share;

(b) the calculation of basic earnings per share does not require any assumptions relating to the future conversion of potential equity shares into equity shares; and

(c) basic earnings per share is readily understandable.

63. A company may also have 'potential equity shares', i.e., instruments or other contracts that may entitle their holders to equity shares, e.g.,

(a) debentures or other similar instruments and preference shares that are convertible into equity shares;

(b) share warrants and options which, when exercised, would entitle the holder to equity shares;

64. It may be noted that while disclosure of diluted earnings per share is mandatory as per the requirement regarding 'Basis of Issue Price' (para 8 (b) of Part A.I of Clarification XIV, reproduced at para 95 of this Guidance Note), it is not so under the aforesaid requirement under para 9 of Part A.I of

Clarification XIV regarding 'Accounting Ratios'. Thus, under this head, disclosure of basic earnings per share is required. However, both, basic earnings per share and diluted earnings per share provide information which is useful in evaluating past performance and future potential of a company. A company may, therefore, besides disclosing basic earnings per share, also disclose diluted earnings per share where the dilution is material.

65. It should be noted that the term 'earnings per share' encompasses loss per share. Thus, in case of a loss, the auditor should examine that 'loss per share' has been disclosed.

66. *Basic Earnings Per Share*: Basic earnings per share is calculated by dividing the net profit or loss for the period attributable to equity shareholders by the number of equity shares.

67. The auditor should note that for the purpose of calculating basic earnings per share, the earnings for the period attributable to equity shareholders is the net profit or loss for the period after deducting all claims against it other than those of the equity shareholders. The auditor should satisfy himself that this has been calculated in the manner set out in paragraphs 68-71.

68. The amount of net profit attributable to preference shareholders, including preference dividends for the period, should be deducted from the net profit for the period (or added to the net loss for the period) in order to calculate the net profit or loss for the period attributable to equity shares.

69. The amount of preference dividends that is deducted from the net profit for the period should be –

(a) the amount of any preference dividends declared in respect of the period on non-cumulative preference shares; and

(b) the full amount of the required preference dividends in respect of cumulative preference *shares for the period* whether or not the dividends have been declared. The amount of preference dividends for the period would not include the amount of any preference dividends in respect of cumulative preference shares paid or declared during the current period in respect of previous periods.

70. The fixed part of the dividend on participating preference shares should be treated in the same way as a preference dividend. If the participating element is limited (e.g., maximum 15 per cent), the whole of the dividend for

the period may be deducted. If it is unlimited, the appropriate proportion of the earnings for the period to allow for the participating element should be deducted before arriving at the earnings attributable to the equity shares.

71. It should be noted that the number of shares forming equity share capital as at the end of the each year is used as the denominator in calculating basic earnings per share.

72. The auditor should satisfy himself that where equity shares are in partly paid form, these partly paid instruments have been included as equity share equivalents to the extent to which they carry rights at the end of the period to participate in dividends relative to a fully paid-up equity share.

73. In some cases, equity shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include:

(a) a bonus issue;

(b) a consolidation of shares; and

(c) a capital reduction without a decrease in the number of equity shares.

For example, in a bonus issue, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares is increased without an increase in resources.

74. The auditor should check whether the number of equity shares used denominator has been disclosed in the offer document.

75. The auditor should satisfy himself that where there are equity shares of different nominal values, the number of equity shares are calculated by converting all such equity shares into equivalent number of shares of the same nominal value. The auditor should also check that the disclosure of the nominal value per equity share used for the purpose of calculating earnings per share has also been made.

76. *Diluted Earnings Per Share*: Where a company has issued debentures or preference shares convertible into equity shares of the company, or options or warrants to subscribe for equity shares of the company are outstanding, it has entered into obligations which may dilute the earnings per share in the future. A company, in these circumstances, in addition to the basic earnings per share, may also disclose the diluted earnings per share.

77. The auditor should satisfy himself that in calculating diluted earnings per share, only dilutive potential equity shares have been taken into consideration. Potential equity shares are dilutive when their conversion to equity shares would result in a reduction in the basic earnings per share.

78. Depending on the terms of the conversion rights or the options to subscribe, it is possible that the calculation of a figure of earnings per share, based on the assumption that these rights or options had been exercised at the end of the period, would result in increasing the earnings per share above the basic figure. In these circumstances, it is likely that the conversion rights or options would not be exercised, and, therefore, the auditor should check that the resultant figure (i.e., increased earnings per share) is not shown under the head 'Accounting Ratios' if it is greater than the basic earnings per share.

79. Where the price at which the conversion/option is to be exercised is not known, the auditor should check whether this fact has been disclosed.

80. The auditor may note that the diluted earnings per share need not be given if the dilution is not material, in which event that fact may be stated in the offer document.

81. Diluted earnings per share is not disclosed when basic earnings per share is a loss per share. In such cases, the assumed conversion of any potential equity shares reduces the loss per share and is not, therefore, dilutive.

82. A company may have more than one type of convertible debentures or preference shares with differing conversion rights or may have granted differing options or warrants to subscribe. In this event, the auditor should satisfy himself that the diluted earnings per share takes into account only those conversion rights or options which would have a diluting effect on the earnings per share and disregards those which have no such diluting effect.

83. For the purpose of calculating diluted earnings per share, the auditor should satisfy himself that the amount of net profit for the period attributable to equity shareholders is the net profit after tax for the period adjusted for the after-tax effect of-

(a) any dividends recognised in the period for the dilutive potential equity shares;

(b) interest or other expenses recognised in the period for the dilutive potential equity shares;

(c) any other change in income[6] or expense that would result from the conversion of the dilutive potential equity shares.

84. After the potential equity shares are converted into equity shares, the dividends, interest and other expenses associated with those potential equity shares will no longer be incurred. Instead, the new equity shares will be entitled to participate in the net profit attributable to equity shareholders. Therefore, the net profit for the period would be increased by the amount of dividends, interest and other expenses that will be saved on the conversion of the dilutive potential equity shares into equity shares, as stated in paragraph 83. The auditor should further satisfy himself that amounts of dividends, interest and other items have been adjusted for any taxes borne by the company that are attributable to them.

85. For the purpose of calculating diluted earnings per share, the number of equity shares would be the number of equity shares at the end of the period plus the number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares.

86. *General*: The auditor should satisfy himself that the figure of net profit or loss used for calculating basic earnings per share as well as diluted earnings per share is before considering *extraordinary items.*

87. The auditor should check whether the company has disclosed the amounts used as the numerators in calculating basic and diluted earnings per share and a reconciliation of those amounts to the net profit or loss for the period.

88. The auditor should also check that where a company has dilutive potential equity shares, whether full information as to the rights of the holders (existing shareholders, convertible debentureholders, preference shareholders or holders of options or warrants) has been disclosed

Return on Net Worth

89. Return on Net Worth is computed by using the following formula:

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[6] It may be noted that any increase in income should be estimated on a prudent basis. Generally, such an increase may be limited to the amount computed at the prime lending rate of a bank on the monies receivable from the issue of shares as a result of conversion/exercise of option of dilutive potential equity shares.

$$\frac{\text{Net profit before extraordinry items but after adjusted tax}}{\text{Net worth excluding revaluation reserve as at the end of the year}} \times 100$$

90. In the above formula, 'adjusted tax' means the provision for taxation for the period after adjusting for the tax attributable to extraordinary items.

91. The auditor should satisfy himself that for the purpose of computation of above ratio, it has been assumed that the net profit accrues evenly during the year. The computation of net worth is explained in paras 47 to 49 of this Guidance Note. However, in case the assets have been revalued, the effect of revaluation would be ignored to determine the book value of the assets. In other words, assets would be valued at historical cost.

Net Asset Value Per Share

92. The auditor should check that the net asset value (NAV) has been calculated as per the latest audited balance sheet date. Net asset value can be computed either by the net assets method or by the net equity method. Under the former, from the total assets of the company, all liabilities and preference capital, if any, are deducted. The net asset value as calculated from the assets side of the balance sheet in the above manner can be cross-checked by calculating the same by net equity method whereby equity share capital is added to reserves and surplus, deducting therefrom miscellaneous expenditure to the extent not written off and the debit balance of profit and loss account to the extent not adjusted against reserves and surplus.

93. The following points, *inter alia*, should be particularly kept in view by the auditor while examining the computations of the net asset value whether on net assets basis or net equity basis:

(i) Intangible assets like goodwill, patents, trade marks, copyrights, etc., have not been taken into account, unless they have been paid for.

(ii) Revaluation of assets, if any, have not been taken into account.

(iii) Arrears of preference dividend have been provided for.

94. NAV per share is calculated as below:

$$\frac{\text{NAV arrived at as above}}{\text{No. of equity shares at the end of the accounting period.}}$$

Disclosures under 'Basis of Issue Price'

95. Under the heading 'Basis for issue price' the following information shall be disclosed.

(a) (i) Earnings per share, i.e., EPS pre-issue for the last three years (as adjusted for changes in capital),

(ii) P/E pre-issue and comparison thereof with industry P/E where available (giving the source from which industry P/E has been taken),

(iii) Average return on net worth in the last three years,

(iv) Minimum return on increased net worth required to maintain pre-issue EPS;

(v) Net Asset Value per share based on last balance sheet.

(vi) Net Asset Value per share after issue and comparison thereof with the issue price.

Provided that projected earnings shall not be used as a justification for the issue price in the offer document.

(b) The accounting ratios disclosed in the offer document in support of basis of the issue price shell be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised.

An illustrative format of disclosure is given in Annexure 'C'[7].

(Para 8 of Part A.I of Clarification XIV)

Earnings Per Share (EPS)

96. On a perusal of para 8(b) of Part A.I of Clarification XIV reproduced above, it is apparent that all ratios specified under this requirement shall be adjusted for all outstanding conversions and options. Accordingly, EPS to be disclosed as per this requirement is the EPS after taking into account all outstanding conversions and options. The manner of computing the EPS for this purpose would be similar to that used for computing diluted EPS as per paragraphs 76-88 of this Guidance Note. However it should be specifically

[7] Reproduced as Annexure 'H' of this Guidance Note.

noted by the auditor that while the diluted EPS as per the above paragraphs is calculated only if the dilution of the equity shares due to conversions/options results in a reduction in the basic earnings per share, the EPS under this requirement is to be disclosed even if it is higher than the basic earnings per share. Thus, the auditor should satisfy himself that paragraphs 79, 83, 84, 85, 86 and 88 of this Guidance Note have been applied, *mutatis mutandis,* in calculating EPS under this requirement.

Price/Earnings Ratio (P/E Ratio)

97. The pre-issue Price/Earnings ratio should be calculated by using the following formula:

$$\frac{\text{Issue price per share}}{\text{EPS}}$$

EPS to be used in the above formula would be that calculated as per para 96 above.

98. It may be noted from the illustrative format of disclosure given in Annexure ‘C’ to Clarification XIV (reproduced as Annexure ‘H’ to this Guidance Note) that it is the issue price per share which is to be used for computing this ratio (and not the market price per share which is normally used for computation of the Price/Earnings ratio). Accordingly, for this purpose, issue price per share is required to be used. However, the P/E ratio of the company based on issue price is to be compared with the industry P/E ratio based on market price. For the purpose of the industry P/E ratio, the auditor should check that the market price should be the market price for the industry prevailing within one month prior to the date of auditor’s report, or as close thereto as possible.

Average Return on Net Worth

99. The auditor should check that average return on net worth is computed on the basis as described in paras 89 to 91 of this Guidance Note. However, since the ratio is also required to be computed after giving effect to all outstanding conversions and options, the auditor should also examine whether necessary adjustments have been made as explained in para 96 above.

100. For computation of minimum return on increased net worth required to maintain pre-issue EPS, the increased net worth would be the increase in the net worth after the issue, presuming the entire capital issue is subscribed and paid up.

Net Assets Value

101. The auditor should check that the net asset value per share based on last balance sheet is computed as discussed in paras 92 to 94 of this Guidance Note. NAV per share after issue should be based on the presumption that the entire capital issue would be subscribed and paid up. However, since this ratio is also required to be computed after giving effect to all outstanding conversions and options, the auditor should examine whether necessary adjustments have been made as explained in para 96 above.

General

102. In computation of the above ratios, it should be examined by the auditor that the projected earnings have not been used as the basis.

103. For making various computations for above accounting ratios, the auditor should satisfy himself that the various items of profit/loss and assets/liabilities have been adjusted as per the requirements relating to qualifications in auditors' report, previous year's items etc., as discussed in an earlier section of this Guidance Note.

Capitalisation Statement

104. A Capitalisation Statment which shows total debt and net worth and the dept/equity ratios before and after the issue is made. Where there has been a change in the share capital since the date as of which the financial information has been disclosed in the offer document, there shall be a note explaining the nature of the change.

An illustrative format of the Capitalisation Statement is given in Annexure 'D'[8]. (Para 12 of Part A.I of Clarification XIV)

105. In examining the computation of the debt/equity ratio, the following points should be considered by the auditor:

[8] Reproduced as Annexure 'I' of this Guidance Note.

(i) Debt includes only long-term debt, for example, debentures, bonds, long-term loans from financial institutions, etc.

(ii) Preference share capital has been considered as a part of equity, unless it is to be repaid shortly, e.g., within 12 months.

(iii) Convertible debentures and other loans carrying compulsory conversion clause, to the extent of convertibility, has been considered as equity.

(iv) Equity includes paid-up equity share capital, preference capital, and reserves and surplus after deducting therefrom the miscellaneous expenditure to the extent not written off and the debit balance of profit and loss account to the extent not adjusted against reserves and surplus. Further, adjustments for partly paid shares as stated in paragraph 72 of this Guidance Note have also been made.

106. It may be noted that two debt/equity ratios would be calculated and disclosed, namely, one for pre-issue and the other for post-issue.

107. In case there is any change in the share capital since the date in respect of which the financial information has been disclosed in the offer document, the auditor should check that there is a note explaining the nature of the change, for example, issue of bonus shares, issue of shares to vendors against acquisition of property.

Disclosure of Project Expenditure

108. *Details* of:

(a) actual expenditure incurred on the project(in cases of companies raising capital for a project) upto a date not earlier than 2 months of filing the prospectus with SEBI or Registrar of Companies, whichever is later;

(b) means and source of financing such expenditure;

(c) *year-wise break-up of the expenditure proposed to be incurred on the said project.* (para A.2 of Clarification XIII)

109. It may be noted that the above requirement regarding disclosure of actual expenditure incurred on the project and the means and sources of financing such expenditure has to be given up to a date not earlier than two months of filing the prospectus with SEBI or Registrar of Companies, whichever is later. Thus, this information may not necessarily reconcile with the information contained in the statements of profit or loss and assets and

liabilities forming part of the offer document which may have been prepared with reference to a different date.

110. The auditor should obtain a management representation regarding the details of project expenditure as per the aforesaid requirement and means and sources of financing such expenditure. With regard to the verification of information in respect of the aforesaid aspects, the auditor should follow appropriate audit procedures. A management representation may also be obtained regarding yearwise break-up of the expenditure proposed to be incurred on the project. However since the information required to be disclosed as per (c) above is entirely based on management's estimates, this need not be audited.

Bridge Loans

111. Details of' "bridge loan" or other financial arrangement, if any, for incurring expenditure on the project and which would be repaid from the proceeds of the issue. (Para A.3 of Clarification XIII)

112. It should be noted that not all 'bridge loans' or other financial arrangements made for incurring expenditure on the project are required to be disclosed; only those 'bridge loans' which have both the characteristics, *viz.,* (a) the loans are for incurring project expenditure; and (b) the loans would be repaid out of the proceeds of the issue, are required to be disclosed. The auditor should check that the information provided under this requirement reconciles with the information given pursuant to the requirement contained in para 113, to the extent relevant. With regard to the audit procedures to be followed in respect of the above types of loans and other financial arrangements, if any, they would broadly be the same as that followed in case of audit of loans.

Loans

113. The offer document should disclose *principal terms* of *loan and assets charged as security* (Para 6 of Part II. B. of Schedule II to the Companies Act, 1956).

114. The auditor should refer to the relevant loan documents to verify the principal terms of loans and assets charged as securities.

(D) Auditor's Certificate on Profit Forecast

115. The offer document should include *a forecast of the estimated profits for the financial year ending immediately before the date of the offer document (if such information is not already given in the offer document) and for the financial year ending immediately after the date of the offer document duly supported by an auditor's certificate which lists the major assumptions on which the forecast is based and gives assurance on the arithmetical calculations derived from such assumptions.*

Provided however the above disclosures shall not be given by -

(i) *any company which has made projections of future profits in accordance with Clarificatio*n *XIII of SEBI Guidelines which include projected profits for the above period; or*

(ii) *any company which has not commenced commercial production.* (Para 11 of Part A.I of Clarification XIV))

116. As per the above requirement, an auditor's certificate on certain profit forecasts is required to be included in the offer document. The difference between the terms 'certificate' and 'report' has been explained in para 2.2 of the Guidance Note on Audit Reports and Certificates for Special Purposes issued by the Institute of Chartered Accountants of India, which is reproduced below:

> "A reporting auditor should appreciate the difference between the terms 'certificate' and 'report'. A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. Thus when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill."

117. The above requirement specifies profit forecast to be included in the offer document for the following periods:

(a) a forecast of the estimated profits for the financial year ending immediately before the date of the offer document (if such information is not already given in the offer document);

(b) for the financial year ending immediately after the date of the offer document.

118. The above can be understood with the help of the following example. Suppose the date of the offer document is January 10, 1996. The financial statements in respect of the financial year ending, as on December 31, 1995 (being the calendar year), immediately before the date of the offer document, are not ready at the time of the issuance of the prospectus. The financial year ending immediately after the date of the offer document would be one ending on December 31, 1996. Thus, Financial forecasts required to be prepared and certified would be those ending on December 31, 1995 and December 31, 1996.

119. In this context, it would be relevant to note the requirements of para I of Part II (B) of Schedule II to the Companies Act, 1956. which are, *inter alia*, as below:

> "If no accounts have been made up in respect of any part of the period of five years ending on a date three months before the issue of the prospectus, containing a statement of that fact (and accompanied by a statement of the accounts of the company in respect of that part of the said period up to a date not earlier than six months of the date of issue of the prospectus indicating the profit or loss for that period and the assets and liabilities position as at the ending of that period together with a certificate from the auditors that such accounts have been examined and found correct by them. The said statement may indicate the nature of provision or adjustments made or are yet to be made)".

120. As per the above requirement, in respect of the example given in para 118 above, apart from the profit forecasts required to be prepared, the report of the auditors of the company should contain a statement of the fact that no accounts have been made up in respect of the year ending December 31, 1995, which should be included in the prospectus. Also, it is required that a statement of accounts of the company in respect of the period up to a date not earlier than six months of the date of issue of the prospectus, i.e., July 31, 1995 should be included in the prospectus. Such accounts should indicate the profit or loss for that period and the assets and liabilities position

as at the end of that period. They are also required to be accompanied by a certificate from the auditors that such accounts have been examined and found correct by them. It would be seen that as far as the aforesaid statement of accounts for the period ending July 31, 1995 and profit forecast for period ending December 31, 1995 are concerned, there would be a common period of 7 months. Thus, the auditor may note that in a way, the forecast would be in respect of the latter five months since the actual accounts for the initial seven months would be available.

121. It is noted that the requirement regarding auditor's certificate on profit forecast only requires the listing of the major assumptions on which the forecast is based and providing assurance on the arithmetical calculations derived from such assumptions. Thus, the scope of the said certificate is substantially limited compared to carrying on of a review of profit forecasts by an accountant. Accordingly, the recommendations contained in the Guidance Note on Accountant's Report on Profit Forecasts and/or Financial Forecasts, issued by the Institute of Chartered Accountants of India, would not be applicable for the purpose of this certificate.

122. It is required, *inter alia*, that the auditor's certificate should list the major assumptions on which the forecast is based. It is the primary responsibility of the management to prepare the profit forecast, and, accordingly, it should be approved by the Board of Directors of the company before it is included in the offer document. The auditor should, therefore, obtain from the management, the list of major assumptions on the basis of which the forecast has been prepared, which should be stated in his certificate. A suggested format of the Auditor's Certificate is given in Annexure 'J'.

123. The responsibility of the auditor basically is only to satisfy himself that the figures in the profit forecast have been arrived at on the basis of the assumptions (including those related to accounting policies) stated by the directors, e.g., whether the projected sales figures are in consonance with the assumptions pertaining to the expected demand. While the auditor is not required to look into the propriety of the assumptions, yet where the assumptions (including those related to accounting policies) are *prima facie* irrational, e.g., the forecast is based on the assumption regarding utilisation of capacity of the plant and machinery which is totally out of tune with reality, the auditor may advise the management in this regard to revise the forecast.

Unless the forecast is revised, the auditor may consider either not issuing his certificate or state in his certificate his perception about the assumptions.

124. It may be noted that a projection of future profits may also be included in an offer document as per the requirements under Clarification XIII[9]. However, this information is not required to be audited by the auditor since the projections under this requirement are based solely on an appraisal by a financial institution or a scheduled commercial bank.

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[9] No projections of future profits shall be made except:

(a) by a new company: or

(b) by an existing company only if such company is undertaking a new project or is proposing to substantially expand its activities beyond 100% of the existing capacity:

Provided further that the projections by (a) and (b) above may be made only if:

- (a) the projections are based solely on an appraisal by a financial institution or a scheduled commercial bank;
- (b) such appraising agency has financed the project or part thereof or is committed to finance the project or part thereof;
- (c) the projections are not for a period exceeding two years from the date of expected commencement of commercial production or three years from the date of the closure of' the issue, whichever is later;
- (d) the major assumptions on which the projections are based are specified. (Para A.7)

Annexure 'A'

Financial Information Regarding Five Years Statement of Profit or Loss and Statement of Assets and Liabilities Required to be Included in the Auditor's Report

Relevant extracts of Part II B of Schedule II to the Companies Act, 1956, and Clarifications XIV and XIII are reproduced below:

Part II-B of Schedule II to the Companies Act, 1956

"Reports to be set out

1. A report by the auditors of the company with respect to –

(a) profits and losses and assets and liabilities, in accordance with sub-clause (2) or (3) of this clause, as the case may require; and

(b) the rates of the dividends, if any, paid by the company in respect of each class of shares in the company for each of the five financial years immediately preceding the issue of the prospectus, giving particulars of each class of shares on which such dividends have been paid and particulars of the cases in which no dividends have been paid in respect of any class of shares for any of those years;

and, if no accounts have been made up in respect of any part of the period of five years ending on a date three months before the issue of the prospectus, containing a statement of that fact (and accompanied by a statement of the accounts of the company in respect of that part of the said period up to a date not earlier than six months of the date of issue of prospectus indicating the profit or loss for that period and the assets and liabilities position as at the end of that period together with a certificate from the auditors that such accounts have been examined and found correct by them. The said statement may indicate the nature of provision or adjustments made or are yet to be made).

2. If the company has no subsidiaries, the report shall –

(a) so far as regards profits and losses, deal with the profits or losses of the company (distinguishing items of a non-recurring nature) for each of the five financial years immediately preceding the issue of the prospectus; and

(b) so far as regards assets and liabilities, deal with the assets and liabilities of the company at the last date to which the accounts of the company were made up.

3. If the company has subsidiaries the report shall –

(a) so far as regards profits and losses, deal separately with the company's profits or losses as provided by sub-clause (2) and in addition deal either –

   (i) as a whole with the combined profits or losses of its subsidiaries so far as they concern members of the company; or

   (ii) individually with the profits or losses of each subsidiary, so far as they concern members of the company;

   or, instead of dealing separately with the company's profits or losses, deal as a whole with the profits or losses of the company, and, so far as they concern members of the company, with the combined profits or losses of its subsidiaries; and

(b) so far as regards assets and liabilities, deal separately with the company's assets and liabilities as provided by sub-clause (2) and in addition, deal either:

   (i) as a whole with the combined assets and liabilities of its subsidiaries, with or without the company's assets and liabilities; or

   (ii) individually with the assets and liabilities of each subsidiary;

   and shall indicate as respects the assets and liabilities of the subsidiaries the allowance to be made for persons other than members of the company."

Clarification XIV

I. Guidelines Relating to Disclosures in Offer Documents

"In addition to the disclosures which have been specified by SEBI from time to time, the offer document shall contain the additional disclosures specified below:

1. Wherever statements of assets and liabilities and profit and loss or any other financial information is qualified by the notes of an auditor all necessary adjustments, wherever quantification is possible, shall be made in

the statements itself. In particular, the following rectifications/adjustments shall be made:

(i) Adjustments/rectification for all incorrect accounting practices or failures to make provisions or other adjustments which resulted in audit qualifications;

(ii) Material amounts relating to adjustments for previous years shall be identified and adjusted in arriving at the profits of the years to which they relate irrespective of the year in which the event triggering the profit or loss occurred;

(iii) where there has been a change in accounting policy, the profits or losses of the earlier years (required to be shown in the offer documents) and of the year in which the change in the accounting policy has taken place shall be recomputed to reflect what the profits or losses of those years would have been if a uniform accounting policy was followed in each of these years. However, if an incorrect accounting policy is being followed, the recomputation of the financial statements would be in accordance with correct accounting policies;

(iv) Statement of profit or loss shall disclose both the profit or loss arrived at before considering extraordinary items and after considering the profit or loss from extraordinary items. An illustrative format of the disclosure of profits and losses on this basis is given at Annexure 'A'." (Para 1 of Part A.I of Clarification XIV)

2. "Changes (with quantification wherever possible) in the activities of the issuer which may have had a material effect on the statement of profit/loss for the five years. Disclosure of these changes in the activities of the company shall include discontinuance of lines of business, loss of agencies or markets and similar factors." (Para 2 of Part A.I of Clarification XIV)

3. "All significant accounting policies followed in the preparation of the financial statements." (Para 3 of Part A.I of Clarification XIV)

4. "Sales or purchase between companies in the promoter group when such sales or purchases exceed in value in the aggregate 10% of the total sales or purchases of the issuer and also disclose material items of income or expenditure arising out of transactions in the promoter group." (Para 10 of Part A.I of Clarification XIV).

5. "In modification of the existing requirements, the offer document shall disclose details of other income' in all cases where such income (net of related expenses) exceeds 20% of the net profit before tax, including:

(i) the sources and other particulars of such income; and

(ii) an indication as to whether such income is recurring or non-recurring, or has arisen out of business activities/other than the normal business activities." (Para 1 of Part A.III of Clarification XIV)

Clarification XIII

1. "The turnover disclosed in the Profit or Loss Statement shall be bifurcated into:

(a) turnover of products manufactured by the company;

(b) turnover of products traded in by the company; and

(c) details of products not normally dealt in by the company but included in (b) above, shall be mentioned separately." (Para A.4 of Clarification XIII)

2. The statement of assets and liabilities prepared after deducting the amount of revaluation reserve from both fixed assets and reserves and the "net worth arrived at after such deduction." (Para A.5 of Clarification XIII)

Annexure 'B'

Financial Information Required to be Contained in the Report of an Accountant

Relevant extracts of Part II B of Schedule II to the Companies Act, 1956, are reproduced below:

"4. If the proceeds, or any part of the proceeds, of the issue of the shares or debentures are or is to be applied directly or indirectly –

(i) in the purchase of any business; or

(ii) in the purchase of an interest in any business and by reason of that purchase or, anything to be done in consequence thereof, or in connection therewith, the company will become entitled to an interest as respects either the capital or profits and losses or both, in such business exceeding fifty per cent, thereof;

a report made by accountants (who shall be named in the prospectus) upon–

(a) the profits or losses of the business for each of the five financial years immediately preceding the issue of the prospectus; and

(b) the assets and liabilities of the business at the last date to which the accounts of the business were made up, being a date not more than one hundred and twenty days before the date of the issue of the prospectus."

5. (i) If –

(a) if the proceeds, or any part of the proceeds, of the issue of the share or debentures are or is to be applied directly or indirectly in any manner resulting in the acquisition by the company of shares in any other body corporate; and

(b) by reason of that acquisition or anything to be done in consequence thereof or in connection therewith, that body corporate will become a subsidiary of the company;

a report made by accountants (who shall be named in the prospectus) upon –

(i) the profits or losses of the other body corporate for each of the five financial years immediately preceding the issue of the prospectus, and

(ii) the assets and liabilities of the other body corporate at the last date to which its accounts were made up.

(ii) The said report shall –

(a) indicate how the profits or losses of the other body corporate dealt with by the report would, in respect of the shares to be acquired, have concerned members of the company and what allowance would have fallen to be made, in relation to assets and liabilities so dealt with for holders of other shares, if the company had at all material times held the shares to be acquired; and

(b) where the other body corporate as subsidiaries, deal with the profits or losses and the assets and liabilities of the body corporate and its subsidiaries in the manner provided by sub-clause (2) above in relation to the company and its subsidiaries."

Annexure 'C'

Other Financial Information on which the Auditor is Required to Give a Separate Report to the Management

Relevant extracts of Part II B of Schedule II to the Companies Act, 1956, Clarifications XIV and XIII are reproduced below:

Part II-B of Schedule II to the Companies Act, 1956

"6. Principal terms of loan and assets charged as security"

Clarification XIV (Part A)

I. Guidelines Relating to Disclosure in Offer Documents

1. "Profits after tax are often affected by the tax shelters which are available. Some of these are of a relatively permanent nature (for example, arising out of export profits) while others may be limited in point of time (for example, tax holidays for new undertakings). Tax provisions are also affected by timing differences which can be reversed in the future (for example, the difference between book depreciation and tax depreciation). For a proper understanding of the future tax incidence, these factors shall be identified and explained through proper disclosures. An illustrative format of disclosure is given in Annexure 'B'." (Para 7 of Part A.I of Clarification XIV)

2. "Under the heading 'Basis for issue price', the following information shall be disclosed:

(a) (i) Earnings per share, i.e., EPS pre-issue for the last three years (as adjusted for changes in capital);

(ii) P/E pre-issue and comparison thereof with industry P/E, where available (giving the source from which industry P/E has been taken);

(iii) average return on net worth in the last three years;

(iv) minimum return on increased net worth required to maintain pre-issue EPS;

(v) Net Asset Value per share based on last balance sheet;

(vi) Net Asset Value per share after issue and comparison thereof with the issue price.

Provided that projected earnings shall not be used as justification for the issue price in the offer document.

(b) The accounting ratios disclosed in the offer document in support of basis of the issue price shall be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised.

An illustrative format of disclosure is given in Annexure 'C'." (Para 8 of Part A.I of clarification XIV)

3. "The following accounting ratios for each of the accounting periods for which financial information is given:

(a) Earnings per share;

(b) Return on Net Worth; and

(c) Net Asset Value per share." (Para 9 of Part A.I of Clarification XIV)

4. "A Capitalisation Statement which shows total debt and net worth and the debt equity ratios before and after the issue is made. Where there has been a change in the share capital since the date as of which the financial information has been disclosed in the offer document, there shall be a note explaining the nature of the change.

An illustrative format of the Capitalisation statement is given in Annexure 'D'." (para 12 of Part A.I of Clarification IV)

Clarification XIII

1. "Details of:

(a) actual expenditure incurred on the project (in cases of companies raising capital for a project) upto a date not earlier than 2 months of filing the prospectus with SEBI or Registrar of Companies, whichever is later;

(b) means and source of financing such expenditure;

(c) yearwise break-up of the expenditure proposed to be incurred on the said project." (Para A.2 of Clarification XIII)

2. "Details of "bridge loan" or other financial arrangement, if any, for incurring expenditure on the project and which would be repaid from the proceeds of the issue." (Para A.3 of Clarification XIII)

Annexure 'D'

Financial Information which is the Subject Matter of Auditor's Certificate Regarding Certain Aspects of Profit Forecast

Relevant extracts of Clarification XIV are reproduced below:

> "A forecast of the estimated profits for the financial year ending immediately before the date of the offer document (if such information is not already given in the offer document) and for the financial year ending immediately after the date of the offer document duly supported by an auditor's certificate which lists the major assumptions on which the forecast is based and gives assurance on the arithmetical calculations derived from such assumptions.
>
> Provided however the above disclosures shall not be given by –
>
> (i) any company which has made projections of future profits in accordance with Clarification XIII of SEBI Guidelines which include projected profits for the above period; or
>
> (ii) any company which has not commenced commercial production." (Para 11 of Part A.I of Clarification XIV)"

Annexure 'E'

Statement of Profits and Losses

	Year ended 31st March				
	1991	1992	1993	1994	1995
	(Rupees in lakhs)				
Income					
Sales:					
(a) Of products manufactured by the company	1000	1240	1640	1800	1800
(b) Of products traded in by the company	100	60	60	200	200
(c) Total	1100	1300	1700	2000	2000
Other Income[1]	10	30[2]	40	60[3]	100[4]
Increase (Decrease) in Inventories	40	(70)	60	180	310
	1150	1260	1800	2240	2410
Expenditure					
Raw Materials Consumed	400	480	630	1110	1200
Staff Costs	200	220	240	340	400
Other Manufacturing Expenses	240	260	280	540	650
Administration Expenses	40	42	60	80	85
Selling and Distribution Expenses	110	120	130	190	250
Interest	60	55	90	200	140
	1095	1227	1495	2635	2795

[1] As per the requirements of para 1 of Part III of Clarification XIV, the particulars are given in the following footnotes where other income (net of related expenses) exceeds 20% of Earnings Before Tax and Extraordinary Items.

[2] Profit on sale of fixed assets Rs. 12 lakhs. This income is of recurring nature and is incidental to carrying on of the business. Rs. 18 lakhs is on account of profit on cancellation of a forward foreign exchange contract not relating to acquisition of a fixed asset. This income is non-recurring and is not on account of normal business activities.

[3] Profit on sale of fixed assets Rs. 60 lakhs, which is of recurring nature and is incidental to carrying on of the business.

[4] Profit on sale of fixed assets Rs. 40 lakhs, which is of recurring nature and is incidental to carrying on of the business. Profit on sale of investments Rs. 60 lakhs, which is non-recurring and is not on account of normal business activities.

Net Profit before tax and extraordinary items	55	33	305	(295)	(385)
Taxation	25	12	144	(185)	(235)
Net Profit before extraordinary Items	30	21	161	(110)	(150)
Extraordinary items (net of tax)	NIL	49	(64)	800	1000
Net Profit after extraordinary Items	30	70	97	690	850

Annexure 'F'

Suggested Format of the Auditor's Report on Other Financial Information (to be Submitted Separately to the Management)

To

The Board of Directors

XYZ Ltd.

New Delhi.

We have examined the following financial information proposed to be included in the offer document/prospectus of your company in connection with the public issue of ________ equity shares/debentures of Rs. ___________ each for cash at______, aggregating Rs.________ as approved by you and forwarded to us by you/your merchant bankers and annexed to this Report:

1. Tax shelters as stated in para_________ of the above offer document/prospectus.
2. Basis of Issue Price as stated in para________ of the above offer document/prospectus.
3. Accounting Ratios as stated in para_________ of the above offer document/prospectus.
4. Capitalisation Statement as per para_________of the above offer document/prospectus.
5. Details of project expenditure as stated in para _____ of the above Offer document/prospectus other than yearwise break-up of the expenditure proposed to be incurred on the project.
6. Details of bridge loans and other financial arrangement as per para ____ of the above offer document/prospectus.
7. Principal terms of loans and assets charged as securities as per para____of the above offer document/prospectus.

We have relied upon the audited financial statements for the year(s) ending_______ in respect of item(s) at _______above which were not audited by us but by another firm of chartered accountants.[1]

In our view, the above financial information is true and correct and is in accordance with the relevant requirements of Clarifications XIII and XIV issued by SEBI, subject to the following:

[State here qualifications, disclaimers, if any]

For PQR & Company
Chartered Accountants

Date: Sd/-

Place: (Partner)

---

[1] To be included where applicable

Annexure 'G'

Taxation

	Year ended 31st March				
	1991	1992	1993	1994	1995
	(Rupees in lakhs)				
Tax at actual rate on profits[1]	28	70	89	546	675
Adjustments:					
Permanent Differences					
Export Profits	(4)	(5)	(20)	(100)	(120)
Timing Differences					
Difference Between Tax Depreciation and Book Depreciation	(6)	(8)	(9)	(10)	(10)
Other Adjustments	3	3	4	4	5
Net Adjustments	(7)	(10)	(25)	(106)	(125)
Tax Saving thereon	(3)	(5)	(13)	(49)	(58)
Total taxation provision for the year[2]	25	65	76	497	617
Taxation on extraordinary items	NIL	53	(68)	682	852
Tax provision before extraordinary items[3]	25	12	144	(185)	(235)

[1] In the relevant Annexure 'B' of Clarification XIV, the term used is 'Tax at notional rate'. However, since in fact, the actual rate is used to arrive at the figure of tax expense on the profits as per the statement of profit or loss for the five years period included in the offer document, this expression has been used.

[2] The expression used in Annexure 'B' of Clarification XIV is 'Total taxation'. Since this represents the total taxation provision as per the tax profits, this expression has been used.

[3] The expression used in Annexure 'B' of Clarification XIV is 'Tax on profits before Extraordinary Items'. Since this represents tax provision on tax profits before extraordinary items, this expression is used.

Annexure 'H'

Basis for Issue Price

1. Adjusted Earning Per Share (EPS)

(a)	1992-93	Rs. 7.41
(b)	1993-94	Rs. 8.39
(c)	1994-95	Rs. 13.82
(d)	Weighted Average	Rs. 10.94

2. Price/Earning Ratio (P/E) in relation to Issue Price

(a)	Based on 94-95 EPS	37.63
(b)	Industry P/E*	
	(i) Highest	61.2
	(ii) Lowest	0.8
	(iii) Average	25.3

(*Based on Economic Times of 26.6.95)

3. Return on Net Worth

(a)	1992-93	27.36%
(b)	1993-94	28.77%
(c)	1994-95	33.45%
(d)	Weighted Average	30.88%

4. Minimum return on Total Net Worth after Issue Needed to maintain EPS at Rs.13.82 — 14.65%

5. Net Asset Value (NAV)

(a)	As at 31.3.95	Rs. 46.40
(b)	After issue	Rs. 94.29
(c)	Issue Price	Rs. 520.00

Annexure 'I'

Capitalisation Statement

		(Rs. in Lakhs)
	Pre-issue	As adjusted at 30.6.1995 for issue
Short-term Debt	1870	1870
Long term Debt	4370	4370
Shareholders Funds		
Share Capital	4000	4450
Reserves	14570	37520
Total Shareholders Funds	18570	41970
Long Term Debt/Equity	0.24:1	0.10:1

Note: Since 31.3.1995 (which is the last date as of which financial information has been given in para ____of this document) share capital has increased from Rs. 3000 lakhs to Rs. 4000 lakhs by the issue of bonus shares in the ratio of 1 share for every 3 shares.

Annexure 'J'

Suggested Format of Auditor's Certificate Regarding Profit Forecast

To

The Board of Directors
XYZ Company Ltd.,
New Delhi.

We state that the arithmetical calculations involved in the profit forecast as set out in the section headed 'Profit Forecast' in the offer document/prospectus of __________ Ltd., in connection with the public issue of ______________ equity shares/debentures of Rs.____each for cash at ____________aggregating Rs. ________ are correct and in accordance with the following major assumptions made by the company.

____

____

____

____

We further state that the above forecast has been prepared by the company and we have neither appraised the same nor do we vouch the accuracy of the profits as forecasted.

The above certificate has been issued in terms of para 11 of Part A.I. of Clarification No. XIV of SEBI.

For PQR & Company
Chartered Accountants

Date: Sd/-
Place: (Partner)

Appendix I

Securities and Exchange Board of India

Guidelines for Disclosure and Investor Protection

Clarification No. XIII

SEBI recently appointed a committee under the Chairmanship of Shri Malegam in order to strengthen norms for disclosure requirements in the offer documents. The Committee had wide representation from industries, merchant banking community, professionals like auditors and company secretaries, stock exchanges, etc. The Committee report was made available to the public and interested sections in the market for their comments. In addition, discussions have been held in different fora on the recommendations.

Guidelines have already been issued on some recommendations of the committee vide our clarification No. XII dated September 29, 1995. Some of the recommendations of the Committee would also require guidance notes from the Institute of Chartered Accountants of India and some of the recommendations need certain modifications and guidelines on these shall be communicated to the merchant bankers at a later date. Decisions on other recommendations are hereby issued. Part A of these guidelines deals with disclosure requirements.[1] Part B deals with book-building and Part C with other related matters.

It has been decided to provide an additional facility of book-building in the capital issuance process which would retain the retail characteristics but at the same time allow capital to be raised in a more efficient manner. The existing public offering process involves fixation of issue price by the issuer and the lead merchant banker without the flexibility of testing the market and correcting the price suitably. Book-building, is considered to be a possible solution.

Accordingly, guidelines for disclosures, book building and other related matters are issued in Part A, B and C respectively of this clarification. These Guidelines will be applicable to those prospectuses which are filed with SEBI on or after November 1, 1995.

[1] Only Part 'A' of the clarification has been reproduced in this Appendix, since the other parts are not relevant to the subject of disclosure in offer documents.

Unless otherwise specifically modified by the guidelines in clarification No. XIII, all the existing provisions contained in the guidelines as issued by SEBI from time to time shall remain in force.

The present guidelines have been issued in pursuance of sub-section (1) of section 11 of Securities and Exchange Board of India Act, 1992 by way of measures for protection of the interest of the investors in securities and for orderly development and growth of the securities market.

A. Guidelines Relating to Disclosures in Prospectus

Every prospectus submitted to SEBI for vetting shall, in addition to the requirements of Schedule II of the Companies Act, contain/specify the following:

1. An index to the contents of the prospectus.
2. Details of:
   (a) actual expenditure incurred on the project (in cases of companies raising capital for a project) upto a date not earlier than 2 months of filing the prospectus with SEBI or Registrar of Companies, whichever is later:
   (b) means and source of financing such expenditure;
   (c) year-wise break-up of the expenditure proposed to be incurred on the said project.
3. Details of "bridge loan" or other financial arrangement, if any, for incurring expenditure on the project and which would be repaid from the Proceeds of the issue.
4. The turnover disclosed in the Profit or Loss Statement shall be bifurcated into:
   (a) turnover of products manufactured by the company;
   (b) turnover of products traded in by the company; and
   (c) details of products not normally dealt in by the company but included in (b) above, shall be mentioned separately.
5. The statement of assets and liabilities prepared after deducting the amount of revaluation reserve from both fixed assets and reserves and the net worth arrived at after such deduction.

6. The following details in case of companies undertaking major expansions or new projects:

   (a) technology;

   (b) market;

   (c) competition;

   (d) managerial competence;

   (e) capacity build-up,

7. No projections of future profits shall be made except:

   (a) by a new company; or

   (b) by an existing company only if such company is undertaking a new project or is proposing to substantially expand its activities beyond 100% of the existing capacity.

Provided further that the projections by (a) and (b) above may be made only if:

(a) the projections are based solely on an appraisal by a financial institution or a scheduled commercial bank;

(b) such appraising agency has financed the project or part thereof or is committed to finance the project or part thereof;

(c) the projections are not for a period exceeding two years from the date of expected commencement of commercial production or three years from the date of the closure of the issue, whichever is later;

(d) The major assumptions on which the projections are based are specified.

8. A statement by the directors whether there have, in their opinion, arisen since the date of the last financial statements disclosed in the prospectus, any circumstances that materially and adversely affects or is likely to affect the trading or profitability of the company, or the value of its assets, or its ability to pay its liabilities within the next twelve months.

9. The details of:

   (a) the aggregate shareholding of the Promoter Group and of the directors of the Promoter, where the promoter is a body corporate;

(b) aggregate number of securities purchased or sold by the Promoter Group and the directors of the promoter during a period of six months preceding the date on which the draft prospectus is filed with SEBI and to be updated by incorporating the information in this regard till the time of filing the prospectus with the Registrar of Company;

(c) the maximum and minimum price at which purchases and sales referred to in (b) above were made along with the relevant dates.

In the event of it not being possible to obtain information regarding sales and purchases of any relative of the promoters, a statement to that effect should be made in the prospectus and disclosures regarding the sales and purchases of such relative shall be made in the prospectus on the basis of transfers recorded in the books of the company.

Explanation I: For the purposes of clauses (a) to (c) of para 9 above, the term 'Promoter' in relation to securities offered to the public for subscription, shall include –

(a) the person or persons who are in over-all control of the company;

(b) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public;

(c) the person or persons named in the prospectus as promoter(s);

Provided that a director/officer of the issuer company or a person, if they are acting as such merely in their professional capacity shall not be included in the above explanation.

Explanation II: For the purposes of clauses (a) to (c) of para 9 above, the term 'Promoter Group' in relation to securities offered to the public for subscription, shall include-

(a) the 'promoter';

(b) an immediate relative of the Promoter (i.e. any spouse of that person, or any parent, brother, sister or child of the person or of the spouse):

(c) where the 'Promoter' is a corporate body:

    (i) a subsidiary or holding company, of that body;

(ii) any company in which the 'Promoter' holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the Promoter;

(iii) any corporate body in which a group of individuals or corporate bodies or combinations thereof who hold 20% or more of the equity capital in that company also hold 20% or more of the equity capital of the issuer company; and

(d) where the 'promoter' is an individual,

(i) any company in which 10% or more of the share capital is held by the 'Promoter' or an immediate relative of the 'Promoter' or a firm or HUF in which the 'Promoter' or any one or more of his immediate relative is a member;

(ii) any company in which a company specified in (i) above, holds 10% or more, of the share capital;

(iii) any HUF or firm in which the aggregate share of the Promoter and his immediate relatives is equal to or more than 10% of the total.

(e) All persons whose shareholding is aggregated for the purposes of disclosing in the prospectus "shareholding of the promoter group".

Note: The financial institutions and the mutual funds would be exempted from this definition if they get included merely on account of the fact that they hold 10% or more of the equity of the concerned company. This exemption would not apply to the subsidiaries or companies promoted by the financial institutions or to the companies which sponsor the mutual fund.

10. Particulars of:

(i) high, low and average market prices of the shares of the company during the preceding three years;

(ii) monthly high and low prices for the six months preceding the date of filing the draft prospectus with SEBI which shall be updated till the time of filing the prospectus with the Registrar of Company/Stock Exchange concerned;

(iii) number of shares traded on the days when the high and low prices were recorded in the relevant stock exchange during said period of (i) and (ii) above;

(iv) the stock market data referred to above shall be shown separately for period marked by a change in capital structure, with such period commencing from the date the concerned stock exchange recognises the change in the capital structure (e.g. when the shares have become ex-rights or ex-bonus);

(v) the market price immediately after the date on which the resolution of the Board of Directors approving the issue was approved;

(vi) the volume of securities traded in each month during the six months preceding the date on which the issue opens for subscription.

11. Management perception of the internal and external risk factors which shall be given immediately after each of the risk factors and not as a separate heading under management perception.

12. Following information regarding persons with whom technical and Financial agreements have been entered into and in particular:

    (a) place of registration and year of incorporation;

    (b) issued share capital;

    (c) turnover of the last financial year of operation;

    (d) general information regarding such persons relevant to the issuer.

13. Management discussion and analysis of the financial condition and results of the operations as reflected in the financial statements containing:

    (a) a comparison of the significant items of income and expenditure between

        (i) the last period for which financial statement have been prepared and the immediately preceding period;

        (ii) the immediately preceding period and the period.

    (b) Information regarding –

        (i) unusual or infrequent events or transactions;

        (ii) significant economic changes that materially affected or (are likely to) affect income from continuing operations;

(iii) known trends or uncertainties that have had or are expected to have a material adverse impact on sales, revenue or income from continuing operations;

(iv) future changes in relationship between costs and revenues, in case events such as future increase in labour or material costs or prices that will cause a material change are known

(v) the extent to which material increases in net sales or revenue are due to increased sales volume, introduction of new products or services or increased sales prices;

(vi) total turnover of each major industry segment in which the company operates;

(vii) status of any publicly announced new products or business segment;

(viii) the extent to which business is seasonal;

(ix) any significant dependence on a single or few suppliers or customers;

(x) competitive conditions.

14. Details of all "buy-back" and "stand-by" and similar arrangements for purchase of securities by promoters, directors and lead merchant bankers subject to the provisions of para 6 of part C of these guidelines.

15. Following details regarding major shareholders:

   (a) names of the ten largest shareholders as on the date of filing of the prospectus with the Registrar of Companies:

   (b) number of shares held by shareholders at (a) above including number of shares which they would be entitled to upon exercise of warrant, option, right to convert a debenture, loan or other instrument;

   (c) particulars as in (a) and (b) above as on a date two years prior to the date of filing the prospectus with Registrar of Company;

   (d) particulars regarding (a) and (b) above as on a date 10 days prior to the date of filing of the prospectus with the Registrar of Company;

(e) In the event of the company having made a public issue for the first time within the two preceding years, the above information shall he given separately indicating the names of persons who acquired shares by subscriptions to the public issue and those who acquired the shares by allotment on a firm basis or by private placement.

16. A statement to the effect that the issuer accepts no responsibility for statements made otherwise than in the prospectus or in the advertisement any other material issued by or at the instance of the issuer and that any one placing reliance on any other source of information would be doing so at his own risk.

Appendix II

Securities and Exchange Board of India

Guidelines for Disclosure and Investor Protection

Clarification XIV[1]

SEBI has already issued Clarifications no. XII & XIII to the Guidelines for Disclosure and Investor Protection in order to implement the recommendations of the Malegam Committee and thereby strengthen the disclosure norms in the offer documents, and to bring further reforms in the primary market. Clarification No. XIV is being issued to further implement the recommendations of the Malegam Committee which have been accepted by SEBI. Part A of this clarification contains recommendation of the Malegam Committee. The Institute of Chartered Accountants of India would for the sake of uniformity issue Standard guidance notes on the clauses in this clarification which involves accounting standards. Part A of this clarification also contains the additional disclosures which will have to be made in an abridged prospectus.

By way of this clarification the existing guidelines on preferential issues are being modified. Subject to the conditions mentioned in this clarifications securities can now be allotted on preferential basis without mandatory lock-in period. Part B of the clarification contains the details regarding same.

Part C of the clarification lists out the conditions under which an issue of debt instruments can be made without the requirement of an acknowledgement card from SEBI. This will further simplify the procedure relating to issue of debt instruments.

Unless otherwise specifically modified by the Guidelines in Clarification No. XIV, all existing provisions contained in the Guidelines as issued by SEBI from time to time shall remain in force. The present Guidelines are being issued in pursuance of sub-section (1) of Section 11 of Securities and Exchange Board of India Act, 1992 by way of measures for protection of the interest of the investors in securities and for orderly development and growth of the securities market.

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[1] Only Parts 'A' and 'E' of the Clarification have been reproduced in this Appendix since the other parts are not relevant to the subject of disclosures in offer documents.

Part A

I. Guidelines Relating to Disclosures in Offer Documents

In addition to the disclosures which have been specified by SEBI from time to time the offer document shall contain the additional disclosures specified below:

1. Wherever statements of assets and liabilities and profit and loss or any other financial information is qualified by the notes of an auditor all necessary adjustments, wherever quantification is possible, shall be made in the statements itself. In particular, the following rectifications/adjustments shall be made:

   (i) Adjustments/rectification for all incorrect accounting practices or failures to make provisions or other adjustments which resulted in audit qualifications;

   (ii) Material amounts relating to adjustments for previous years shall be identified and adjusted in arriving at the profits of the years to which they relate irrespective of the year in which the event triggering the profit or loss occurred;

   (iii) Where there has been a change in accounting policy, the profits or losses of the earlier years (required to be shown in the offer documents) and of the year in which the change in the accounting policy has taken place shall be recomputed to reflect what the profits or losses of those years would have been if a uniform accounting policy was followed in each of these years. However, if an incorrect accounting policy is being followed, the recomputation of the financial statements would be in accordance with correct accounting policies;

   (iv) Statement of profit or loss shall disclose both the profit or loss arrived at before considering extraordinary items and after considering the profit or loss from extraordinary items. An illustrative format of the disclosure of profits and losses on this basis is given at Annexure 'A'.

2. Changes (with quantification wherever possible) in the activities of the issuer which may have had a material effect on the statement of profit/loss for the five years. Disclosure of these changes in the

activities of the company shall include discontinuance of lines of business, loss of agencies or markets and similar factors.

3. All significant accounting policies followed in the preparation of the financial statements.

4. All financial information given in the offer document including accounting ratios shall be audited.

5. The information at (a) to (k) below regarding other ventures/companies promoted by the same promoters shall be required to be made only in respect of five largest listed companies as determined by market capitalisation one month before the date of filing offer document with SEBI. Such information shall contain the following on the basis of latest audited statements wherever applicable:

   (a) Date of Incorporation;

   (b) Nature of activities;

   (c) Equity Capital;

   (d) Reserves (including revaluation reserve);

   (e) Sales;

   (f) Profit after tax (PAT);

   (g) Earnings per share (EPS);

   (h) Net Asset Value (NAV);

   (i) The highest and lowest market price of shares during the preceding six months with suitable disclosures for changes in capital structure during the period and the market value on the date of filing the offer document with the Registrar of Companies;

   (j) If any of the companies has made public or rights issue in the preceding three years, the issue price of the security, the current market price and particulars of changes in the capital structure, if any, since the date of issue and a statement regarding the cost and progress of implementation of the project in comparison with the cost and implementation schedule given in the offer document; and

(k) Information regarding adverse factors related to the company and in particular regarding:

   (i) whether the company has become a sick company within the meaning of the Sick Industrial Companies (Special Provisions) Act, 1985 or is under winding up;

   (ii) whether the company has made a loss in the immediately preceding year and if so, the profit or loss figures for the immediately preceding three years.

Provided that the above information shall also be given in case of any other listed company promoted by the promoters which has become a BIFR company or is under winding up or has a negative net worth.

7. Profits after tax are often affected by the tax shelters which are available. Some of these are of a relatively permanent nature (for example, arising out of export profits) while others may be limited in point of time (for example, tax holidays for new undertakings). Tax provisions are also affected by timing differences which can be reversed in the future (for example, the difference between book depreciation and tax depreciation). For a proper understanding of the future tax incidence, these factors shall be identified and explained through proper disclosures. An illustrative format of disclosure is given in Annexure 'B'.

8. Under the heading 'Basis for issue price' the following information shall be disclosed:

   (a) (i) Earnings per share i.e. EPS pre-issue for the last three years (as adjusted for changes in capital),

   (ii) P/E pre-issue and comparison thereof with industry P/E where available (giving the source from which industry P/E has been taken);

   (iii) average return on net worth in the last three years;

   (iv) minimum return on increased net worth required to maintain pre-issue EPS;

   (v) Net Asset Value per share based on last balance sheet;

   (vi) Net Asset Value per share after issue and comparison thereof with the issue price.

Provided that projected earnings shall not be used as a justification for the issue price in the offer document.

(b) The accounting ratios disclosed in the offer document in supper of basis of the issue price shall be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised.

An illustrative format of disclosure is given in Annexure 'C'.

9. The following accounting ratios for each of the accounting periods for which financial information is given:

   (a) Earnings per share;

   (b) Return on net worth; and

   (c) Net Asset Value per share.

10. Sales or purchase between companies in the promoter group when such sales or purchases exceed in value in the aggregate 10% of the total sales or purchases of the issuer and also disclose material items of income or expenditure arising out of transactions in the promoter group.

11. A forecast of the estimated profits for the financial year ending immediately before the date of the offer document (if such information is not already given in the offer document) and for the financial year ending immediately after the date of the offer document duly supported by an auditors' certificate which lists the major assumptions on which the forecast is based and gives assurance on the arithmetical calculations derived from such assumptions.

    Provided however the above disclosures shall not be given by:

    (i) any company which has made projections of future profits in accordance with Clarification XIII of SEBI Guidelines which include projected profits for the above period; or

    (ii) any company which has not commenced commercial production.

12. A Capitalisation Statement which shows total debt and net worth and the debt/equity ratios before and after the issue is made. Where there has been a change in the share capital since the date as of which the

financial information has been disclosed in the offer document, there shall be a note explaining the nature of the change.

An illustrative format of the Capitalisation Statement is given in Annexure 'D'.

II. Disclosures in Abridged Prospectus and Letter of Offer

1. The Abridged Prospectus and Letter of Offer shall also disclose, in addition to the existing requirements, the following items which are required to be disclosed in the offer document:

   (a) The following items as are specified in Schedule II of the Companies Act.

   Part I of Schedule II:

   Clause 1 (d) Provisions of sub-section (1) of Section 68A of the Companies Act, 1956 relating to punishment for fictitious applications.

   Clause 1 (f) Declaration about the issue of allotment letters/refunds within a period of 10 weeks/6 weeks and interest in case of delay in refund at the prescribed rate under Section 73(2)/(2A).

   Clause V (d) Names, addresses and occupation of non-whole-time directors (giving their directorships in other companies).

   Clause VII(a) Outstanding litigation.

   Clause VII(c) Any material development after the date of the latest balance sheet and its impact on performance and prospects of the company.

   Part II of Schedule II:

   Clause A.2 Expert opinion obtained if any.

   Clause A.3 Change, if any, in directors and auditors during the last three years and reasons thereof.

   Clause C.9 Option to Subscribe.

   ClauseC.15 Material contracts and time and place of inspection.

   (b) The following items as are required to be disclosed as per clarification XIII issued by SEBI on October 12, 1995.

Para	Subject
2	Details of expenditure on project
10	Stock Market Data
13	Management discussion and analysis
14	Buy Back and Stand by arrangements
15	Details of shareholders

(c) The following items as are required to be disclosed as per part A I of this Clarification.

Para	Subject
8	Basis for issue price and accounting ratios
9	Accounting ratios

III. Amendments to the Disclosure and Investor Protection Guidelines

1. Disclosures under the Heading 'Other Income'

In modification of the existing requirements, the offer document shall disclose details of 'Other Income' in all cases where such income (net of related expenses) exceeds 20% of the net profit before tax, including:

(i) the sources and other particulars of such income; and

(ii) an indication as to whether such income is recurring or non-recurring, or has arisen out of business activities/other than the normal business activities.

2. Reservation to Employees in a Public Issue

In Clarification No. VIII dated October 11, 1993 clause 3(b) provides for ceiling on reservation for employees in any public issue. The existing limit of 200 shares that can be allotted on firm basis to a permanent/regular employee of the issuer company in a public issue or to a permanent employee of the promoting companies in case of a new company is removed and made inapplicable. The issuers will therefore be free to make reservation for the employees in a public issue subject however, to the existing overall limit of 10% of the size of the issue as per existing Guidelines.

3. Promoters Minimum Contribution

Clarification VII dated August 10, 1993 modified the requirement of minimum promoters' contribution. In further modification, the mandatory requirement of minimum promoters contribution and lock-in of the same is hereby removed only in the case of issue of securities by company which is a listed company for at least three years and has a three-years track record of dividend payment out of preceding past five years. The promoters will, however, have to continue to disclose the extent to which they are participating in the public or rights issue. Similarly, in case of companies where no identifiable promoter or promoter group exists, guidelines for minimum promoters' contribution and lock-in of promoters' shares will not apply.

4. Issue of Shares at Premium by Unlisted Companies

In case a division of a company is spun off into a separate company then the track record of profitability of the division would be considered as per the existing guidelines. Accordingly, an unlisted company formed out of a division of an existing company can issue shares at a premium in case they comply with the requirements specified in Clarification no. VI dated December 23, 1992. The track record of profitability of the division spun off shall be established on the basis of an auditor's certificate.

Part E

Applicability of the Above Clarification

1. Part A-I and Part A-II of this clarification will be applicable to all offer documents to be filed with SEBI on or after May 1, 1996.
2. Part A-III will come into effect from March 4, 1996 and will be applicable even to those offer documents which are pending with SEBI provided an acknowledgement card for the same has not been issued by SEBI prior to March 4, 1996.
3. Part B of this clarification will come into effect from March 4, 1996.
4. Part C of this clarification will come into effect from March 4, 1996 and will be applicable to those offer documents which are pending with SEBI provided an acknowledgement card from the same has not been issued by SEBI prior to March 4, 1996.
5. Part D of this clarification will come into effect from March 4, 1996.

Place : Mumbai

Date : March 1, 1996

Annexure 'A'

Statement of Profits and Losses

	Year ended 31st March 1991	1992	1993	1994	1995
	(Rupees in lakhs)				
Income					
Sales:					
(a) Of products manufactured by the Company	1000	1240	1640	1800	1800
(b) Of products traded in by the Company	100	60	60	200	200
(c) Total	1100	1300	1700	2000	2000
Other Income	10	30	40	60	100
Increase (Decrease) in Inventories	40	(70)	60	180	310
	1150	1260	1800	2240	2410
Expenditure					
Raw Materials Consumed	400	480	630	1110	1200
Staff Costs	200	220	240	340	400
Other Manufacturing Expenses	250	260	280	540	650
Administration Expenses	40	42	60	80	85
Selling and Distribution Expenses	110	120	130	190	250
Interest	60	55	90	200	140
	1095	1227	1495	2635	2795
Net Profit before tax and extraordinary items	55	33	305	(295)	(385)
Taxation	25	12	144	(185)	(235)
Net Profit before extraordinary items	30	21	161	(110)	(150)
Extraordinary items (net of tax)	NIL	49	(64)	800	1000
Net Profit after extraordinary items	30	70	97	690	850

Annexure 'B'

Taxation

	Year ended 31st March				
	1991	1992	1993	1994	1995
	(Rupees in lakhs)				
Tax at notional rate	28	70	89	546	675
Adjustments:					
Export Profits	(4)	(5)	(20)	(100)	(120)
Difference between Tax					
Depreciation and Book Depreciation	(6)	(8)	(9)	(10)	(10)
Other Adjustments	3	3	4	4	5
Net Adjustments	(7)	(10)	(25)	(106)	(125)
Tax Saving thereon	(3)	(5)	(13)	(49)	(58)
Total taxation	25	65	76	497	617
Taxation on extraordinary items	NIL	53	(68)	682	852
Tax on profits before extraordinary items	25	12	144	(185)	(235)

Annexure 'C'

Basis for Issue Price

1.	Adjusted Earning Per Share (EPS)	
	(a) 1992-93	Rs. 7.41
	(b) 1993-94	Rs. 8.39
	(c) 1994-95	Rs. 13.82
	(d) Weighted Average	Rs. 10.94
2.	Price/Earning Ratio (P/E) in relation to Issue Price	
	(a) Based on 94-95 EPS	37.63
	(b) Industry P/E*	
	(i) Highest	61.2
	(ii) Lowest	0.8
	(iii) Average	25.3
	(* Based on Economic Times of 26.6.95)	
3.	Return on Net Worth	
	(a) 1992-93	27.36%
	(b) 1993-94	28.77%
	(c) 1994-95	33.45%
	(d) Weighted Average	30.88%
4.	Minimum return on Total Net Worth after Issue Needed to maintain EPS at Rs. 13.82	14.65%
5.	Net Asset Value (NAV)	
	(a) As at 31.3.1995	Rs. 46.40
	(b) After issue	Rs. 94.29
	(c) Issue Price	Rs. 520.00

Annexure 'D'

Capitalisation Statement

	Pre-issue	As adjusted at 30.6.1995 for issue (Rs. in lakhs)
Short-term Debt	1870	1870
Long term Debt	4370	4370
Shareholders Funds		
Share Capital	4000	4450
Reserves	14570	37520
Total Shareholders Funds	18570	41970
Long Term Debt/Equity	0.24:1	0.10:1

Note: Since 31.3.1995 (which is the last date as of which financial information has been given in para of this document) share capital has increased from Rs. 3000 lakhs to Rs.4000 lakhs by the issue of bonus shares in the ratio of 1 share for every 3 shares.

Clarification

Applicability of the 'Guidance Note on Audit Reports/Certificates on Financial Information in Offer Documents' to Rights Issues*

1. Consequent upon the issuance of Clarification No. XIV to Guidelines for Disclosure and investor Protection, issued by the Securities and Exchange Board of India (SEBI) in March, 1996, the Institute of Chartered Accountants of India (ICAI) had issued the Guidance Note on Audit Reports/Certificates on Financial Information in Offer Documents. A question has now been raised as to whether the said Guidance Note is applicable to the rights issues made by the companies and, if so, the manner in which the auditor should report. The matter has been considered by the Research Committee of the ICAI and the clarification in this regard follows hereinafter.

2. Section 56 of the Companies Act, 1956, dealing with matters to be stated and reports to be set out in the prospectus, *inter alia,* states in sub-section (5) thereof as below:

> "(5) This section shall not apply –
>
> (a) to the issue to existing members of debenture holders of a company of a prospectus or form of application relating to shares in, or debentures of the company, whether an applicant for shares or debentures will or will not have the right to renounce in favour of other persons."

3. SEBI have issued Clarification X[1]: "Guidelines for Disclosure and Investor Protection-Guidelines for Rights Issue", which require, *inter alia,* to include the matters specified in Annexure I to the aforesaid Clarification. The Annexure, *inter alia,* contains financial information to be included in the letter of offer in respect of a rights issue.

4. The preamble to Clarification XIV states that "SEBI has already issued Clarifications No. XII and XIII to the Guidelines for Disclosure and Investor Protection in order to implement the recommendations of the Malegam Committee and thereby strengthen the disclosure norms in the offer documents..." Part A.I of Clarification XIV also states that "in addition to the

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* Published in December, 1999 issue of 'The Chartered Accountant', p.80.

[1] RMB (DIP Series) Circular No.1 (95-96), dated May 23, 1995.

disclosures which have been specified by SEBI from time to time the offer document shall contain the additional disclosures specified below:

> ”Para 4 of Part A.I of Clarification XIV further requires that “all financial information given in the offer document including accounting ratios shall be audited”.

5. The Research Committee notes from the above that by virtue of sub-section (5) of Section 56 of the Companies Act, 1956, Schedule II to the Companies, 1956, is not applicable in case of rights issues. However, by Clarification X issued by SEBI, certain financial information is required to be included in the letter of offer in case of rights issue and other Clarifications issued by SEBI, viz., XIII and XIV, require additional information to be disclosed in the offer documents. Accordingly, the financial information in respect of the aforesaid clarifications identified in the ‘Guidance Note on Audit Reports/Certificates on Financial Information Offer Documents’, issued by the ICAI, will also have to be included as financial information in the letter of offer regarding rights issues.

6· The Committee notes that as per the requirement of SEBI through Clarification XIV, reproduced in para 4 above, all financial information contained in offer document shall be audited. Thus, it is necessary that the financial information required to be contained in the letter of offer regarding rights issues shall also be audited. However, the Committee notes that since the financial information as per Annexure I to Clarification X of SEBI is required to be signed by the directors of the company, no financial information can be included in the report of the auditors as it would be in the case of a public issue by virtue of Schedule II to the Companies Act. As such, in respect of the financial information contained in the letter of offer, the auditor of the issuer company should give a separate report in nature and form as suggested in Annexure F to the ‘Guidance Note on Auditor’s Reports/Certificates on Financial Information in Offer Documents’ after appropriate modifications. This audit report should also be reproduced in the letter of offer separately.